

**AUDIT TRAIL
RULE ENFORCEMENT REVIEW
OF THE
CHICAGO BOARD OF TRADE
AND THE
CHICAGO MERCANTILE EXCHANGE**



**Division of Market Oversight
November 21, 2014**

I. Rule Enforcement Review Scope

The Division of Market Oversight (“Division”) has conducted a rule enforcement review¹ of the audit trail program of the Chicago Mercantile Exchange (“CME”) and the Chicago Board of Trade (“CBOT”) (collectively, the “Exchanges”), which are wholly-owned subsidiaries of CME Group, Inc. (“CME Group”).² The Division’s review covered the period from October 1, 2012 to September 30, 2013 (the “target period”).³

The Division reviewed the Exchanges’ compliance with Core Principle 10 (*Trade Information*) and the Commission’s related regulations codified in Commission regulations §§ 38.550–553, which require that an exchange maintain an audit trail program in order to prevent and detect customer and market abuse.⁴ In addition, the Division reviewed the Exchanges’ compliance with Core Principle 2 (*Compliance With Rules*), and specifically Commission regulation § 38.155, which requires that an

¹ Rule enforcement reviews are intended to present an analysis of an exchange’s compliance capabilities during the period under review. Such reviews deal only with exchange programs directly addressed in the review and do not assess all programs, core principles, or Commission regulations. The Division’s analyses and conclusions are based, in large part, upon the Division’s evaluation of the exchange’s staffing, compliance programs and rules, a sample of investigation and disciplinary case files, and other exchange documents. This evaluation process, in some instances, identifies specific issues with particular exchange compliance programs or methods, but is not designed to uncover every instance where an exchange fails to effectively comply with the core principles or Commission regulations. Neither is such a review intended to go beyond the quality of the exchange’s self-regulatory systems to include direct surveillance of the market.

This review, and the analyses and conclusions herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The Division’s analyses and conclusions in this report are limited to the exchanges at CME and CBOT, and do not address the audit trail program of any other CME Group exchange, including the New York Mercantile Exchange (“NYMEX”), or the Commodity Exchange, Inc. (“COMEX”).

² CME Group is composed of the following exchanges: CME, CBOT, NYMEX, and COMEX. Each exchange is registered as a designated contract market (“DCM”).

³ The Exchanges’ audit trail program was previously reviewed in the Division’s September 13, 2010 rule enforcement review, which covered the target period from January 1, 2008 to January 1, 2009 (the “2010 CME-CBOT Review”).

⁴ The DCM Core Principles in the Commodity Exchange Act (“CEA”), as amended by the Dodd–Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (“Dodd–Frank Act”), became effective on July 16, 2011. See CEA section 5(d), 7 U.S.C. § 7(d). The Commission’s DCM regulations became effective on October 17, 2012. See Final Rules, Core Principles and Other Requirements for Designated Contract Markets, 77 Fed. Reg. 36612 (June 19, 2012). Because there was only a short period where the Commission’s Final Rules were not in effect during the target period, the Division reviewed the Exchanges for compliance with those regulations. The Division did not, however, examine the Exchanges’ compliance with the safe storage provisions in Core Principle 10 and related Commission regulation § 38.552(d) because the Exchanges’ data storage and security procedures will be examined by the Division in a separate review.

exchange establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews.

In conducting this rule enforcement review, the Division interviewed compliance officials and staff from the Exchanges and considered a demonstration made by the Exchanges concerning the electronic systems used to conduct its audit trail program. The Division also reviewed documents produced by the Exchanges, including:

- the Exchanges' audit trail review procedures, the Exchanges' Rulebooks,⁵ and related Advisory Notices;
- organizational charts and personnel summaries;
- meeting minutes of the Board of Directors and the Market Regulation Regulatory Oversight Committee;
- audit trail review and investigation logs;
- audit trail review files, investigative files, and enforcement action files; and
- related warning letters and summary fines.

The Division analyzed the Exchanges' audit trail program to determine whether the program is in compliance with the core principles and Commission regulations stated above, and whether there are any deficiencies or recommendations for the program. For purposes of this report, a *deficiency* is an area where the Division believes an exchange is not in compliance with a Commission regulation and must take corrective action and a *recommendation* concerns an area where the Division believes the exchange should improve its compliance program. As set forth below, the Division found that the Exchanges generally demonstrated compliance with Core Principles 2 and 10, and Commission regulations § 38.155 and §§ 38.550–552, and found three deficiency findings under Commission regulation § 38.553.

⁵ A rule that is specific to CME/CBOT is referred to as a "CME/CBOT Rule" and a rule that applies to all of the CME Group exchanges is referred to as a "CME Group Rule."

The Division provided the Exchanges with an opportunity to review and comment on a draft of this report on September 29, 2014. On October 6, 2014, Division staff conducted an exit conference with the Exchanges' officials to discuss the report's findings and deficiencies.

II. Summary of Findings and Recommendations or Deficiencies Requiring Corrective Action

A. Findings without Recommendations or Deficiencies Requiring Corrective Action

1. Compliance Staff and Resources (Core Principle 2, Commission Regulation § 38.155)

- The Division found that the Exchanges have sufficient audit trail program staff to demonstrate compliance with Core Principle 2 and Commission regulation § 38.155. During the target period, the Data Quality Assurance Group ("DQA Group") was responsible for reviewing compliance with all audit trail and recordkeeping requirements across the CME Group exchanges. The DQA Group had 10 staff members reporting to the Executive Director of the Strategic and Technology Initiatives Group ("STI Group"), a division of the CME Group's Market Regulation Department ("Market Regulation"). Shortly after the target period, the DQA Group added a director and an additional data investigator. In early 2014, the DQA Group was renamed Data Investigations and moved to Market Regulation's Investigations Group.

2. Trade Information, Audit Trail Required, and Elements of an Acceptable Audit Trail Program (Core Principle 10, Commission Regulations §§ 38.551–552)

- The Division found that the Exchanges' audit trail complies with Core Principle 10 and Commission regulations §§ 38.551–552. The Regulatory Application for Processing In-Memory Data ("RAPID") system records the raw audit trail data captured or created by Globex. Open outcry audit trail data is entered into CME Group's clearing system. Post-clearing trade data, which includes electronic and open outcry audit trail data and allocation data, is recorded by the Regulatory Historical Repository ("RHR") database. The data from the RHR database is loaded into the SMART system, which provides the Exchanges with the ability to electronically search and analyze the electronic and open outcry audit trail data, reconstruct trading, identify possible trade violations, and track a customer order from time of receipt through disposition.

3. Enforcement of Audit Trail Requirements (Commission Regulation § 38.553)

- The Division typically found the quality and documentation of the audit trail reviews to be thorough and complete. In addition, the Division notes that during the target period, the Exchanges were diligent about continuing to improve and enhance the audit trail program and the timeliness with which audit trail reviews are completed. As discussed below, the Division identified three deficiencies concerning the Exchanges' enforcement of audit trail requirements and compliance with Commission regulation § 38.553.

- The Exchanges conduct annual audit trail reviews of clearing member firms for electronic trading and open outcry trading. The Exchanges supplement these annual reviews with programs that review front-end audit trail data, review usage patterns associated with Tag 50 IDs (user identification), identify users that are inaccurately submitting Tag 1028 data (i.e., whether an order is being entered by an automated trade system (“ATS”) or manually), identify improper customer type indicator (“CTI”) code entry, and identify the improper use of suspense accounts, as well as Computerized Trade Reconstruction (“CTR”) reviews.
- During the target period, the Exchanges opened 74 annual electronic trading audit trail reviews, 46 of which were closed or referred to Market Regulation’s Enforcement Group by the end of the target period. The Exchanges opened 63 annual open outcry audit trail reviews and closed 48 of them by the end of the target period. The Exchanges opened 167 routine audit trail reviews for front-end audit trail, Tag 50 ID, Tag 1028, suspense account, and CTI code usage, and by the end of the target period, 137 reviews had been closed or referred to the Enforcement Group. The Exchanges also opened and closed 237 CTR reviews.

B. Findings with Deficiencies Requiring Corrective Action

1. Annual Audit Trail and Recordkeeping Reviews (Commission Regulation § 38.553(a))

- During the target period, the Exchanges did not annually “review . . . randomly selected samples of front-end audit trail data for order routing systems” of its clearing firms, as required by Commission regulation § 38.553(a)(1). Rather, the Exchanges reviewed annual certifications from its clearing firms that the firms were complying, and only occasionally reviewed randomly selected samples of front-end audit trail data. The Exchanges now regularly review randomly selected samples of front-end audit trail data as part of a new routinely conducted audit trail program.
 - **Deficiency: Although the Exchanges have taken remedial action, the Exchanges must ensure that their program for reviewing front-end audit trail data is effective and the reviews are conducted in a timely manner.**
- The Division found that the Exchanges are not at least annually reviewing and enforcing a provision of the Exchanges’ user identification assignment policy. Commission regulation § 38.553(a)(1) requires exchanges to at least annually review the “process by which user identifications are assigned.” The Exchanges’ policy for the assignment of Tag 50 IDs provides, in part: “Where a single ATS Operator or an ATS Team is responsible for multiple trading models, algorithms, programs, or systems that trade the same product and potentially could trade opposite one another, each such model, algorithm, program, or system must be assigned a unique Tag 50 ID” (the “ATS Tag 50 ID policy”).⁶
 - **Deficiency: The Exchanges must develop a program to at least annually review and enforce the assignment process of Tag 50 IDs to automated trading models,**

⁶ CME Group Market Regulation Advisory Notice, Identification and Registration of Globex Operator IDs (Tag 50 IDs), RA0908-15 (Sept. 10, 2009), available at http://www.cmegroup.com/rulebook/files/CME_Group_RA0908-5.pdf (“Tag 50 ID Advisory Notice”).

algorithms, programs, and system in order to enforce the Exchanges' ATS Tag 50 ID policy.

2. Enforcement Program Required (Commission Regulation § 38.553(b))

- The Division found that during the target period, the Exchanges issued five summary fines of \$500 and two summary fines of \$750 per offense for electronic trading audit trail deficiencies discovered during the Exchanges' routine electronic audit trail reviews. The Division believes that an initial summary fine amount of \$500 or \$750 per audit trail deficiency is not a "meaningful sanction" or a sanction "sufficient to deter recidivist behavior," as required by Commission regulation § 38.553(b).
 - **Deficiency: The Exchanges must ensure that the minimum summary fine amount for electronic trading audit trail deficiencies on each Exchange is "meaningful" and "sufficient to deter recidivist behavior." This minimum summary fine amount should be published in CME Group's rules.**

The accompanying Compliance Matrix describes in more detail the Exchanges' compliance with Core Principles 2 and 10, and the Commission's related regulations codified in § 38.155 and §§ 38.550–553.

COMPLIANCE MATRIX

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/Recommendations ⁷
Core Principle 2 – Compliance With Rules		
<p>§ 38.155 Compliance staff and resources (audit trail)</p> <p>(a) Sufficient compliance staff. A designated contract market must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The designated contract market's compliance staff also must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 38.158(b) of this part.</p> <p>(b) Ongoing monitoring of compliance staff resources. A designated contract market must monitor the size and workload of its compliance staff annually, and ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate level of compliance resources and staff, the designated contract market should</p>	<p>CME Group's Market Regulation Department ("Market Regulation") provides compliance services to the CME Group exchanges. A division of Market Regulation, the Strategic and Technology Initiatives Group ("STI Group"), which is responsible for the continued development of CME Group's automated surveillance and new strategic initiatives, includes the Data Quality Assurance Group ("DQA Group").⁸ The DQA Group is responsible for reviewing compliance with electronic and open outcry audit trail and recordkeeping requirements across all of the CME Group exchanges. The division of work within the DQA Group is generally by type of audit trail review (e.g., open outcry audit trail review or electronic audit trail review), rather than by exchange.</p> <p>During the target period, the DQA Group had 10 staff members reporting to the Executive Director for the STI Group. Shortly after the target period, the DQA Group added two more employees, a director and an additional data investigator, for a total of 12 staff members.</p> <p>In connection with implementing the Commission's audit trail regulations that became effective at the beginning of the target period, and the Exchanges' efforts to continue improving the audit trail program, during the target period and continuing thereafter, the</p>	<p>No deficiencies or recommendations.</p>

⁷ This column contains: (1) deficiency findings where the Division believes the Exchanges were not in compliance with a Commission regulation and must take corrective action and (2) recommendations where the Division identifies areas for improvement.

⁸ In early 2014, to reflect the restructuring and changes made to the DQA Group, it was renamed Data Investigations and moved from the STI Group to Market Regulation's Investigations Group under the oversight of the Executive Director and Global Head of Investigations.

<p>consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.</p>	<p>DQA Group was restructured to conduct more frequent, routine audit trail reviews rather than primarily relying on annual reviews. As part of that restructuring, a new role of Program Architect was added to define, design, and implement new audit trail programs, processes, and procedures, and measure the effectiveness of those programs. In addition, the DQA Group began training and focusing its staff on conducting more investigative work rather than referring all potential audit trail deficiencies to Market Regulation’s Investigations Group or the Enforcement Group.</p>	
Core Principle 10 – Trade Information		
<p>§ 38.550 Core Principle 10</p> <p>The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information:</p> <p>(a) To assist in the prevention of customer and market abuses; and</p> <p>(b) To provide evidence of any violations of the rules of the contract market.</p>	<p>See discussion below addressing Commission regulations §§ 38.551–38.553.</p>	
<p>§ 38.551 Audit trail required</p> <p>A designated contract market must capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses. Such data must be sufficient to reconstruct all transactions within a reasonable period of time and to provide evidence of any violations of the rules of the designated contract market. An acceptable audit trail must also permit the designated contract market to track a customer</p>	<p>Globex is the electronic trading platform used by all of the CME Group exchanges. During the target period, Globex received an average volume of approximately 1.4 billion order and order modification messages per month, and executed an average volume of approximately 223 million contracts per month. Trading on Globex accounts for approximately 90 percent of all trades executed on the Exchanges.</p> <p>The Regulatory Application for Processing In-Memory Data (“RAPID”) system records the raw audit trail data captured or created by Globex, which includes all orders, cancellations, modifications, and trade messages. The date and time of each</p>	<p>No deficiencies or recommendations.</p>

<p>order from the time of receipt through fill, allocation, or other disposition, and must include both order and trade data.</p>	<p>message and each matched trade is recorded to the nearest millisecond. A daily archive is created from the raw RAPID data, which is retained for at least five years. Market Regulation can use RAPID as a tool to view all Globex order and trade data on a real-time or historical basis.⁹ Open outcry audit trail data is entered into CME Group’s clearing system.</p> <p>Post-clearing trade data, which includes electronic and open outcry audit trail data and allocation data, is recorded by CME Group’s Regulatory Historical Repository (“RHR”) database.¹⁰ An archive is created from the RHR database and retained for at least five years.</p> <p>The data from the RHR database is loaded onto CME Group’s Sophisticated Market Analysis Research Technology (“SMART”) system and is viewed by Market Regulation on a T+1 basis.¹¹ The SMART system brings together for investigators all cleared trade and allocation data for both the electronic and open outcry venues at the Exchanges.</p>	
<p>§ 38.552 Elements of an acceptable audit trail program</p> <p>(a) <i>Original source documents.</i> A designated contract market’s audit trail must include original source documents. Original source documents include unalterable, sequentially identified records on which trade execution information is</p>	<p>All open outcry orders must include the information required by CME/CBOT Rule 536.A, which sets forth the order entry requirements for members and floor brokers, including the date, time of order entry, time of order execution, account identifier, price, quantity, bracket, opposite trader, and clearing member. Trades or order executions must be recorded on an approved electronic device or trading card in non-erasable ink, which is provided to the clearing member for submission to the clearing system. Pursuant to CME/CBOT Rule 536.A.1, customer orders</p>	<p>No deficiencies or recommendations.</p>

⁹ For a description of the RAPID system, see the Division’s [date] rule enforcement review of NYMEX and COMEX’s trade practice surveillance program, which covered the target period from July 1, 2012 through June 30, 2013 (the “2014 NYMEX-COMEX Review”).

¹⁰ Other support, development, and IT regulatory groups are responsible for the creation and processing of the audit trail in the RHR/SMART and RAPID systems.

¹¹ For a description of the SMART system, see the 2014 NYMEX-COMEX Review.

originally recorded, whether recorded manually or electronically. Records for customer orders (whether filled, unfilled, or cancelled, each of which shall be retained or electronically captured) must reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), and the time of order entry. For open-outcry trades, the time of report of execution of the order shall also be captured.

(b) *Transaction history database.* A designated contract market's audit trail program must include an electronic transaction history database. An adequate transaction history database includes a history of all trades executed via open outcry or via entry into an electronic trading system, and all orders entered into an electronic trading system, including all order modifications and cancellations. An adequate transaction history database also includes:

- (1) All data that are input into the trade entry or matching system for the transaction to match and clear;
- (2) The customer type indicator code;
- (3) Timing and sequencing data adequate to reconstruct trading; and
- (4) Identification of each account to which fills are allocated.

(c) *Electronic analysis capability.* A designated contract market's audit trail program must include electronic analysis capability with respect to all audit trail data in the transaction history database. Such electronic analysis capability must ensure that the ability to reconstruct trading and

must be in the form of a written or electronic record and include the specific account(s) for which the order was placed and an electronic timestamp reflecting the date and time such order was modified, returned, confirmed, or cancelled. In addition, orders that will be bunched and allocated to other accounts must contain the information required by CME Group Rule 536.C.

All orders entered into Globex must include the information required by CME Group Rule 536.B, including the CTI code, user identification (Tag 50 ID), account number, executing firm number, give-up firm and account number, and whether the order is entered by an automated trade system ("ATS") or manually (Tag 1028). Each order carries a trader order number, assigned by the front-end system used by the trader entering the order, and a host order number, assigned by Globex upon receipt of the order. In addition, orders that will be bunched and allocated to other accounts must contain the information required by CME Group Rule 536.C.

CME Group's clearing system and RHR database record the clearing and post-clearing information for executed open outcry trades. The RAPID system records all of the information and messages entered into Globex for electronic trading, including all orders, order modifications, cancellations, and CTI codes, as well as all responses and trades matched by Globex. The post-clearing information for electronic trading is recorded in the RHR database. The open outcry and electronic audit trail data from the RHR database is loaded into the SMART system.

The SMART system provides the Exchanges with the ability to electronically analyze the electronic and open outcry audit trail data, as well as reconstruct trading, identify possible trading violations, and track a customer order from time of receipt through disposition.

<p>the designated contract market has identify possible trading violations with respect to both customer and market abuse.</p>		
<p>§ 38.553 Enforcement of audit trail requirements – (a) Annual audit trail and recordkeeping reviews</p> <p>A designated contract market must enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and persons and firms subject to designated contract market recordkeeping rules to verify their compliance with the contract market’s audit trail and recordkeeping requirements. Such reviews must include, but are not limited to, the following:</p> <p>(1) For electronic trading, audit trail and recordkeeping reviews must include reviews of randomly selected samples of front-end audit trail data for order routing systems; a review of the process by which user identifications are assigned and user identification records are maintained; a review of usage patterns associated with user identifications to monitor for violations of user identification rules; and reviews of account numbers and customer type indicator</p>	<p><u>The Exchanges’ Audit Trail Requirements</u></p> <p>With respect to electronic trading, CME Group Rule 536.B.2 provides that entities certified by the Exchange(s) to connect an order routing/front-end system to Globex are responsible for creating an audit trail of each message entered into Globex.¹² Clearing members guaranteeing a connection to Globex are responsible for maintaining or causing to be maintained the order routing/front-end electronic audit trail.</p> <p>With respect to open outcry trading, CME/CBOT Rule 536.A provides that members are required to record trade data electronically or on written trading cards, and provide their clearing member with any trading documents that are necessary for submission to the clearing system.¹³ Trading documents must be submitted and time-stamped no later than 15 minutes after the end of a half-hour time interval.</p> <p><u>The Exchanges’ Electronic Trading Audit Trail Reviews</u></p> <p>During the annual electronic audit trail reviews of the Exchanges’ clearing members, the DQA Group reviewed (i) certifications that front-end audit trail data is maintained by the clearing firm for a minimum of five years; (ii) the assignment and maintenance of user identifications (i.e., Tag 50 IDs) and records by its clearing members; and (iii) usage patterns associated with Tag 50 IDs. The</p>	<p>See deficiencies below.</p>

¹² See also CME Group, Market Regulation Advisory Notice, Order Routing/Front-End Audit Trail Requirements, RA 1309-5 (Aug. 12, 2013), available at <http://www.cmegroup.com/rulebook/files/cme-group-ra1309-5.pdf>.

¹³ See also CME and CBOT Market Regulation Advisory Notice, Computerized Trade Reconstruction (“CTR”) Monthly Edit Programs, RA 1009-3 (Jan. 3, 2011), available at <http://www.cmegroup.com/rulebook/files/CME-CBO-RA1009-3-Rule-536F.pdf>.

codes in trade records to test for accuracy and improper use.
(2) For open outcry trading, audit trail and recordkeeping reviews must include reviews of members' and market participants' compliance with the designated contract market's trade timing, order ticket, and trading card requirements.

DQA Group also reviewed, on an as-needed basis, the front-end audit trails of any new front-end systems requesting a connection to Globex.

The DQA Group also developed and implemented new programs to routinely monitor clearing firms for audit trail compliance more frequently than the annual electronic audit trail reviews. These programs include reviewing usage patterns associated with Tag 50 IDs (user identifications) and identifying users that are inaccurately submitting data in Tag 1028 (which indicates whether orders are being entered manually or by an ATS).

The Division found, however, that during the target period the Exchanges did not annually "review . . . randomly selected samples of front-end audit trail data for order routing systems" of its clearing firms, as required by Commission regulation § 38.553(a)(1). Rather, the Exchanges were reviewing annual certifications from the clearing firms and only occasionally reviewing randomly selected samples of front-end audit trail data. The Exchanges have since begun regularly reviewing randomly selected samples of front-end audit trail data as part of a new routinely conducted audit trail program.

The Division also found that the Exchanges are not at least annually reviewing and enforcing a provision of the Exchanges' user identification (Tag 50 ID) assignment policy. Commission regulation § 38.553(a)(1) requires exchanges to at least annually review the "process by which user identifications are assigned." The Exchanges' ATS Tag 50 ID policy provides: "Where a single ATS Operator or an ATS Team is responsible for multiple trading models, algorithms, programs, or systems that trade the same product and potentially could trade opposite one another, each such

Deficiencies Requiring Corrective Action

- Although the Exchanges have taken remedial action, the Exchanges must ensure that their program for reviewing front-end audit trail data is effective and the reviews are conducted in a timely manner.
- The Exchanges must develop a program to review and enforce the assignment of Tag 50 IDs to automated trading models, algorithms, programs, and systems in order to enforce the Exchanges' ATS Tag 50 ID policy.

	<p>model, algorithm, program, or system must be assigned a unique Tag 50 ID.”¹⁴</p> <p><u>The Exchanges’ Open Outcry Trading Audit Trail Reviews</u>¹⁵</p> <p>During the annual open outcry audit trail reviews of the Exchanges’ clearing firms, staff conducts back office audits of each clearing member with open outcry trading volume to evaluate and enforce compliance with the Exchanges’ trade timing, order ticket, and trading card requirements.¹⁶</p> <p>The Exchanges also review open outcry audit trail data during monthly Computerized Trade Reconstruction (“CTR”) reviews of their members.¹⁷ The CTR program reviews computerized recordkeeping exceptions on a monthly basis for compliance with the Exchanges’ open outcry trade timing, and related order ticket and trading card requirements.</p>	
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¹⁴ See Tag 50 ID Advisory Notice.

¹⁵ The process for the Exchanges’ open outcry audit trail reviews has remained substantially unchanged since the Division reviewed the Exchanges’ audit trail program in the 2010 CME-CBOT Review.

¹⁶ See CME/CBOT Rule 536.F.

¹⁷ The CTR reviews are described in CME/CBOT Rule 536.F.

	<p><u>The Exchanges' Audit Trail Reviews Applicable to Both Electronic and Open Outcry Trading</u></p> <p>The DQA Group also implemented routine audit trail reviews, for both electronic and open outcry trading, to more frequently monitor the entry of CTI codes and the use of suspense accounts for give-up trades.¹⁸</p>	
<p>§ 38.553 Enforcement of audit trail requirements – (b) Enforcement program required</p> <p>A designated contract market must establish a program for effective enforcement of its audit trail and recordkeeping requirements for both electronic and open-outcry trading, as applicable. An effective program must identify members and persons and firms subject to designated contract market recordkeeping rules that have failed to maintain high levels of compliance with such requirements, and levy meaningful sanctions when deficiencies are found. Sanctions must be sufficient to deter recidivist behavior. No more</p>	<p><u>Annual Audit Trail Reviews Conducted During the Target Period</u></p> <p>During the target period, the Exchanges opened 74 annual electronic trading audit trail reviews.¹⁹ By the end of the target period, eight of those reviews were referred to the Enforcement Group for violations of CME Group rules,²⁰ three reviews resulted in fines of \$1,000, eight reviews resulted in warning letters, 29 reviews were closed with no action, and 26 reviews remained open, although only five of those open reviews remained open by the end of the calendar year.</p> <p>During the target period, the Exchanges opened 63 annual open outcry (i.e., back office) audit trail reviews. By the end of the target period, 16 of those reviews resulted in fines of \$2,500-5,000 (and five fines were rescinded);²¹ 32 reviews were closed with no action, and 15 reviews remained open, although only two of those reviews remained open by the end of the calendar year.</p>	<p>See deficiency below.</p>

¹⁸ See CME-CBOT Rule 536.A.1 (Customer Orders); CME Group Rule 536.C (Bunched Orders and Orders Eligible for Post Execution Allocation). Suspense accounts are used by firms to hold execution (give-ups), post-execution account, and bunched order business until trades are moved to the underlying specific accounts.

¹⁹ There are 72 clearing firm members at CME Group, and all but eight of those firms are clearing firm members of CME and/or CBOT. Although the annual audit trail review of each clearing firm for each exchange is conducted simultaneously by the DQA Group, for the purpose of the discussion in this document, each exchange's review is counted separately.

²⁰ As of this date, three of the reviews referred to the Enforcement Group resulted in fines ranging from \$1,000-7,000, and the rest are pending.

²¹ Open outcry trading fines can be rescinded pursuant to the procedure in CME-CBOT Rule 536.F, which allows a member 15 days to present evidence to Market Regulation in support of having the fine dismissed.

than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

The Division generally found the quality and documentation of the annual reviews to be thorough and complete. By the end of calendar year 2013, the DQA Group had opened an annual electronic or open outcry audit trail review of every clearing firm with electronic and/or open outcry trading volume during calendar year 2013. During the target period, it typically took nine-and-a-half months or less to complete an electronic trading audit trail review, and less than three months for an open outcry audit trail review. The Division noted that several annual electronic audit trail reviews opened prior to the target period and closed during the target period took longer than 12 months to complete, and that four annual audit trail reviews opened during the target period took longer than 12 months to complete. The Division recognizes, however, that there were mitigating factors in those reviews, including the size of the clearing firm and amount of data involved, as well as the DQA Group's restructuring of the audit trail program and staffing changes during that time period. The Division also notes that the time to complete the electronic audit trail reviews continued to improve as the DQA Group refined its audit trail review program and staffing, and it encourages the Exchanges to continue taking steps to improve the timeliness of its reviews.

Routine Audit Trail Reviews Conducted During the Target Period

During the target period, the DQA Group also opened 167 reviews²² related to its routine reviews of front-end audit trail, Tag 50 ID, Tag 1028, suspense account, and CTI code usage. By the end of the target period, 137 of those reviews were either closed by the DQA Group with no action, a warning letter, a summary fine

²² The Division notes that some reviews involved multiple clearing firms within one review or case number.

	<p>ranging from \$500–4,000 per exchange, or referred to the Enforcement Group.²³ The DQA Group also opened 237 CTR reviews, which were all closed within four months of being opened, resulting in warning letters or fines of \$1,000–1,500. Accordingly, the Division found that during the target period, these reviews were typically either closed by the DQA Group or referred to the Enforcement Group in a timely manner.</p> <p><u>Summary Fines</u></p> <p>CME/CBOT Rule 536.F provides for summary fines for CTR deficiencies and open outcry audit trail deficiencies, including a minimum summary fine per offense of \$1,000, \$1,500, or \$2,500, and a maximum fine of up to \$5,000 or \$10,000, depending on the deficiency. Violations that are more egregious are referred to the Probable Cause Committee.</p> <p>CME Group Rule 512, which became effective at the start of the target period, gave the DQA Group, in consultation with others in Market Regulation, expanded authority to issue summary fines for audit trail and recordkeeping deficiencies.²⁴ This authority was further expanded during the target period to include nonmembers who are subject to the jurisdiction of the Exchanges and to include Tag 1028 deficiencies.²⁵ CME Group Rule 512 authorizes summary fines of up to \$5,000 per offense per individual and \$10,000 per offense per firm. Violations that are more egregious</p>	
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²³ All of the cases referred to the Enforcement Group were closed by the end of May 2014 and resulted in fines ranging from \$2,000–16,000.

²⁴ See CME Group Market Regulation Advisory Notice, Implementation of Rule 512 (Reporting Infractions), RA 1208-5 (Aug. 30, 2012) *available at* http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/CMEGroup_RA1208-5.html. Prior to the adoption of CME Group Rule 512, the DQA Group could close an electronic audit trail review with no action or issue a warning letter, but deficiencies were referred to investigators in the Investigations Group or Enforcement Group.

²⁵ See CME Group Market Regulation Advisory Notice, Summary Fines for Reporting Infractions, RA 1307-5 (June 17, 2013), *available at* <https://www.cmegroup.com/rulebook/files/RA1307-5.pdf>.

	<p>are referred to the Enforcement Group.</p> <p>The Division did not find instances where the DQA Group issued a warning letter to the same person or entity found to have committed the same rule violation within a rolling 12 month period. However, the Division found that during the target period, the Exchanges issued five summary fines of \$500 and two summary fines of \$750 per offense for electronic trading audit trail deficiencies discovered during the Exchanges' routine electronic audit trail reviews. The Division believes that an initial summary fine amount of \$500 or \$750 per audit trail deficiency is not a "meaningful sanction" or "sufficient to deter recidivist behavior," as required by Commission regulation § 38.553(b).²⁶</p>	<p><u>Deficiency Requiring Corrective Action</u></p> <ul style="list-style-type: none"> • The Exchanges must ensure that the minimum summary fine amount for electronic trading audit trail deficiencies on each Exchange is "meaningful" and that sanctions are "sufficient to deter recidivist behavior." The minimum summary fine amount should be published in CME Group's rules.
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²⁶ The Division conveyed its view that an initial summary fine amount should be at least \$1,000 for open outcry audit trail deficiencies in the 2010 CME-CBOT Review. In response, the Exchanges included a \$1,000 initial summary fine amount for open outcry audit trail deficiencies in CME Group Rule 536.F.