

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of

Harry Karkazis,

Respondent.

CFTC Docket No: 07-01

**ORDER INSTITUTING PROCEEDINGS
PURSUANT TO SECTIONS 6(c) AND 6(d)
OF THE COMMODITY EXCHANGE
ACT, AS AMENDED, MAKING
FINDINGS AND IMPOSING REMEDIAL
SANCTIONS**

RECEIVED
CFTC
2006 DEC 22 2:33
OFFICE OF ADMINISTRATIVE
PROCEDURES

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that Harry Karkazis has violated Section 4b(a)(1)(iv) of the Commodity Exchange Act, as amended (“Act”), 7 U.S.C. § 6b(a)(1)(iv), and Commission Regulation 1.35(d)(6) and (7), 17 C.F.R. §§ 1.35(d)(6) and (7) (2006). Therefore, the Commission deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether Karkazis has 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 this administrative proceeding, Karkazis has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the facts or findings of facts or violations herein, Karkazis acknowledges service of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of

the Commodity Exchange Act, As Amended, Making Findings and Imposing Remedial Sanctions (“Order”).¹

III.

The Commission finds the following:

A. SUMMARY

Between April and July 2002, Harry Karkazis, a floor broker in the trading pit of the Chicago Mercantile Exchange’s (“CME”) Standard & Poor’s 500 Stock Price Index futures contract (“S&P 500”) indirectly traded opposite his customer orders in violation of Section 4b(a)(1)(iv) of the Act. During the relevant time, Karkazis stood on the top step of the S&P 500 trading pit. As a top step broker in the S&P 500 pit, Karkazis was prohibited by reason of CME Rule 541² from engaging in dual trading, i.e., trading S&P contracts for his own account on any day when he filled customer orders for S&P contracts. Because Karkazis engaged in the business of filling customer orders, the only trading that Karkazis was permitted to do for his own account was to offset bona fide errors made in the course of filling customer orders.

As part of his trading, Karkazis indirectly traded opposite his customer orders for purposes other than to resolve bona fide errors. Karkazis also failed to submit his cards to his

¹ Karkazis 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 Karkazis does not consent to the use of the Offer, or the findings consented to in the Offer or this Order, as the sole basis for any other proceeding brought by the Commission other than a proceeding in bankruptcy relating to Karkazis, or to enforce the terms of this Order. Nor does Karkazis consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, by any other party in any other proceeding. Solely with respect to any bankruptcy proceeding relating to Karkazis or any proceeding to enforce this Order, Karkazis agrees that the findings in this Order shall be taken as true and correct and be given preclusive effect, without further proof. Further, Karkazis agrees to provide immediate notice to the Commission by certified mail of any bankruptcy proceeding filed by, on behalf of, or against him.

² During the relevant time, CME Rule 541 [Trading Restrictions Respecting the S&P Stock Price Index Futures Contract] provided, in pertinent part:

A member shall not trade an S&P futures contract for his own account while on the top step of the S&P 500 futures pit, except that a member may liquidate a position that resulted from error.

clearing member in a timely fashion and in at least one instance cannot account for the whereabouts of his trading card.

B. SETTling RESPONDENT

Harry Karkazis currently resides in Riverwoods, Illinois, and has been continuously registered as a floor broker pursuant to Sections 4e and 4f of the Act, 7 U.S.C. §§ 6e and 6f, since at least 1989. He has also been a member of the CME since 1989.

C. FACTS

Floor brokers who fill customer orders from the top step of the S&P 500 trading pit are prohibited by CME Rule 541 from trading for their own account other than to offset errors made in the course of filling customer orders. Consequently, the only trades that should be in the error accounts of S&P top step floor brokers should be the result of errors, not intentional trades.

Between April and July 2002, Karkazis profited from indirectly trading opposite his customers. That is, Karkazis took the opposite side of his customer orders into his own account through noncompetitive round-turn trades with accommodating traders, whose involvement disguised the nature of the transactions. This practice, also known as indirect bucketing, is, with limited exceptions not relevant here, illegal.³ The indirect buckets exhibit the following trading pattern or configuration: Karkazis noncompetitively purchased and sold the same or nearly the same quantity, at or about the same price, at or about the same time opposite the same accommodating trader. One side of Karkazis' trades was for a customer and the other side was for his own error account. As to the accommodating trader, both the purchase and sale were for his personal account. This practice permitted Karkazis to establish a position for his own account (and in Karkazis' case, his error account) at a pre-arranged, noncompetitive price.

³ "Bucketing" is defined by the Commission as "[d]irectly or indirectly taking the opposite side of a customer's order into a broker's own account or into an account in which a broker has an interest, without open and competitive execution of the order on an exchange." The CFTC Glossary (http://www.cftc.gov/opa/glossary/opaglossary_a.htm 2004).

On at least 4 occasions Karkazis engaged in trades opposite the same local trader which fit the indirect bucketing pattern. Karkazis made approximately \$42,000 as a result of these 4 trades. Specifically, on April 10, May 20, May 21 and July 10, 2002, Karkazis' indirectly traded opposite his customer's orders at prices other than those prevailing in the market at the time the trade was executed. The trades were done at prices that benefited Karkazis.

The April 10, 2002 trade is illustrative of Karkazis' conduct. Shortly after 8:30 a.m. Karkazis sold 5 June S&P contracts to a local trader at 1119.00 to fill two customer orders.⁴ Almost immediately, the local trader sold back 5 contracts to Karkazis at 1119.50. These 5 contracts cleared in Karkazis' error account. The local trader made \$625 from his purchase at 1119.00 and his sale at 1119.50. These trades left Karkazis' long 5 contracts in his error account at 1119.50. However, based on the sequencing of the trades on the local trader's card, the lowest price trading in the market at the time these trades occurred was 1119.80. Consequently, the customers and Karkazis were filled at an off-market price. The customers were disadvantaged by \$1,000 on this fill, namely the difference between 1119.0 and 1119.80. Consequently, Karkazis was long at 1119.50 when the market was already trading at a higher price, at 1119.80.

Approximately one hour later, Karkazis offset his 5 contract long position by selling 5 contracts to the same local for 1128.0. As a result of this trade, Karkazis made more than \$10,000 in his error account. Although the offsetting trades occurred around 9:30 a.m., Karkazis did not turn in his error card to his clearing futures commission merchant ("FCM") until approximately 2:44 p.m.

⁴ The S&P 500 futures contract (ticker symbol: SP) is equivalent to \$250 times the value of the Standard & Poor's 500 Stock Price Index. The futures contract has a minimum price fluctuation, or "tick," of 0.10 index points, which is equivalent to \$25.00 per contract per tick. In trading terminology, traders equate "100 points" with a single index point, so a SP futures price move from 1119.00 to 1119.50 would be a "50 point" move, equating to a profit or loss of \$125.00 per contract.

Floor brokers record the trades made for their error accounts on trading cards which the floor broker must submit to the FCM carrying the floor broker's error account for timestamping and data entry. Karkazis, as a member of the CME, a contract market, was required under CME rules to submit his error cards to his carrying FCM no later than 15 minutes after the end of the 30-minute interval in which the trades recorded on the trading card were executed.

Karkazis frequently failed to submit his trading cards for his error account within the prescribed time period. During 2002, Karkazis submitted 274 trading cards to his clearing FCM. His clearing member was able to produce 225 of these trading cards. Approximately 64% of the trading cards (142 cards) produced by Karkazis' clearing FCM were timestamped late.

Pursuant to Commission Regulation 1.35(d), Karkazis used pre-numbered trading cards to record his trades. During 2002, Karkazis failed to submit at least 6 trading cards within the numeric sequence for clearing. One of those cards related to an out-trade⁵ between Karkazis and a local trader. On May 13, 2002, at approximately 9:00 a.m., a local trader recorded that he bought 4 contracts from Karkazis. Karkazis did not have a customer order to sell 4 contracts; ultimately the trade cleared his error account. Subsequently, the market traded higher, making the short position unprofitable. The local trader (who was long) subsequently changed the quantity of the trade from 4 contracts to 2 and attributed the change to an out-trade with Karkazis, thereby halving Karkazis' loss. As for Karkazis, he was missing a trading card in the series of pre-numbered trading cards he was using that day to record his errors. He had used error cards numbered 483 and 484 to record and offset an error relating to 2 contracts that had

⁵ The CFTC Glossary defines an out trade as "a trade that cannot be cleared by a clearing organization because the trade data submitted by the two clearing members or two traders involved in the trade differs in some respect (e.g., price and/or quantity). In such cases, the two clearing members or traders involved must reconcile the discrepancy, if possible, and resubmit the trade for clearing. If an agreement cannot be reached by the two clearing members or traders involved, the dispute would be settled by an appropriate exchange committee."

occurred earlier in the trading session. The next card in sequence was 485, which was not turned into Karkazis' clearing FCM. Karkazis cannot account for the whereabouts of this trading card. Karkazis recorded a 2-lot opposite the local trader on card 486.

D. LEGAL DISCUSSION

The bucketing of a customer order includes directly or indirectly taking the opposite side of a customer's order into a broker's own account or into an account in which a broker has an interest, without open and competitive execution of the order on an exchange. *In re Mayer*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,259 at 46,120, n.12 and 46,137 (CFTC Feb. 3, 1998), *aff'd sub nom. Reddy v. CFTC*, 191 F.3d 109 (2d Cir. 1999). The practice is illegal because the customer's order is not executed competitively and the futures market's purpose of aiding price discovery is frustrated. In addition, because the transaction is arranged in a manner that permits the opposite trader to buy and sell the same month of the same futures contract at the same or similar price, the broker is able to negate market risk while breaking even or earning a profit. *In re Gorski*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,726 at 56,068 n.15 (CFTC March 24, 2004); *Reddy v. CFTC*, 109 F.3d 109, 115 (2d Cir. 1999) (finding virtually simultaneous buys and sells between a floor broker and an accommodating trader at substantially the same price to be indirect buckets when the floor broker executes one trade for his customer and the other trade for his own account).

Indeed, a floor broker may not only avoid market risk, but may engage in the practice of indirect bucketing specifically in order to profit from price volatility. A floor broker who buckets his customer orders at the current bid (or offer), acquires the ability to buy at the prevailing bid (or sell at the offer) and potentially turn a quick, risk-free profit by immediately

selling at the offer (or buying at the bid).⁶ However, when a floor broker buckets his customer orders at a past price, he may enjoy an advantage of several ticks. In those instances, the floor broker is able, after the fact, to establish a position for himself at an earlier traded price, but offset the position he acquired for himself at the current market price.⁷

A broker who buckets customer orders violates Section 4b(a)(1)(iv) of the Act. *See In re Reddy*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,271 at 46,203 (CFTC Feb. 4, 1998), *aff'd sub nom. Reddy v. CFTC*, 191 F.3d 109 (2d Cir. 1999). Between April 2002 and July 2002, Karkazis violated Section 4b(a)(1)(iv) of the Act by indirectly bucketing his customers' orders.

Commission Regulation 1.35(d)(6) requires members of contract markets to "be accountable for all trading cards prepared pursuant to contract market rules in exact numerical sequence, whether or not such trading cards are relied on as original source documents." Karkazis, as a member of the CME, was accountable for all of his numbered trading cards. However, he cannot account for the whereabouts of his trading card 485 which is missing from the sequence of cards used on May 13, 2002.

Commission Regulation 1.35(d)(7) states that trading records prepared by a member of a contract market must be submitted in accordance with contract market rules. CME Rule 536 required Karkazis to submit his trading cards to his clearing FCM within 15 minutes of the end of the 30 minute interval in which the trade was executed pursuant to a published schedule. For

⁶Normally there is a spread of a tick between the "bid" – i.e., the price at which traders are willing to buy – and the "offer" or "ask" – i.e., the price at which traders are willing to sell. Thus, a trader who manages to buy at the bid and sell at the offer – a strategy known as "scalping" – normally will profit by the amount of the spread. *See In re Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,401 (CFTC Nov. 26, 1986). The ability to buy at the bid and sell at the offer is known as getting the "edge."

⁷Bucketing orders also allows a floor broker to trade at quantities for his own account that market conditions may not have supported.

example, all trades executed between 8:30:00 and 8:59:59 a.m. were required to be time stamped no later than 9:15:00 a.m. Karkazis regularly submitted his cards in late and, thus, violated the Rule. Regulation 1.35(d)(6) and (7) were designed "to limit the opportunity for the fabrication or alteration of trade records, to assure accountability for trading cards and to enhance exchange audit trails and trade surveillance." *Final Rule - Trading Cards and Submission of Trading Records; Amendments to Commission Regulation 1.35*, 55 FR 8127-02, 1990 WL 330899 (March 7, 1990).

IV.

OFFER OF SETTLEMENT

Karkazis has submitted an Offer of Settlement in which he neither admits nor denies the allegations of the Complaint or the findings in this Order. Subject to the foregoing, Karkazis: acknowledges service of this Order and admits the jurisdiction of the Commission with respect to the matters set forth in this Order; and waives: (1) a hearing; (2) all post-hearing procedures; (3) judicial review by any court; (4) any objection to the staff's participation in the Commission's consideration of the Offer; (5) all claims which he may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000), and Part 148 of the Regulations, 17 C.F.R. §§ 148.1, *et seq.*, relating to or arising from this action; and (6) 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.

Karkazis stipulates that the record basis on which this Order is entered consists of this Order and the findings to which he has consented in his Offer, which is incorporated in this Order. Karkazis consents to the Commission's issuance of this Order, which makes findings as set forth herein, and orders Karkazis to cease and desist from violating the provisions of the Act

and the Regulations he is found to have violated; suspends Karkazis' registration for 3 months; orders that Karkazis shall be liable for payment of a civil monetary penalty of thirty-five thousand dollars (\$35,000); and orders Karkazis to comply with his undertaking as set forth in the Offer and this Order.

V.

FINDING OF VIOLATIONS

Solely on the basis of the consent evidenced by the Offer, and prior to any adjudication on the merits, the Commission finds that Karkazis violated Section 4b(a)(1)(iv) of the Act, 7 U.S.C. § 6b(a)(1)(iv), and Commission Regulation 1.35(d)(6) and (7), 17 C.F.R. § 1.35(d)(6) and (7) (2006).

VI.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

A. Karkazis cease and desist from violating Section 4b(a)(1)(iv) of the Act, 7 U.S.C. § 6b(a)(1)(iv), and Commission Regulation 1.35(d)(6) and (7), 17 C.F.R. § 1.35(d)(6) and (7) (2006).

B. Karkazis' registration as a floor broker be and hereby is suspended for three months beginning on the first Monday following the entry of this Order.

C. Karkazis pay a civil monetary penalty in the amount of thirty-five thousand dollars (\$35,000) within ten (10) days of the date of the entry of this Order. Karkazis shall pay this penalty 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 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

If the payment is to be made by electronic funds transfer, contact Marie Bateman at 405-954-6569 for instructions. Karkazis shall accompany payment of the penalty with a cover letter that identifies Karkazis, and the name and docket number of this proceeding. Karkazis shall simultaneously submit a copy of the cover letter and the form of payment to: Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581; and if this amount is not paid in full within fifteen (15) days of the due date, Karkazis shall be prohibited automatically from the privileges of all registered entities, and, if he is registered with the Commission, such registration shall be suspended automatically until he 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.

D. Karkazis shall comply with the following undertaking set forth in the Offer:

Neither Karkazis, nor any of his agents, employees, or other individual or entity acting on his behalf, shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in the Order, or creating, or tending to create, the impression that the Order is without a factual basis; provided however, that nothing in this provision affects Karkazis': (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to

which the Commission is not a party. Karkazis shall take all steps necessary to ensure that his agents or employees, if any, understand and comply with this undertaking.

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

By the Commission.

A handwritten signature in cursive script, reading "Catherine D. Daniels", written over a horizontal line.

Catherine D. Daniels
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: December 27, 2006