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SILVER TRADING: THE REDDIT REBELLION AND COMMODITIES MARKETS?

The Wall Street Journal has reported that the CFTC and DOJ are scrutinizing trading in the silver markets, which may have followed a similar pattern to the recent retail-trading "rebellion" in GameStop and other stocks. While any retail traders participating in concerted trading intended to impact commodity-related prices can expect to draw scrutiny from the CFTC (or potentially the SEC or DOJ), the authorities may ultimately be more focused on those who lead any concerted trading as well as any institutional and other large traders, including those who may have engaged in "momentum ignition" to push prices up, and on the other side of the market, those who may have sold aggressively in an effort to "defend" lower silver prices. More information on this topic and related topics can be found in Clifford Chance's Guide to United States and United Kingdom Derivative and Commodity Market Enforcement Regimes.[1]

In the past month, the prices of several stocks, including most notably the video game retailer GameStop, rose meteorically, pushed up by enthusiastic retail investors who touted the stocks on the WallStreetBets subreddit and other social media.[2] More recently, the prices of spot silver and silver futures have also risen dramatically; silver exchange traded funds ("ETFs") have seen greatly increased trading volumes; and some online physical silver retailers temporarily found themselves unable to meet the demand for physical silver.[3] Although less certain, it appears that the increased silver prices may also have been caused by a subset

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1 Available at https://www.cliffordchance.com/content/dam/cliffordchance/PDFs/guide-us-and-uk-derivative-and-commodity-market-enforcement-regimes-(april%202019).pdf.

2 Chris Alcantara, *Reddit's /r/wallstreetbets astronomical rise*, THE WASHINGTON POST (Jan. 29, 2021), https://www.washingtonpost.com/technology/2021/01/29/wallstreetbets-reddit-gamestop/?arc404=true.

3 Eddie Spence, Jake Lloyd-Smith, & Yvonne Yue Li, *Silver Prices Surge to Eight-Year High Amid Reddit-Fueled Frenzy*, BLOOMBERG (Jan. 31, 2021, 5:39 PM), https://www.bloomberg.com/news/articles/2021-01-31/silver-spikes-at-the-week-s-open-as-reddit-hordes-pile-in-again?sref=1kJVNqnU; Henry Sanderson, *Silver price hits 8-year high as retail traders take aim*, FINANCIAL TIMES (Feb. 1, 2021), https://www.ft.com/content/d46e8623-09af-4a1f-b7e5-207616388b0f.

of retail investors encouraging each other on Reddit and other websites. As with GameStop, the retail interest in silver appears to derive at least in part from a desire to "punish" institutional traders who, the retailer traders believe, are suppressing prices to benefit their short positions.[4]

The U.S. government has taken note, and reports indicate that the Commodity Futures Trading Commission ("CFTC") and the Department of Justice ("DOJ") are investigating potentially manipulative trading of silver futures and silver ETFs.[5] Treasury Secretary Janet Yellen has also convened a meeting of financial regulators to discuss market volatility driven by retail trading in GameStop, silver and other products.[6] The Securities and Exchange Commission ("SEC") might also seek to investigate any potentially manipulative trading of silver ETF shares. These investigations will likely include close scrutiny of communications by any number of retail traders whose enthusiastic online statements bear some similarities to the communications upon which the CFTC has based prior "coordinated trading" price-manipulation cases. Ultimately, however, the authorities may be more inclined to focus upon individuals who organized and led any concerted retail-buying spree to raise price, and on any institutional traders who traded silver in a manner intended to influence prices, such as traders utilizing "momentum ignition" intended to capitalize on retail interest and raise prices, or even traders who sold in order to defend lower prices against the increased retail buying interest.

CFTC, SEC and DOJ Jurisdiction

The CFTC and SEC have separate but potentially overlapping jurisdiction over the trading of various silver products, but the legal standards for any manipulation action brought by either regulator would likely be similar, given the similarities in the securities and commodities manipulation prohibitions,[7] and in the relevant CFTC and SEC rules.[8] Any trading of silver futures or swaps, as well as wholesale interstate trading of physical silver, would be subject to the anti-manipulation provisions of the Commodity Exchange Act and would be subject to CFTC's civil enforcement jurisdiction.[9] Silver ETF share offerings which are registered under the U.S. securities laws would be subject to the SEC's direct regulatory oversight and civil enforcement authority.[10] The CFTC's enforcement jurisdiction over trading of silver ETF shares would be less direct.[11] Although not without litigation risk, the CFTC could seek to exercise enforcement jurisdiction over potentially manipulative trading of silver ETFs based on the price impact that such trading would be expected to have on the prices of silver commodities. Because shares of silver ETFs effectively represent an interest in physical silver

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4 Patrick Ian Perez, *Retail Day-Traders Turn their Sights to Silver*, GREYSHEET (Feb. 1, 2021), https://www.greysheet.com/news/story/retail-day-traders-turn-their-sights-to-silver.

5 Dave Michaels, *GameStop Mania Is Focus of Federal Probes Into Possible Manipulation*, WALL STREET JOURNAL (Feb. 11, 2021), https://www.wsj.com/articles/gamestop-mania-is-focus-of-federal-probes-into-possible-manipulation-11613066950.

6 Jeanna Smialek & Deborah B. Solomon, *Yellen and Regulators Met Amid Gamestop Frenzy to Discuss Market Volatility*, THE NEW YORK TIMES (Feb. 4, 2021), https://www.nytimes.com/2021/02/04/business/economy/yellen-gamestop.html.

7 *Compare* 7 U.S.C. 9(1) *with* 15 U.S.C. 78j(b).

8 *Compare* CFTC Rule 180.1 *with* SEC Rule 10b-5.

9 The Commodity Exchange Act gives CFTC jurisdiction over the trading of "commodities," which is very broadly defined and includes any products (other than securities) for which futures contracts are currently traded—such as silver. 7 U.S.C. 1a(9).

10 *See, e.g.*, 15 U.S.C. 78i, 78j, 78l.

11 Silver ETFs are generally not structured as commodity pools for Commodity Exchange Act purposes, and the sponsors are generally not commodity pool operators or commodity trading advisors. As a result, silver ETFs are typically not subject to regulatory oversight by CFTC.

that is held by the ETF sponsor, the sponsor must buy and sell physical silver as ETF shares are issued and redeemed, respectively, and this buying and selling would affect the price of physical silver, as well as the price of silver futures and swaps.

In addition to the CFTC's and SEC's civil enforcement authority, the DOJ can criminally prosecute manipulation under both the Commodity Exchange Act[12] and the Securities Exchange Act[13]. The DOJ might also seek to prosecute any price manipulation involving fraud under other statutes whose elements might be more easily satisfied, such as mail fraud[14] or wire fraud[15].

Potential Theories of Violation

The CFTC and DOJ have previously settled manipulation and attempted-manipulation cases based on "coordinated trading" to move prices, including most notably in its FX and ISDAFix settlements with a number of large banks from 2014 to 2018. In those matters, the CFTC and DOJ alleged that traders at various banks shared information about their positions in chatrooms and agreed to trade in a manner that would benefit the positions of chatroom participants. Here, the authorities would likely be interested in determining whether similar coordination occurred among retail traders in silver-related markets. In order to prove manipulation, the regulator could not merely demonstrate that retail traders and others had taken to social media to cheerlead. Rather, the authorities would need to demonstrate (1) that the coordinating traders had the collective ability to influence market prices; (2) that the coordinating traders had an intent to create an artificial price (or, perhaps, a reckless disregard for price integrity); (3) the existence of an artificial price; and (4) that the coordinating traders caused the artificial price.[16] In order to prove attempted manipulation, the authorities would need to demonstrate that the coordinating traders had the collective ability and the specific intent to create an artificial price, but would not have to prove the existence of an artificial price.

The authorities can also be expected to scrutinize the long silver-trading activities of institutional and other large traders around this same time period. For example, the regulators will likely seek to determine whether large traders may have utilized a "momentum ignition" tactic by buying silver (whether in physical silver or through a spot, futures or ETF position, or some combination), while encouraging retail traders to join in through social media. This sort of strategy could potentially be prosecuted under either an anti-manipulation theory or an anti-fraud theory. Under the latter theory, the authorities would need to show that in igniting momentum, the trader had made a knowingly or recklessly false statement of material fact intended to induce trading.[17]

The authorities will also likely be interested in determining whether any institutional or other large traders with short positions traded in a manner intended to resist rising prices caused by retail-buying efforts. Notably, in the 2013 "London

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[12] 7 U.S.C. 13(a).
[13] 15 U.S.C. 78ff(a).
[14] 18 U.S.C. 1341.
[15] 18 U.S.C. 1343.
[16] *In re Ind. Farm Bureau Coop. Ass'n, Inc., and Louis M. Johnston*, CFTC Docket No. 75-14, 1983 WL 30249 (Dec. 17, 1982); CFTC Rule 180.1.
[17] CFTC Rule 180.1; SEC Rule 10b-5.

Whale" matter, the CFTC settled allegations that a London-based trader at a large bank had engaged in fraud-based manipulation through reckless selling of credit-default swaps that caused the price of those swaps to fall, benefiting the trader's large short position.[18] In that case—as may be the case in today's silver market—other traders had become aware that a market participant had a very large short position, and had bought aggressively in response, exerting upward pressure on price.[19] The London Whale's large sales in response to this buying exerted downward pressure on price. Arguably, the CFTC could have charged both the aggressive longs and the London Whale under the same theory of reckless price manipulation, but it chose to focus its fire on the short-seller "defending" price rather than the buyers seeking to push prices up. If the authorities are similarly minded today, then they may be particularly interested in the activities of silver traders with large, short positions.

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Ultimately, any charging decisions made by the CFTC, SEC or DOJ may involve certain practical considerations. A recent case (which the CFTC lost following a bench trial) underscores that trading intended to influence price is not *per se* illegal, because the trading must either intend to cause an artificial price, or must otherwise be reckless as to the risk of artificial-price creation.[20] In other words, it is not unlawfully manipulative to trade in a manner intended to move commodity prices to a level which the trader sincerely believes more accurately reflects the value of the product traded. Here, one can imagine a circumstance in which retail traders band together to bid up silver prices, on what they claim to be a sincere belief that those prices have been artificially suppressed by large institutional shorts, and those shorts sell aggressively to defend prices that they claim to believe reflect the actual value of silver. In such a circumstance, in which market participants on both sides might plausibly claim to be moving prices based on their sincere beliefs, a regulator's decision whether to align with one side of the market or the other could come down to a practical judgement about the strength of evidence, particularly any communications that would support or undercut either or both of such claims. In addition, the prospect of bringing factually complex manipulation cases against dozens or even hundreds of retail traders could be a daunting factor for a regulator—or perhaps even for the DOJ. Further, while the CFTC and SEC are independent agencies that are theoretically insulated from political considerations, and while the DOJ similarly strives for independence from political considerations, each of them may face some pressure to focus in large measure on institutional short sellers, who have been the target of wide and vocal popular criticism for their role in the markets.

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[18] CFTC Docket No. 14-01, 2013 WL 6057042 (Oct. 16, 2013).
[19] *Id*.
[20] *U.S. Commodity Futures Trading Comm'n v. Wilson*, 27 F. Supp. 3d 517, 532 (2014).

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