

**MARKET SURVEILLANCE
RULE ENFORCEMENT REVIEW
OF THE
MINNEAPOLIS GRAIN EXCHANGE, INC.**



**Division of Market Oversight
June 5, 2015**

I. Rule Enforcement Review Scope

The Division of Market Oversight (“Division”) has conducted a rule enforcement review of the market surveillance program of the Minneapolis Grain Exchange, Inc. (“MGEX” or “Exchange”).¹ The Division’s review of the Exchange’s market surveillance program covered the period from April 15, 2013 to April 14, 2014 (“target period”).² The Division reviewed the Exchange’s compliance with Core Principle 2 (*Compliance With Rules*),³ Core Principle 4 (*Prevention of Market Disruption*),⁴ and Core Principle 5 (*Position Limitations or*

¹ Rule enforcement reviews, and the resultant reports prepared by the Division, are intended to present an analysis of an exchange’s compliance capabilities during the period under review. Such reviews deal only with exchange programs directly addressed in the review and do not assess all programs, core principles, or Commission regulations. The Division’s analyses and conclusions are based, in large part, upon the Division’s evaluation of a sample of market surveillance files and other exchange documents. This evaluation process, in some instances, identifies specific issues with particular exchange compliance programs or methods, but is not designed to uncover every instance where an exchange fails to effectively comply with the core principles or Commission regulations.

This report, and the analyses and conclusions 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. The Division’s analyses and conclusions in this report are limited to MGEX.

² The Division notes that as part of this rule enforcement review it also conducted a follow-up to the Division’s 2013 review of the MGEX audit trail, trade practice surveillance, disciplinary, and dispute resolution programs to determine whether the Exchange implemented the Division’s recommendations that focused on audit trail and trade practice surveillance (*available at* <http://www.cftc.gov/ucm/groups/public/@iodcms/documents/file/rermgex090613.pdf>). The Division found that MGEX appropriately implemented the Division’s recommendations.

³ Core Principle 2 - *Compliance With Rules*: (A) In general – The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including: (i) Access requirements; (ii) The terms and conditions of any contracts to be traded on the contract market; and (iii) Rules prohibiting abusive trade practices on the contract market. (B) Capacity of contract market. The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market. (C) Requirement of rules. The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this section, including the capacity to carry out such international information-sharing agreements, as the Commission may require.

⁴ Core Principle 4 - *Prevention of Market Disruption*: The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including: (a) methods for conducting real-time monitoring of trading; and (b) comprehensive and accurate trade reconstructions.

Accountability)⁵ under Section 5(d) of the Commodity Exchange Act (the “Act”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,⁶ and the Commission’s related regulations codified in §§ 38.155, 38.158, 38.250-256, and 38.300-301, which relate to an exchange’s market surveillance program.⁷

To evaluate the Exchange’s market surveillance program, and its compliance with Core Principles 2, 4, and 5 and Commission Regulations §§ 38.155, 38.158, 38.250-256, and 38.300-301, Division staff interviewed compliance officials and staff from the Exchange’s Department of Audits and Investigations (“A&I”) and received a demonstration of the automated surveillance systems used by the Exchange to conduct market surveillance. The Division also analyzed responsive documents produced by the Exchange’s staff, including the following:

- the Exchange’s market surveillance procedures manual and guidelines;
- automated computer reports and other documents generated by the Exchange’s market surveillance tools;
- market surveillance investigation logs and files;
- organizational charts and summaries of personnel and staffing; and

⁵ Core Principle 5 - *Position Limitations or Accountability*: To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.

⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (“Dodd-Frank Act”). Title VII of the Dodd-Frank Act became effective on July 16, 2011.

⁷ On May 10, 2012, the Commission issued its Final Rules, *Core Principles and Other Requirements for Designated Contract Markets*, 77 Fed. Reg. 36612 (June 19, 2012) (“New DCM Regulations”), which became effective prior to the target period on October 17, 2012, to codify rules in lieu of guidance and acceptable practices for certain core principles, including Core Principles 2, 4, and 5. Because the New DCM Regulations were in effect for the entirety of the target period, the Division reviewed the Exchange’s market surveillance program for compliance with the New DCM Regulations.

- minutes of disciplinary committee, Board of Directors, and Regulatory Oversight Committee meetings held during the target period.

The Division analyzed the Exchange's market surveillance program to determine whether the program complies with the core principles and Commission regulations stated above, and whether there are any deficiencies in or recommendations for the program. For purposes of rule enforcement review reports, 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.

As set forth below, the Division found that the Exchange maintains experienced market surveillance staff and an adequate market surveillance program to demonstrate compliance with Core Principles 2, 4, and 5, and Commission Regulations §§ 38.155, 38.158, 38.250-256, and 38.300-301. The Division did not identify any deficiencies. The Division made two recommendations for improvement.

The Division provided the Exchange with an opportunity to review and comment on a draft of this report on April 29, 2015. On May 7, 2015, Division staff conducted an exit conference with Exchange officials to discuss the report's findings and recommendations.

II. Products and Trading Volume During the Target Period

Total trading volume at MGEX during the target period was 1,786,406 contracts, an average of 148,867 contracts per month. In the 12-month period since the target period, the Exchange's total trading volume was 2,149,094 contracts, a monthly average of 179,071 contracts. MGEX offered 14 products for trading during the target period, but two products accounted for nearly all of the total volume. Hard Red Spring Wheat ("HRSW") futures and

options products accounted for 98.5 percent and 1.3 percent of the total volume, respectively.⁸

The Apple Juice Concentrate (“AJC”) futures and options contracts traded on a limited basis and collectively accounted for 0.2 percent of the total volume.⁹

Electronically traded futures and options for both the HRSW and AJC contracts traded on Globex, the CME Group, Inc.’s (“CME Group”) electronic trading platform accounted for approximately 83 percent (1,482,455 contracts) of the Exchange’s volume during the target period. Additionally, HRSW options contracts traded in a room located at the Exchange’s headquarters contributed one percent (16,427 contracts) to the Exchange’s total volume. The remaining 16 percent (287,524 contracts) consisted of off-exchange transactions.

III. Summary of Findings, Deficiencies Requiring Corrective Action, and Recommendations

A. Findings without Deficiencies Requiring Corrective Action or Recommendations

1. *Compliance Staff and Resources (Core Principle 2, Commission Regulation § 38.155)*
 - The Division found that the Exchange has sufficient market surveillance staff to demonstrate compliance with Core Principle 2 and Commission Regulation § 38.155. The Exchange’s market surveillance program is conducted by four A&I staff investigators and is jointly headed by the Chief Regulatory Officer (“CRO”) and the Exchange’s Chief of Staff.
2. *Prevention of Market Disruption and General Requirements (Core Principle 4, Commission Regulations §§ 38.250-251)*
 - The Division found that MGEX maintains an adequate market surveillance program to comply with Core Principle 4 and Commission Regulations §§ 38.250-251 (and as discussed below, Core Principle 5 and Commission Regulations §§ 38.158, 38.250-256, and 38.300-301).

⁸ In addition to the HRSW contracts, the Exchange offered electronic trading for five agricultural index futures and options contracts during the target period: National Corn Index, National Soybean Index, Hard Red Spring Wheat Index, Hard Red Winter Wheat Index, and Soft Red Winter Wheat Index. These products are offered for trading on Globex and had no trading volume during the target period and to date.

⁹ The AJC contracts were launched on August 13, 2012 and are offered for trading on Globex.

- The primary tool used by the Exchange to collect and evaluate daily market activity is the Daily Market Surveillance Log (“DMSL”). The information on the DMSL is obtained from computer-generated reports and is used by A&I to identify possible price manipulation or price distortion and to increase the surveillance of expiring contracts. For real-time market monitoring, A&I uses several automated tools including a CME Group subscription-based application called EOS Trader that enables A&I to monitor market activity for price variations, including prices in a contract month that are not moving in correlation with other contract months, as well as large volume increases.

3. Additional Requirements for Physical-Delivery Contracts (Commission Regulation § 38.252)

- The Division found that MGEX has adequate procedures to demonstrate compliance with Commission Regulation § 38.252. A&I monitors convergence between the contract price and the underlying commodity, particularly going into the delivery month, by downloading the USDA Marketing Services cash price statistics and reviewing prices of the HRSW contract for the front and nearby months as well as the front month price for the Chicago Board of Trade and Kansas City wheat contracts to compare the intermarket spreads. As expiration approaches, A&I reviews the Open Share of Market Report and Volume and Open Interest by Clearing Member Report to closely monitor the gross house and customer positions (futures) and the Delta Position Large Traders Report (options) to detect problems of potential concentration of positions among clearing members. In addition, A&I monitors the availability of deliverable supplies to ensure an orderly liquidation for both the HRSW and AJC contracts.

4. Additional Requirements for Cash-Settled Contracts (Commission Regulation § 38.253)

- The Division found that MGEX has adequate procedures to demonstrate compliance with Commission Regulation § 38.253. The Exchange offers electronic trading for five agricultural index futures contracts that are cash-settled: National Corn Index, National Soybean Index, Hard Red Spring Wheat Index, Hard Red Winter Wheat Index, and Soft Red Winter Wheat Index. As noted above, there was no volume in these contracts during the target period. A&I’s Training Manual includes appropriate procedures to monitor the pricing of each index to which the contracts will settle.

5. Ability to Obtain Information (Commission Regulation § 38.254)

- The Division found that the Exchange has adequate rules to obtain information from market participants. MGEX Rule 2009.00. (Records of Transactions) requires Exchange members and market participants to retain full, complete and systematic records of their activity and MGEX Rule 283.00. (Audits and Investigations) provides the Exchange with the authority to collect this information.

6. Risk Controls for Trading (Commission Regulation § 38.255)

- The Division found that MGEX has adequate rules and procedures to demonstrate compliance with Commission Regulation § 38.255. Pursuant to a Services Agreement with the CME Group, MGEX is responsible for determining with respect to all MGEX Globex contracts (1) when a trading halt, delayed opening, or other suspension of trading is required; and (2) when trading should resume or open, as a result of regulatory requirements, market conditions or other emergencies. MGEX is also responsible for determining when a trade cancellation or modification is required for all MGEX Globex contracts. The Exchange rules also provide for a non-reviewable range for all MGEX contracts.
- Globex includes functionality to minimize excessive price movements, including stop spike logic and a price banding mechanism. Stop spike logic introduces a momentary pause in matching (reserved state) when triggered stops would cause the market to trade outside predefined values (i.e., non-reviewable range). The price banding mechanism subjects all incoming orders to price verification and rejects all orders with clearly erroneous prices.

7. Trade Reconstruction (Commission Regulation § 38.256)

- The Division found that MGEX has the ability to comprehensively and accurately reconstruct trading. A&I receives a daily audit data file from the CME Group called the “GAT file” that includes all electronic trade activity and serves as the Exchange’s electronic audit trail. A&I can also access complete audit trail data for both electronic and open outcry trading from the Exchange’s Market Surveillance Database.

8. Position Limitations and/or Accountability (Core Principle 5, Commission Regulations §§ 38.300-301)

- Subject to the recommendation below under Commission Regulation § 38.301 regarding the Exchange’s hedge exemption application process for the HRSW futures contract, the Division found that the Exchange has adequate rules and procedures related to position limits. The Exchange adopted the federal position limits for the HRSW contract contained in Commission Regulation § 150.2. With respect to detecting position limit violations, A&I receives daily large trader information (“Large Trader Report”) for the HRSW contract from the Commission. The Large Trader Report is an Excel spreadsheet sent via FTP which lists MGEX accounts that reached the reporting levels for futures and/or options. A&I uses the large trader information to monitor positions, position holders, and distinguish speculative positions from hedge positions. For the AJC contract, MGEX Rule 5411.00. (Position Limits) specifies the position limits. MGEX monitors all AJC positions and position holders through various tools including the Customer Gross Margin Report.

9. Investigations and Investigation Reports (Commission Regulation § 38.158)

- A&I opens a formal investigation, after the CRO’s approval, whenever daily market surveillance, a customer or trader complaint, or a Commission referral indicates the possibility of a violation of Exchange rules, the Act, or Commission regulations. A&I reviews material from the underlying investigation or complaint. In addition, A&I collects and analyzes other relevant data, including trade data, audit trail information, and/or the various computer-generated from the DMSL.
- The Division reviewed a total of 12 market surveillance investigations, including all 11 investigations that were closed by the Exchange during the target period, and one investigation that was opened during the target period and closed after the target period. Subject to the recommendation below concerning the sufficiency of documentation for investigations, the Division found that MGEX adequately conducted investigations. The Division found the quality of the investigative work to be thorough and complete and the investigations were closed in a timely manner.

B. Findings with Recommendations

1. Position Limitations and Accountability (Commission Regulation § 38.301)

- The Exchange does not have a rule that provides a hedge exemption application process for the HRSW futures contract. The Exchange informed the Division that MGEX did not receive any hedge exemption requests during the target period and such a request would be rare. The Exchange should consider adopting a hedge exemption application process in the Exchange’s rulebook for the HRSW futures contract which sets forth the process. Without such a process, there is no way for a market participant to request an exemption.
 - **Recommendation: The Exchange should consider adopting a hedge exemption application process in the Exchange’s rulebook for the Hard Red Spring Wheat futures contract.**

2. Investigations and Investigation Reports (Commission Regulation § 38.158)

- The Division found that the Exchange generally maintains adequate documentation of its investigations, including pertinent underlying trade documents, correspondence, computer reports, and summaries of the activity examined. The Division did identify one investigation out of the 12 investigations it reviewed where A&I did not fully document its analysis in either the investigation report or the investigation file. First, A&I did not document a complete trade reconstruction of the market activity surrounding the trade in question (e.g., active bids, offers, status of the order book). Instead, A&I only provided the daily price statistics and related-orders activity. Second, A&I did not indicate whether the “related-orders” were the only active orders before and at the time of the trade in question. Third, A&I did not include the Account Name Position Analysis Report that A&I used to verify the conflicting nature of the account identified as a Customer Type Indicator Code 4 (i.e., customer)

on the order details and as a house account on delivery-related documents. Without such documentation, it is difficult to assess the sufficiency of the Exchange's investigation and whether closing the investigation with no action was appropriate.

- **Recommendation: The Exchange should take appropriate measures to ensure that all market surveillance investigations are well-documented.**

The accompanying Compliance Matrix in Section IV below includes a thorough analysis of the Exchange's compliance with Core Principles 2, 4, and 5 under Section 5(d) of the Act, and the Commission's related regulations codified in Commission Regulations §§ 38.155, 38.158, 38.250-256, and 38.300-301.

IV. Compliance Matrix

CFTC Regulation	Findings Regarding the Exchanges' Compliance Target Period 4/15/13 – 4/14/14	Deficiencies/Recommendations
<p>§ 38.155 Compliance staff and resources (market surveillance)</p> <p>(a) Sufficient compliance staff. A designated contract market must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The designated contract market's compliance staff also must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 38.158(b) of this part.</p> <p>(b) Ongoing monitoring of compliance staff resources. A designated contract market must monitor the size and workload of its compliance staff annually, and ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate level of compliance resources and staff, the designated contract market should consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be</p>	<p>MGEX's market surveillance responsibilities are carried out by the Department of Audits and Investigations ("A&I") which consists of four staff investigators and is jointly headed by the Chief Regulatory Officer ("CRO") and the Exchange's Chief of Staff. The Division found that the Exchange maintains sufficient A&I staff to conduct market surveillance.</p> <p>The CRO reports to the Regulatory Oversight Committee ("ROC") and is primarily responsible for overseeing A&I's performance of its self-regulatory responsibilities, including management of the Exchange's market surveillance, audit trail, trade practice surveillance, disciplinary, and dispute resolution programs. The CRO reviews investigations prepared by A&I staff investigators, assesses surveillance matters, and evaluates and administers disciplinary actions such as warning letters and settlements. The Chief of Staff reports to the President of the Exchange and is primarily responsible for overseeing A&I administrative matters. These responsibilities include hiring investigators, conducting annual A&I employee performance evaluations, and assigning and monitoring the timeliness of A&I work.</p> <p>The current CRO served as CRO from 2009 to May of 2012 and was reappointed in April of 2013. The Chief of Staff joined MGEX in 1996 and was appointed Chief of Staff in 2005. A&I staff investigator experience ranges from one to eight years.</p> <p>A&I staff levels are monitored regularly by the CRO and the Chief</p>	<p>None</p>

<p>assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.</p>	<p>of Staff. In addition, the ROC evaluates A&I staff levels and resources via an annual report that considers, among other things, A&I staff turnover, qualifications, and compensation.</p>	
Core Principle 4 Prevention of Market Disruption		
<p>§ 38.250 Core Principle 4</p> <p>The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including:</p> <p>(a) Methods for conducting real-time monitoring of trading; and</p> <p>(b) Comprehensive and accurate trade reconstructions.</p>	<p>See discussion below addressing Commission Regulations §§ 38.251-256.</p>	<p>None</p>
<p>§ 38.251 General requirements</p> <p>A designated contract market must:</p> <p>(a) Collect and evaluate data on individual traders' market activity on an ongoing basis in order to detect and prevent manipulation, price distortions and, where possible, disruptions of the physical-delivery or cash-settlement process;</p>	<p><u>Collecting and Evaluating Data to Detect and Prevent Manipulation and Price Distortions</u></p> <p>The primary tool used by the Exchange to collect and evaluate daily market activity is the Daily Market Surveillance Log (“DMSL”). The information on the DMSL is obtained from computer-generated reports and is used by A&I to identify possible price manipulation or price distortion and to increase the surveillance of expiring contracts. Reports maintained on the DMSL include:</p>	<p>None</p>

<p>(b) Monitor and evaluate general market data in order to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand;</p> <p>(c) Demonstrate an effective program for conducting real-time monitoring of market conditions, price movements and volumes, in order to detect abnormalities and, when necessary, make a good-faith effort to resolve conditions that are, or threaten to be, disruptive to the market; and</p> <p>(d) Demonstrate the ability to comprehensively and accurately reconstruct daily trading activity for the purposes of detecting trading abuses and violations of exchange-set position limits, including those that may have occurred intraday.</p>	<ul style="list-style-type: none"> • Open Share of Market Report – identifies the top three position holders in the two front month contracts for Hard Red Spring Wheat (“HRSW”) and Apple Juice Concentrate (“AJC”); • Trading Activity Surveillance – identifies the number of brokers/User IDs traded for each futures and options contract; • Trade Totals – shows the buy and sell activity for each commodity; • Deliveries/Exercises – identifies the deliveries and option exercises that occurred in each commodity; • Large Traders – identifies the top five traders’ volume, percentage of volume, number of trades and percentage of total trades for each commodity; • Broker vs. Broker – identifies brokers with a volume greater than 100 contracts and where more than 30 percent of the broker’s total volume is opposite another broker; • Broker vs. Clearing Member – identifies brokers with a volume greater than 100 contracts and where more than 30 percent of the broker’s total volume is with one clearing member; • Option Surveillance – identifies volume for all strike prices that were opened for each contract month and commodity (on the business day); • Open Interest – identifies the front month, total open interest, and volume change for HRSW and AJC futures and options; and • Volume – identifies the total volume traded for both futures and options for all commodities. <p>As part of its daily surveillance responsibilities, A&I monitors the availability of deliverable grade grain for the HRSW contract and apple juice concentrate for the AJC contract, in relation to open</p>	
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	<p>interest and concentrations of positions. A&I also monitors unusual price relationships and/or price volatility in the expiring contract month, which might indicate manipulation or supply pressures on the market. A&I uses the Settlement Manipulation Report to analyze market activity during the closing period and any time period throughout the trading day. This report enables A&I to view price and order activity to identify any large orders entering the market, particularly during the closing period.</p> <p><u>Real-Time Monitoring of the Market</u></p> <p>With respect to real-time market monitoring, A&I uses EOS Trader, a CME Group subscription-based application, to monitor market activity for price variations, including prices in a contract month that are not moving in correlation with other contract months, as well as large volume increases. EOS Trader displays real-time market data for futures and options instruments and spreads, including best bid and ask quantity, best bid and ask price, and volume for each instrument and spread. A&I also uses FirmSoft, a CME Group subscription-based order management tool that provides real-time access to working and filled MGEX orders. FirmSoft enables A&I staff to view and save relevant order information, including entry time, fill time, contract month, strategy type, and order number. Additionally, A&I uses Barchart, a website that provides real-time price, quotes, volume, charts, and technical analysis for commodities, futures, stocks, options, forex, and ETF markets. Barchart allows A&I to view prices and intermarket spread relationships between MGEX, Chicago Board of Trade (“CBOT”) Soft Red Winter Wheat, and Kansas City Hard Red Winter Wheat contracts. By monitoring the price changes and spread relationships, A&I can detect price movements that could indicate an underlying problem in the market.</p>	
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Reconstructing Trading to Detect Position Limit Violations

As discussed below in the Division’s findings regarding the Exchange’s compliance with Commission Regulation § 38.256, MGEX has the ability to reconstruct both electronic and open outcry trading.

MGEX adopted the federal position limits for HRSW contained in Commission Regulation § 150.2 and MGEX Rule 5411.00. governs the position limits for the AJC contract (*see* discussion below concerning Regulation § 38.256 for the position limits for both HRSW and AJC). With respect to detecting position limit violations, A&I receives a daily large trader information Excel spreadsheet (“Large Trader Report”) for the HRSW contract from the CFTC via FTP. The Large Trader Report lists MGEX accounts that reached the reporting levels for futures and/or options. A&I uses the large trader information to monitor positions, position holders, and distinguish speculative positions from hedge positions. If an account or owner approaches the position limits, A&I will monitor daily activity to ensure it does not exceed the position limits during the trade day or at the end of the day. For the AJC contract, MGEX monitors all AJC positions and position holders through various tools including the daily Customer Gross Margin Report that MGEX’s clearinghouse receives from its clearing members.

A&I also uses various applications and reports to monitor for intraday position limit violations. Specifically, A&I reviews the previous day’s end-of day position report, the DMSL large traders table which shows the top five traders’ volume and percentage of volume, FirmSoft to view the orders placed by traders during the trading day to determine whether any positions are close to the Exchange’s position limits, and the Customer Gross Margin

	Report.	
<p>§ 38.252 Additional requirements for physical-delivery contracts</p> <p>For physical-delivery contracts, the designated contract market must demonstrate that it:</p> <p>(a) Monitors a contract's terms and conditions as they relate to the underlying commodity market and to the convergence between the contract price and the price of the underlying commodity and show a good-faith effort to resolve conditions that are interfering with convergence; and</p> <p>(b) Monitors the supply of the commodity and its adequacy to satisfy the delivery requirements and make a good-faith effort to resolve conditions that threaten the adequacy of supplies or the delivery process.</p>	<p><u>Monitoring Convergence Between the Contract Price and Underlying Commodity</u></p> <p>A&I monitors convergence, particularly going into the delivery month. Specifically, A&I downloads the USDA Marketing Services cash price statistics; reviews prices of the HRSW contract for the front and nearby months as well as the front month price for the CBOT and Kansas City wheat contracts from Barchart to compare the intermarket spreads; and creates graphical charts of futures and cash basis prices. A&I analyzes this information for unusual or lack of convergence and will elevate any concerns to the CRO. A&I did not identify any convergence issues during the target period. A&I also considers external factors that may impact the market, such as economic news, embargoes, weather, and domestic and foreign market crises because this information may have a fundamental impact on the HRSW contract and convergence. A&I also monitors the railcar tariffs because they are part of the basis amount (i.e., difference between the cash and futures price).</p> <p><u>Monitoring Contract Expirations</u></p> <p>As expiration approaches, A&I reviews the Open Share of Market Report and Volume and Open Interest by Clearing Member Report to closely monitor the gross house and customer positions (futures) and the Delta Position Large Trader Report (options) to detect problems of potential concentration of positions among clearing members. A&I monitors the three largest long and short future position holders and the largest short put and call holders in the nearby month to ensure that futures contracts are liquidated in an orderly manner and that options are properly exercised. A&I also</p>	None

	<p>reviews the Account Name Position Analysis Report (“ANPAR”) and the Large Trader Report provided by the CFTC to monitor positions and position holders as expiration approaches. The ANPAR is particularly useful because the information assists A&I in identifying position holders and their ability to make or take delivery. If A&I has any questions or issues regarding a particular position it contacts the clearing firm or position holder. MGEX did not identify any unusual or problematic expirations during the target period.</p> <p><u>Monitoring Deliverable Supplies</u></p> <p>A&I monitors the availability of deliverable supplies to ensure an orderly liquidation for both the HRSW and AJC contracts. Each week, A&I reviews the Stocks of Grain and the Apple Juice Concentrate Report to determine the availability of deliverable grade spring wheat and apple juice concentrate in relation to open long positions. Both of the reports are compiled by using data obtained by MGEX from reports submitted by Exchange-approved grain elevator operators and warehouses. The reports compare figures from the previous week and for the same week in the previous year, which allows A&I to assess any adverse changes. If there are material changes in the deliverable supplies of 10 percent or more, A&I contacts the grain elevator operator or warehouse to verify the accuracy of the supply information and the reason for such a change. A&I did not identify any deliverable supply issues during the target period.</p>	
<p>§ 38.253 Additional requirements for cash-settled contracts</p> <p>(a) For cash-settled contracts, the designated contract market must demonstrate that it:</p>	<p>The Exchange offers electronic trading for five agricultural index futures contracts that are cash-settled: National Corn Index, National Soybean Index, Hard Red Spring Wheat Index, Hard Red Winter Wheat Index, and Soft Red Winter Wheat Index. However, there was no volume in these contracts during the target period. A&I’s Training Manual includes appropriate procedures to monitor</p>	<p>None</p>

<p>(1) Monitors the pricing of the index to which the contract will be settled; and</p> <p>(2) Monitors the continued appropriateness of the methodology for deriving the index and makes a good-faith effort to resolve conditions, including amending contract terms where necessary, where there is a threat of market manipulation, disruptions, or distortions.</p> <p>(b) If a contract listed on a designated contract market is settled by reference to the price of a contract or commodity traded in another venue, including a price or index derived from prices on another designated contract market, the designated contract market must have rules or agreements that allow the designated contract market access to information on the activities of its traders in the reference market.</p>	<p>the pricing of each index to which the contracts will settle. The Exchange does not offer any contracts for trading that are settled by reference to the price of a contract or commodity traded in another venue.</p>	
<p>§ 38.254 Ability to obtain information</p> <p>(a) The designated contract market must have rules that require traders in its contracts to keep records of their trading, including records of their activity in the underlying commodity and related derivatives markets, and make such records available, upon request, to the designated contract market.</p>	<p>The Exchange maintains two rules that provide the Exchange with the authority to obtain information from market participants:</p> <ul style="list-style-type: none"> • MGEX Rule 2009.00. (Records of Transactions) – Requires Exchange members and market participants to retain full, complete and systematic records of their activity, including records in the underlying commodity and related derivatives markets as well as related cash and forward transactions. • MGEX Rule 283.00. (Audits and Investigations) – Provides the Exchange with the authority to collect information and 	<p>None</p>

<p>(b) A designated contract market with participants trading through intermediaries must either use a comprehensive large-trader reporting system (LTRS) or be able to demonstrate that it can obtain position data from other sources in order to conduct an effective surveillance program.</p>	<p>documents and the authority to examine books and records kept by any market participant from whom information has been requested.</p> <p>As noted above with respect to the Exchange’s compliance with Commission Regulation § 38.251, the Exchange receives daily large trader information for the HRSW contract from the CFTC and position information for the AJC contract in the Customer Gross Margin Report that MGEX’s clearinghouse receives from its clearing members daily. The Large Trader Report lists MGEX accounts that reached the reporting levels for futures and/or options. The Large Trader Report also contains the account identification, expiration date, amount of futures and/or option positions (long or short, puts or calls), designation of commercial or noncommercial, the strike price, the account code and the reporting firm alpha name.</p>	
<p>§ 38.255 Risk controls for trading</p> <p>The designated contract market must establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market.</p>	<p><u>Electronic Trading and Services Agreement with CME Group and Globex Functionality</u></p> <p>A Services Agreement entered into by MGEX and CME Group prescribe the responsibilities of each party in the event of an electronic trading halt, delay, or suspension. Pursuant to the Services Agreement, MGEX is responsible for determining with respect to all MGEX Globex contracts (1) when a trading halt, delayed opening, or other suspension of trading is required and (2) when trading should resume or open, as a result of regulatory requirements, market conditions or other emergencies. MGEX is required to provide the CME Global Command Center (“GCC”) with as much advance notice of the halt, delay or suspension, and of the time when trading shall resume, as is practicable under the circumstances, and CME shall use commercially reasonable efforts to control trading in accordance with such instructions. During the</p>	<p>None</p>

target period, MGEX experienced a trading halt on April 8, 2014, that was initiated by the GCC due to Globex technical issues.

The Services Agreement also provides that MGEX is responsible for determining with respect to any MGEX Globex Contract, when a trade cancellation or modification is required as a result of regulatory requirements, market conditions or other emergencies in accordance with the requirements of MGEX rules. In such event, MGEX must provide the GCC with as much advance notice of the trade cancellation or modification as is practicable under the circumstances, and CME shall use commercially reasonable efforts to comply with the instructions. The non-reviewable range for HRSW is \$.10 per bushel and \$.20 per gallon for AJC. There were no trade cancellations or modifications during the target period.

Globex includes functionality to minimize excessive price movements. For example, stop spike logic introduces a momentary pause in matching (reserved state) when triggered stops would cause the market to trade outside predefined values (i.e., non-reviewable range). Globex also includes a price banding mechanism that subjects all incoming orders to price verification and rejects all orders with clearly erroneous prices.

Open Outcry Trading

For open outcry trading, MGEX uses its price reporting system and Trade Entry Matching System (“TEMS”) to enforce price limits. The pit reporter monitors prices and will prevent a quote above or below the daily price limit to be disseminated to the public through its price reporting system. Trades entered into TEMS with prices above or below the daily price limits, which are not reported to the pit reporter, may not clear. The Exchange did not identify any open outcry trades that cleared outside the daily price limits during

	the target period.	
<p>§ 38.256 Trade reconstruction</p> <p>The designated contract market must have the ability to comprehensively and accurately reconstruct all trading on its trading facility. All audit-trail data and reconstructions must be made available to the Commission in a form, manner, and time that is acceptable to the Commission.</p>	<p>CME Globex, the Exchange’s electronic trading platform, maintains a complete electronic record of all orders entered and all transactions executed, including the terms and time of entry for each order, all order modifications/cancellations, and all matched trades. A&I receives a daily audit data file from the CME Group called the “GAT file” that includes all electronic trade activity and serves as the Exchange’s electronic audit trail. Additionally, A&I uses FirmSoft to access information regarding working and filled MGEX orders on Globex and previously cleared trade activity. FirmSoft also provides A&I with the ability to search real-time and prior electronic trade activity by various methods, including: account number, User ID, order type, and client order ID for the current trade date and the last five trading sessions. A&I can also access complete audit trail data for both electronic and open outcry trading from the Exchange’s Market Surveillance Database.</p>	None
Core Principle 5 Position Limitations or Accountability		
<p>§ 38.300 Core Principle 5</p> <p>To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.</p>	<p>As noted above in the discussion regarding the Exchange’s compliance with Commission Regulation § 38.251, MGEX adopted the federal position limits contained in Commission Regulation § 150.2 for the HRSW contract. Therefore, the position limits are 600 contracts in the spot month and 12,000 contracts for a single month and all-months-combined. For the AJC contract, MGEX Rule 5411.00. (Position Limits) provides for position limits of 100 contracts in the spot month and 1,000 contracts in a single month and all-months-combined. The daily Large Trader Report the Exchange receives from the CFTC enables A&I to identify any accounts that appear to be approaching a speculative position limit. For the AJC contract, MGEX monitors all AJC positions and position holders through various tools including the Customer Gross Margin Report. If A&I identifies an account of concern, staff will contact the respective clearing member to obtain further</p>	None

	information as deemed appropriate. During the target period, the Exchange did not have any market participants that approached or exceeded the position limits in either HRSW or AJC.	
<p>§ 38.301 Position limitations and accountability</p> <p>A designated contract market must meet the requirements of parts 150 and 151 of this chapter, as applicable.</p>	<p>As noted above, MGEX has adopted limits for the HRSW and AJC contracts. For the HRSW options contract and AJC futures and options contracts, MGEX rules provide a formal application process for market participants to request a hedge exemption from position limits. The application must include certain information including a description of the size and nature of the proposed transactions and information that will demonstrate that the proposed transactions are bona fide hedging transactions. The Exchange does not have a rule that provides a hedge exemption application process for the HRSW futures contract. MGEX informed the Division that the Exchange did not receive any hedge exemption requests during the target period and such a request would be rare. The Exchange should consider adopting a hedge exemption application process in the Exchange’s rulebook for the HRSW futures contract. Without such a process, there is no way for a market participant to request an exemption.</p>	<p><u>Recommendation</u></p> <p>The Exchange should consider adopting a hedge exemption application process in the Exchange’s rulebook for the Hard Red Spring Wheat futures contract.</p>
<p>§ 38.158 Investigations and investigation reports</p> <p>(a) Procedures. A designated contract market must establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation must be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the designated contract market that indicates a reasonable basis for finding that a</p>	<p><u>Investigation Procedures</u></p> <p>A&I opens a formal investigation, after the CRO’s approval, whenever daily market surveillance, a customer or trader complaint, or a Commission referral indicates the possibility of a violation of Exchange rules, the Commodity Exchange Act, or Commission regulations. When an investigation is initiated, it is assigned a file reference number and additional information relevant to the investigation is entered into a computerized database, including among other things, the start date of the investigation, individual(s) or entity(ies) under investigation, the investigator assigned to the investigation, source of the investigation, potential rule violation(s), and a short summary</p>	<p><i>See below, under “Conduct of Investigations” for a recommendation related to documentation for investigations.</i></p>

<p>violation may have occurred or will occur.</p> <p>(b) Timeliness. Each compliance staff investigation must be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.</p> <p>(c) Investigation reports when a reasonable basis exists for finding a violation. Compliance staff must submit a written investigation report for disciplinary action in every instance in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report must include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.</p> <p>(d) Investigation reports when no reasonable basis exists for finding a</p>	<p>explaining why the investigation was initiated.</p> <p>A&I reviews material from the underlying investigation or complaint. Additionally, A&I collects and analyzes other relevant data, including trade data, audit trail information, and/or the various computer-generated data from the DMSL. Information is also collected from market participants through document requests and interviews are conducted with the relevant individual(s) or entity(ies) under investigation.</p> <p>All information pertinent to an investigation is maintained in a physical file folder. The folder includes staff work product, correspondence, documentation of interviews, reports related to the investigation, and documents and/or exhibits supporting any allegations noted during an investigation. The Exchange maintains computer-generated documents such as interview requests and interview summaries in an electronic file.</p> <p><u>Investigation Disposition</u></p> <p>Investigations are closed by a staff investigator subject to review by a peer investigator and the CRO for final review. An individual from the Exchange's Legal Department may also be asked to review an investigation before it is closed. When A&I concludes that no reasonable basis exists for finding a rule violation, the investigation is closed with no action. If A&I is unable to determine whether a reasonable basis exists for finding a rule violation, A&I will refer the matter to the Disciplinary Committee for review. Where rule violation(s) are found and A&I seeks to impose a sanction greater than a warning letter or summary fine, the investigation is referred to the Disciplinary Committee. In all cases when investigations are closed, A&I prepares an investigation report which includes the reason(s) the investigation was initiated,</p>	
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<p>violation. If after conducting an investigation, compliance staff determines that no reasonable basis exists for finding a violation, it must prepare a written report including the reason(s) the investigation was initiated; a summary of the complaint, if any; the relevant facts; and compliance staff's analysis and conclusions.</p> <p>(e) Warning letters. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.</p>	<p>a summary of the complaint and any rules potentially violated, the relevant facts, and A&I's conclusions.</p> <p><u>Closed Investigations</u></p> <p>The Division reviewed a total of 12 market surveillance investigations, including all 11 investigations that were closed by the Exchange during the target period, and one investigation that was opened during the target period and closed after the target period.</p> <p>Of the 12 closed investigations (some included more than one potential rule violation), five involved MGEX Rule 718.01. (Offsets and Transfer Trades in a Delivery Month), one involved MGEX Rule 1227.00. (Trading Session Submission), four involved MGEX Rule 2069.00. (Reporting Requirements and Sanctions), nine involved MGEX Rules 2100.00. (Method of Clearing) and 2101.00.C. (Reporting Deadlines), and one involved MGEX Rules 732.00. (Attempt to Upset Market Prohibited) and 733.00. (Fictitious Bids or Offers Prohibited).</p> <p>The results of the 12 closed investigations were: closed with no action (three); issuance of staff warning letters (two); staff summary fines (four); and referral to the Exchange's Disciplinary Committee (three).</p> <p><u>Timeliness of Investigations</u></p> <p>The 12 market surveillance investigations reviewed by the Division were all completed in a timely manner. Counting from the time each investigation was initiated and ending the date the investigation was closed (or, for investigations which were referred to the Exchange's Disciplinary Committee, the Disciplinary</p>	
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	<p>Committee referral date), the average length of time investigations were open was 76 days. Eight investigations were closed in 90 days or less and four investigations were open for at least 90 days but less than 179 days.</p> <p><u>Conduct of Investigations</u></p> <p>The Division reviewed the adequacy of the Exchange’s conduct in the 12 closed market surveillance investigations. The Division found the quality of the investigative work in the 12 investigations reviewed to be thorough and complete. A&I investigators adequately collected, reviewed, and analyzed relevant data. In addition, the Division found that the Exchange’s decisions whether or not to pursue disciplinary action were appropriate.</p> <p>The Division also found that the Exchange generally maintains adequate documentation of their investigations, including pertinent underlying trade documents, correspondence and interviews, computer reports, analysis of the activity examined, and investigation reports. However, in the investigation closed after the target period, the Division found that the A&I did not fully document its analysis in either the investigation report or investigation file. First, A&I did not document a complete trade reconstruction of the market activity surrounding the trade in question (e.g., active bids, offers, status of the order book). Instead, A&I only provided the daily price statistics and related-orders activity. Second, A&I neglected to indicate whether the “related-orders” were the only active orders before and at the time of the trade in question. Third, A&I did not include the ANPAR that A&I staff used to verify the conflicting nature of the account identified as a Customer Type Indicator Code 4 (i.e., customer) on the order details and as a house account on delivery-related documents. Such documentation is necessary for the Division to</p>	<p><u>Recommendation</u></p> <p>The Exchange should take appropriate measures to ensure that all market surveillance investigations are well-documented.</p>
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	<p>assess the sufficiency of the Exchange's investigation and whether closing the investigation with no action was appropriate.</p> <p><u>Warning Letters</u></p> <p>The Exchange issued warning letters to two respondents based on investigations closed during the target period for violating MGEX Rule 718.01. (Offsets and Transfer Trades in a Delivery Month). In its review of these warning letters, the Division found no instances in which the Exchange issued warning letters to the same person or entity for committing the same rule violation within a twelve month period.</p>	
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