

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

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Office of Proceedings
Proceedings Clerk
10:30 am, Jan 02, 2013

In the Matter of: :
: **CFTC Docket No. 13-10**
:
:
R.J. O'Brien & Associates, LLC : **ORDER INSTITUTING PROCEEDINGS**
: **PURSUANT TO SECTIONS 6(c) AND 6(d)**
: **OF THE COMMODITY EXCHANGE ACT**
: **AND MAKING FINDINGS AND**
Respondent : **IMPOSING REMEDIAL SANCTIONS**
:

I.

The Commodity Futures Trading Commission (the "Commission") has reason to believe that R.J. O'Brien & Associates, LLC ("RJO" or the "Respondent"), a registered futures commission merchant ("FCM"), has violated Commission Regulation ("Regulation") 166.3, 17 C.F.R. § 166.3 (2011). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted to determine whether Respondent engaged in the violation 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, 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 Commodity Exchange Act, as amended, Making Findings and Imposing Remedial Sanctions ("Order").¹

¹ 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 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 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.

The Commission finds the following:

A. Summary

From at least January 2003 to February 2007, (the “relevant period”) RJO, a registered FCM, failed to diligently supervise its employees, agents, officers and associated persons (“APs”) in their handling of orders for commodity futures trading accounts controlled by a single guaranteed introducing broker (“GIB”) of RJO, and the GIB’s AP, sole principal, and owner. The GIB had several individual customers whose accounts it managed, and the GIB’s AP separately operated a small commodity pool (“Pool”). During the relevant period, 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 with RJO for the GIB’s customer accounts, the Pool accounts and the GIB’s AP’s corporate and 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. A bunched order is a discretionary order for commodity futures or options entered for execution for more than one account that is eligible for post-execution allocation, if the requirements of Commission Regulation 1.35(1-a) are met.

RJO failed to follow procedures it had in place concerning the placement of bunched orders by account managers. For example, RJO 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. RJO also did not employ adequate procedures to monitor, detect, and deter unusual activity concerning trades that were allocated post-execution, or for supervision of its employees handling and processing bunched orders. By such acts, RJO failed to diligently supervise the handling of customer orders in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2011).

B. Respondent

R.J. O’Brien & Associates, LLC is registered with the Commission as a FCM, with its principal place of business located at 222 South Riverside Plaza, Suite 900, Chicago, Illinois, 60606.

C. Facts

During the relevant period, the GIB and its AP employed a post-execution trade allocation scheme at RJO that allocated profitable trades to the benefit of the GIB or AP personally, and unprofitable trades to the detriment of the GIB’s customers. The AP accomplished this by improperly using bunched orders and not providing account identifiers until after RJO had reported the execution of the trades to him. RJO failed to follow its procedures and policies which required that the account managers provide the allocation instructions and account identifiers for the accounts used in the bunched orders prior to the entry of the orders. RJO also failed to have adequate procedures to detect its improper handling of bunched orders and post execution allocation of trades and to detect unusual activity or wrongful

conduct, such as a potential trade allocation, through improper use of bunched orders. As a result of the post-execution allocation scheme, the GIB's customers and the Pool operated by the AP sustained losses of up to \$183,000.

The GIB and its AP had, at any given time, between nine and 25 customer accounts which they introduced to RJO and managed and traded on behalf of the customers. Some of the customer accounts were discretionary accounts. Separate and apart from the GIB, its AP, acting in his individual capacity, operated a commodity Pool for which he claimed an exemption from registration pursuant to CFTC Regulation 4.13(a)(2), 17 C.F.R. § 4.13(a)(2). The GIB's AP was the general partner and operator of the Pool. The Pool had five investors with a total of \$285,000 in contributions. The Pool account was introduced to and carried at RJO. The GIB also had a proprietary account, which its AP treated as a personal account, and the AP had a personal trading account in his own name at RJO (collectively, "AP's personal accounts").

During the relevant period, the AP, by and through its GIB, placed orders through RJO's electronic trading platform in a group account that identified the trades as belonging to the GIB. By using this group account, the GIB and its AP entered bunched orders. Commission Regulation 1.35(a-1) generally requires that FCMs create and maintain a written record of customer orders immediately upon receipt of the order including account identification. Commission Regulation 1.35(a-1) (5) permits the post-execution allocation of customer orders by eligible contract account managers only if certain enumerated requirements are met.

Commission Regulation 1.35(a-1)(5) requirements include that the account managers ensure that the post-execution allocations are: 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. Commission Regulation 1.35(a-1)(4)(iv)(C) requires that FCMs that execute orders or that carry accounts eligible for post-execution allocation, and members of contract markets that execute such orders, must maintain records that, as applicable, identify each such order subject to post-execution allocation and the accounts to which the contracts executed for such order are allocated.

The protocol established by RJO required that the GIB have on file with RJO a pre-set allocation plan for allocating the trades made in the group account to the various accounts in the GIB's control. RJO's policies also prohibited proprietary accounts being bunched with customer accounts, and that non-discretionary customer accounts could not be included in a bunched order, except in very limited circumstances, not applicable here.

In certain instances after the trade was determined by the AP to be profitable, the GIB's AP would subsequently, and in violation of RJO's protocols, send an e-mail to RJO post-execution which identified the allocation of orders to his personal accounts and to those of his clients or the Pool. These improper allocation e-mails contained directions to place trades in both non-discretionary and discretionary customer accounts, as well as the AP's two personal accounts. At times, the bunched order process was used for only a single account or one lot

orders, which is an impermissible use of bunched orders. The allocation e-mails in question were always sent after the orders were filled, and in most cases several hours after an order had been filled.

The second allocation method utilized by the GIB while at RJO involved only commodity futures contracts for cotton (“cotton futures contracts”). Specifically, the GIB’s AP telephoned in orders for cotton futures contracts directly to an independent floor broker at the exchange. After the floor broker executed the orders, he would submit them electronically to RJO. The GIB’s AP did not provide account numbers at the time he placed orders with the floor broker, but rather he would call or e-mail RJO later in the day directing which contracts were to be allocated to which accounts. The GIB’s AP made trades in cotton in this manner through accounts carried at RJO during the relevant period.

In February 2007, the GIB and AP transferred their proprietary, customer, and Pool accounts to a different FCM where the trade allocation fraud continued. RJO only learned of the GIB and its AP’s fraudulent post-trade allocation conduct when the National Futures Association (“NFA”) notified RJO in early 2009.²

IV.

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

² As the GIB was a guaranteed IB of RJO, acting within the scope of that guarantee, RJO was responsible for the losses suffered by the customers of the GIB and its AP. In 2009, RJO paid approximately \$183,000 in restitution to the GIB’s customers, and the Pool.

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).³

As described above, due to deficiencies in RJO's supervisory system and its failure to properly implement and monitor supervisory procedures, RJO 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.

V.

FINDING OF VIOLATION

Based on the foregoing, the Commission finds that during the relevant period, RJO violated Regulation 166.3, 17 C.F.R. § 166.3 (2011).

VI.

OFFER OF SETTLEMENT

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

- A. Acknowledges receipt of service of this Order;
- B. Admits the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;
- C. Waives:

³ Through an Interpretive Notice issued by NFA in 1997 and revised in 2003, NFA addressed the allocation of bunched orders for multiple accounts pursuant to Commission Regulation 1.35(a-1)(5) and the responsibilities of the FCM. The Notice stated "FCMs retain the responsibility to monitor for unusual allocation activity," and "if the FCM has actual or constructive notice that allocations may be fraudulent, the FCM must take appropriate action", including "mak[ing] reasonable inquiry into the matter and referring to the proper regulatory authorities."

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, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and
 8. any claims of Double Jeopardy based on 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 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 Regulation 166.3, 17 C.F.R. §166.3 (2011);
 2. orders Respondent to cease and desist from violating Regulation 166.3, 17 C.F.R. §166.3 (2011);
 3. orders Respondent to pay a civil monetary penalty in the amount of three hundred thousand dollars (\$300,000), plus post-judgment interest; and
 4. orders Respondent to comply with the conditions and undertakings 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 Regulation 166.3, 17 C.F.R § 166.3 (2010), as described herein;
- B. Respondent shall pay a civil monetary penalty in the amount of \$300,000 within ten (10) business days of the date of entry of this Order (the "CMP Obligation"). Post-judgment interest shall accrue on the CMP Obligation beginning 10 business days after the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2006). Respondent(s) 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, then 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: 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) 954-5644

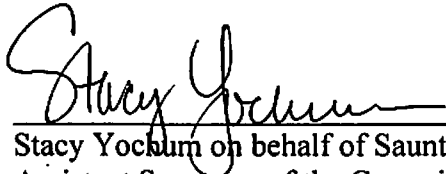
If payment is to be made by electronic funds transfer, Respondent(s) shall contact Linda Zurhorst or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent(s) shall accompany payment of the CMP Obligation with a cover letter that identifies the paying Respondent and the name and docket number of this proceeding. The paying Respondent shall simultaneously transmit copies of the cover letter and the form of payment to the Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

- C. Respondent, and its successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:
 1. Public Statements: Respondent agrees that neither it, nor any of its successors and 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 any 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.
2. Change of Address/Phone: Until such time as RJO satisfies in full its CMP Obligation as set forth in this Order, RJO shall provide written notice to the Commission by certified mail of any change to its telephone number and mailing address within ten (10) calendar days of the change.
 3. Partial Satisfaction: Respondent understands and agrees that any acceptance by the Commission of partial payment of Respondent's CMP Obligation shall not be deemed a waiver of its obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.

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

By the Commission.



Stacy Yochum on behalf of Sauntia S. Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: January 2, 2013