

**RULE ENFORCEMENT REVIEW
OF THE
MINNEAPOLIS GRAIN EXCHANGE**



**Division of Market Oversight
September 16, 2004**

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RULE ENFORCEMENT REVIEW OF THE MINNEAPOLIS GRAIN EXCHANGE

I. INTRODUCTION

The Division of Market Oversight (“Division”) has completed a rule enforcement review of the market surveillance, audit trail, trade practice surveillance, disciplinary, and dispute resolution programs of the Minneapolis Grain Exchange (“MGEX” or “Exchange”) for compliance with related core principles under Section 5(d) of the Commodity Exchange Act (“Act”), as amended by the Commodity Futures Modernization Act of 2000 (“CFMA”), and Part 38 of the Commission’s regulations.¹ The review covers the period of December 1, 2002 through December 1, 2003 (“target period”).

The core principles focused on in the review include Core Principle 4, *Monitoring of Trading*, which relates to an exchange’s program to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process; Core Principle 5, *Position Limitations or Accountability*, which relates to an exchange’s program for enforcing its speculative position limits and position accountability rules; Core Principle 10, *Trade Information*, which relates to an exchange’s audit trail program for the recording and safe storage of trade information in a manner which enables prevention of customer and market abuses and enforcement of exchange rules; Core Principles 2, *Compliance With Rules*, and 12, *Protection of Market Participants*,

¹ Rule enforcement reviews prepared by the Division are intended to present an analysis of an exchange’s overall compliance capabilities for the period under review. Such reviews deal only with programs directly addressed in the review and do not assess all programs. The Division’s analyses, conclusions, and recommendations are based, in large part, upon the Division’s evaluation of a sample of investigation and disciplinary case files, 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 address effectively all exchange rule violations or other deficiencies. Neither is such a review intended to go beyond the quality of the exchange’s self-regulatory systems to include direct surveillance of the market, although some direct testing is performed as a measure of quality control.

which relate to an exchange's program for enforcing its rules, conducting disciplinary proceedings, and protecting market participants from abusive practices; and Core Principle 13, *Dispute Resolution*, which relates to an exchange's alternative dispute resolution program for market participants. Appendix B to Part 38 provides acceptable practices for demonstrating compliance with these core principles.²

For purposes of this review, Division staff interviewed officials and staff from the Exchange's Department of Audits and Investigations ("A&I").³ The Division also reviewed numerous documents used by A&I in carrying out the Exchange's self-regulatory responsibilities. These documents included, among other things, the following:

- computer reports and other documentation used routinely for audit trail enforcement and market and trade practice surveillance;
- audit trail recordkeeping and trade practice investigation files;
- trade practice investigation, floor surveillance, and disciplinary logs;
- disciplinary case files;
- minutes of disciplinary committee and Board of Directors ("Board") meetings held during the target period; and
- compliance procedures manual and guidelines.

The Division provided the Exchange an opportunity to review and comment on a draft of this report on August 26, 2004. On September 1, 2004, Division staff conducted an exit conference with MGEX officials to discuss the report's findings and recommendations.

² Appendix B to Part 38 of the Commission's regulations provides guidance concerning the core principles with which a designated contract market must comply to maintain its designation. In addition, Appendix B provides acceptable practices for several of the core principles. Although the acceptable practices establish non-exclusive safe harbors, they do not establish a mandatory means of compliance with the core principles. Appendix B provides acceptable practices for Core Principles 2, 10, 13, and 17. However, acceptable practices are not set forth for Core Principle 12. In promulgating Part 38, the Commission reserved the authority to adopt acceptable practices for Core Principle 12 at a later date.

³ A copy of the January 22, 2004 transcript of the interview can be found in Appendix 1.

II. SUMMARY OF FINDINGS AND RECOMMENDATIONS

A. Market Surveillance

Findings

- MGEX maintains an adequate market surveillance program. The Exchange conducts daily market surveillance to identify possible price manipulation or distortion and to ensure orderly liquidation of expiring contracts.
- The Exchange monitors volume and open interest, the relationship between cash and futures prices, spread and basis relationships, size and ownership of deliverable supply, and the size of large trader positions relative to total open interest and deliverable supply. Exchange staff also monitor the bona fides of EFP transactions.

The Division has no recommendations in this area.

B. Audit Trail

Findings

- MGEX maintains an adequate audit trail program. MGEX's audit trail includes a record of all trade data for open outcry trades in the form of order tickets, trading cards, and computer storage of all data entered into the Exchange's clearing system. For trades on MGEXpress, the Exchange's electronic trading platform during the target period, the audit trail includes a complete electronic record of all entries into the matching engine.
- MGEX's members manually record the time of execution of open outcry trades to the nearest minute. Exchange staff use a computerized verification program to monitor and enforce compliance with trade timing requirements. During the target period, Exchange members maintained an average open outcry trade timing accuracy rate of approximately 96 percent.
- Audit trail reviews of each member's compliance with MGEX recordkeeping rules are typically conducted once each year, and the reviews conducted during the target period found high rates of compliance with recordkeeping requirements. However, floor members who do not trade on the date selected for review may escape inclusion in such reviews.

Recommendation

- **The Exchange should identify the floor members not included in its annual audit trail reviews of clearing members, and implement supplementary review procedures which ensure that the trading cards and order tickets of those floor members are reviewed within a reasonable period of time.**

C. Trade Practice Surveillance

Findings

- MGEX maintains an adequate trade practice surveillance program. In order to identify instances of potential trade practice violations that require further inquiry or investigation, Exchange staff conduct daily review of computer-generated exceptions and conduct daily floor surveillance.
- MGEX closed 35 investigations during the target period, six of which involved potential substantive trade practice violations. With one exception, the Exchange's trade practice investigations were thorough. All investigations were well documented, included appropriate analyses, and were completed in a timely manner.
- In one investigation concerning potential wash trading, the Exchange reviewed 14 trades listed in an exception report for one trading day, but did not expand its investigation to include additional trading days in order to determine whether a pattern of potential violations existed.

Recommendation

- **The Exchange should expand the scope of investigations to include additional trading dates when review of exception reports suggests the possibility of trading violations.**

D. Disciplinary Program

Findings

- MGEX maintains an adequate disciplinary program. Exchange disciplinary committees are convened whenever the Exchange determines at the conclusion of an investigation that charges should be brought against a member for rule violations. Exchange rules ensure due process for disciplinary hearings.

- No substantive trade practice matters were referred to disciplinary committees during the target period. MGEX referred 11 investigations involving non-substantive violations to disciplinary committees, imposing fines totaling \$14,325.
- MGEX's disciplinary process was less than timely with respect to approximately one third of the investigations it decided to forward to the Business Conduct Committee during the target period. In several instances, there were substantial delays in forwarding matters to the BCC, in issuing charges, or both.

Recommendation

- **The Exchange should ensure that investigations are presented to the appropriate disciplinary committee promptly after they are closed with a recommendation for disciplinary proceedings, and that charges are issued promptly.**

E. Dispute Resolution Program

Findings

- The Exchange maintains an adequate alternative dispute resolution program for market participants. One customer dispute was submitted to arbitration during the target period, and was handled in accordance with the Exchange's arbitration procedures.

The Division has no recommendations in this area.

III. COMPLIANCE STAFF

The Exchange's compliance staff is headed by the Vice President, Market Administration ("Vice President"), who joined MGEX in 1987, became Compliance Director in 1991, and assumed his current position in June 1997. The Vice President reports to the Exchange President and is responsible for the oversight and management of MGEX's market surveillance, audit trail, trade practice surveillance, financial surveillance and disciplinary programs. The Vice President oversees the three organizational components of the Exchange's staff, which are the Service Division, the MGEXpress Operations Department, and the Trading Floor Operations Department.

The Service Division consists of the Department of Audits and Investigations ("A&I"), which carries out the Exchange's market surveillance, trade practice surveillance, and audit trail programs. A&I is also responsible for financial surveillance and oversight of membership issues. The Department is headed by the Director of Surveillance, who reports to the Vice President. The Director joined MGEX in February 1991 as a staff investigator, and assumed his current position in March 2001. A&I's staff is comprised of two investigators who report to the Director of Surveillance. One investigator has been with the Exchange for approximately three years, and the other for approximately two years.⁴ Both investigators conduct market surveillance, trade practice surveillance, and financial surveillance, and are trained in all aspects of the Exchange's surveillance program.

The MGEXpress Operations Department is responsible for the operations of electronic futures and options trading, while surveillance of electronic trading is conducted by A&I. The

⁴ One staff investigator was hired in December 2000 as an Exchange Room Clerk and became a staff investigator in July 2001. The other staff investigator was hired in March 2001 as a Compliance Assistant and became a staff investigator in August 2002.

MGEXpress Department is headed by a Manager, who supervises two employees.⁵ The employees operate the help desk for the customer service center, assisting MGEXpress customers with issues such as direct access, connectivity and trading rights.

The Trading Floor Operations Department is headed jointly by two Managers, who share responsibility for supervising six full-time and part-time Exchange Room clerks. The clerks conduct surveillance of trading pit activity, prepare and distribute market data, report futures and options quotations, and assist with member services.

The Exchange appears to have adequate staffing levels to monitor its markets.

IV. MARKET SURVEILLANCE

A. Daily Surveillance Activities

A&I conducts daily market surveillance in order to identify possible price manipulation or distortion and ensure orderly liquidation of expiring contracts. All surveillance activities are recorded in the Daily Market Surveillance Log (“DMSL”). A&I monitors volume and open interest, the relationship between cash and futures prices, spread and basis relationships, size and ownership of deliverable supply, and the size of large trader positions relative to total open interest and deliverable supply.

During the target period, the Exchange’s total volume of 1,128,253 contracts was concentrated in its futures and options contracts for hard red spring wheat, which had a total volume of 1,057,945 futures and 44,301 options contracts. The Exchange de-listed its futures and options contracts for white wheat and durum wheat and its options contracts for European spring wheat on March 20, 2003, during the target period, due to low volume. Spring wheat is

⁵ The Manager of the MGEXpress Operations Department was hired in August 1994 as a staff investigator and assumed his current position in May 2002.

the only commodity for which the Exchange currently offers active contracts for trading by open outcry. In February 2002, the Exchange introduced electronic trading of two new cash-settled contracts, the National Corn Index (“NCI”) and National Soybean Index (“NSI”) via a new electronic trading system, MGEXpress. A third new contract, the Hard Winter Wheat Index (“HWI”) was added for MGEXpress trading in May 2003. During the target period, the total trading volume on MGEXpress was 26,006 contracts, including 5,908 NCI futures, 1,298 NCI options, 13,561 HWI futures, and 5,239 HWI options contracts. Trading on MGEXpress was suspended on July 2004, after the conclusion of the target period.

1. Volume And Open Interest

A&I reviews several computer-generated volume and open interest reports daily to analyze potential market congestion. The Open Share Of Market-Regular Report, Open Share Of Market-Segregated Report, MGEX Futures Trades And Open Positions Report, and MGEX Options Trades And Open Positions Report show the gross open positions for both customer and house accounts at each of the Exchange’s clearing members. A&I staff review these reports to detect potential problems or concentrations of positions with any one clearing member.⁶ Staff record the largest long and short positions in the nearby and nearest deferred month for each MGEX contract in the DMSL, and review this information daily along with the percentage of open interest held by each clearing member. Staff also consider external factors that may impact the market, such as economic news, weather, or domestic or foreign market crises. In addition, staff can consult MGEX’s historical data on volume and open interest by reviewing previous daily volume and open interest reports, which are saved in a database on the clearinghouse server.

⁶ Generally, A&I staff will review situations where a firm has 75% or more of the open market share in an expiring contract to determine if manipulation is likely or evident.

A&I staff also review all open contracts daily for any significant changes in clearing member open interest, defined as an increase or decrease of 30% or more in the total open interest in any contract month. Staff monitor such changes by reviewing the Volume and Open Interest By Commodity Report and Volume and Open Interest By FCM Report. These reports show, by clearing member and commodity, for each contract month or option strike price, the gross volume, deliveries and options exercises, delivery or exercise intentions, transfer trades and EFPs, and each member's ending long and short positions. When significant changes are detected, staff conduct further inquiry and analysis to ascertain the reasons for the change and the impact, if any, on the market.

2. Price Changes And Intermarket Relationships

To detect unusual price movements or aberrations in price relationships that could indicate an underlying problem, A&I conducts daily reviews of price changes and spread relationships. A&I staff record daily price ranges and settlement prices for all futures contracts traded on the Exchange. Each day, staff calculate and record changes in settlement prices by comparing the current day's settlement price with the previous day's settlement price, and calculate the spread differential by comparing the current day's settlement price in deferred months to the spot month settlement price for each commodity.

Staff monitor intermarket spread relationships by comparing daily price ranges and settlement prices for MGEX hard red spring wheat contracts to daily price ranges and settlement prices on the wheat markets of the Chicago Board of Trade ("CBOT") and Kansas City Board of Trade ("KCBT"), as well as to the daily price ranges and settlement prices for the HWI contract traded on MGEXpress. Similar monitoring of spread relationships for MGEX's electronically-traded NCI, NSI and HWI contracts is done by comparing daily price ranges and settlement prices for those contracts with daily price ranges and settlement prices for CBOT corn futures,

CBOT soybean futures and KCBT wheat futures, respectively. A&I staff also track changes in these spread relationships which may occur over time. If aberrations in relationships are found, A&I staff investigate to determine possible reasons for the discrepancies and evaluate the effect on the market and the nearby contract month. No significant price abnormalities were noted in any MGEX market during the target period.

In addition to monitoring price movements and spread relationships for wheat futures and options, A&I staff also monitor cash grain prices collected by the U.S. Department of Agriculture, which are displayed on the Exchange's web site. A&I also monitors news which could affect prices and spread relationships. For this purpose, staff regularly consult a variety of online news services, including Ag Online and Agriculture.com, DTN, Reuters, and Future Source.

3. Deliverable Supplies

A&I monitors deliverable supply for the Exchange's hard red spring wheat contract, its only active contract involving delivery, through the weekly Stocks of Grain Report prepared by the Exchange. This report details the deliverable, non-deliverable (including ungraded), and Commodity Credit Corporation ("CCC") stocks of grain held in Exchange-approved warehouses for the Minneapolis-St. Paul-Red Wing, Minnesota, and the Duluth-Superior, Minnesota, switching areas, which are the delivery points for the spring wheat contract. For comparative purposes, the report also includes figures from the previous week and for the same week during the previous year. A&I staff prepare the report as of each Friday, using data compiled from required reports submitted by grain elevator operators on MGEX Form 38M, and the Exchange releases the report the following Tuesday.

If significant changes in deliverable supply are observed, such as a variance of ten percent up or down, A&I staff contact the cash market participants involved to verify the

accuracy of the supply information and the reason for the change. A&I also monitors reports disseminated by the Port of Duluth-Superior concerning outgoing tonnage of grain shipped from the port, and reports concerning rail shipments of grain to the three delivery points. These reports are monitored weekly on a routine basis, and daily during contract expiration months.

Each licensed public grain warehouse in the two switching districts is also required to transmit a weekly report of all grain stocks to the MGEX Weighing Department. The Weighing Department compiles the information submitted into one report, which it shares with A&I. A&I compares this information with the Stocks of Grain Report in order to detect any significant discrepancies. No significant discrepancies were identified during the target period.

4. Heightened Surveillance Of Expiring Contracts

A&I intensifies surveillance of expiring contracts in an effort to facilitate orderly liquidations. The heightened surveillance typically begins when a futures contract becomes the nearby contract, or on the first day of the month prior to the month in which an option contract expires.⁷ During the target period, all MGEX futures and options contracts were liquidated in an orderly manner.

Surveillance of expiring contracts focuses on close monitoring of the size of large trader positions relative to total open interest, size and ownership of deliverable supply, and the positions of other large traders. A&I reviews the Open Share Of Market Report and Volume And Open Interest By FCM Report for potential concentrations of positions among clearing members. Staff closely monitor the three largest long and short position holders in the nearby futures month. If a clearing member has 75 percent or more of the open market share in an expiring contract, A&I will generally contact the clearing member to determine the intentions of

⁷ For example, increased surveillance of the December 2003 spring wheat futures contract began in the last week of September 2003 when the September 2003 spring wheat futures contract expired, and enhanced surveillance of the December 2003 spring wheat option contract began on November 1, 2003.

the clearing firm's customers, and to ensure that customers with short positions are capable of making deliveries.

Staff also identify position holders and evaluate their ability to make or take delivery through review of the Account Name Position Analysis Report, which lists reportable position holders by name, account number(s), net position and percentage of market held, for each contract and contract month. This report is routinely generated and reviewed each week. To determine whether there is an adequate supply of grain with dispersed rather than concentrated ownership, and to review whether concentrated ownership could make the market susceptible to manipulation, A&I also compares open interest in expiring contracts with MGEX's weekly Stocks of Grain Report.

To heighten review of expiring options, A&I reviews the Delta Position Large Trader Report on a weekly basis and more frequently, when needed. The report lists all options traders holding reportable options positions, setting forth the number of options held by each trader, the nature of the position (long or short, put or call), the designation of commercial or noncommercial use, the carrying FCM, the CFTC reportable ID number, the delta, and the futures equivalent.⁸ The report allows A&I to monitor the largest options holders for both house and customer accounts.

A&I tracks exercise of options through the Exercise Trade Register Report, which lists options positions exercised on the prior business day. This report details the clearing member, premium, quantity bought or sold, and the exercise dollar amount. Exercise information is also available through the Report of Exercises published daily by the clearinghouse, which lists each clearing member's exercised options positions. The clearinghouse sends an Options Expiration

⁸ An options delta represents the amount an option's premium will change for a given change in the underlying futures price. The futures equivalent of an options position is equal to the gross open interest times the delta.

Reminder memo to each clearing member about a week prior to expiration, in order to remind clearing members of the requirements for options expiration. Pursuant to MGEX Regulations, the clearinghouse automatically exercises in-the-money options, unless notice to cancel automatic exercise is given by the carrying clearing member to the clearinghouse. Each clearing member also receives the In-The-Money Report Summary, which details for each in-the-money option the FCM code, the name of the house or customer holding the option, the number of long or short contracts held, and the settlement price of the expiring contract. A&I verifies that the clearinghouse received a written notification from the carrying clearing member in the event that an in-the-money option is not automatically exercised.

B. Large Trader Reporting And Speculative Limit Enforcement

A&I monitors reportable futures and options positions by reviewing the Account Name Position Analysis Report and the Delta Position Large Trader Report, which list each reportable account and position by clearing member. A&I staff also receive a report of reportable positions in futures and options via encrypted email from the Commission's Kansas City office on a weekly basis, and can request additional updates when needed.⁹ A&I uses all of these reports to monitor the activity of large traders and identify possible position concentrations that could disrupt the market.

The majority of MGEX market participants are agribusiness firms that utilize MGEX contracts for hedging purposes. Other market participants who engage in speculative trading rarely, if ever, approach the speculative limits for futures or options positions. However, A&I staff monitor clearing members' open positions for potential speculative limit violations by reviewing the Open Share Of Market reports for futures contracts and the Delta Position Large

⁹ The Commission's large trader reporting system uses data filed by FCMs and clearing firms under Parts 16 and 17 of the Commission's Regulations.

Trader Report for options contracts. No individual accounts approached speculative limits during the target period. Should a speculative limit violation be detected, an investigation will be initiated and the matter referred to a disciplinary committee for further review and possible action.

C. Monitoring Of EFP Transactions

Exchange rules permit the exchange of futures for physical commodities (“EFPs”), at prices mutually agreed to by the two parties to the transaction.¹⁰ EFPs executed on MGEX are typically used by commercials who have hedged their cash positions in the futures market. During the target period, EFPs at MGEX involved 152,821 spring wheat futures contracts, or more than 14% of the Exchange’s total spring wheat futures volume. Trade data for EFP transactions are submitted to the clearinghouse and must include the clearing member, price, quantity, commodity, contract month, and the appropriate symbol identifying the trade as an EFP.

A&I reviews EFPs during its annual audit trail reviews of each clearing member. As part of each audit trail review, A&I staff request the underlying documents for all EFPs transacted by the clearing member, such as confirmations, invoices and warehouse receipts, and reviews them to verify that the transactions are bona fide and that the necessary cash transaction documentation exists. A&I retains copies of the documents in its audit trail review file.

A&I also reviews EFPs in conjunction with its daily review of the Exchange’s trade register, the Time Audit Report (“TAR”), for possible trading violations. A&I staff look for EFPs with unusual characteristics that may warrant investigation, such as EFPs that show the same account on both sides, involve unusual large quantities, or are priced outside the daily

¹⁰ MGEX Rules 719.00 and 2057.00. Under these rules, if the price for an EFP is not mutually agreed to by the date of shipment, the cash grain buyer has the option to set the price within that day’s trading range.

trading range. If irregularities are found, A&I will contact the clearing member or account owner to request documentation verifying the bona fides of the EFP.

Under both of these procedures for review of EFPs, A&I found no EFPs that warranted investigation during the target period. Division staff reviewed A&I's files concerning examination of EFPs during audit trail reviews and also found no EFP irregularities. The files contained copies of appropriate underlying documents, and investigation reports reflected A&I's findings.

D. Conclusions And Recommendations

The Division found that MGEX maintains an adequate market surveillance program. The Exchange conducts daily market surveillance to identify possible price manipulation or distortion and to ensure orderly liquidation of expiring contracts. In so doing, the Exchange monitors volume and open interest, the relationship between cash and futures prices, spread and basis relationships, size and ownership of deliverable supply, and the size of large trader positions relative to total open interest and deliverable supply. Exchange staff also monitor the bona fides of EFP transactions. The Division has no recommendations in this area.

V. AUDIT TRAIL PROGRAM

A. Recording of Trade Data

1. Open Outcry Orders

At MGEX, customer orders for open outcry trading are recorded on order tickets prepared by clearing member staff. Each order ticket must include an account identifier and order number, and be timestamped upon receipt of the order.¹¹ Upon execution, the broker

¹¹ MGEX Rule 756.00.

records the essential trade data on the order ticket and returns it to the clearing firm's desk on the trading floor, where it is timestamped again.¹²

MGEX floor members record transactions for their own accounts on double-sided, pre-printed, sequenced trading cards, with buys on one side and sells on the other. For each trade, the trading card must contain essential trade matching data and the transaction time to the nearest minute.¹³ Members must record purchases and sales in non-erasable ink, in exact chronological order of execution, on sequential lines of the trading card without skipping lines between trades and must cross out any remaining lines on the trading card. Opening and closing periods must also be identified. Trading cards are collected by clearing members within 15 minutes of each designated 30-minute trading interval.

Clearing members submit trade data from order tickets and trading cards to the MGEX clearinghouse through the Exchange's automated Trade Data Entry And Matching System ("TEMS"), by keying the data into TEMS computer terminals located in clearing firm booths on the trading floor. Trade data must be entered into TEMS within 45 minutes of the conclusion of each 30-minute interval.¹⁴

¹² In some instances, an independent broker may record the fill of a customer order on his or her trading card rather than on the order ticket. When this occurs, the broker turns in the trading card and the order ticket involved (which are normally cross-referenced to each other) to the clearing member at the same time.

¹³ The trade data required include the commodity, quantity, date, identity of the executing and opposite brokers, contract month, and price (or, in the case of spreads, the differential). For option trades, the trading card must also show the premium and a put/call indicator. See MGEX Rule 2062.00.

¹⁴ MGEX Resolution 2101.00.C.

2. MGEXpress Orders

Orders for electronic trading on MGEXpress can be entered only by authorized clearing members.¹⁵ Customers wishing to place orders for electronic trading may do so by submitting the order to a clearing member by telephone or otherwise. Clearing member staff can enter orders into MGEXpress only after logging on to an MGEXpress terminal and entering a unique user identification as well as a password. If an order cannot immediately be entered into the trading system, the member must prepare a written order ticket containing the terms of the order, the account identifier, and required timestamps. Customer orders must be entered before orders are placed for accounts in which the member has a personal, financial or proprietary interest.¹⁶

MGEXpress matches all orders according to an algorithm which gives priority to orders at the best price and to orders with the same price according to the time they were entered into the system.¹⁷ The trading system automatically records all keystrokes entered and the time of their entry. This information is maintained on the LogB record and provides the Exchange with a complete audit trail of each transaction. The time of each transaction recorded into the system cannot be altered and no order can be erased from the LogB record. Although an order may be cancelled or changed, the original order is always retained and the trading system records the identification of the MGEX authorized user making changes or canceling the order.

B. Trade Timing For Open Outcry Trades

MGEX requires the floor brokers on both the buy and sell sides of each transaction to record the time of execution, to the nearest minute, on the brokers' trading cards (for personal

¹⁵ As stated earlier, MGEXpress was operational during the target period. Trading was suspended in July 2004.

¹⁶ MGEX Rule 1806.00.

¹⁷ Changes to an order which do not affect the conditions for the algorithm (including reduction of quantity and changes of validity time, open or close indicator, client or account identifier, and free text) are allowed without loss of priority in the order book. All other order modifications, such as an increase of quantity or change in price, are handled as a deletion of the existing order and an entry of a new order with a new order number and timestamp.

trades) or the order tickets involved (for all other trades).¹⁸ As noted earlier, this information is entered into TEMS by clearing member staff. The brokers on each side of a trade must also give immediate verbal notice of the price at which the trade has been executed to the Exchange's floor staff, who enter the reported trade price into MGEX's price reporting system. The system displays the price on the board above the pit and includes it in the Exchange's Time and Sales Report ("time and sales").

The Exchange monitors compliance with its requirement that trade times be accurate within one minute through daily automated review of its trade register, the TAR. The TAR details all trades in chronological order and contains time and sales data. It automatically compares the time reported for all cleared trades with the times listed in time and sales data, to determine whether the trade times submitted by clearing members from their trading records are verified by the prices and times of execution recorded in the time and sales.¹⁹

A&I reviews all trades listed in TAR exception reports concerning potential trade timing inaccuracies, in order to enforce MGEX's trade timing rules and to calculate the Exchange's trade timing accuracy rate. MGEX calculates trade timing accuracy for each side of a trade. If one side but not the other is flagged with an error code, the execution time of the side with the error code is deemed inaccurate and the time recorded by the error-free side is accepted as accurate. If an error code applies to both sides of a trade, both sides are counted as inaccurate.

¹⁸ MGEX Rules 2062.00 and 2063.00.

¹⁹ The TAR generates five timing error exception reports which identify execution times which may have been reported inaccurately. The five error codes are: Bought Side-No Trade ("BNT"), where no trade is indicated in time and sales data within one minute of the time recorded by the buyer; Sold Side-No Trade ("SNT"), where time and sales shows no trade within one minute of the time recorded by the seller; Time Out of Limits ("TOL"), where data comparison verifies the times recorded by both buyer and seller, but there is more than one minute between the two times; Bought Side-Untimed Trade ("BUT"), where a trade has cleared without a transaction time on the buy side; and Sold Side-Untimed Trade ("SUT"), where a trade has cleared without a transaction time on the sell side.

Each floor broker's timing error rates are recorded in the Broker Error Type Report ("BETR"). A&I reviews daily, weekly, and monthly data in the BETR to assess the accuracy of each member's manually-recorded execution times. If A&I finds that a member's trade timing error rate exceeds specified thresholds, A&I examines the underlying trade documents as well as the time and sales data and determines the "audited" error threshold.²⁰ The "audited" rate includes adjustments based on the cause of timing errors, such as keypunch errors by clearing member personnel or an error by the observer in recording the trade. If the audited error rate is found to be between two and five percent, the member is sent a reminder letter. If the audited error rate is between five and eight percent, the member is sent a warning letter. If the audited timing error rate exceeds eight percent, the matter may be forwarded to a disciplinary committee for disciplinary action.

The Exchange opened and closed two investigations based on timing error rate thresholds during the target period.²¹ In both investigations, the members involved were issued staff reminder letters. The limited number of investigations opened based on timing error rates can be attributed to a continued high rate of compliance by MGEX members in recording trade execution times. The Exchange's monthly timing accuracy rate for all spring wheat futures and options transactions combined during the target period was approximately 96 percent.²²

²⁰ On a daily basis, a member with an overall 20% timing error rate and at least 20 timing errors will be investigated unless the member is already the subject of an open investigation. On a monthly basis, a member with an overall 10% total timing error rate and at least 20 timing errors may be investigated. In addition, all trades cleared without trade times or which otherwise appear suspicious are investigated.

²¹ Investigations 03-I-08 and 03-I-18.

²² This accuracy rate is based on data provided by MGEX for all contracts on two representative trade dates for each month during the target period.

C. Floor Order Tickets And Trading Cards

MGEX conducts a yearly audit trail review of each clearing member to evaluate, among other things, compliance with the Exchange's order ticket and trading card recordkeeping requirements. A&I examines all of the clearing member's trading cards and order tickets for one randomly-selected trading day. If review of trade documents for the selected date discloses recordkeeping issues, A&I may expand the review to include other days.²³

A&I closed audit trail reviews of nine of its 13 clearing members during the target period, including four reviews opened prior to the target period and five opened during the target period.²⁴ A&I also opened four additional audit trail reviews during the target period which remained open at the end of the period.²⁵

In the course of the nine closed reviews, A&I examined a total of 315 order tickets prepared by the nine clearing firms and 125 trading cards prepared by 35 floor members whose trades were cleared by those firms on the dates selected for the reviews. These members accounted for 69 percent of the Exchange's total open outcry volume during the target period. As a result of these reviews, the Exchange issued 30 staff reminder letters for recordkeeping, submission, or timestamping deficiencies. In the four reviews still open at the end of the target period, A&I examined order tickets and trading cards for an additional five floor members not included among the 35 covered in the closed reviews. These five members accounted for an additional 20 percent of the Exchange's total target period open outcry volume.

²³ A&I also checks compliance with Exchange recordkeeping requirements by examining order tickets and trading cards requested in the course of trade practice investigations.

²⁴ The four closed investigations which were opened prior to the target period included Investigations 02-I-21, 02-I-22, 02-I-24 and 02-I-25. The five closed investigations which were opened during the target period included Investigations 02-I-28, 02-I-29, 02-I-30, 03-I-14, 03-I-16.

²⁵ Investigations 03-I-25, 03-I-27, 03-I-30, and 03-I 31.

Twenty of the 60 floor members who executed spring wheat futures and options trades at MGEX during the target period were not reviewed in the course of the audit trail reviews conducted during the target period because they had not traded on the dates selected for review. These 20 members accounted for 11% of the Exchange's open outcry volume. Because the Exchange's system of audit trail reviews of clearing members can result in some members not being reviewed for substantial periods, the Division believes that the Exchange should identify the members not included in its regular audit trail reviews, and implement supplementary review procedures which ensure that the trading cards and order tickets of those members are reviewed within a reasonable period of time.

In the nine closed audit trail reviews, A&I found a high rate of compliance with the Exchange's recordkeeping requirements. All order tickets examined contained account identification, and 99 percent (311) of the order tickets included both entry and exit timestamps. All trading cards were written in non-erasable ink, and 99 percent (123) had transactions recorded in sequence, had no skipped lines, and included the date, commodity, price, quantity and the put or call indicator where applicable. Ninety-two percent (115) of the trading cards properly identified opening and closing periods. In addition, all of the trading cards indicated the executing and opposite clearing firms, and 98 percent (122 cards) were collected by the clearing member within 15 minutes of the applicable 30-minute trading interval. Finally, 90 percent (112) of the trading cards were preprinted with members' identification and trading card sequence number, and had unused lines properly marked through.

The Division examined A&I's files for the nine reviews closed during the target period, and found that the reviews were thorough and well documented. Each file included an investigation summary, copies of original source documents, spreadsheets and workpapers

prepared by A&I staff detailing the findings of each transaction reviewed, an investigation report, and copies of staff reminder letters where applicable.

D. Safe Storage Capability

MGEX stores trade data for its open outcry trades in both electronic and hard copy form. Copies of each day's TAR, time and sales, and TEMS clearing data are stored on the clearinghouse's mainframe computer. The mainframe retains between one and two years' worth of these data on two duplicate computer disks, one of which serves as the active disk and the other as a back-up. The clearinghouse also has a back-up computer, housed in another part of the Exchange building, which stores approximately two years of trade data on a main disk and a back-up disk. A copy of each day's trade data in the clearinghouse computer is taken off-site each evening. In addition, each year's trade data is recorded on tape and stored in secure office space at the Exchange. MGEX also retains five years' worth of open outcry trade data in hard copy form, stored in a vault in the Exchange building.²⁶

For electronic trades, MGEXpress maintains a time-indexed record of all keystrokes entered into the trading system on each trading day in that day's Log B file. Copies of each day's Log B file are retained on a hard disk at a facility in New York maintained by OM Technology AB ("OM"), which operates MGEX's trading host under a contract with the Exchange. Incremental back-ups of MGEXpress trade data are made every night except on Fridays, when full back-ups are run. The full back-ups, which include all daily data back-ups for the week, are transferred weekly to an OM off-site storage facility in New Jersey, and retained for seven years.

²⁶ The clearinghouse has a vault for retaining hard copies of reports such as trade recapitulation sheets, position reports and exercise reports. A&I has a separate vault for retaining hard copies of reports such as the TAR and BETR.

E. Conclusions and Recommendations

The Division found that MGEX maintains an adequate audit trail program. The Exchange's program for enforcing compliance with its one-minute trade timing rule uses a computerized verification program to monitor and enforce timing compliance. During the target period, Exchange members maintained an average open outcry trade timing accuracy rate of approximately 96 percent.

The Exchange also has adequate procedures to assess and enforce member compliance with its order ticket and trading card recordkeeping requirements. The Exchange typically reviews each clearing member's compliance once each year, examining all order tickets and trading cards for one day. During the course of nine recordkeeping reviews closed during the target period, the Exchange found high rates of compliance with the Exchange's various recordkeeping rules. However, the Division also found that floor members who do not trade on the date selected for an audit trail review can escape inclusion in such reviews for substantial periods. For example, one very active member was not the subject of an audit trail review for at least three years.

Finally, the Division found that MGEX has adequate safe storage capability for its trade data. The Exchange retains five years' worth of open outcry trade data in both computerized and hard copy form, and retains seven years' worth of electronic trading data. Both open outcry and electronic trade data are stored offsite on computer disks.

Therefore, the Division recommends that the Exchange:

- **Identify the floor members not included in its annual audit trail reviews of clearing members, and implement supplementary review procedures which ensure that the trading cards and order tickets of those floor members are reviewed within a reasonable period of time.**

VI. TRADE PRACTICE SURVEILLANCE PROGRAM

A. Automated Surveillance System

MGEX's Time Audit Report and Broker Error Type Report serve together as the Exchange's automated trade practice surveillance system for identification of potential trading abuses. As stated previously, the TAR combines the details of all futures and options trades in chronological order with Exchange time and sales data. The TAR generates exception reports based on preset parameters that identify possible substantive trade practice abuses, such as wash trading or trading ahead.²⁷ The BETR lists all error codes generated by the TAR for each floor broker.

On a daily basis, A&I staff review all exception reports generated by the TAR, and review the BETR to look for patterns of exceptions concerning individual brokers. In addition to using the TAR and BETR, staff can also conduct customized searches of the historical trade data stored in the Exchange's clearinghouse computer database. Investigators can sort these data by broker or account number, focusing on any time period or error code desired. Pursuant to the guidelines in the Exchange's Compliance Manual, an inquiry is always conducted if ten percent of an individual broker's trades on any trading day, or five percent of a broker's trades during any month, appear on exception reports regarding potential substantive trade practice abuses.²⁸

A&I opens a formal investigation into instances of potential trade practice violations whenever an initial staff review of exception reports, an investigator's analysis of trade data, a floor surveillance observation, or an inquiry indicates that an investigation is warranted.

²⁷ The TAR generates exception reports identifying potential instances of the following: accommodation trading, wash trading, buyer or seller trading ahead, money pass, invalid ring trades, invalid spread trades, price above daily high, price below daily low, and post settlement trade errors.

²⁸ Inquiries are also conducted concerning trades without trade times, trades outside the day's trading range, trades outside the post settlement session trading limits, and EFPs transacted more than 20 cents outside the daily trading range.

Investigations are also opened for all customer or member complaints and all referrals by the Commission.

In each investigation, A&I reviews all trades by the members involved which were executed during the review period selected for the investigation.²⁹ Copies of all documents requested are maintained in the investigation file. If members or other witnesses are interviewed, an A&I staff member present at the interview prepares a written summary of what was said, which is also maintained in the investigation file.³⁰ At the conclusion of an investigation, A&I prepares an investigation report detailing the steps taken during the investigation and the reasons for A&I's determination concerning what action, if any, should be taken.

MGEX tracks the progress and timeliness of investigations in an investigation log maintained by A&I staff.³¹ The log lists for each investigation the investigation number, source (e.g., TAR review, audit trail review, or referral), date opened, date closed, staff assigned, completion deadline date, members investigated, rules which may have been violated, and actions taken as a result of the investigation.

B. Floor Surveillance

Automated surveillance is supplemented by floor surveillance. A&I staff conduct floor surveillance during the openings and closings of all contracts and at three randomly selected times during the trading session. One staff investigator is present on the trading floor five minutes prior to the open and remains on the trading floor five to 15 minutes after the open. If trading opens on a volatile note, the staff investigator may remain on the trading floor to monitor

²⁹ Staff also examine the trading documents obtained for recordkeeping compliance.

³⁰ Interviewees are afforded an opportunity to review the interview summaries and note any disagreement they may have with its contents. The Exchange does not record interviews, and the summaries do not constitute complete transcripts of the interviews.

³¹ Sample pages from the investigation log are attached in Appendix 2.

the trading until volume activity subsides. At the close, the staff investigator will be present on the trading floor approximately 15 minutes before the closing bell and will remain on the trading floor several minutes after the post-settlement session. When they conduct floor surveillance, investigators look for indications of, among other things, trades executed prior to the opening or after the close, disclosure of orders, noncompetitive trading, improper bidding or offering and transactions not executed by open outcry.

The Exchange documents floor surveillance in two logs. Floor surveillance activities are documented in the “market log,” which notes the date and time period when floor surveillance was conducted, prices and price changes, possible trading infraction observed, and current market conditions. The badge numbers of traders present on the trading floor during several one-minute time periods during the time floor surveillance is conducted are listed in the “pit population log.” This log can be used by A&I to verify who was on the floor at the time of a particular trade.³²

C. Adequacy of Investigations

The Exchange closed 35 trade practice investigations during the target period, including six opened prior to the target period and 29 opened during the target period. Eight additional investigations opened during the target period remained open at its conclusion. All 35 closed investigations, and seven of the eight investigations still open at the end of the target period, resulted from the Exchange’s surveillance programs. One of the open investigations resulted

³² During the target period, six non-substantive investigations were opened based on floor surveillance observations by A&I or trading floor staff. Investigation 03-I-26 resulted in a \$125 fine against a floor broker for use of an earpiece connected to a cell phone while in the trading pit, in violation of Exchange rules. Investigations 03-I-03, 03-I-04, and 03-I-05 resulted in issuance of letters of reprimand concerning violations of MGEX’s decorum and dress rules, and Investigation 03-I-22 resulted in a letter of reprimand for violation of Exchange rules regarding uncommercial conduct. Investigation 03-I-10 resulted in issuance of staff reminder letters to two members concerning appropriate behavior during the open and close.

from a Division referral.³³ Of the 35 closed investigations, 14 (40%) resulted from automated surveillance exceptions, 10 (29%) resulted from floor surveillance and referrals by Trading Floor Operations Department staff, nine (26%) resulted from routine audit trail reviews of trading cards and order tickets, and two (5%) resulted from review of clearinghouse delivery notices.

Six of the 35 closed investigations involved potential trade practice violations of a substantive nature, including noncompetitive trading, wash trading, prearranged trading, or trading ahead of customer orders. One of the eight investigations still open at the end of the target period also involved possible substantive trade practice violations. In addition, five investigations closed during the target period (including one of the six closed investigations into possible substantive violations) and one open investigation involved possible violations of the Exchange's transfer trade rules.

With one exception, the Division's review of the 35 closed investigations found that investigations were thorough. Investigators requested, obtained, and reviewed pertinent trading documents in a timely fashion, and made proper analyses. Each file contained a cover sheet summarizing the investigation, copies of relevant computer-generated reports, copies of trading records, workpapers, interview summaries (where applicable), past disciplinary history, an investigation report, and copies of disciplinary letters.

The investigation that was not sufficiently thorough concerned potential wash trading by a trader who entered 28 orders for several accounts.³⁴ The orders were matched against each other, some for the same account, which resulted in the trades appearing as possible wash trades on the Exchange's exception report. Upon identifying the trades, A&I did not expand its review to include trades for these accounts on additional days. Division staff did review additional

³³ No customer complaints were received during the target period.

³⁴ Investigation 03-I-20.

trading days and found a pattern of similar trades, which were subsequently referred to the Exchange. As a result of the referral, the Exchange opened a second, related investigation into the trades, which involved additional orders placed by the same trader and two additional traders.

A&I closed both investigations after concluding that the orders involved were executed in accordance with Exchange rules and were not violative. The Division believes, however, that A&I should have expanded its initial investigation at the outset to include a review of trading for the accounts involved on additional days, in order to determine whether a pattern of similar potential violations existed.

D. Timeliness of Investigations

The Division also examined the 35 investigations closed during the target period for timeliness, and found that all of them were closed in a timely manner. All 35 investigations were closed within five months after they were opened. In the 2001 Review, the Division recommended that the Exchange complete investigations in a more timely manner. The present review indicates that the Exchange has complied with this recommendation.

E. Conclusions and Recommendations

The Division found that MGEX maintains an adequate trade practice surveillance program. Exchange staff conduct daily review of computer-generated exception reports concerning all trading at the Exchange in order to identify instances of potential trade practice violations requiring further inquiry or investigation. Exchange staff also conduct daily floor surveillance of open outcry trading at both the open and the close and at various times during the trading day. With one exception, the Exchange's investigations were thorough. In addition, all investigations were well documented and included appropriate analyses. Finally, all investigations were completed in a timely manner.

The Division believes, however, that an Exchange investigation into possible wash trading should have been more thorough. When the Exchange found 14 instances of possible wash trading by a trader on a single day, it should have expanded its investigation at the outset to review trading activity for the accounts involved on additional days, to determine whether a pattern of similar potential violations existed.

Therefore, the Division recommends that the Exchange:

- **Expand the scope of its investigations to include additional trading dates when review of exception reports suggests the possibility of trading violations**

VII. DISCIPLINARY PROGRAM

A. Disciplinary Committees and Procedures

The Exchange has two disciplinary committees, the Futures Trading Conduct Committee (“FTCC”) and the Business Conduct Committee (“BCC”). The FTCC has jurisdiction over matters concerning futures and option trading, including consideration of possible trading violations, while the BCC has jurisdiction over all other potential violations, such as registration issues, clearing house matters, position limits and margins.³⁵ The disciplinary committees do not have a regular meeting schedule, but meet on an as-needed basis when called to do so by the Vice President for Market Administration after he approves an A&I recommendation that a matter be brought before one of the committees.

³⁵ The FTCC consists of seven members, including the Chairperson of the Board of Directors (“Board”), the Exchange President, and five members of the Exchange appointed by the Chairperson. The BCC is comprised of the Chairperson of the Board, the Chairperson of the Clearinghouse Committee, the Exchange President and four members appointed by the Chairperson of the Board. Pursuant to Exchange rules, the FTCC and BCC must include at least one committee member who is not a member of the Exchange in all cases where the subject of a proceeding is a member of the Board, the BCC, or the FTCC, or where the allegations involve either price manipulation or financial harm to a nonmember. A BCC or FTCC member may not participate as a member of the Committee if the member has a financial, personal, or prejudicial interest or concern in the matter before the Committee. The Committees determine whether any of their members have such an interest or concern.

Upon receiving an investigation report, a disciplinary committee may issue a notice of charges, issue a warning or reminder letter, direct A&I to gather additional information, or determine that no reasonable basis exists for taking disciplinary action. A notice of charges sets forth the alleged violation and the exchange rules believed to have been violated, and advises the respondent of his right to a hearing. The respondent has 10 days to file a written response and to request a hearing. Failure to do so is deemed to be an admission of the charges and a waiver of the right to a hearing. At the discretion of the disciplinary committee, A&I may be given authority to negotiate or enter into a settlement with the respondent after a notice of charges has been issued.

Following a hearing, the disciplinary committee may take disciplinary action, or close the case based upon a finding that no violation occurred. If the committee finds that there has been a violation, it may issue a letter of reprimand, a monetary fine, a suspension from membership, or a recommendation to the Board for expulsion. Any suspension of 30 days or more, any fine of \$10,000 or more, or any expulsion, is subject to approval by the Board.³⁶

A&I can also issue staff reminder letters (“SRLs”) and staff warning letters (“SWLs”) administratively for infractions of recordkeeping, decorum, or other similar rules, without the matter being referred to a disciplinary committee. All SRLs and SWLs are recorded in investigation files, and become part of the recipients’ disciplinary histories.

B. Adequacy of Sanctions Imposed

During the target period, no substantive trade practice matters were referred to the FTCC. The Exchange referred 11 investigations involving non-substantive violations to the BCC. Five of the 11 investigations involved violation of rules governing transfer trades; two involved

³⁶ The respondent can appeal the findings or penalty imposed by the Committee to the Board. However, appeals are heard at the discretion of the Board. The Board’s decision on the appeal is based on the record of the hearing. If the respondent does not file an appeal, the penalty becomes effective on the date set forth in the Committee’s decision.

inaccurate reports to the clearing house; two involved nonpayment of exchange fees; one involved failure to meet working capital and net worth requirements; and one involved decorum violations. The BCC issued Notices of Charges in all 11 cases. Nine cases were concluded by settlements, and hearings were held in the remaining two cases.

In the 11 cases, MGEX assessed fines totaling \$14,325. The fines imposed ranged from \$125 to \$4,500.³⁷ They included a total of \$11,000 in fines assessed against four clearing members for transfer trade violations; \$1,200 in fines against one member for failure to pay required fees and deposits; a \$1,000 fine assessed against a member for financial and reporting requirement violations; a total of \$1,000 in fines assessed against two clearing members for submitting inaccurate delivery notices; and a \$125 fine against a member for decorum violations.

A&I issued seven staff warning letters and 43 staff reminder letters during the target period.³⁸ Two SWLs were issued for electronic trading system security violations, and one was issued for misuse of the electronic trading system.³⁹ Four SWLs and 43 SRLs were issued for recordkeeping violations. A&I also issued five letters of reprimand for decorum violations.

³⁷ One fine of \$4,500 and one fine of \$3,000 were each imposed for transfer trade violations in two cases considered together by the BCC. In each instance, only one of the two cases belonged to the target period.

³⁸ In the 2001 Review, the Division recommended that MGEX enforce its limits on repeated SRLs and SWLs involving MGEX Rule 725.01, which requires prompt reporting of the price of all pit transactions to the Exchange's market observers. The Division reviewed the SRLs and SWLs issued during the target period for violations of this rule, to determine whether they were in accordance with Exchange guidelines. Six SRLs and one SWL issued during the target period involved violations of Rule 725.01. All seven letters were issued in accordance with MGEX's guidelines governing sanctions for violations of Rule 725.01.

³⁹ In the matter involving the electronic trading system, a clearing member employee logged on to MGEXpress under the user name of another employee of the member, with the consent of the second employee. The actions of both employees violated Exchange rules regarding electronic trading security.

C. Timeliness of Disciplinary Proceedings

Of the 11 investigations referred to the BCC during the target period, seven were handled in a timely fashion once the decision was made to submit the matter to the BCC. Six investigations were presented to the BCC within approximately one month of the date they were closed by A&I, and one was presented to the BCC within approximately two months of the date it was closed. Disciplinary action was completed in these seven matters within approximately one to three months of their receipt by the BCC.

With respect to the remaining four investigations, the disciplinary process was less than timely. Investigation 02-I-26 was not forwarded to the BCC until more than six months had passed after it was closed by A&I.⁴⁰ Investigations 03-I-06, 03-I-09, and 03-I-11 were not forwarded to the BCC until approximately four months after they were closed, and charges were not issued in those cases until more than three additional months had passed after the BCC received them.⁴¹

D. Conclusions And Recommendations

The Division found that MGEX maintains an adequate disciplinary program. Exchange disciplinary committees are convened when the Exchange determines at the conclusion of an investigation that charges should be brought against a member for rule violations. Exchange rules ensure due process for disciplinary hearings

No substantive trade practice matters were referred to disciplinary committees during the target period. MGEX referred 11 investigations involving non-substantive violations to disciplinary committees, imposing fines totaling \$14,325.

⁴⁰ Investigation 02-I-26 was closed by A&I in April 2003, but was not presented to the BCC until October, 2003. The disciplinary process was then concluded in approximately an additional three months.

⁴¹ Charges were also delayed for approximately two months after BCC receipt of Investigation 03-I-12, for which the disciplinary process was otherwise reasonably timely, having been completed within four months after A&I closed its investigation.

The Division also found that MGEX's disciplinary process was less than timely with respect to approximately one third of the investigations presented to the BCC. Untimely disciplinary proceedings can diminish deterrence and reduce self-regulatory effectiveness. When disciplinary proceedings are delayed for extended periods of time after investigations are concluded, proof can become problematic as memories fade and witnesses may become less available.

The Division therefore recommends that the Exchange:

- **Ensure that investigations are presented to the appropriate disciplinary committee promptly after they are closed with a recommendation for disciplinary proceedings, and that charges are issued promptly after a disciplinary committee determines that charges should be issued.**

VIII. DISPUTE RESOLUTION

MGEX provides dispute resolution services for resolving disputes between Exchange members and their customers through its Customer Claims Arbitration program ("arbitration program"). Customers of Exchange members can submit any dispute arising out of a trade made on the Exchange for arbitration by filing a written complaint with the Exchange within two years after the date of the transactions from which the dispute arose. If a customer files an arbitration complaint, participation in the arbitration is mandatory for the member involved under Exchange rules.

Complaints are arbitrated by a Customer Claims Arbitration Panel consisting, of three Exchange members whose principal business activity is related to futures and options trading.

Members are appointed to serve on the Panel by the Exchange's President or Secretary.⁴² All proceedings are governed by the standards of the American Arbitration Association.

Written complaints, answers, and replies are served on both parties. Each side must cooperate in voluntary exchange of relevant documents and information, and the Exchange must make available any relevant documents in its possession.⁴³

Complaints are heard in a hearing before the Panel, at which each party has the right to be represented by counsel and to present statements and question witnesses under oath. The Panel must issue a decision in writing as soon as practicable after the hearing. Decisions must be based on the record of the hearing, and are final and binding on the parties. No appeal is permitted except where required under applicable law.

During the target period only one matter was submitted by a customer for arbitration. The dispute concerned payment for a rail car hopper used for shipping grain, and a question as to whether the hopper was damaged before it was received. The arbitration panel ruled that the complainants had failed to present sufficient evidence to support their claim.

The Division found that MGEX maintains an adequate dispute resolution program, and has no recommendations in this area.

⁴² Members may not serve on a Panel for any matter with respect to which they have any conflict of interest, and ex parte contact with Panel members by either side during the proceedings is not permitted.

⁴³ In case of disputes regarding document production, the Panel has the power to subpoena documents it deems relevant.