

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of

J.P. MORGAN SECURITIES LLC

Respondent.

CFTC Docket No: 12-14

Office of
Product Development
Prudential Bank

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**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 J.P. Morgan Securities LLC (“JPMS” or “Respondent”) violated Section 4c(a)(1) of the Commodity Exchange Act (“Act”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, Title VII (the Wall Street Transparency and Accountability Act of 2010), §§ 701-774, 124 Stat. 1376 (enacted July 21, 2010) (“Dodd-Frank Act”), to be codified at 7 U.S.C. § 6c(a)(1), and Commission Regulation (“Regulation”) 1.38(a), 17 C.F.R. § 1.38(a) (2011). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondent engaged in the violations as 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, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Act, Making Findings and Imposing Remedial Sanctions (“Order”) and acknowledges service of this Order.

¹ Respondent consents 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 Respondent does 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 a proceeding in bankruptcy or to enforce the terms of this Order. Nor does Respondent consent to the use of the Offer or this Order, or the findings or conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

III.

The Commission finds the following:

A. SUMMARY

Respondent confirmed the execution of a prearranged trade, which was a fictitious sale and noncompetitive. The trade occurred on the floor of the Chicago Board of Trade (“CBOT”) and involved ten year U.S. Treasury Note Futures spreads (“ten year spreads”). As set forth below, Respondent, through the acts of one of its employees, violated Section 4c(a)(1) of the Act and Regulation 1.38(a).

B. RESPONDENT

J.P. Morgan Securities LLC is a subsidiary of JPMorgan Chase & Co. and is located in New York, New York. JPMS is a futures commission merchant (“FCM”) and has been registered with the Commission as such since 1982. The conduct at issue involved an employee of J.P. Morgan Futures Inc. (“JPMF”), an FCM that subsequently merged with JPMS in June 2011, with JPMS assuming JPMF’s liabilities.² That employee is now employed by JPMS in the same capacity.

C. FACTS

On May 25, 2010, a JPMF customer electronically transmitted an order to JPMF, directing the sale of 11,642 ten year spreads. The customer called a JPMF employee to confirm the order for the sale of 11,642 ten year spreads. During that same phone call, the customer asked the JPMF employee to look for any “all or none,”³ because the customer also wanted to buy those spreads.

After the call with the customer, the JPMF employee called the JPMF desk at the CBOT and asked whether there were any “all or none” in the ten year spreads. The desk said no. The JPMF employee asked the desk to keep him posted.

Shortly thereafter, the same customer placed an all or none bid for 11,642 ten year spreads with another FCM, and the bid was called out to the CBOT floor. The JPMF desk called the JPMF employee to relay the bid. Once the JPMF employee confirmed that the bid was an all or none for 11,642 ten year spreads, the JPMF employee hit that bid and sold the 11,642 ten year spreads. As a result, the customer was on both sides of the transaction.⁴

² Respondent is therefore liable for any violations committed by JPMF. For simplicity sake, “Respondent” refers to either JPMS or JPMF for purposes of this Order.

³ An “all or none” order is an order that needs to be filled in its entirety with respect to quantity and may not be filled partially.

⁴ The customer is an investment manager and had underlying clients on both sides of the transaction. The clients on the buy side were completely different than the clients on the sell side.

IV.

LEGAL DISCUSSION

A. Respondent Confirmed the Execution of a Prearranged Trade in Violation of Section 4c(a)(1) of the Act.

Section 4c(a)(1) of the Act makes it unlawful “for any person to offer to enter into, enter into, or confirm the execution of . . . a fictitious sale.” The Act does not define what a “fictitious sale” is, but that term includes wash sales, accommodation trades, and prearranged trades. *In re Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,902-03 (CFTC Apr. 4, 1986). “[T]he central characteristic 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.” *Id.* at 31,902.

Congress’ intent in enacting Section 4c(a) was to “ensure that all trades are focused in the centralized marketplace to participate in the competitive determination of the price of the futures contracts.” *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,742 (CFTC Dec. 10, 1997) (quoting S. Rep. No. 93-1131, at 16-17 (1974)). In other words, Section 4c(a) was meant “to prevent collusive trades conducted away from the trading pits,” *Merrill Lynch Futures, Inc. v. Kelly*, 585 F. Supp. 1245, 1251 n.3 (S.D.N.Y. 1984), and “to outlaw insofar as possible all schemes of trading that are artificial and not the result of arms-length trading on the basis of supply and demand factors,” *In re Goldwurm*, 7 Agric. Dec. 265, 276 (1948).

A prearranged trade is a textbook example of a fictitious sale. “By determining trade information such as price and quantity outside the pit, then using the market mechanism to shield the private nature of the bargain from public scrutiny, both price competition and market risk are eliminated.” *In re Collins*, Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,903.

On May 25, 2010, Respondent, through its employee, confirmed the execution of a prearranged trade. During pre-execution communications, Respondent’s customer confirmed to the JPMF employee an order to sell 11,642 ten year spreads, but the customer then asked the JPMF employee to look for any all or none, as the customer also wanted to buy those spreads. The JPMF employee knew or should have known that the customer was attempting to engage in a prearranged trade where the customer was on both sides of the transaction. At the very least, the JPMF employee had a duty to inquire regarding the customer’s intention. *See In re Three Eight Corp.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,749 at 40,445-46 (CFTC Jun. 16, 1993) (finding that a broker has a duty under Section 4c(a) to inquire when receiving suspect orders). Instead of inquiring as to the customer’s intent, the JPMF employee looked for an all or none bid of 11,642 contracts and executed against it, and Respondent therefore violated Section 4c(a)(1) of the Act.

B. Respondent Violated Regulation 1.38(a).

Commission Regulation 1.38(a) requires that 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.

A noncompetitive trade is generally transacted in accordance with an express or implied agreement between the participants. *See, e.g., In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,652 (CFTC Jan. 25, 1991). A trade can be noncompetitive even if executed in the pit. *In re Buckwalter*, Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,683. Prearranged trading is a form of noncompetitive trading in violation of Regulation 1.38(a). *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,213 at 35,003 (CFTC Apr. 14, 1988).

As explained, *supra*, Respondent, through its employee, confirmed the execution of a prearranged trade. Respondent therefore violated Regulation 1.38(a).

C. Respondent is Liable for Its Employee's Acts and Omissions Pursuant to Section 2(a)(1)(B) of the Act and Regulation 1.2.

The JPMF employee committed the above referenced acts in violation of Section 4c(a)(1) of the Act and Regulation 1.38(a) while acting within the scope of his employment with Respondent. Pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B) (2006), and Regulation 1.2, 17 C.F.R. § 1.2 (2011), JPMF is liable for the acts and omissions of the employee and is therefore liable for violating Section 4c(a)(1) of the Act and Regulation 1.38(a).

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that on May 25, 2010, Respondent violated Section 4c(a)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011).

VI.

OFFER OF SETTLEMENT

Respondent has submitted an Offer in which it, without admitting or denying the findings herein:

- A. Acknowledges receipt and service of this Order;
- B. Admits the jurisdiction of the Commission with respect to all the matters set forth in this Order;
- C. Waives:
 - 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 it may possess under the Equal Access to Justice Act, 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 (2011), relating to, or arising from, this proceeding;
 7. 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, 857-68 (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 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;
- D. Stipulates that the record basis on which this Order is entered shall consist solely of the findings contained in this Order, to which Respondent has consented to in the Offer;
- E. Consents, solely on the basis of the Offer, to the Commission's entry of this Order that:
1. Makes findings by the Commission that Respondent violated Section 4c(a)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011);
 2. Orders Respondent and its successors and assigns to cease and desist from violating Section 4c(a)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011);
 3. Orders Respondent to pay a civil monetary penalty in the amount of one hundred forty thousand dollars (\$140,000), plus post-judgment interest; and
 4. Orders Respondent and its successors and assigns to each comply with the undertaking 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. Respondent shall cease and desist from violating Section 4c(a)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011).
- B. Respondent shall pay a civil monetary penalty in the amount of one hundred forty thousand dollars (\$140,000) within ten (10) days of the date of the entry of this Order ("CMP Obligation"). If the CMP Obligation is not paid 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 the Order pursuant to 28 U.S.C. § 1961 (2006). Respondent 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, Respondent shall make the payment payable to the Commodity Futures Trading Commission, and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Accounts Receivables – AMZ-340
E-mail Box: 9-AMC-AMZ-AR-CFTC
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone 405-954-6569

If payment is to be made by electronic transfer, Respondent shall contact Linda Zurhorst or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the CMP Obligation with a cover letter that identifies itself and the name and docket number of this proceeding. 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.

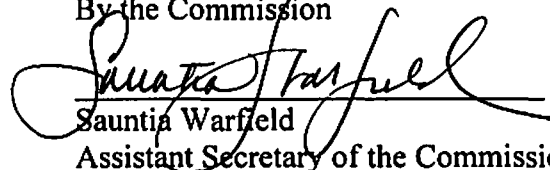
- C. Respondent and its successors and assigns shall comply with the following undertaking set forth in its Offer:

Public Statements: Respondent agrees that neither it nor any of its successors, assigns, 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 Respondent's (i) testimonial obligations, or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondent and its successors and assigns 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

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

Sauntia Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: March 8, 2012