

**UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION**

**Received
C.F.T.C.
2011 MAY 25 AM 9:50
Office of Proceedings**

In the Matter of: : CFTC Docket No. 11-13
: :
Cadent Financial Services LLC : **ORDER INSTITUTING PROCEEDINGS**
: **PURSUANT TO SECTIONS 6(c) AND 6(d)**
Respondent : **OF THE COMMODITY EXCHANGE ACT**
: **AND MAKING FINDINGS AND**

: **IMPOSING REMEDIAL SANCTIONS**
: :

I.

The Commodity Futures Trading Commission (the "Commission") has reason to believe that Cadent Financial Services LLC ("Cadent" or the "Respondent"), a registered futures commission merchant ("FCM"), has violated Commission Regulation ("Regulation") 166.3, 17 C.F.R. § 166.3 (2007). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted to determine whether the Respondent engaged in the violations set forth herein, and to determine whether an order should be issued imposing remedial sanctions.

II.

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

¹ The Respondent consents 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 the Respondent does not consent to the use of this Order or the Offer, or the findings and 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 does the Respondent consent to the use of the Offer or this Order, or the findings and conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

III.

A. Summary

From February 2007 through at least October 2007, (the “relevant period”) Cadent, a registered Futures Commission Merchant (“FCM”), failed to diligently supervise its employees and associated persons (“APs”) in their handling of orders for commodity futures trading accounts controlled by a guaranteed introducing broker (“GIB”) of Cadent, and the GIB’s AP, sole principal and owner. The GIB had several individual customers that it managed, and the GIB’s AP separately operated a small commodity pool (“pool”). Over approximately 9 months, the GIB’s AP engaged in an unlawful trade allocation scheme for his personal benefit and to the detriment of the GIB’s customers and the pool. The GIB’s AP placed bunched orders, *i.e.*, orders placed for multiple accounts, with Cadent for the GIB’s customer accounts, the pool accounts and the GIB’s AP’s personal accounts, waited to see which trades were profitable and then allocated the profitable or more profitable trades to his personal accounts and unprofitable or less profitable trades to GIB customer accounts or the pool account.

Cadent failed to follow procedures it had in place concerning the placement of bunched orders by account managers. Cadent failed to ensure that it always received a post-allocation plan prior to or contemporaneously with the GIB’s AP’s filing of bunched orders. Cadent also permitted the GIB’s AP to make continual account changes to any allocations made. Moreover, Cadent failed to adequately respond to numerous indicators of questionable activity and to investigate whether the GIB’s AP’s post-execution allocations were detrimental to Cadent’s customers. By such acts, Cadent failed to diligently supervise the handling of customer orders in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2007).

B. Respondent

Cadent Financial Services LLC is registered with the Commission as a FCM, with its principal place of business located at 150 S. Wacker Drive, Suite 1310, Chicago, IL 60606.

C. Facts

Cadent’s Failure to Diligently Supervise In Connection with a Trade Allocation Scheme

Beginning in February 2007, the GIB introduced several individual customer accounts to Cadent. At any given time, there were between nine and 25 customer accounts. The GIB’s AP also operated a commodity pool, for which he claimed a registration exemption pursuant to Regulation 4.13(a)(2), 17 C.F.R. § 4.13(a)(2) (2007). The GIB’s AP was the general partner and operator of the pool. The GIB had a trading account held in another name which the GIB’s AP claimed was his personal trading account. The GIB’s AP also had a personal trading account in his own name.

For approximately 9 months, the GIB’s AP routinely used bunched orders to place trades with Cadent. A bunched order is an order placed for multiple accounts. Regulation 1.35 (a-1) permits the post-execution allocation of customer orders by eligible account managers only if specific enumerated requirements are met. Among the requirements are that allocations must be:

1) made as soon as practicable after the entire transaction is executed but in any event, no later than a time sufficiently before the end of the day the order is executed; and 2) fair and equitable with no account or group of accounts receiving consistently favorable or unfavorable treatment. In addition, the allocation methodology must be sufficiently objective and specific to permit independent verification of the fairness of the allocations.

The GIB's AP used the bunched orders to allocate trades among his personal accounts and the customer and pool accounts in an unjust and inequitable manner. Specifically, the trades allocated to the GIB's AP's personal accounts were overwhelmingly profitable, while the accounts of his customers and the pool were overwhelmingly losing. The GIB's AP did not participate in many of the trades he allocated, but when he did, he allocated the profitable trades to his personal accounts. For example, in a two month period, the GIB's AP submitted fifty-eight allocations after the execution of the trades. The GIB's AP allocated trades to his personal accounts in eleven instances with Cadent, and all of these trades were profitable except one \$37 losing trade. Through this allocation scheme, the GIB's AP defrauded his customers of potential profits that should have been theirs.

The GIB's AP did not have, as required, procedures for allocating bunched orders for multiple accounts in a fair and non-preferential way to ensure that no account received consistently favorable or unfavorable treatment. Rather, the GIB's AP placed the bunched orders without any contemporaneous allocation of the trades or with only a tentative allocation that he revised after the execution of the trades. Throughout the relevant period, the GIB's AP would submit "account change request forms" either on the trade date or several days after the trades were allocated, requesting that the trades be placed in another account. The GIB's AP gave varying excuses to Cadent, including that he gave an incorrect account number, had a 'fat finger' error, or had issues with the order platform. To alleviate these purported errors, Cadent switched the GIB's AP to a different order platform. However, the GIB's AP continued to request account changes and eventually, Cadent terminated his ability to enter bunched orders.

Although Cadent's policies and procedures provided that fill allocations must be provided prior to placement of block orders, Cadent failed to ensure it had the appropriate allocation from the GIB's AP in many instances. Cadent also routinely allowed the GIB's AP to change account numbers for allocations, at times, several days after the trade date. Despite this pattern, Cadent never detected the transparent allocation scheme perpetuated by the GIB's AP to benefit his personal trading accounts. Moreover, even after terminating his ability to enter bunched orders, Cadent did not investigate the GIB's AP's trading and allocations to determine whether the allocations were fair and equitable or whether customers were being harmed until after the National Futures Association ("NFA") brought the GIB's AP's possibly fraudulent activities to its attention.²

² Prior to this Order, Cadent compensated the GIB's customers and the pool participants for the losses they sustained as a result of the trade allocation scheme.

D. Legal Discussion

Regulation 166.3 requires that every Commission registrant (except APs who have no supervisory duties) diligently supervise the handling by its partners, officers, employees and agents of all of its commodity interest accounts and activities relating to its business as a registrant. In order to prove a violation of Regulation 166.3, it must be demonstrated that either: (1) the registrant's supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *In re Murlas Commodities, Inc.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485 at 43,161 (CFTC Sept. 1, 1995); *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC Apr. 1, 1992); *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352 at 39,168-69 (CFTC Aug. 5, 1992).

Under Regulation 166.3, a registrant has a "duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents." *Sanson Refining Co. v. Drexel Burnham Lambert, Inc.* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,596 at 36,566 (CFTC Feb. 16, 1990) (quoting *Lobb v. J.T. McKerr & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,568 at 36,444 (CFTC Dec. 14, 1989)). Thus, "a showing that the registrant lacks an adequate supervisory system [standing alone] can be sufficient" to establish a breach of duty under Regulation 166.3. *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997). The lack of an adequate supervisory system can be established by showing that the registrant failed to develop proper procedures for the detection of wrongdoing. *CFTC v. Trinity Fin. Group Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,179 at 45,635 (S.D. Fla. Sept. 29, 1997), *aff'd in relevant part, vacated in part and remanded sub nom. Sidoti v. CFTC*, 178 F.3d 1132 (11th Cir. 1999) (respondent failed to establish and maintain meaningful procedures for deterring and detecting fraud by their employees, and knew of specific incidents of misconduct but failed to take reasonable steps to correct the problems in violation of Regulation 166.3).

As described above, due to deficiencies in Cadent's supervisory system and its' failure to properly implement and monitor supervisory procedures, Cadent failed to diligently supervise the handling by its partners, employees and agents of all of its commodity interest accounts and activities relating to its business as a registrant and therefore violated Regulation 166.3. Cadent failed to follow procedures it had in place concerning the placement of bunched orders by account managers. Cadent failed to ensure that it always received a post-allocation plan prior to or contemporaneously with the GIB's AP's filing of the bunched orders. Cadent also permitted the GIB's AP to make continual account changes to allocations previously made. Furthermore, Cadent failed to respond to numerous indicators of questionable activity and to investigate whether the GIB's AP's post-execution allocations were detrimental to Cadent's customers.

IV.

FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that Cadent violated Regulation 166.3, 17 C.F.R. § 166.3 (2007).

V.

OFFER OF SETTLEMENT

The Respondent has submitted an Offer in which it acknowledges service of this Order, admits the jurisdiction of the Commission with respect to the matters set forth in this Order and waives: 1) the service and filing of a complaint and notice of hearing; 2) a hearing and all post-hearing procedures; 3) judicial review by any court; 4) any and all objections to the participation of any member of the Commission's staff in consideration of the Offer; 5) any and all claims that it may possess under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504 (2006) and 28 U.S.C. § 2412 (2006), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1-30 (2010), relating to, or arising from this proceeding; 6) any and all claims that it 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 7) any claim of double jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief.

The Respondent stipulates that the record on which this Order is entered consists of this Order and the findings in this Order consented to in its Offer. The Respondent consents to the Commission's issuance of this Order, which makes findings as set forth herein and orders that the Respondent: 1) cease and desist from violating Regulation 166.3, 17 C.F.R. §166.3 (2007); 2) pay a civil monetary penalty in the amount of \$125,000; and 3) comply with the undertakings set forth herein.

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

VI.

ORDER

Accordingly, **IT IS HEREBY ORDERED THAT:**

- A. The Respondent shall cease and desist from violating Regulation 166.3, 17 C.F.R § 166.3 (2010);
- B. The Respondent shall pay a civil monetary penalty in the amount of \$125,000 within ten (10) business days of the date of entry of this Order. The Respondent shall pay the civil

monetary penalty by making electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than electronic funds transfer, 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: Marie Bateman – AMZ-300
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone 405-954-6569

If payment by electronic transfer is chosen, the Respondent shall contact Marie Bateman or her successor at the telephone number above to receive payment instructions and shall fully comply with those instructions. The Respondent shall accompany payment of the penalty with a cover letter that identifies the Respondent and the name and docket number of this proceeding. The Respondent shall simultaneously transmit copies of the cover letter and the form of payment to: (1) the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581; and (2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission at the same address. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2) (2006), if this amount is not paid in full within fifteen (15) days of the due date, the Respondent shall be prohibited automatically from the privileges of all registered entities, and, if registered with the Commission, such registration shall be suspended automatically until it has shown to the satisfaction of the Commission that payment of the full amount of the penalty with interest thereon to the date of the payment has been made.

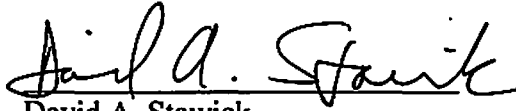
C. The Respondent shall comply with the following conditions and undertaking as consented to in the Offer:

Cadent agrees that neither it nor any of its agents or employees under its 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 Cadent's (i) testimonial obligations or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Cadent shall undertake all steps necessary to ensure that all of its agents and/or employees under its authority or control understand and comply with this agreement.

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

By the Commission:

Dated: May 25, 2011

A handwritten signature in black ink, appearing to read "David A. Stawick", written over a horizontal line.

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission