

**DISCIPLINARY PROGRAM  
RULE ENFORCEMENT REVIEW  
OF  
CBOT, CME, COMEX, AND NYMEX**



**Division of Market Oversight  
November 30, 2017**

**RULE ENFORCEMENT REVIEW OF  
THE CBOT, CME, COMEX, AND NYMEX  
DISCIPLINARY PROGRAM**

**Commodity Futures Trading Commission – Division of Market Oversight**

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## **I. Rule Enforcement Review Scope**

The Division of Market Oversight (“Division”) has completed a rule enforcement review of the disciplinary program of the Chicago Board of Trade (“CBOT”), the Chicago Mercantile Exchange (“CME”), the Commodity Exchange, Inc. (“COMEX”), and the New York Mercantile Exchange, Inc. (“NYMEX”) (collectively, the “Exchanges”), wholly-owned subsidiaries of CME Group, Inc. (“CME Group”).<sup>1</sup> The Division’s review of the Exchanges’ disciplinary program covered the period from July 15, 2015 to July 15, 2016 (“target period”). The Division reviewed the Exchanges’ compliance with Core Principle 13 (*Disciplinary Procedures*)<sup>2</sup> under Section 5(d) of the Commodity Exchange Act (“Act” or “CEA”),<sup>3</sup> and the Commission’s related regulations codified in Commission regulations 38.700–712, which relate to an exchange’s disciplinary procedures.

To evaluate the Exchanges’ disciplinary program, and their compliance with Core Principle 13 and Commission regulations 38.700–712, Division staff interviewed compliance officials and staff from CME Group’s Market Regulation Department (“MRD”), which provides compliance, enforcement, and other self-regulatory services to the Exchanges, pursuant to

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<sup>1</sup> The Division’s rule enforcement reviews seek to present an analysis of an exchange’s overall compliance capabilities during the period under review. Such reviews target those programs directly addressed in the review and do not assess all programs or core principles. The Division’s analyses, conclusions, and recommendations are based, in large part, upon the Division’s evaluation of a sample of investigations and other exchange documents. This evaluation process, in some instances, identifies specific deficiencies in particular exchange investigations or methods but is not designed to uncover all instances in which an exchange does not effectively address all exchange rule violations or other deficiencies.

The findings and recommendations in this rule enforcement review are limited to the Exchanges and their products. This rule enforcement review, and the findings and recommendations 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.

<sup>2</sup> Core Principle 13 - Disciplinary Procedures: The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.

<sup>3</sup> 7 U.S.C. 1 et seq.

Regulatory Services Agreements. The Division also analyzed responsive documents produced by the Exchanges' staff, including the following:

- disciplinary case logs and files;
- organizational charts and summaries of personnel and staffing;
- summaries of procedures designed to prevent conflicts of interest;
- minutes of disciplinary committees, Floor Conduct Committee, Board of Directors, Executive Committee, and Market Regulation Oversight Committee (“MROC”) meetings held during the target period; and
- compliance procedures manuals and handbooks, disciplinary rules, and other overviews of MRD’s disciplinary procedures.

The Division analyzed the Exchanges’ disciplinary program to determine whether the program is in compliance with the core principle 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.<sup>4</sup>

Positively, the Division found that the Exchanges maintain experienced enforcement staff and a generally adequate disciplinary program to demonstrate compliance with Core Principle 13 and Commission regulations 38.700–709 and 38.711. However, the Division made four recommendations relating to compliance with Commission regulation 38.710, and one recommendation relating to compliance with Commission regulation 38.712.

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<sup>4</sup> The Division notes that MRD is primarily responsible for administering each Exchanges’ disciplinary program. Therefore, any recommendation or deficiency related to MRD is a recommendation or deficiency that applies to all of the Exchanges.

The Division provided the Exchanges with an opportunity to review and comment on a draft of this report on October 16, 2017. On October 24, 2017, Division staff conducted an exit conference with the Exchanges' officials to discuss the report's findings and recommendations.

## **II. Summary of Findings, Recommendations, and Deficiencies**

### **A. Findings without Recommendations or Deficiencies**

#### *1. Enforcement Staff (Commission regulation 38.701)*

- The Enforcement Group (“Enforcement Group” or “Enforcement”) is responsible for prosecuting all disciplinary cases for the Exchanges. The Enforcement Group is led by an experienced management team that includes a Global Enforcement Counsel in New York and two regional Enforcement Counsels, one in New York and one in Chicago. During the target period, the Enforcement Group consisted of 13 Enforcement Attorneys.

#### *2. Core Principle 13 (Commission regulation 38.700); Disciplinary Panels (Commission regulation 38.702); Notice of Charges (Commission regulation 38.703); Right to Representation (Commission regulation 38.704); Answer to Charges (Commission regulation 38.705); Denial of Charges and Right to Hearing (Commission regulation 38.706); Hearings (Commission regulation 38.707); Decisions (Commission regulation 38.708); and Final Decisions (Commission regulation 38.709).*

- The Division found that the Exchanges have sufficient disciplinary program rules and procedures to demonstrate compliance with Core Principle 13 under Section 5(d) of the CEA, and Commission regulations 38.700, 38.702–709. The Exchanges' rules are designed to ensure due process for disciplinary proceedings, and give the Exchanges the authority to discipline, suspend, or permanently bar members or market participants found to have committed rule violations.

#### *3. Disciplinary Sanctions (Commission regulation 38.710)*

- The Division reviewed 85 of the 151 closed disciplinary cases (18 for CBOT, 33 for CME, nine for COMEX, 16 for NYMEX, and nine for multiple CME Group Exchanges) and found that, subject to the recommendations below relating to Commission regulation 38.710 and with the exception of fines that were reduced due to respondents' claim of financial hardship, sanctions imposed during the target period were reasonable relative to the violations alleged and the evidence presented. In addition, the Division found that the Exchanges' Business Conduct Committees (“BCC”) consistently considered

the respondent's disciplinary history and any customer harm when determining sanctions.

- In the 85 closed cases reviewed by the Division, the Exchanges assessed a total of 80 fines in 63 cases. The imposed fines totaled \$4,307,500, ranging from \$5,000 to \$300,000. The Exchanges also assessed a total of \$7,935,470 in disgorgement from 17 respondents, ranging from \$1,787.50 to \$2,938,545. In addition, the Exchanges ordered four respondents to pay a total of \$287,536 in customer restitution; issued suspensions for 63 individuals ranging from 15 days to eight years; and imposed permanent bars on membership against ten respondents.<sup>5</sup>

#### 4. *Warning Letters (Commission regulation 38.711)*

- The Division found that the Exchanges' maintain a warning letter policy prohibiting the issuance of more than one warning letter per rolling 12-month period for the same violation, as required by Commission regulation 38.711. Of the 85 cases reviewed by the Division, the Enforcement Group issued a total of 17 warning letters in 12 cases. None of the warning letter recipients received more than one warning letter during the target period for the same violation.

## **B. Findings with Recommendations**

### 1. *Disciplinary Sanctions (Commission regulation 38.710)*

- The Exchanges issued two types of suspensions during the target period: (1) suspensions of all direct and indirect access to the trading floor or electronic trading or clearing platform ("direct and indirect access suspensions"); and (2) suspensions of direct access to the trading floor or electronic trading or clearing platform ("direct access-only suspensions"). Of the 63 suspensions issued during the target period, 55 were direct and indirect access suspensions, while eight were direct access-only suspensions.
- The Division reviewed the seven cases that resulted in eight direct access-only suspensions and found that MRD did not document or explain how the facts and circumstances of these cases supported the issuance of direct access-only suspensions, or the factors MRD considered in determining the appropriate length of the direct access-only suspensions.
- **Recommendation: MRD should document and explain each instance where it recommends or supports the issuance of a direct access-only suspension. Such explanation should articulate the specific facts and**

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<sup>5</sup> MRD defines disgorgement as illicit profits returned to the Exchanges by the respondent and restitution as payment to a party financially injured by the respondent's actions.

**circumstances of the case that support the issuance of a direct access-only suspension, and how MRD determined the appropriate length of the suspension term.**

- The Exchanges largely rely on futures commission merchants (“FCMs”) to ensure that suspended individuals do not electronically access the Exchanges. The Exchanges can conduct ad hoc queries of “Tag 50 IDs” to identify whether any Tag 50 IDs associated with suspended individuals are trading, but such queries are not done on a routine basis.
  - **Recommendation: The Exchanges should either monitor for prohibited trading activity by suspended individuals or firms, such as trading by Tag 50 IDs that belong to suspended individuals, or establish a rule explicitly requiring FCMs to monitor for such activity.**
- In certain cases, Enforcement takes into account a respondent’s financial condition in supporting a lesser financial penalty. The Division reviewed five cases during the target period in which financial condition was considered and found that Enforcement did not clearly articulate how it determined the appropriate sanction based on the circumstances.
  - **Recommendation: The Exchanges should document and explain how they determine the appropriate sanction where a respondent’s financial condition justifies a lesser financial penalty.**
- Of the 85 disciplinary cases reviewed by the Division, warning letters were issued to 17 respondents in 12 cases. In addition to reviewing those 12 cases, the Division selected for further review 10 cases, four complaints, and 14 research files in which warning letters were issued during the target period. In total, the Division found that in three cases, two complaints and one research file, the Exchanges should have taken disciplinary action in lieu of issuing a warning letter.
  - **Recommendation: The Exchanges should take appropriate disciplinary action in lieu of issuing a warning letter in future cases that involve misconduct similar to the cases that were identified by the Division in this Report.**

2. *Additional Sources for Compliance (Commission regulation 38.712)*

- The Exchanges maintain minutes for each BCC meeting. For each case listed on the agenda, the minutes indicate whether a settlement offer was accepted by the BCC. The minutes do not capture any additional detail regarding the BCC’s decision to accept or reject the settlement offer. For settlement offers that are accepted by the BCC, the Panel’s rationale for accepting the offer is based on the factors set forth in the MRD Supporting Memo, and is therefore

documented. However, if the BCC decides to reject a settlement offer recommended by Enforcement, the rationale for this decision is not documented anywhere in the case file, either while the matter is pending or once it has been resolved, by either Enforcement or the BCC.

- **Recommendation: The Exchanges should ensure that the BCC's rationale for rejecting a settlement offer is documented. Such documentation may be completed once the matter has been resolved and after the appeal period for the matter has lapsed.**

Additional details regarding the facts and analysis relevant to the Division's review are contained in the Compliance Matrix in Appendix A.

**III. Appendix A**

**Compliance Matrix**

<b>CFTC Regulation</b>	<b>Findings Regarding the Exchanges' Compliance Target Period 7/15/15 – 7/15/16</b>	<b>Deficiencies/Recommendations<sup>6</sup></b>
<b>Core Principle 13 – Disciplinary Procedures</b>		
<p>§ 38.700 Core Principle 13</p> <p>The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.</p>	<p>The Division found that the Exchanges maintain adequate disciplinary procedures to investigate potential rule violations, prosecute cases, and discipline members or market participants who are found to have violated the Exchanges' rules.</p>	<p>No deficiencies or recommendations.</p>
<p>§ 38.701 Enforcement Staff</p> <p>A designated contract market must establish and maintain sufficient enforcement staff and resources to effectively and promptly prosecute possible rule violations within the disciplinary jurisdiction of the contract market. A designated contract market must also monitor the size and workload of its enforcement staff annually, and ensure that its</p>	<p>The Enforcement Group (“Enforcement Group” or “Enforcement”), within CME Group’s Market Regulation Department (“MRD”), is responsible for prosecuting all disciplinary cases and is led by an experienced management team that includes a Global Enforcement Counsel in New York and two regional Enforcement Counsels, one in New York and one in Chicago. During the target period, the Enforcement Group consisted of 13 Enforcement Attorneys.<sup>7</sup></p> <p>To determine whether the Enforcement Group maintains sufficient staff to promptly prosecute possible rule violations, the Division</p>	<p>No deficiencies or recommendations.</p>

<sup>6</sup> This column contains: (1) deficiency findings where the Division believes the Exchange was not in compliance with a Commission regulation and must take corrective action and (2) recommendations where the Division identifies areas for improvement.

<sup>7</sup> The Executive Director and the two regional Directors have management responsibilities but also serve as Enforcement Attorneys; therefore, they are included in the Enforcement Attorney total. The Division notes that this is an increase from the staffing levels observed during the November 21, 2014 CME Group Disciplinary RER, which covered the target period of April 1, 2012 to March 31, 2013.

<p>enforcement resources and staff are at appropriate levels. The enforcement staff may not include either members of the designated contract market or persons whose interests conflict with their enforcement duties. A member of the enforcement staff may not operate under the direction or control of any person or persons with trading privileges at the contract market. A designated contract market's enforcement staff may operate as part of the designated contract market's compliance department.</p>	<p>reviewed 85 of the 151 disciplinary cases closed during the target period (18 for CBOT, 33 for CME, nine for COMEX, 16 for NYMEX, and nine for multiple CME Group Exchanges). Of the 85 reviewed cases, 39 cases were closed in less than 12 months, 29 cases took between 12 and 24 months to close and 15 cases took more than 24 months to close. The Division found there were mitigating circumstances that justified the delay in these cases, such as complex fact patterns and multiple respondents.</p>	
<p>§ 38.702 Disciplinary Panels</p> <p>A designated contract market must establish one or more disciplinary panels that are authorized to fulfill their obligations under the rules of this subpart. Disciplinary panels must meet the composition requirements of part 40 of this chapter, and must not include any members of the designated contract market's compliance staff or any person involved in adjudicating any other stage of the same proceeding.</p>	<p>Each of the Exchanges maintains two disciplinary panels, a Probable Cause Committee (“PCC”) and a Business Conduct Committee (“BCC”). The PCC receives and reviews investigation reports prepared by MRD and determines whether there is a reasonable basis for finding that a violation of exchange rules may have occurred which warrants the issuance of charges. The BCC is responsible for conducting settlement hearings and contested hearings based on charges issued by the PCC. Each committee is composed of five people: a panel chair, two exchange members (or employees of exchange member firms), and two non-members. At least one of the exchange member panelists must be from the exchange where the case originated.<sup>8</sup></p>	<p>No deficiencies or recommendations.</p>
<p>§ 38.703 Notice of Charges</p> <p>If compliance staff authorized by a designated contract market or a designated contract market</p>	<p>The Division found that the notice of charges issued during the target period adequately provided the elements required by Commission regulation 38.703. If a PCC Panel decides to issue charges, it directs the Enforcement Group to issue a notice of</p>	<p>No deficiencies or recommendations.</p>

<sup>8</sup> CBOT, CME, COMEX, and NYMEX Rules 402.A and 406.

<p>disciplinary panel determines that a reasonable basis exists for finding a violation and that adjudication is warranted, it must direct that the person or entity alleged to have committed the violation be served with a notice of charges and must proceed in accordance with the rules of this section. A notice of charges must adequately state the acts, conduct, or practices in which the respondent is alleged to have engaged; state the rule, or rules, alleged to have been violated (or about to be violated); and prescribe the period within which a hearing on the charges may be requested. The notice must also advise that the charged respondent is entitled, upon request, to a hearing on the charges.</p>	<p>charges stating, among other things, the conduct in which the respondent is alleged to have engaged, as well as the alleged rule violations. The notice of charges also advises the respondent that the matter will be heard by a BCC Panel and includes the time and place of the hearing.<sup>9</sup></p>	
<p><b>§ 38.704 Right to Representation</b></p> <p>Upon being served with a notice of charges, a respondent must have the right to be represented by legal counsel or any other representative of its choosing in all succeeding stages of the disciplinary process, except any member of the designated contract market's board of directors or disciplinary panel, any employee of the designated contract market, or any person substantially related to the</p>	<p>Notice of charges issued by the Enforcement Group state that the respondent has the right to be represented by legal counsel. In addition, the Exchanges' procedures and rules also address the respondent's right to counsel.<sup>10</sup></p>	<p>No deficiencies or recommendations.</p>

<sup>9</sup> CBOT, CME, COMEX, and NYMEX Rule 407.B.

<sup>10</sup> CBOT, CME, COMEX, and NYMEX Rules 407.B and 408.A.

underlying investigations, such as material witness or respondent.		
<p>§ 38.705 Answer to Charges</p> <p>A respondent must be given a reasonable period of time to file an answer to a notice of charges. The rules of a designated contract market governing the requirements and timeliness of a respondent's answer to charges must be fair, equitable, and publicly available.</p>	<p>Notice of charges issued by the Enforcement Group give the respondent 21 days to answer the notice. In addition, the answer period and procedures governing the respondent's answer to charges are publicly disclosed in the Exchanges' rulebooks.<sup>11</sup></p>	<p>No deficiencies or recommendations.</p>
<p>§ 38.706 Denial of Charges and Right to Hearing</p> <p>In every instance where a respondent has requested a hearing on a charge that is denied, or on a sanction set by the disciplinary panel, the respondent must be given an opportunity for a hearing in accordance with the requirements of §38.707 of this part.</p>	<p>The Exchanges' rules provide for a hearing on charges that are denied.<sup>12</sup> The Division did not identify any instances during the target period where a respondent's request for a hearing was denied.</p>	<p>No deficiencies or recommendations.</p>
<p>§ 38.707 Hearings</p> <p>(a) A designated contract market must adopt rules that provide for the following minimum requirements for any hearing conducted pursuant to a notice of charges:</p> <p>(1) The hearing must be fair, must be</p>	<p>Disciplinary hearings are conducted in accordance with the Exchanges' rules:</p> <ul style="list-style-type: none"> <li>• Hearings are held before members of the BCC. No formal rules of evidence apply, but hearings are structured and must be fair.<sup>13</sup></li> <li>• The respondent may request and review, in advance of the hearing, records or other evidence in possession of the Exchanges.<sup>14</sup></li> </ul>	<p>No deficiencies or recommendations.</p>

<sup>11</sup> CBOT, CME, COMEX, and NYMEX Rule 407.C.

<sup>12</sup> CBOT, CME, COMEX, and NYMEX Rule 407.B and C.

<sup>13</sup> CBOT, CME, COMEX, and NYMEX Rule 408.

<p>conducted before members of the disciplinary panel, and must be promptly convened after reasonable notice to the respondent. The formal rules of evidence need not apply; nevertheless, the procedures for the hearing may not be so informal as to deny a fair hearing. No member of the disciplinary panel for the matter may have a financial, personal, or other direct interest in the matter under consideration.</p> <p>(2) In advance of the hearing, the respondent must be entitled to examine all books, documents, or other evidence in the possession or under the control of the designated contract market. The designated contract market may withhold documents that are privileged or constitute attorney work product, documents that were prepared by an employee of the designated contract market but will not be offered in evidence in the disciplinary proceedings, documents that may disclose a technique or guideline used in examinations, investigations, or enforcements proceedings, and documents that disclose the identity</p>	<ul style="list-style-type: none"> <li>• Enforcement Group staff participates in the hearings and presents the case at each hearing.<sup>15</sup></li> <li>• Respondents are entitled to appear personally and may call and cross-examine witnesses.<sup>16</sup></li> <li>• The Exchanges maintain rules that require persons within their jurisdiction who are called as witnesses to participate in the hearing and produce any evidence they may have.<sup>17</sup></li> <li>• All hearings are recorded and such recordings may be requested by the respondent. If a transcript is requested, the respondent is responsible for the cost of producing the transcript.<sup>18</sup></li> </ul>	
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<sup>14</sup> CBOT, CME, COMEX, and NYMEX Rule 408.B.

<sup>15</sup> CBOT, CME, COMEX, and NYMEX Rule 408.D.

<sup>16</sup> CBOT, CME, COMEX, and NYMEX Rule 408.D.

<sup>17</sup> CBOT, CME, COMEX, and NYMEX Rules 408.A and 418.

<sup>18</sup> CBOT, CME, COMEX, and NYMEX Rule 408.D.

<p>of a confidential source.</p> <p>(3) The designated contract market's enforcement and compliance staffs must be parties to the hearing, and the enforcement staff must present their case on those charges and sanctions that are the subject of the hearing.</p> <p>(4) The respondent must be entitled to appear personally at the hearing, must be entitled to cross-examine any persons appearing as witnesses at the hearing, and must be entitled to call witnesses and to present such evidence as may be relevant to the charges.</p> <p>(5) The designated contract market must require persons within its jurisdiction who are called as witnesses to participate in the hearing and to produce evidence. It must make reasonable efforts to secure the presence of all other persons called as witnesses whose testimony would be relevant.</p> <p>(6) If the respondent has requested a hearing, a copy of the hearing must be made and must become a part of the record of the proceeding. The record must be one that is capable of being accurately transcribed; however, it need not be transcribed unless the transcript is requested by Commission staff or the respondent, the decision is appealed pursuant to the rules of the designated contract</p>		
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<p>market, or is reviewed by the Commission pursuant to section 8c of the Act or part 9 of this chapter. In all other instances a summary record of a hearing is permitted.</p> <p>(b) [Reserved]</p>		
<p>§ 38.708 Decisions</p> <p>Promptly following a hearing conducted in accordance with §38.707 of this part, the disciplinary panel must render a written decision based upon the weight of the evidence contained in the record of the proceeding and must provide a copy to the respondent. The decision must include:</p> <p>(a) The notice of charges or a summary of the charges;</p> <p>(b) The answer, if any, or a summary of the answer;</p> <p>(c) A summary of the evidence produced at the hearing or, where appropriate, incorporation by reference of the investigation report;</p> <p>(d) A statement of findings and conclusions with respect to each charge, and a complete explanation of the evidentiary and other basis for such findings and conclusions with respect to each charge;</p> <p>(e) An indication of each specific rule that the respondent was found to have violated; and</p>	<p>The Division found that the BCC promptly rendered written decisions following hearings during the target period. The Division also found that each BCC decision for the five contested and 10 default hearings reviewed by the Division included a summary of the charges, any answer by a respondent, a summary of the evidence produced at the hearing, a statement of findings and an explanation regarding the basis for such findings, the specific rule(s) violated by the respondent, and a declaration of the sanctions imposed against the respondent.</p>	<p>No deficiencies or recommendations.</p>

<p>(f) A declaration of all sanctions imposed against the respondent, including the basis for such sanctions and the effective date of such sanctions.</p>		
<p><b>§ 38.709 Final Decisions</b></p> <p>Each designated contract market must establish rules setting forth when a decision rendered pursuant to this section will become the final decision of such designated contract market.</p>	<p>A respondent who is found guilty of an offense or is otherwise aggrieved by a decision of or sanction imposed by the BCC may appeal to a hearing panel of the Board of Directors within 10 days of receiving notice of the decision or sanction, provided that the sanction imposed is greater than \$10,000 or a five-day suspension. In addition, MRD may appeal a BCC decision or sanction, or a PCC decision not to issue requested charges, to a hearing panel of the Board within 10 days of receiving notice of the decision. Board hearing panels consist of a director appointed by the Chairman of the Board to serve as chairman of the panel, and two additional directors, one of whom must be a non-member. Appellate Panel decisions are deemed a decision of the Board and are the final decision of the exchange.<sup>19</sup></p>	<p>No deficiencies or recommendations.</p>
<p><b>§ 38.710 Disciplinary Sanctions</b></p> <p>All disciplinary sanctions imposed by a designated contract market or its disciplinary panels must be commensurate with the violations committed and must be clearly sufficient to deter recidivism or similar violations by other market</p>	<p><u>Fines, Restitution and Disgorgement Levied During the Target Period</u></p> <p>The Exchanges closed 151 disciplinary cases (a majority of which were resolved via settlement agreement). The Division reviewed 85 of the 151 closed disciplinary cases and found that, with the exception of fines that the Exchanges’ reduced due to respondents’ claim of financial hardship,<sup>20</sup> fines imposed during the target period were reasonable relative to the violations alleged and the evidence</p>	<p>See recommendations below.</p>

<sup>19</sup> CBOT, CME, COMEX, and NYMEX Rule 411. On December 14, 2016, the Exchanges increased the threshold for an appeal to \$25,000 or a 10-day suspension.

<sup>20</sup> See discussion below regarding Financial Condition.

<p>participants. All disciplinary sanctions, including sanctions imposed pursuant to an accepted settlement offer, must take into account the respondent's disciplinary history. In the event of demonstrated customer harm, any disciplinary sanction must also include full customer restitution, except where the amount of restitution, or to whom it should be provided, cannot be reasonably determined.</p>	<p>presented. In addition, the Division found that the Exchanges' BCC consistently considered the respondent's disciplinary history and any customer harm when determining sanctions. In the 85 cases reviewed by the Division, the Exchanges assessed a total of \$4,307,500 in fines ranging from \$5,000 to \$300,000.</p> <ul style="list-style-type: none"> <li>• CBOT Fines totaled \$540,000 and ranged from \$5,000 – \$100,000.</li> <li>• CME Fines totaled \$1,480,000 and ranged from \$5,000 – \$125,000.</li> <li>• COMEX Fines totaled \$855,000 and ranged from \$5,000 – \$175,000.</li> <li>• NYMEX Fines totaled \$1,432,500 and ranged from \$7,500 – \$300,000.</li> </ul> <p>In addition, the Exchanges ordered four respondents to pay a total of \$287,536 in customer restitution; and assessed \$7,935,470 in disgorgement ranging from \$1,787.50 to \$2,938,545.</p> <p><u>Suspensions Issued During the Target Period</u></p> <p>The Exchanges issued suspensions for 63 individuals ranging from 15 days to eight years; and imposed permanent bars on membership against 10 respondents. The Exchanges issued two types of suspensions: (1) suspensions of all direct and indirect access to the trading floor or electronic trading or clearing platform (“direct and indirect access suspensions”); and (2) suspensions of direct access</p>	
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	<p>to the trading floor or electronic trading or clearing platform (“direct access-only suspensions”).<sup>21</sup> Of the 63 suspensions issued during the target period, 55 were direct and indirect access suspensions, while eight were direct access-only suspensions.</p> <p><u>Direct Access-Only Suspension Cases</u></p> <p>The Exchanges stated that it imposes direct access-only suspensions on a limited, case-by-case basis and offered the following as examples of when the Exchanges have used direct access-only suspensions: (1) the respondent’s violative conduct is not related to the respondent’s supervisory responsibilities at a firm or trading on behalf of a customer; and/or (2) the respondent is solely responsible for executing customer orders and direct and indirect access suspension would affect the respondent’s customer’s ability to trade. The Exchanges have also asserted that direct access-only suspensions would only be appropriate where the violation is one that generally involves direct trading by a respondent, and where it would be difficult, if not impossible, for the respondent to engage in the violation via indirect trading.</p> <p>The Division reviewed the seven cases that resulted in eight direct access-only suspensions and found that MRD did not document or explain how the facts and circumstances of these cases supported the issuance of direct access-only suspensions, or the factors MRD considered in determining the appropriate length of the direct access-only suspensions. Without this supporting analysis, it is not clear how the Exchanges value the penalty associated with a direct access-only suspension. The Division believes the BCC needs this information to ensure it issues sanctions that are commensurate</p>	<p>See recommendations below.</p> <p><u>Recommendation</u></p> <p>MRD should document and explain each instance where it recommends or supports the issuance of a direct access-only suspension. Such explanation should articulate the specific facts and circumstances of the case that support the issuance of a</p>
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<sup>21</sup> In this context, trading indirectly would permit another individual, such as a broker or another authorized individual, to enter trades on behalf of the suspended individual.

	<p>with the violation committed by the respondent. This information will also help ensure that MRD and the BCC apply direct access-only suspensions in a consistent manner. Finally, the information may be relevant to the MROC as it reviews the adequacy of the Exchanges’ disciplinary program and the BCC’s performance under the Acceptable Practices for Core Principle 16.<sup>22</sup></p> <p><u>Monitoring Suspended Individuals</u></p> <p>Once the Exchanges issue suspensions, they largely rely on futures commission merchants (“FCMs”) to ensure that suspended individuals do not electronically access the Exchanges. The Exchanges publicly disseminate notices of all disciplinary actions. Therefore, all FCMs that are signed up to receive such notices are notified if any of their customers have been suspended. The Exchanges do not ensure that FCMs receive notices of all disciplinary actions, nor do the Exchanges’ rules obligate FCMs to restrict the access of suspended individuals or firms. The Exchanges can conduct ad hoc queries of “Tag 50 IDs”<sup>23</sup> to identify whether any Tag 50 IDs associated with suspended individuals are trading. This is not routinely done, however, as the Exchanges believe such monitoring would be of limited value given that suspended individuals or firms would be more inclined to attempt to access the Exchanges through a new Tag 50 ID.</p> <p>The Division believes that the effectiveness of a sanction depends, in part, on an exchange’s ability to adequately monitor and enforce such sanction. For disciplinary fines and disgorgement and restitution amounts ordered by the BCC, the Exchanges monitor to</p>	<p>direct access-only suspension, and how MRD determined the appropriate length of the suspension term.</p> <p><b><u>Recommendation</u></b></p> <p>The Exchanges should either monitor for prohibited trading activity by</p>
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<sup>22</sup> The Exchanges have adopted the Acceptable Practice’s safe harbor requirements to comply with Core Principle 16, which provides that the ROC shall include in its annual report a review the performance of an exchange’s disciplinary committees and panels.

<sup>23</sup> A Tag 50 ID is a unique identifier of the individual or an Automated Trading System (“ATS”) that entered the order into CME Globex.

	<p>ensure that payment has been received by the date specified in the notice of decision. Any respondent that fails to make such payments forfeits direct and indirect access to the Exchanges until payment has been received, and may also be subject to further sanction under Rule 432.S.<sup>24</sup> The Exchanges do not monitor for trading activity by suspended individuals, and therefore cannot effectively enforce suspension bans.</p> <p><u>Financial Condition of Respondents</u></p> <p>In certain cases, Enforcement takes into account a respondent's financial condition in supporting a lesser financial penalty. To demonstrate financial hardship, respondents must complete a Statement of Financial Condition form detailing the respondent's assets, liabilities, and cash flow information, and expenses, as well as provide financial statements, tax forms, and pay stubs.</p> <p>As stated above, the Division found that fines imposed during the target period were reasonable relative to the violations alleged and the evidence presented, with the exception of five cases in which Enforcement supported a lesser financial penalty due to a respondent's financial condition.<sup>25</sup> The Division reviewed these five cases and found that while Enforcement noted that it considered the respondent's financial condition, it did not clearly explain how it determined the appropriate sanction based on the circumstances. It is difficult for the Division to ascertain whether these sanctions are adequate and comparable to other sanctions based on similar financial considerations without such information. Similarly, the absence of such explanation may impact the MROC's ability to review adequacy of the Exchanges' disciplinary</p>	<p>suspended individuals or firms, such as trading by Tag 50 IDs that belong to suspended individuals, or establish a rule explicitly requiring FCMs to monitor for such activity.</p> <p><b><u>Recommendation</u></b></p> <p>The Exchanges should document and explain how it determines the appropriate sanction where a respondent's financial condition justifies a lesser financial penalty.</p>
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<sup>24</sup> CBOT, CME, COMEX, and NYMEX Rule 444.

<sup>25</sup> See discussion under Fines, Restitution and Disgorgement Levied During the Target Period.

	<p>program and the BCC’s performance under the Acceptable Practices for Core Principle 16.</p> <p><u>Warning Letter Cases</u></p> <p>Warning letters may be issued from MRD, Enforcement, and at the direction of the BCC. Pursuant to Rule 407, warning letters issued upon the conclusion of an investigation “shall not constitute either the finding of a Rule violation or a penalty,”<sup>26</sup> as the authority to make findings on rule violations rests solely with the BCC.<sup>27</sup> Of the 85 disciplinary cases reviewed by the Division, warning letters were issued to 17 respondents in 12 cases. In addition to reviewing those 12 cases, the Division selected for further review 10 cases,<sup>28</sup> four complaints, and 14 research files in which warning letters were issued during the target period.<sup>29</sup> In total, the Division found that in three cases, two complaints and one research file, the Exchanges should have taken disciplinary action in lieu of issuing a warning letter.</p> <p><i>Wash Trades</i></p> <p>In Case 12-9055, an FCM, acting on behalf of a customer, placed orders with a floor broker to buy and sell 250 expiring Live Cattle futures contracts, for purposes of freshening long futures position</p>	<p>See recommendations below.</p>
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<sup>26</sup> CBOT, CME, COMEX, and NYMEX Rule 407.

<sup>27</sup> CBOT, CME, COMEX, and NYMEX Rule 402.A.

<sup>28</sup> In nine of the 10 cases, warning letters were issued by MRD and did not result in referral to Enforcement. One case was referred to Enforcement and resulted in a warning letter.

<sup>29</sup> Cases are matters for which the Exchanges determined a reasonable indication of potential rule violations existed at the time the matters are initiated; complaints are matters initiated via a customer complaint; and research files are matters for which the Exchanges determined further review was merited.

	<p>dates and delaying delivery. The Executive Vice President (“EVP”) and Principal<sup>30</sup> stated to the customer that the method by which he could freshen the positions was a “grey area.” In addition, another employee at the FCM manually overrode the default settings of the FCM’s back office processing system in order to facilitate the transactions. Although Enforcement conceded that the EVP knew or should have known that that the Exchanges prohibit wash trading for the purpose of freshening positions, Enforcement nonetheless believed that the violation was a systemic failure by the firm and not solely by the EVP, as it related to training, education, and knowledge of Exchange rules. Enforcement was also concerned that taking disciplinary action against the EVP would amount to “double-dipping.” Accordingly, the Exchange fined the firm \$70,000 for violating Rules 432.W (Failure to Diligently Supervise), 534 (Wash Trades Prohibited), and 807 (Open Long Positions During Delivery Month); fined the broker who executed the trades \$20,000 and imposed a 10 day direct access-only suspension for violating Rule 534; and issued the EVP a warning letter in connection with Rule 534.</p> <p>In Case 15-0127, an IB entered a series of orders on behalf of his customers that resulted in self-matched trades for five accounts. The subject trades were executed on December 22, 2014, for 55 contracts of the August 2015 Feeder Cattle futures, and were executed to realize gains. Although MRD determined that the IB should have known the activity in question violated Rule 534, it nonetheless issued a warning letter. MRD concluded that the length of time the orders were sitting, which was less than 20 seconds, demonstrated that it was not the IB’s intent to immediately offset the trades. MRD also considered that the subject activity was an isolated incident and that the IB did not have a disciplinary</p>	<p>See recommendations below.</p>
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<sup>30</sup> The introducing broker (“IB”) was registered with NFA as an associated person.

	<p>history.</p> <p>In RSRH 15-3541, an ATS malfunction resulted in self-matched trades for a total of 3,448 contracts. The FCM stated that the ATS was not configured to send the appropriate Self-Match Prevention Identifier<sup>31</sup> on each order message. Although the firm operating the ATS identified the issue after the self-match activity occurred, it did not implement a fix for four days. MRD issued a warning letter in connection with Rules 534 and 576 (Identification of Globex Terminal Operators), and the associated Market Regulation Advisory Notices (“MRANs”). In issuing a warning letter, MRD considered that the firm had an adequate system for detecting and rectifying ATS malfunctions.</p> <p>The Division believes the conduct at issue in these warning letters warranted disciplinary action. Wash trades affect market integrity by creating an illusion of legitimate, bona fide market interest. Such conduct may erode the public’s confidence in the futures market. These concerns, together with the facts and circumstances of each case, lead the Division to believe that warning letters issued in the above-mentioned cases were not commensurate with the violations committed. The EVP in Case 12-9055 knew, or should have known, that the wash trades he was facilitating were inappropriate. To mitigate concerns of “double-dipping,” the Exchanges could have taken action against both the firm and the EVP, in proportion to the rule violations they committed. In Case 15-0127, the Division believes that the IB, who is registered with the National Futures Association (“NFA”), should have known that his orders would result in self-trades given that the trades were in an illiquid market and in the back-months contracts, and exposed to the market for less than 20 seconds. In RSRH 15-3541, the</p>	<p>See recommendations below.</p>
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<sup>31</sup> CME Group offers optional functionality that allows an executing firm to prevent the matching of orders for accounts with common ownership if both the buy and sell orders contain the same Self-Match Prevention Identifier and Executing Firm ID.

	<p>Division is concerned that the individual(s) authorized to turn off the ATS were not notified of the malfunction for three days after the self-match activity occurred, and did not implement a fix for four days after the malfunction. Additionally, because some of the trading activity occurred in back-year contracts, the wash trades that resulted from the ATS malfunction accounted for almost a quarter of the trading in those contracts on a given day—a significant amount of wash volume.</p> <p><i>Disruptive Trading and Spoofing</i></p> <p>Complaint 16-2463 originated as a complaint regarding an individual who entered and cancelled 13 50-lot orders in the CBOT March 2016 Wheat futures contract during the pre-open sessions priced lower than the prevailing Indicative Opening Price (“IOP”) on two trade dates. On one of these dates, the respondent’s trading activity resulted in numerous fluctuations in the IOP that were transmitted to the entire trading community and prompted another trader to issue a complaint with MRD. MRD found two additional instances of similar activity in the March 2016 Corn futures market, amounting to a total of eight 50-lot offers that were entered and cancelled, resulting in changes in the IOP. The respondent indicated to MRD that he did not intend to trade the orders, but instead hoped to discern other participants’ automated trading strategies. MRD issued a warning letter for Rule 575 (Disruptive Practices Prohibited) and the associated MRAN, based on (a) the brief and isolated nature of these incidents; (b) that no similar activity was identified; and (c) that the activity ceased once the Exchange reached out to the respondent.</p> <p>Case 14-9934, involved a respondent who entered 250 30-lot orders (“large orders”) in the March 2014 Copper futures contract. Over the course of seven days, the respondent fully cancelled 100</p>	<p>See recommendations below.</p>
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	<p>percent of his large orders. The individual also entered 4,840 small orders (under 30-lot), and cancelled 82.93 percent of these orders. The purpose of cancelling these orders was to obtain fills on his small orders resting on the other side of the order book. The respondent openly admitted to MRD that he had engaged in 14 instances of spoofing activity, but stated that he was not aware at the time that such activity was prohibited. The respondent ceased this trading activity once his clearing firm asked him to terminate the spoofing trading behavior. MRD issued a warning letter for Rules 432.B2 (General Offenses)<sup>32</sup> and 575 because the subject trading activity comprised only 5.4 percent of the respondent's large orders and 1.12 percent of the respondent's total traded contracts, and that the spoofing pattern took place sporadically over a two-month period.</p> <p>Complaint 15-2353 originated as a complaint regarding an individual who entered 46 orders of 100 contracts or greater in the October 2015 Reformulated Blendstock for Oxygenate Blending ("RBOB") Gasoline futures market, and subsequently cancelled all 46 orders. Smaller orders resting on the opposite side of the market traded as a result of the cancellations. The respondent explained to MRD that there was no reason or purpose for the order placement other than he was "just playing around" and that the orders were really not meant to be executed. MRD issued a warning letter for Rule 575 on because the small number of contracts initially involved, the activity occurred on a single date, and the respondent ceased the trading activity once he was contacted.</p> <p>The Division believes the conduct at issue in these warning letters warranted disciplinary action. Disruptive trading and spoofing can cause significant harm to the marketplace. Entering and canceling orders in quick succession without the intent to trade creates a false</p>	<p>See recommendations below.</p>
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<sup>32</sup> Rule 432.B.2 makes it an offense "to engage in conduct or proceedings inconsistent with just and equitable principles of trade."

	<p>sense of supply and demand, which market participants may rely upon when making trading decisions. Similarly, non-bona fide order entry during the pre-open session may cause the IOP to fluctuate and reflect artificial prices. These concerns, together with the facts and circumstances of each case, lead the Division to believe that warning letters issued in the above-mentioned cases were not commensurate with the violations committed. In particular, the Division does not necessarily agree with MRD that the trading activity at issue Case 14-9934 and Complaint 15-2353 was de minimus. The Division is concerned that the respondents in both cases knowingly entered non-bona fide orders and openly admitted to such activity. The Division also does not necessarily agree that the instances in Complaint 16-2463 were isolated given that they occurred in two separate markets and affected 21 50-lot orders.</p> <p>The Division believes that disciplinary action in the above-mentioned cases would have served as a deterrent not only to the respondents, but also other market participants. Public notification of disciplinary sanctions sends the message to other market participants that such conduct will not be tolerated. Furthermore, sanctions become part of a respondent’s public disciplinary history, and must be taken into consideration in determining sanctions for any future violative activity. The Exchanges failure to take disciplinary action in the above-mentioned cases means that the respondents’ misconduct will not be reflected in their public disciplinary history.</p>	<p><b><u>Recommendation</u></b></p> <p>The Exchanges should take appropriate disciplinary action in lieu of issuing a warning letter in future cases that involve misconduct similar to the cases that were identified by the Division in this Report.</p>
<p>§ 38.711 Warning Letters</p> <p>Where a rule violation is found to have occurred, no more than one warning letter may be issued per rolling 12-month period for the same</p>	<p>The Exchanges maintain a warning letter policy prohibiting the issuance of more than one warning letter per rolling 12-month period for the same violation. Of the 85 cases reviewed by the Division, the Enforcement Group issued a total of 17 warning letters in 12 cases. None of the warning letter recipients received</p>	<p>No deficiencies or recommendations.</p>

violation.	more than one warning letter during the target period for the same violation.	
<p>§ 38.712 Additional Sources for Compliance</p> <p>Applicants and designated contract markets may refer to the guidance in appendix B of this part to demonstrate to the Commission compliance with the requirements of §38.700 of this part.</p>	<p>The Division notes that the Exchanges’ rules provide, among other things, that:</p> <ul style="list-style-type: none"> <li>• Any charge in the notice of charges not denied in whole or in part shall be deemed admitted by the BCC.<sup>33</sup></li> <li>• The BCC shall have the authority to take emergency actions.<sup>34</sup></li> <li>• MRD may issue summary fines that shall not be less than \$1,000 per offense and shall not exceed \$5,000 per offense for individuals or \$10,000 per offense for firms for the inaccurate, incomplete or untimely submission of data, records or information.<sup>35</sup></li> </ul> <p><u>Documentation of Settlement Offers Rejected by the BCC</u></p> <p>During the target period, the Exchanges permitted respondents to submit settlement offers that were supported by the Enforcement Group (“supported settlements”) as well as settlement offers that were not supported by the Enforcement Group (“unsupported settlements”).<sup>36</sup> Respondents were permitted to submit supported settlement offers any time prior to a hearing and were not limited to the number of offers that could be submitted, whereas only one</p>	See recommendation below.

<sup>33</sup> CBOT, CME, COMEX, and NYMEX Rule 407.C.

<sup>34</sup> CBOT, CME, COMEX, and NYMEX Rule 402.C.

<sup>35</sup> CBOT, CME, COMEX, and NYMEX Rule 512.B.

<sup>36</sup> As of December 14, 2016, the Exchanges eliminated the use of unsupported settlement offers.

	<p>unsupported settlement offer was permitted to be presented after the PCC had issued charges.</p> <p>Prior to the settlement hearing for either a supported or unsupported settlement offer, the Enforcement Group prepares and distributes to the BCC panel a “BCC Hearing Packet,” which includes the settlement offer, a list of comparable cases, and a draft of the Notice of Disciplinary Action. BCC Hearing Packets for supported settlements also include a memorandum in support of the settlement offer (“MRD Supporting Memo”) which outlines trading activity at issue, findings from the investigation, the respondent’s disciplinary history, and the factors that the Enforcement Group considered in recommending settlement. BCC Hearing Packets for unsupported settlements include a memorandum in opposition of the settlement offer (“MRD Opposition Memo”) which outlines the factors for MRD’s opposition to the settlement offer, as well as copies of the charging memorandum and the respondent’s answer to the charges.</p> <p>The Exchanges maintain minutes for each BCC meeting. These minutes include the date, time and location of the hearing, a list of cases on the agenda, and a list of the BCC members and MRD staff present. For each case listed on the agenda, the minutes indicate whether a settlement offer was accepted by the BCC. The minutes do not capture any additional detail regarding the BCC’s decision to accept or reject the settlement offer. For settlement offers that are accepted by the BCC, the Panel’s rationale for accepting the offer is based on the factors set forth in the MRD Supporting Memo, and is therefore documented. However, if the BCC decides to reject a settlement offer recommended by Enforcement, the rationale for this decision is not documented anywhere in the case file, either while the matter is pending or once it has been resolved, by either Enforcement or the BCC.</p>	<p>See recommendation below.</p>
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	<p>The Exchanges assert that Enforcement staff can often surmise the BCC’s reasons for rejecting the settlement offer based on the types of questions raised by at the hearing. While such dialog at the hearing may provide Enforcement staff some insight into the BCC’s decision-making, there may be additional factors raised during the BCC’s deliberation to which Enforcement staff is not privy. Therefore, the Division believes that documenting the BCC’s basis for rejecting a supported settlement offer is necessary to ensure that the Enforcement Group clearly understands all the factors that formed the basis of the BCC’s decision, and can use this insight when recommending settlement offers involving similar facts and circumstances. Documenting this information will also promote consistency among disciplinary panels, since the views of each BCC panel may differ based on the views of the individual members. Finally, such documentation is necessary to ensure that the MROC has the information to review the adequacy of the Exchanges disciplinary program and the BCC’s performance under the Acceptable Practices for Core Principle 16.</p>	<p><b><u>Recommendation</u></b></p> <p>The Exchanges should ensure that the BCC’s rationale for rejecting a settlement offer is documented. Such documentation may be completed once the matter has been resolved and after the appeal period for the matter has lapsed.</p>
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