

## Exhibit B



# NEW CONTRACTS PENDING APPROVAL AT CFTC

[last updated at 08/03/98 11:52 AM]

- **Contracts Submitted Under 10-Day FAST TRACK Procedures** Eligible applications include: (1) futures and option contracts using cash settlement rather than physical delivery, excluding contracts based on stock indexes and certain agricultural commodities; (2) futures and option contracts on major foreign currencies; and (3) options on futures.
- **Contracts Submitted Under 45-Day FAST TRACK Procedures** Eligible applications include futures contracts and options on physicals, excluding contracts based on stock indexes.
- **Contracts Being Processed Under Regular Review Procedures** Includes all contracts not being processed under FAST TRACK review procedures.
- **New Contracts Approved in Last Three Months**

## Pending New Contracts Submitted Under 10-Day Fast Track Procedures.

Exchange	Commodity	Type	Date Rec'd	Comments Due By	Staff Remarks	Effective Date
none						

Filings under FAST TRACK procedures are at the discretion of the exchange. New contract applications eligible for 10-day FAST TRACK procedures include: (1) futures contracts using cash settlement rather than physical delivery, based on any commodity except those covered under the CFTC/SEC Accord (stock index and corporate bond contracts) excluding contracts based on stock indexes and certain enumerated agricultural commodities; (2) physical delivery futures contracts on major currencies; and (3) options on futures. An exchange may list a contract for trading on the day after the effective date shown in the last column unless the date is extended or FAST TRACK review is ended. Under FAST TRACK, the initial 10-day effective date may be extended once for an additional 30 days (40 days total). For applications not meeting FAST TRACK requirements or if requested by the exchange, FAST TRACK review is ended and the regular review procedures for new contract applications apply (see the table below).



## Pending New Contracts Submitted Under 45-Day Fast Track Procedures.

Exchange	Commodity	Type	Date Rec'd	Comments Due By	Staff Remarks	Effective Date
none						

Filings under FAST TRACK procedures are at the discretion of the exchange. New contract applications eligible for 45-day FAST TRACK procedures include physical delivery and cash settled futures and option contracts based on any commodity except those under the CFTC/SEC Accord (stock index and corporate bond contracts). An exchange may list a contract for trading on the day after the effective date shown in the last column unless the date is extended or FAST TRACK review is ended. Under FAST TRACK, the initial 45-day effective date may be extended once for an additional 30 days (75 days total). For applications not meeting FAST TRACK requirements or if requested by the exchange, FAST TRACK review is ended and the regular review procedures for new contract applications apply (see the table below).



## Pending New Contracts Being Reviewed Under Regular Procedures.

*Includes all pending contracts not being processed under FAST TRACK review procedures.*

Exchange	Commodity	Type	Date Recd	Comments Date	Status/Remarks
CME	Eurodollar FRA, 3-month	future	07/31/98		
CME	Eurodollar FRA, 3-month	option	07/31/98		
CME	Nonfat Dry Milk	future	06/05/98	07/16/98	
CME	Nonfat Dry Milk	option	06/05/98	07/16/98	
CME	Dry Whey	future	06/05/98	07/16/98	
CME	Dry Whey	option	06/05/98	07/16/98	
FCOM	Cattle, Live	future	01/17/97	01/26/98	The live cattle contracts are the first designation applications submitted by FUTURECOM, a new exchange which plans to conduct trading electronically via the internet.
FCOM	Cattle, Live	option	01/17/97	01/26/98	(see above remark)
FCOM	Technology Index	future	06/17/98	07/24/98	FUTURECOM is a new exchange which plans to conduct trading electronically via the internet.
FCOM	Technology Index	option	06/17/98	07/24/98	FUTURECOM is a new exchange which plans to conduct trading electronically via the internet.
NYMEX	Hong Kong Stock Index	future	11/12/96	08/29/97	Subject to SEC review under the Accord.
NYMEX	Hong Kong Stock Index	option	11/12/96	08/29/97	Subject to SEC review under the Accord.
CFFE	US Treasury Bonds	future	01/07/98	07/16/98	The Treasury instrument contracts are the first designation applications submitted by Cantor Financial Futures Exchange, new exchange which plans to conduct trading electronically in affiliation with the NYCE.
CFFE	US Treasury Notes, 10-Year	future	01/07/98	07/16/98	The Treasury instrument contracts are the first designation applications submitted by Cantor Financial Futures Exchange, new exchange which plans to conduct trading electronically in affiliation with the NYCE.
CFFE	US Treasury Notes, 2-Year	future	01/07/98	07/16/98	The Treasury instrument contracts are the first designation applications submitted by Cantor Financial Futures Exchange, new exchange which plans to conduct trading electronically in affiliation with the NYCE.
CFFE	US Treasury Notes, 5-Year	future	01/07/98	07/16/98	The Treasury instrument contracts are the first designation applications submitted by Cantor Financial Futures Exchange, new exchange which plans to conduct trading electronically in affiliation with the NYCE.



### New Contract Applications Processed in 1998

Exchange	Commodity	Type	Date Appl	Status/Remarks
CME	Pork Composite	future	07/31/98	
CME	Pork Composite	option	07/31/98	
MGE	Electricity, Twin Cities, On-Peak	future	07/13/98	
MGE	Electricity, Twin Cities, On-Peak	option	07/13/98	
MGE	Electricity, Twin Cities, Off-Peak	future	07/13/98	
MGE	Electricity, Twin Cities, Off-Peak	option	07/13/98	
CME	Japanese Government Bonds, 10-Year	future	06/08/98	Deemed approved under Fast Track procedures.
CME	Japanese Government Bonds, 10-Year	option	06/08/98	Deemed approved under Fast Track procedures.
CBT	Electricity, TVA Hub	future	06/08/98	
CBT	Electricity, TVA Hub	option	06/08/98	
NYMEX	Coal, Central Appalachian	future	05/11/98	Deemed approved under Fast Track procedures.
NYMEX	Coal, Central Appalachian	option	05/11/98	Deemed approved under Fast Track procedures.
CBT	Electricity, Com Ed	future	05/08/98	Deemed approved under Fast Track procedures.

CBT	Electricity, Com Ed	option	05/08/98	Deemed approved under Fast Track procedures.
CBT	Corn	future	05/07/98	
CBT	Soybean	future	05/07/98	
CME	Pork Bellies, Frozen	future	05/05/98	
CME	Pork Bellies, Frozen	option	05/05/98	
CME	Russian Ruble	future	04/20/98	
CME	Russian Ruble	option	04/20/98	
CME	Bankruptcy Index, Quarterly	future	04/13/98	Deemed approved under Fast Track procedures.
CME	Bankruptcy Index, Quarterly	option	04/13/98	Deemed approved under Fast Track procedures.
CME	Euro Canada	future	04/13/98	Deemed approved under Fast Track procedures.
CME	Euro Canada	option	04/13/98	Deemed approved under Fast Track procedures.
NYMEX	Electricity, Cinergy	future	03/23/98	Deemed approved under Fast Track procedures.
NYMEX	Electricity, Cinergy	option	03/23/98	Deemed approved under Fast Track procedures.
NYMEX	Electricity, Entergy	future	03/23/98	Deemed approved under Fast Track procedures.
NYMEX	Electricity, Entergy	option	03/23/98	Deemed approved under Fast Track procedures.
NYFE	NYSE Small Composite	future	03/03/98	
CME	ECU/British Pound Cross Rate	future	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/British Pound Cross Rate	option	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Canadian Dollar Cross Rate	future	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Canadian Dollar Cross Rate	option	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Deutsche Mark Cross Rate	future	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Deutsche Mark Cross Rate	option	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Japanese Yen Cross Rate	future	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Japanese Yen Cross Rate	option	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Swiss Franc Cross Rate	future	02/23/98	Deemed approved under Fast Track procedures.
CME	ECU/Swiss Franc Cross Rate	option	02/23/98	Deemed approved under Fast Track procedures.
CME	Overnight Federal Funds Effective Rate	future	02/23/98	Deemed approved under Fast Track procedures.
CME	Overnight Federal Funds Effective Rate	option	02/23/98	Deemed approved under Fast Track procedures.
CME	Milk, BFP Mini	option	02/03/98	Deemed approved under Fast Track procedures.
MGE	Durum Wheat	option	01/02/98	Approved with proposal to reactivate trading in dormant durum wheat contract.
CBT	Dow Jones Transportation Average	future	NA	CFTC review terminated because on 12/04/97 the SEC determined the contract does not meet Accord requirements.
CBT	Dow Jones Transportation Average	option	NA	CFTC review terminated because on 12/04/97 the SEC determined the contract does not meet Accord requirements.
CBT	Dow Jones Utilities Average	future	NA	CFTC review terminated because on 12/04/97 the SEC determined the contract does not meet Accord requirements.
CBT	Dow Jones Utilities Average	option	NA	CFTC review terminated because on 12/04/97 the SEC determined the contract does not meet Accord requirements.



- For those applications submitted in electronic form, the rules containing the terms and conditions may be viewed or printed by clicking on the contract name. A copy of the proposed rules for applications not submitted in electronic form may be received by contacting the Secretariat by telephone at 202-418-5100, or via e-mail.
- Written comments on the proposed terms and conditions of pending contracts listed above may be sent via e-mail or by facsimile transmission at fax number 202-418-5521. Please be sure to identify the exchange and contract in your correspondence.
- Questions about any of the contracts listed above may be sent via e-mail, by facsimile transmission at fax number 202-418-5527, or by telephone at (202) 418-5270. Please be sure to identify the exchange and contract in your correspondence.
- The exchange may have additional information about new contracts submitted for approval. Click [here](#) for links to the exchanges.

Pending Contracts

Pending Rule Amendments

Designated Contracts

Pending Items & Federal Register Releases



## Exhibit C

**Rule Enforcement Review  
of the  
NEW YORK COTTON EXCHANGE**

**Division of Trading and Markets  
July 28, 1998**

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**RULE ENFORCEMENT REVIEW**  
**OF THE**  
**NEW YORK COTTON EXCHANGE**

**I. INTRODUCTION - PURPOSE AND SCOPE**

The Division of Trading and Markets ("Division") has completed a limited-scope rule enforcement review of the self-regulatory programs of the New York Cotton Exchange ("NYCE" or "Exchange").<sup>1</sup> The purpose of this review was to evaluate the Exchange's trade practice surveillance and disciplinary action programs for their compliance with Sections 5a(a)(8) and 5a(b) of the Commodity Exchange Act ("Act") and Commission Regulation 1.51. This review was limited in scope because the Division recently evaluated the Exchange's audit trail and recordkeeping systems and floor surveillance, trade practice surveillance, and disciplinary action programs as part

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<sup>1</sup> 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 investigatory cases 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.

For purposes of this report, "NYCE" or "Exchange" will refer to the New York Cotton Exchange, which includes the Financial Instruments Division ("FINEX"), and to the Citrus Associates of the New York Cotton Exchange, Inc. All surveillance activities for these markets are performed by the same Exchange personnel. Since the date of the last rule enforcement review, NYCE has acquired the New York Futures Exchange ("NYFE") as a wholly-owned subsidiary. NYFE was the subject of a separate rule enforcement review presented to the Commission on September 30, 1997.

of its review of the Exchange's petition for exemption from the dual trading prohibition contained in Section 4j(a) of the Act and Commission Regulation 155.5.<sup>2</sup> The Commission granted the Exchange's petition by Order on July 16, 1997.<sup>3</sup>

This review covers the period of September 1, 1996 to August 31, 1997 ("target period"). The Division's previous rule enforcement review of the Exchange's compliance program was presented to the Commission on April 26, 1994 ("1994 Review").<sup>4</sup> In the 1994 Review, the Division found that NYCE had adequate trade practice surveillance and disciplinary programs, and recommended that the Exchange develop and maintain a floor surveillance log. With regard to the Exchange's audit trail program, the Division recommended that the Exchange: (1) develop a program for comparing the accuracy of member-recorded execution times for straddles with time and sales data and including that data in calculating the Exchange's trade timing accuracy rate; (2) establish procedures for a regular review of order tickets to ensure member compliance with order ticket recordkeeping requirements; and (3) take steps to improve member compliance with the trading card collection requirements of Commission Regulation 1.35(j). The last of these recommendations is implicated in the findings of this review.<sup>5</sup>

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<sup>2</sup> In addition, the Exchange's market surveillance program was evaluated in a separate rule enforcement review presented to the Commission on February 24, 1998.

<sup>3</sup> 62 Fed. Reg. 39213 (July 22, 1997).

<sup>4</sup> A copy of the 1994 Review can be found in Appendix 1.

<sup>5</sup> A discussion of trading card submission and time bracket issues can be found *infra* at p. 12.

In its response letter to the 1994 Review, the Exchange indicated that it would comply with all the recommendations, including the development of a floor surveillance log reflecting, at a minimum, the persons conducting floor surveillance, times of surveillance, and any observations and follow-up activities. During the course of the present review, the Division found that the Exchange was maintaining a floor surveillance log as described.

## II. METHODOLOGY

During an on-site visit to the Exchange in October 1997, Division staff interviewed Exchange Compliance officials and conducted a review of Exchange documents that included, among others, the following:

- Computer reports and other documentation used routinely in the conduct of trade practice surveillance;
- All trade practice investigation and disciplinary action files for cases closed during the target period;
- Trade practice investigation and disciplinary action logs;
- Minutes of the meetings of the disciplinary committees held during the target period; and
- Compliance manuals and guidelines.

The Division provided the Exchange with the opportunity to review and comment on a draft of this report on June 25, 1998. On June 30, 1998, Division staff conducted an exit conference with NYCE officials to discuss the report's findings and recommendations.

### **III. CURRENT FINDINGS AND RECOMMENDATIONS**

#### **A. Trade Practice Surveillance Program**

##### **Findings:**

- The Exchange's Compliance staff has lost a number of investigators, which has diminished the Exchange's ability to perform its self-regulatory responsibilities.
- Investigations examined were thorough and well-documented, and investigation reports complied with Commission regulations.
- The Exchange's investigations were generally completed in a timely manner. The Exchange closed 63 investigations during the target period, of which 48, or 76 percent, were completed within the four-month requirement set forth in Commission Regulation 8.06.
- Many of the trading documents examined by Exchange staff during the course of Exchange investigations reflected possible violations of Commission Regulation 1.35(j)(3) for failure to use a new trading card after each 30-minute trading interval. These possible violations went unnoticed by Exchange staff.

##### **Recommendations:**

- The Exchange should report to the Division within 60 days of the date of this review its plans for hiring additional Compliance investigators, including any plans and timetables for merging the NYCE and CSCE Compliance Departments.
- The Exchange should identify possible recordkeeping violations during the course of reviewing documents obtained in connection with an investigation, and issue appropriate sanctions to those traders whose documents are in violation.

## B. Disciplinary Program

### Findings:

- NYCE disciplinary matters are promptly referred to disciplinary committees, disciplinary action is taken in a reasonably timely manner, and findings appear to be supported by the evidence.
- Penalties imposed during the target period for trade practice, audit trail and recordkeeping violations included fines totaling \$50,900, five-year and 14-day suspensions, and three cease and desist orders.
- Three disciplinary cases, all involving trade practice violations, accounted for \$38,500 of the \$50,900 total fines, both suspensions, and three orders to cease and desist.
- In a case closed shortly after the end of the target period, the Exchange imposed a fine that was inappropriately small relative to the profit made on an illegal transaction.

### Recommendation:

- The Exchange should consider any profit made by a member from his or her violative conduct in determining an appropriate sanction.

## IV. TRADE PRACTICE SURVEILLANCE - SECTIONS 5a(a)(8) AND 5a(b) AND COMMISSION REGULATIONS 1.51(a)(2), (4), (5) AND (6)

Section 5a(a)(8) of the Act requires each exchange to enforce all bylaws, rules, regulations, and resolutions made or issued by it, the governing board or any committee. Section 5a(b) of the Act requires each contract market to maintain and to use a system to monitor trading to detect and deter violations of the contract market's rules committed in the making of trades. Under Section 5a(b)(1), such a system must include, among other things, trade practice surveillance systems capable of reviewing,

and used to review, trade data in order to detect violations committed in making trades and executing customer orders; floor surveillance; and the commitment of resources necessary for a trade monitoring system to be effective in detecting and deterring trade practice violations, including adequate staff to develop and prosecute disciplinary actions.

In addition, Commission Regulation 1.51 has long required that each exchange use due diligence in maintaining a continuing program for the surveillance of trading practices on the floor of the exchange; for the investigation of customer complaints and other alleged or apparent violations of the exchange bylaws, rules, regulations and resolutions; and for such other surveillance, record examination, and investigation as is necessary to enforce exchange bylaws, rules, regulations and resolutions.

#### A. Dual Trading Review

In July 1997, toward the end of the current target period, the Division evaluated the Exchange's floor surveillance program and trade practice surveillance systems, as well as its commitment of resources to those systems, for the purpose of evaluating the Exchange's dual trading petition. At that time, the Division found that the size of the Exchange's Compliance Department ("Compliance") staff appeared to be appropriate to the size of the Exchange and its trading volume. The Division also concluded that the Exchange's self-regulatory budget was adequate, and that the Exchange has committed sufficient monetary resources to automating elements of its trade practice surveillance system. In addition, the Division's examination of NYCE's floor surveillance program

revealed that the Exchange conducts floor surveillance on every open and close, at random times during the day, and when warranted by special market conditions.

The Division's dual trading review also included an examination of the various computerized reports that the Exchange uses in order to monitor trading activity and to discover possible trade practice abuses. These include the Exchange's trade register, known as the "Daily Brokerage Recap" ("DBR"), as well as a variety of exception reports generated by Compliance's Exchange Computer Surveillance System ("ECSS"). These reports are designed to identify either specific types of trading violations, such as trading ahead of a customer order or accommodation trading, or to highlight unusual activity that may warrant further examination, such as large trades or instances where a broker has made large profits on day trades against the same opposite broker. The Division concluded that the Exchange reviewed the DBR daily and the ECSS exception reports at least three times a week, and that it used the information generated by its trade monitoring system to open investigations and take disciplinary action when appropriate.<sup>6</sup> As stated earlier, the Commission exempted the Exchange from the Commission's dual trading prohibition by Order dated July 16, 1997.

At the time of the dual trading petition, the Compliance staff included the Director of Compliance, eight investigators, an Office Manager, and an Administrative Assistant. However, since that time, one investigator has gone on disability leave, three investigators have left Compliance, and one staff member from the Floor Operations

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<sup>6</sup> 62 Fed. Reg. at 39214.

Department was transferred to Compliance as an investigator. Thus, Compliance has lost a net of three investigators since July 1997, or almost one-half of its investigative staff. Combined with the hiring freeze in place due to the Exchange's pending merger with the Coffee, Sugar & Cocoa Exchange, Inc. ("CSCE"), staff departures have begun to affect the timeliness of some investigations, although during most of the target period investigations were being conducted in a timely manner. As of June 1998, Compliance had a total of eight staff members,<sup>7</sup> including the Director of Compliance, Office Manager, and Administrative Assistant, all of whom are acting as investigators to try to compensate for staff losses.

The Division believes that the size of the personnel losses suffered by NYCE's Compliance Department significantly diminish the Exchange's ability to perform its self-regulatory responsibilities adequately. The Division recognizes that these staffing difficulties are largely associated with the pending merger and that additional changes, including a single merged compliance staff, may flow from the merger.<sup>8</sup> Nonetheless, because the staff losses may have a serious impact on its trade practice program, the Division recommends that the Exchange take steps to hire additional Compliance investigators.<sup>9</sup> The Division requests that the Exchange report its plans for this hiring,

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<sup>7</sup> This number does not include the investigator on disability leave, who is still a member of Compliance staff.

<sup>8</sup> On December 22, 1997, the memberships of both the NYCE and the CSCE voted to merge and form the Board of Trade of the City of New York. The merger was approved by the Commission on April 24, 1998 and initially closed on June 10, 1998.

<sup>9</sup> The Division's concerns in this regard are amplified by the possibility that the Exchange will have to assume compliance responsibilities for the proposed Cantor Financial Futures Exchange ("CFFE"), a

including any plans and timetables for merging the NYCE and CSCE Compliance Departments, to the Division within 60 days of the date of this review.

## **B. Adequacy of Investigations**

The Compliance staff initiates and conducts investigations when information obtained indicates that a possible violation of Exchange rules may have occurred. That information may be derived from floor surveillance, reviews of computer exception reports or other computerized records, such as the DBR, or from external sources that include Commission and National Futures Association ("NFA") referrals, and member and customer complaints.

During the target period, Compliance opened a total of 91 investigations. Of these, 37 were internally generated by Compliance, including 28 (31 percent) through review of the Trading Ahead Exception Report; four (4 percent) through review of the Accommodation Trading Exception Report; and five (5 percent) through review of other computer reports. Fifteen investigations (16 percent) were opened based upon customer complaints; eight (9 percent) were initiated because of member complaints or referrals; and 30 (33 percent) were based upon Commission referrals concerning

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joint venture between NYCE and Cantor Fitzgerald L.P. CFFE's application for designation as a contract market is currently undergoing Division review.

possible trading ahead of customer orders.<sup>10</sup> No source was given for one other investigation.<sup>11</sup>

At the initiation of an inquiry, the investigator will request information from the members involved by sending them an appropriate form letter. Once the requested information is received, the investigator reviews it along with other records, including the DBR, and determines if additional information is needed or if it is necessary to conduct interviews with any of the members involved.

Once a decision has been made to open an investigation, it will be logged into one of two logs maintained by Compliance. The "NYCE Investigation Case Log - Referred Cases" reflects all investigations which are referred to Compliance by the Commission, as well as certain investigations referred by other departments of the Exchange, generally involving issues related to market surveillance and member financial requirements. All other investigations are recorded in the "NYCE Investigation Case Log." Both logs include, for each investigation, the date it was opened, the trade date and market involved, the member being investigated, the nature of the inquiry, its category (e.g., trade practice, personal conduct, financial), source,<sup>12</sup> status, the date it was closed or otherwise disposed of (such as by referral to a

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<sup>10</sup> The 30 referrals from the Commission were originally sent to NYCE as a single referral; the Exchange subdivided it into 30 investigations, one for each involved broker.

<sup>11</sup> The investigation without a listed source was opened by a Compliance investigator who became ill and was ultimately placed on permanent disability leave. Exchange staff is unable to ascertain its source, though it was likely opened based upon another investigation.

<sup>12</sup> The log will also note when an investigation involves floor surveillance, even if that was not the original source of the investigation.

disciplinary committee), the number and date of any disciplinary notice, and the initials of the investigator.<sup>13</sup>

The Division reviewed all 63 of the Exchange's trade practice investigations that were closed during the target period, including seven Commission referrals. The investigations reviewed included, among others, investigations of possible trading ahead, accommodation trading, and other non-competitive trading, as well as customer complaints.

The Division found that the investigations were thorough and well-documented. Each investigation file contained the relevant documentation, including copies of trading cards, order tickets, computerized exception reports, DBRs, and Time and Sales reports. In cases where Compliance staff conducted interviews as part of the investigation, memoranda describing the interviews were included in the investigation files. Some files also contained tape recordings of the interviews. Each file for an investigation closed without further action contained a "closeout" memo describing the investigation, including how it was initiated, the facts developed during the course of the investigation, and the staff's conclusions and recommendations. Full investigation reports were issued in cases where Compliance concluded that referral to a disciplinary committee was warranted. These reports included the basis of the investigation, a summary of the complaint, a detailed recitation of the facts, and the staff's conclusions and recommendations.

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<sup>13</sup> A copy of NYCE's Investigation Case Log can be found in Appendix 2.

In the course of reviewing the Exchange's investigation files, however, the Division observed that a significant number of the trading cards reviewed as part of the investigations did not comply with the Commission Regulation 1.35(j)(3) requirement that a new card be used for each 30-minute trading interval. Although these cards reflected trades occurring in multiple brackets, the investigation files did not indicate that Compliance noticed these violations, or either warned or sanctioned Exchange members for failure to comply with recordkeeping requirements.

### C. Timeliness of Investigations

The Division found that the Exchange's investigations were generally completed in a timely manner. Of the 63 trade practice investigations closed during the target period, including 15 opened prior to the start of the period, 48 (76 percent) were completed in four months or less.<sup>14</sup> Another six (10 percent) were closed within four to six months, and nine (14 percent) were closed within six months to one year. Of the 48 investigations that were both opened and closed during the target period, 45 (94 percent) were closed within four months and none was open for longer than six months. Of the 15 investigations that were opened prior to and closed during the target period, three were closed within four months or less, three were closed within four to six months, and nine were closed within six months to one year.

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<sup>14</sup> Commission Regulation 8.06 requires that an investigation generally be completed within four months, except when significant reason exists to extend it beyond that time frame. Significant reasons may include the complexity of the matter, as well as the number of documents required to be analyzed in order properly to determine if a rule violation occurred.

Sixty-nine trade practice investigations remained open at the end of the target period. Of these, 34 had been open less than four months or were subsequently closed in less than four months; two had been open four to six months; six were open longer than six months; and 27 had been open at least one year.<sup>15</sup>

During the target period, the Exchange initiated 15 investigations based upon customer complaints and completed nine of them.<sup>16</sup> The Division reviewed those nine cases, in addition to a tenth which was completed eight days after the end of the target period. Nine of the cases involved complaints relating to bad fills, while the tenth concerned a futures commission merchant ("FCM") that misinformed its customer about the customer's market position. Nine of the cases were closed in less than four months, and one was closed in just over six months. The Division found that the investigations in these customer complaint cases were timely, thorough and well-documented.

#### D. Conclusions and Recommendations

The Division found that the Exchange's Compliance Department has suffered significant recent staff losses that it has not yet been able to remedy because of the

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<sup>15</sup> The 27 investigations that had been open at least one year included 10 Commission referrals (submitted to the Exchange as a group) and several other investigations that were originally assigned to the investigator now on permanent disability leave, then reassigned to another investigator who has since left Compliance.

<sup>16</sup> Commission Regulation 1.51(a)(4) requires each exchange to maintain a continuing program for the investigation of complaints received from customers concerning the handling of their accounts or orders. An exchange is responsible for investigating customer complaints to determine whether such complaints result from the failure of a member to comply with exchange rules. The program should consist of a meaningful inquiry into every complaint alleging facts which, if true, would constitute a violation of exchange rules. See Contract Market Rule Enforcement Program Guideline No. 2, 1 Comm. Fut. L. Rep. (CCH) ¶ 6430 (May 13, 1975).

Exchange's pending merger with the CSCE. Because these losses may have a serious impact on the Exchange's trade practice surveillance program, the Division is requesting that the Exchange take steps to hire additional investigators.

The Division further found that the Exchange's trade practice investigations were generally thorough, well-documented, and completed in a timely manner. Appropriate interviews were held, investigation files contained relevant documentation, and final investigation reports complied with Commission Regulation 8.07. The Division discovered, however, that a significant number of the trading cards collected by the Exchange in the course of trade practice investigations reflected trades made over multiple 30-minute bracket periods, in violation of Commission Regulation 1.35(j)(3). Review of the investigation files did not indicate that the Exchange was either observing or pursuing recordkeeping violations revealed during investigations.

Based on its review, the Division recommends that NYCE:

1. Report to the Division within 60 days of the date of this review its plans for hiring additional Compliance investigators, including any plans and timetables for merging the NYCE and CSCE Compliance Departments.
2. Identify possible recordkeeping violations during the course of reviewing documents obtained in connection with an investigation, and issue appropriate sanctions to those traders whose documents are in violation.

## **V. DISCIPLINARY ACTIONS - SECTION 5a(b) AND COMMISSION REGULATION 1.51 (a)(7)**

### **A. Introduction**

Under Section 5a(b) of the Act, an exchange must use information gathered through its trade monitoring system to bring appropriate disciplinary actions and to

assess meaningful penalties against violators. In addition, Commission Regulation 1.51(a)(7) requires that each exchange use due diligence in maintaining a continuing affirmative action program which results in prompt, effective disciplinary action for violations of exchange rules. When reviewing disciplinary programs, the Division considers, among other factors, the support for findings made in disciplinary actions, the adequacy of sanctions imposed, and the timeliness of the procedures.<sup>17</sup> The Division also assesses compliance with Commission Regulations 8.09 and 8.17, which require, respectively, that disciplinary committees review investigation reports in a timely manner and issue either a notice of charges or a written decision stating the reasons why no further action will be taken, and that hearings be convened promptly after reasonable notice.

## B. NYCE Disciplinary Action Procedures

The Exchange has three types of disciplinary committees which address violations of the Exchange's rules. These are the Business Conduct Committee ("BCC"), the Supervisory Committee ("SC"), and the Floor Committee ("FC").<sup>18</sup> In addition, the Exchange's Board also has jurisdiction over Exchange disciplinary matters.

The BCC reviews investigation reports submitted by Compliance and, based on its review, directs Compliance to conduct further investigation or determines whether a

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<sup>17</sup> Contract Market Rule Enforcement Program Guideline No. 2, 1 Comm. Fut. L. Rep. (CCH) ¶ 6430 (May 13, 1975).

<sup>18</sup> The FC is charged with ensuring proper observance of orderly trading procedures, floor decorum and attire, and the timely submission and accuracy of records. FC actions may be taken summarily in accordance with exchange rules and are not subject to the procedures for disciplinary proceedings. The FC can impose fines up to \$5000 and one day suspensions of trading privileges.

prosecution for a rule violation should be instituted. The SC conducts hearings regarding rule violations, determines guilt or innocence, and fixes penalties for violations. Both the BCC and the SC may accept offers of settlement. By rule, the Board must review all settlement offers accepted by the committees, and may accept, reject, or propose modifications to the terms of the offer.

The composition of the BCCs for NYCE, including FINEX, and for Citrus Associates differ slightly,<sup>19</sup> but in each case the BCC's functions are carried out by at least three-member Business Conduct Panels ("BCPs"). The BCC Chairman appoints a BCP to meet and review each investigation report.<sup>20</sup> The BCP, in its discretion, may allow the member or member firm charged to present an oral or written statement at the meeting.

Upon receipt of an investigation report, BCPs may (1) request that more information be collected concerning an alleged violation; (2) determine that no reasonable basis exists for finding a rule violation or that prosecution is otherwise unwarranted; (3) determine that a reasonable basis exists for finding a rule violation and direct Compliance to issue a complaint against the offending member; or (4) direct Compliance to consider entering into a settlement agreement.<sup>21</sup> If Compliance believes

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<sup>19</sup> See NYCE By-Law §1.26 and Citrus By-Law §28.

<sup>20</sup> NYCE Rules 10.05 and 10.06. Compliance screens the panel for potential conflicts of interest before an investigation report goes to a BCP. Compliance then provides the BCC Chairman with a list of potential panel members and includes any information that may be useful in the selection process.

<sup>21</sup> NYCE Rules 10.06(c), (d)(1), and (d)(2).

that only a minor rule infraction has occurred, it has the authority and discretion to issue warning letters to the subject of the investigation without BCC approval.<sup>22</sup>

The respondent may submit a written offer of settlement to the BCP at any time after the BCP has received the investigation report from Compliance. However, once the notice of a hearing before the SC has been filed, settlement offers must be submitted to the SC. Settlement offers are conveyed to the appropriate committee through Compliance. The settlement offer may be accepted, rejected or altered by the BCP. Any accepted settlement offer is subject to review and approval by the Board.<sup>23</sup>

As noted above, the SC conducts hearings to determine liability and fixes penalties for violations. Similar to the BCCs, the SCs for NYCE and FINEX and for Citrus Associates differ slightly in composition,<sup>24</sup> but each conducts its business through at least three-member supervisory panels ("SPs") appointed by the SC Chairman. As with the BCPs, Compliance screens the SPs for conflicts of interest. No member of the SC may serve on an SP if he or she participated at any prior stage of the disciplinary proceeding or if he or she has any conflicts of interest with the matter under consideration. Complaints issued by Compliance are filed with the SC and also are served on the respondent.

If a complaint is issued, the respondent must answer it within 20 days from the date of service or he or she will be deemed to have admitted all of the allegations in the

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<sup>22</sup> NYCE Rule 10.04(c).

<sup>23</sup> NYCE Rule 10.16.

<sup>24</sup> See NYCE By-Law §1.17 and Citrus By-Law §18.

complaint. If the respondent answers the complaint, any allegation he fails to deny specifically will be deemed admitted.<sup>25</sup>

When a respondent fails to answer a complaint or deny an allegation, the SP may find that the respondent violated the relevant rules and may propose a penalty for such violations. The SP will notify the Secretary of the Exchange regarding the penalty and the Secretary will notify Compliance and the respondent. Within 10 days of this notification, the respondent may request a hearing before the SP on either a denied charge or a proposed penalty. Otherwise, he or she will be deemed to have accepted the proposed penalty.<sup>26</sup>

At the hearing, Compliance presents the case before the SP. The respondent has the right to appear at the hearing and may be represented by counsel. Both Compliance and the respondent are entitled to call and to cross-examine witnesses and to present other evidence, although formal rules of evidence need not be applied. A record of the hearing is made, either by a reporter or on tape.<sup>27</sup>

The SP renders its decision by majority vote and files it with the Secretary. The penalties imposed on a respondent for each rule violation may include one or more of the following: (a) a fine of up to \$50,000 per violation; (b) a cease and desist order; (c) censure; (d) suspension; or (e) expulsion.<sup>28</sup>

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<sup>25</sup> NYCE Rule 10.09.

<sup>26</sup> NYCE Rule 10.10.

<sup>27</sup> NYCE Rule 10.12.

<sup>28</sup> NYCE Rule 10.13. The SP may issue an order of prohibition with respect to former members over whom the Exchange retains jurisdiction. When effective, an order may prohibit and/or place restrictions

The SP's decision is deemed final on the date of the filing of the decision,<sup>29</sup> except that any settlement offer accepted by the SP is subject to review and approval by the Board,<sup>30</sup> and any decision to expel a member is subject to Board approval.<sup>31</sup> No other SP decisions can be appealed to the Board.

NYCE's disciplinary action procedures appear to comply with the Commission's requirements, as set forth in Part 8 of the Commission's regulations.

### C. Sanctions Imposed

The Division reviewed the Exchange's disciplinary action and investigation report logs, various disciplinary committee minutes, and the log of Commission Regulation 9.11 disciplinary action notices issued by the Exchange reflecting disciplinary actions taken during the 12-month target period. Penalties imposed by NYCE for trade practice, audit trail and recordkeeping violations consisted of fines totaling \$50,900, one five-year suspension and one 14-day suspension, both for trade practice violations, and three orders to cease and desist.<sup>32</sup> During the target period, three disciplinary actions involving substantive trading violations were taken as the result of decisions made by either the BCC or SC. The respective FCs issued fines in 77 matters, 27 for recordkeeping and audit trail-related violations, and 50 for violations of

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upon members in effecting transactions in contracts on the Exchange with, through or for the benefit of the former member.

<sup>29</sup> NYCE Rule 10.15.

<sup>30</sup> NYCE Rule 10.16

<sup>31</sup> NYCE Rule 10.14.

<sup>32</sup> The Exchange also imposed \$7000 in fines for financial rule violations during the target period, all for failure by members to provide the Exchange with adequate information as to financial condition.

floor trading protocol, such as bidding through an offer. The FC fines ranged from \$50 to \$2000.<sup>33</sup> The smaller fines were for violations such as late submission of information to clearing and bidding into an offer, while the \$2000 fine was for failure to resolve outrades in a timely fashion.

In the three BCC and SC actions, three members were sanctioned for trade practice offenses. The penalties imposed for these offenses, two of which were the result of settlement agreements, included \$38,500 of the \$50,900 in fines assessed during the target period, all three orders to cease and desist, and both suspensions. In the first case, a broker was fined \$25,000, given a 14-day suspension, and ordered to cease and desist for two trade practice violations: (1) acknowledging a favorable trade that he did not record on his trading card and subsequently advising the opposite broker that the trade was not an error but rather a consummated trade, thus generating a profit of \$7550 in his account; and (2) utilizing a customer order to generate a profit of \$9500 in his own account. The broker generated the \$9500 profit by placing contracts purchased for the customer into his own account, allegedly because he thought the customer order had been canceled, and selling the contracts on the close for a profit. Meanwhile, the broker told the customer that nothing had been done on the customer's order. In the second case, a broker was fined \$7500, suspended for five years, and ordered to cease and desist for failing to record transactions executed for a customer on his trading card, and then liquidating those positions against market-on-close orders in order to create a

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<sup>33</sup> The 77 FC disciplinary actions accounted for \$12,400 of the \$50,900 in total fines assessed during the target period.

profit of \$9600 in a particular customer account. In the third case, a broker was fined \$6000, and ordered to cease and desist and attend broker training and ethics courses for engaging in non-competitive and prearranged trades, misallocating customer orders, and taking the opposite side of a customer order without prior written consent. In this last case, however, the broker did not make a profit from his activity.<sup>34</sup>

In addition, the BCC reviewed three other trade practice cases shortly after the end of the target period, one of which has resulted in a fine of \$11,000. In that case, one broker was cited for taking the other side of a customer's order without the customer's prior written consent and also received warning letters for failing to notify the Exchange of his formation of a broker association, and failing to submit a copy of his trading cards to the Exchange on a timely basis. In the same case, a second broker also received a warning letter for failing to notify the Exchange of the formation of the broker association.<sup>35</sup> This case is noteworthy because the trading activity for which the first broker was disciplined resulted in a profit to him of over \$20,000, yet the fine was for only \$11,000. Because the broker apparently retained a \$9000 net profit after the

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<sup>34</sup> When a floor broker or floor trader knowingly participates in multiple noncompetitive executions of customer orders, he or she has engaged in serious misconduct that both "damage[s] the integrity of the market and . . . erode[s] public confidence in the integrity of the futures industry." *In re Rouso*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,310 (CFTC Aug. 20, 1997). Penalties imposed for such misconduct, therefore, "should reflect and seek to deter the betrayal of the public interest caused by the [wrongdoer's] abuse of customers and a regulated public market." *In re Reddy*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (CFTC Feb. 4, 1998).

<sup>35</sup> The case involved a July/May customer spread order which the first broker began to fill as if it were an outright July buy order because, he claimed, he only saw the buy side of the order ticket initially. He placed the contracts he had purchased into his personal account, and then attempted to offset his error by selling May contracts. He then gave the customer order back to his clerk, who handed it to the second broker. The first broker then liquidated his July and May positions in a trade with the second broker, who was filling the customer order, though the first broker claimed he was unaware of that at the time.

fine, the Division believes that the penalty was inappropriately small relative to the profit made from the illegal transaction, as well as inadequate to be effective in deterring future similar violations. The Division believes that, as was indicated in the Commission's 1994 Guidance to Self-Regulatory Organizations on sanctions,<sup>36</sup> it is important for an exchange to consider any profit made by a member from his or her violative conduct in determining an appropriate sanction.<sup>37</sup>

The second case has resulted in a \$2000 fine for one broker for obliterating information on his trading card and a finding of no violation for another broker. The two members had originally been charged with prearranged trading. In the third case, the SP is seeking a settlement with two members that includes a total of \$100,000 in fines, two months' suspension, and cease and desist orders. The members are charged with prearranged trading, misuse of customer orders and alteration of quantities on a trading card to the detriment of the customer and the benefit of themselves, withholding executable customer orders from the market for the convenience of another member, inserting trades on trading cards out of sequence, and failing to submit one ply of their trading cards to the Exchange in a timely fashion.

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<sup>36</sup> The Guidance was issued in conjunction with the Commission's report, "A Study of CFTC and Futures Self-Regulatory Organization Penalties," November 1994.

<sup>37</sup> The Division is also of the view that if the broker in question was not to be fined all of his profit, then a trading suspension would be an appropriate additional sanction. In the past, the Commission has expressed the view that trading suspensions are especially appropriate for trade practice violations.

#### D. Timeliness of Disciplinary Proceedings

Commission Regulation 8.09 requires that an exchange disciplinary committee promptly review each investigation report and, if the committee determines that additional investigation or evidence is needed, promptly direct the enforcement staff to conduct further investigation. Within 30 days of receiving a completed investigation report, an exchange disciplinary committee must also either (1) determine that no reasonable basis exists for finding a violation or that prosecution is otherwise unwarranted and direct that no further action be taken or (2) determine that a reasonable basis exists for finding a violation which should be adjudicated and direct that the alleged violator be served with a notice of charges.<sup>38</sup>

The BCC met seven times during the target period and reviewed two trade practice investigations involving two members. It also met two weeks after the end of the target period to consider a third investigation involving two members. In each instance, the BCC made a determination on whether to charge a party at the committee meeting at which it formally reviewed the investigation report,<sup>39</sup> and also indicated what form of settlement it would be willing to accept. Thus, NYCE's BCC acted well within the 30-day time period set forth in Commission Regulation 8.09. Each of these three cases was resolved by settlement agreement in accordance with the terms which

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<sup>38</sup> A notice of charges is the equivalent of the Exchange's complaint and states the conduct in which the member is alleged to have engaged, the rule violation alleged, any predetermined penalty, and the member's rights with respect to a hearing. Commission Regulation 8.11.

<sup>39</sup> The BCC Chairman usually receives the investigation report the day it is signed by Compliance. The report is usually given to the members of the BCP hearing the case at least a week before the hearing.

the BCC indicated it would accept, and the disciplinary notices were all issued between three weeks and slightly over two months after the date of the BCC meeting. The Division believes that these time periods were reasonable. NYCE's Board reviews settlement offers at its regular bimonthly meetings following the date the offer is made.

### **E. Conclusions and Recommendations**

Based upon its review, the Division found that the Exchange generally maintains an adequate disciplinary program. Disciplinary matters are promptly referred to disciplinary committees, disciplinary action is taken in a reasonably timely manner, findings appear to be supported by the evidence. In one disciplinary action taken shortly after the end of the target period, however, an \$11,000 fine was levied for a trade practice violation that had led to a profit of over \$20,000 for the member being sanctioned. As the fine still left the member with a profit of \$9000, the Division believes that this disciplinary action was inadequate and may not deter similar violations in the future. During the target period, penalties imposed by NYCE for trade practice, audit trail, and recordkeeping violations consisted of fines totaling \$50,900, one five-year suspension, one 14-day suspension, and three orders to cease and desist.

Based on its review, the Division recommends that NYCE:

Consider any profit made by a member from his or her violative conduct in determining an appropriate sanction.