UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of:	)	
Velocity Futures LLC,	)	**CFTC Docket No. 13 – 28**
Respondent.	)	

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

I.

The Commodity Futures Trading Commission ("Commission") has reason to believe that for 264 days between June 16, 2011 and March 6, 2012 (the "Relevant Period"), Velocity Futures LLC ("Velocity" or "Respondent") violated Section 4f(b) of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 6f(b) (2006), and Commission Regulation 1.17, 17 C.F.R. § 1.17 (2013). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Velocity has engaged in the violations as set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of this administrative proceeding, Respondent has submitted an Offer of Settlement of Respondent ("Offer"), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions ("Order") and acknowledges service of this Order.[1]

[1] Respondent consents to the entry of this Order and the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party provided, however, that Respondent does not consent to the use of the Offer, or the findings or conclusions consented to in this Order, as the sole basis for any other proceeding brought by the

III.

The Commission finds the following:

A. Summary

Velocity is a registered futures commission merchant ("FCM") located in Houston, Texas. Velocity enters orders and executes trades on a variety of designated contract markets through other FCMs on behalf of retail clients. Velocity is wholly owned by its parent corporation, VFT Holdings LLC ("VFT"). At the times pertinent to the facts stated in this Order, the sole member of VFT with voting rights on management issues, and the sole managing member of VFT, is Velocity's Chief Executive Officer ("Velocity's CEO").

During the Relevant Period, Velocity improperly accounted for liabilities arising out of two adverse arbitration awards, including the subsequent settlement of those awards, and a cash infusion from its sole owner, VFT. After restating its books to properly account for these events, Velocity failed to meet its adjusted minimum net capital requirements as set forth in Section 4f(b) of the Act, 7 U.S.C. § 6f(b) (2006), and Commission Regulation 1.17, 17 C.F.R. § 1.17 (2013), on 264 days during the Relevant Period.

B. Respondent

Velocity is a registered FCM with its headquarters located at Houston, Texas. Velocity has been continuously registered with the Commission as an FCM since 2002.

C. Facts

On June 16, 2011, the National Futures Association ("NFA") issued two arbitration awards totaling $2.5 million jointly and severally against Velocity and Velocity's CEO in favor of foreign claimants ("the Awards"). Velocity negotiated a purported release of Velocity that required either Velocity's CEO or Velocity to pay $1 million to claimants by July 8, 2011 and additional monthly payments totaling another $1 million.

On July 6, 2011, Velocity, Velocity's CEO, and the claimants executed a settlement agreement ("the Settlement Agreement"). The Settlement Agreement released Velocity from all liability for the Awards in exchange for (1) a $1 million payment to be made on the same date as execution, either from Velocity's CEO or Velocity and (2) 24 monthly payments of $45,455.67 from Velocity's CEO ("the Deferred Payments"). On July 6, 2011, Velocity made a payment of $1 million to the claimants. On the same day, Velocity received an $800,000 cash

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

contribution from VFT[2] and treated that cash contribution as an increase in the existing subordinated loan from VFT to Velocity. This existing subordinated loan was governed by a 2007 subordinated loan agreement ("the SLA") that was scheduled to mature in 2010 but which instead was in forbearance. The SLA was not approved as a revolving subordinated loan by the NFA and did not have the necessary provisions to qualify as a revolving subordinated loan.[3]

The Velocity LLC agreement provided for members, managers and officers to obtain indemnification for losses incurred in connection with Velocity's business. Subsequent to entering into the Settlement Agreement, Velocity's CEO began seeking indemnification pursuant to the Velocity LLC agreement for each of the monthly payments he was to make to the claimants. On July 13, 2011, at Velocity's CEO's direction and order, Velocity paid to the settling claimants the full amount of Velocity's CEO's first monthly payment of 45,455.67. Velocity booked the payment as an ordinary business expense. Subsequently, until March 2012, (1) Velocity made all monthly payments on behalf of Velocity's CEO, (2) Velocity's CEO requested indemnification for these payments pursuant to the indemnification provision in Velocity's LLC agreement, and (3) each request was approved by a resolution of Velocity's parent company, VFT, and signed by Velocity's CEO in his capacity as the managing member of the parent company.

During its on-site audit in 2011, NFA discovered deficiencies in the SLA. In particular, the SLA had been in forbearance since 2010, NFA had not approved a new subordinated loan agreement and the initial SLA was not approved as a revolving subordinated loan. NFA informed Velocity that the July 2011 cash payment should be treated as an increase in paid-in capital from VFT, which would have the same effect as a subordinated loan on Velocity's adjusted net capital position, namely to increase the assets but not the liabilities of Velocity. Subsequently, NFA determined that the improper subordinated loan was simply a loan between VFT and Velocity and therefore needed to be booked as both an asset and a general liability, which together did not serve to increase Velocity's adjusted net capital position. Consequently, at NFA's direction, on February 21, 2012 Velocity restated its books to show the $600,000 cash contribution as both an asset and a liability rather than a subordinated loan.

In late February, 2012, NFA reviewed the indemnification resolutions between VFT and Velocity's CEO. NFA determined that because Velocity was liable to indemnify Velocity's CEO for any payments he made to the claimants, Velocity's failure to accrue a liability in connection with such future indemnification payments was not acceptable to the NFA. Consequently, on March 6, 2012 Velocity restated its books to show a liability on June 16, 2011 for $2 million for the Awards, which included the $1 million payment made by Velocity on July 6, 2011 as well as the Deferred Payments to be made by Velocity's CEO. On March 6, 2012,

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[2] The $800,000 increase in subordinated debt was subsequently reduced to a $600,000 increase due to a $200,000 repayment from Velocity to VFT.

[3] For instance, the SLA did not include a provision that allowed for periodic advances or that no advance would be made within 3 years of the maturity date. Commission Regulation 1.17(d)(1), 17 C.F.R 1.17(d)(1) (2013).

Velocity's CEO paid the remaining amounts owed under the Settlement Agreement and executed a release of any and all rights of indemnification from Velocity related to the Awards and Settlement Agreement. As a result of the restatements required by the NFA, Velocity's books showed it failed to meet its minimum capital requirements from June 16, 2011 to March 6, 2012.

Velocity has cooperated fully with Division of Enforcement staff throughout the course of its investigation.

IV. LEGAL DISCUSSION

A. Velocity Failed to Meet its Minimum Financial Requirements

The Act and Commission Regulations set forth minimum financial requirements for FCMs. Once Velocity properly accounted for the cash payment from VFT and the Awards, including the Deferred Payments under the Settlement Agreement, Velocity failed to meet the minimum financial requirements as set forth in the Act and Commission Regulations.

Pursuant to Section 4f(b) of the Act, 7 U.S.C. § 6f(b) (2006), "no person desiring to register as futures commission merchant shall be so registered unless he meets such minimum financial requirements as the Commission may by regulation prescribe as necessary to insure his meeting his obligations as a registrant, and each person so registered shall at all times continue to meet such prescribed minimum financial requirements . . . ."

Commission Regulation 1.17(a)(1)(i), 17 C.F.R 1.17(a)(1)(i) (2013) delineates an FCM's adjusted net capital requirements as the greater of $1,000,000 or various other measures inapplicable to Velocity. Consequently, at all relevant times, Velocity was required to maintain adjusted net capital of $1,000,000.

1. <u>The July 6, 2011 cash payment from VFT was not made pursuant to a proper subordinated loan agreement and, consequently, did not increase Velocity's minimum capital</u>

Commission Regulation 1.17(c)(4)(i), 17 C.F.R 1.17(C)(4)(i) (2013) provides that satisfactory subordination agreements, as defined in Commission Regulation 1.17(h), 17 C.F.R 1.17(h) (2013) can be excluded from the liabilities of a registrant when determining compliance with their minimum net capital requirement set forth in Commission Regulation 1.17(a)(1)(i), 17 C.F.R 1.17(a)(1)(i) (2013). A subordinated loan agreement can be "revolving"—allowing for a maximum amount of credit that may be borrowed in advance as the need arises during the term of the agreement. However, the SLA did not contain the appropriate provisions to qualify as a revolving subordinated loan, and was not approved as such.

Because the July 6, 2011 cash payment from VFT to Velocity was not made pursuant to an approved revolving subordinated loan agreement, it should have been treated as a loan between the two companies and not counted towards Velocity's minimum capital requirement.

2. Velocity should have accrued a liability for the Awards on June 16, 2011.

A registered FCM is required to accrue for its liabilities in conformity with generally accepted accounting principles ("GAAP"). Commission Regulation 1.17(c)(4), 17 C.F.R 1.17(c)(4) (2013). Pursuant to GAAP, a contingent liability must be accrued when the amount of loss can be reasonably estimated and it is probable that a liability has been incurred. *See* Financial Accounting Standards Board Codification Section 450-20-25. There is no question that Velocity could reasonably estimate the amount of the Awards, and subsequently the Deferred Payments under the Settlement Agreement, as these amounts were specifically delineated.

Further, it was probable that Velocity would ultimately pay the Awards, including the Deferred Payments, pursuant to Velocity's CEO's right of indemnification. Velocity's CEO first requested indemnification only one week after the Settlement Agreement was signed. Subsequently, Velocity made all of the Deferred Payments on behalf of its CEO. Further, because Velocity's CEO was the sole owner of VFT, Velocity's parent corporation, it was apparent that all of his requests for indemnification would be granted. In fact, Velocity actually made all of the Deferred Payments directly to the claimants, and Velocity's CEO's requests for indemnification were perfunctorily granted by VFT resolutions signed by Velocity's CEO.

Because both of the GAAP conditions for accrual of a contingent liability were met, a liability for the Awards was required to be accrued on June 16, 2011.

3. Once Velocity properly accounted for the cash payment from VFT and the Awards, it did not meet its minimum financial requirements.

Once Velocity restated its financial statements to reflect the Awards, including the Deferred Payments, as company liabilities and the cash payment from VFT as a debt in addition to an asset, Velocity was under its minimum capital requirement for 264 days.

V. FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that, during the Relevant Period, Velocity violated Section 4f(b) of the Act, 7 U.S.C. § 6f(b) (2006), and Commission Regulation 1.17, 17 C.F.R. §1.17 (2013).

VI. OFFER OF SETTLEMENT

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

A. Acknowledges receipt of service of this Order;

B. Admits the jurisdiction of the Commission with respect to all matters set forth in this

Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;

C. Waives:

1. the filing and service of a complaint and notice of hearing;

2. a hearing;

3. all post-hearing procedures;

4. judicial review by any court;

5. any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer;

6. any and all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. §504 (2006) and 28 U.S.C. §2412 (2006), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1-30 (2012), relating to, or arising from, this proceeding;

7. any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and

8. any claims of Double Jeopardy based on the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;

D. Stipulates that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Velocity has consented in the Offer;

E. Consents, solely on the basis of the Offer, to the Commission's entry of this Order that:

1. makes findings by the Commission that Velocity violated Section 4f(b) of the Act, 7 U.S.C. § 6f(b) (2006), and Commission Regulation 1.17, 17 C.F.R. §1.17 (2013);

2. orders Velocity to cease and desist from violating Section 4f(b) of the Act, 7 U.S.C. § 6f(b) (2006), and Commission Regulation 1.17, 17 C.F.R. §1.17 (2013);

3. orders Velocity to pay a civil monetary penalty in the amount of three hundred thousand dollars ($300,000), within ten (10) days of the date of entry of this Order, plus post-judgment interest; and

4. orders Velocity and its successors and assigns to comply with the conditions and undertakings consented to in the Offer and as set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept the Offer.

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

A. Velocity shall cease and desist from violating Section 4f(b) of the Act, 7 U.S.C. § 6f(b) (2006), and Commission Regulation 1.17, 17 C.F.R. §1.17 (2013).

B. Velocity shall pay a civil monetary penalty in the amount of three hundred thousand dollars ($300,000), within ten (10) days of the date of the entry of this Order (the "CMP Obligation"). If the CMP Obligation is not paid in full within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2006). Velocity shall pay the CMP Obligation by electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than electronic funds transfer, the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
Attn: Accounts Receivables – AMZ 340
E-mail Box: 9-AMC-AMZ-AR-CFTC
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone: (405) 954-5644

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

C. Velocity and its successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:

1. Public Statements: Velocity agrees that neither it nor any of its successors and assigns, agents or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Velocity's: (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Velocity and its successors and assigns shall undertake all steps necessary to ensure that all of its agents and/or employees under its authority or control understand and comply with this agreement.

D. Partial Satisfaction: Velocity understands and agrees that any acceptance by the Commission of partial payment of Velocity CMP Obligation shall not be deemed a waiver of its obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.

E. Change of Address/Phone: Until such time as Velocity satisfies in full its CMP Obligation as set forth in this Order, Velocity shall provide written notice to the Commission by certified mail of any change to its telephone number and mailing address within ten (10) calendar days of the change.

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

By the Commission

Melissa Jurgens
Secretary of the Commission
Commodity Futures Trading Commission

Dated: August 26, 2013