

UNITED STATES OF AMERICA  
BEFORE THE  
COMMODITY FUTURES TRADING COMMISSION

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CFTC Docket No. 09-12

IN THE MATTER OF  
J.P. MORGAN FUTURES INC.

Respondent.

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

**I.**

The Commodity Futures Trading Commission ("Commission") has reason to believe that J.P. Morgan Futures Inc. ("JPMFI"), a registered futures commission merchant ("FCM"), has violated Section 4d(a)(2) of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 6d(a) (2006), and Commission Regulations ("Regulations") 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3, 17 C.F.R. §§ 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3 (2009). Therefore, the Commission deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether JPMFI has engaged in the violations as set forth herein and to determine whether an order should be issued imposing remedial sanctions.

**II.**

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

<sup>1</sup> JPMFI consents to the entry of this Order, the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that JPMFI does not consent to the use of the Offer, or the findings or conclusions consented to in this Order, as the sole basis for any other proceeding brought by the Commission, other than in a proceeding in bankruptcy or to enforce the terms of this Order. Nor does JPMFI consent to the use of the Offer or this Order, or the findings or conclusions consented to in the Offer or this Order, by any other party in any other proceeding.

### III.

The Commission finds the following:

#### A. Summary

During the period May 31, 2007 through June 6, 2007 (the "relevant time"), JPMFI maintained accounts in which it kept customer funds (the "segregated accounts") and separate accounts in which it kept its own funds (the "house account"). At the close of business on May 31, 2007, the segregated accounts had a balance of approximately \$9.6 billion of which JPMFI had its own funds of approximately \$725 million (the "excess funds"). On June 1, 2007, JPMFI processed transactions related to the delivery of Treasury notes that resulted in JPMFI's segregated accounts being insufficiently funded. That is, the amount of segregated funds on deposit was less than the total amount of funds required to be kept segregated.

JPMFI further did not finish computing its segregation requirements until after 3 PM on June 4, 2007 instead of noon on June 4, 2007 as required, and did not notify the Commission that its segregated accounts had been insufficiently funded until June 6, 2007 instead of noon on June 4, 2007, when it should have known of the under-segregation. Additionally, JPMFI did not have a process in place to determine the impact of expected withdrawals from the segregated accounts on the amount required to be kept in segregation.

JPMFI has since enhanced existing procedures by implementing a segregation forecasting process to ensure that proper segregation is maintained.

#### B. Respondent

**J.P. Morgan Futures Inc.** maintains its principal offices at 277 Park Avenue, New York, NY 10172. JPMFI has been registered with the Commission as a FCM since November 23, 1982.

#### C. Facts

During the relevant time, JPMFI maintained segregated accounts in which it kept customer funds and the separate house account in which it kept its own funds.

At the close of business on May 31, 2007, JPMFI had approximately \$9.6 billion in its segregated accounts of which approximately \$725 million were excess funds. On May 31, 2007, JPMFI received delivery notices from the Chicago Board of Trade ("CBOT") for delivery of 5-year and 2-year Treasury notes (the "Treasuries") to satisfy the delivery obligations from expiring Treasury note futures contracts held by JPMFI and its customers.

On June 1, 2007, JPMFI processed \$2,761,346,381.46 for the delivery of the Treasuries through its house account; \$2,244,101,668.36 of that amount consisted of customer deliveries and the remainder was due to house affiliate proprietary deliveries and certain delivery errors for

which JPMFI assumed responsibility. On the same day, JPMFI processed \$1,329,374,138.12 of customer payments along with the corresponding delivery of treasuries to the underlying customers. JPMFI had received instructions to re-tender the next day a significant majority of the remaining Treasuries belonging to customers.

To pay for the remainder of the total delivery, JPMFI transferred \$1,450,000,000 from its segregated accounts to its house account. However, the Treasuries (exclusive of those Treasuries already delivered directly to customers) were not transferred to the segregated accounts, but remained in the house account. These securities were sufficient, had they been moved to a segregated accounts on this day, to allow JPMFI to maintain proper funding of its segregated account.

As a result of these transactions, by the end of business on June 1, 2007, the amount of funds on deposit in the segregated accounts was approximately \$8.4 billion which was less than the total amount of funds required to be kept segregated by approximately \$750 million.

On the next business day, June 4, 2007, JPMFI processed \$1,207,264,794.56 of re-deliveries. During the same day, JPMFI transferred \$1,250,000,000 from its house account to the segregated accounts, which resulted in JPMFI being sufficiently segregated.

On the same day, June 4, 2007, JPMFI did not finish its preliminary computations of its segregation requirements for June 1, 2007 until approximately 3 PM, instead of noon on June 4, 2007 as required.

On June 4 and 5, 2007, JPMFI staff reviewed the causes of the under-segregation in an attempt to determine if the computation was in error. JPMFI should have informed the Commission of this under-segregation on noon of June 4, 2007, when it should have known that its funds on deposit in the segregated accounts was less than required. Instead, JPMFI did not inform the Commission until mid-morning on June 6, 2007.

During the relevant time, JPMFI did not have a process in place to determine the impact of expected withdrawals from the segregated accounts on the amount required to be kept in segregation. Since the events in question, JPMFI has adopted internal policies to forecast daily what effect any expected withdrawals (such as delivery obligations) will have on segregation requirements and additionally adopted internal policies to reduce the possibility that JPMFI will use excess funds in the segregated accounts to fund the payment for deliveries received for its own account or those of any affiliates.

#### **D. Legal Discussion**

##### ***Undersegregation of customer funds***

Section 4d(a)(2) of the Act, 7 U.S.C. § 6d(a) (2006), provides that it shall be unlawful for any person to engage as a FCM unless such person shall "treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or

contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant . . . .”

Regulations 1.20 and 1.21, 17 C.F.R. §§ 1.20 and 1.21 (2009), require that all customers’ funds be separately accounted for, properly segregated and treated as belonging to such customers, and not commingled with the funds of any other person.

Regulation 1.23, 17 C.F.R. § 1.23 (2009), prohibits a FCM from drawing upon customer segregated funds beyond its actual interest therein.

By transferring \$1,450,000,000 from its segregated accounts to its house account, JPMFI drew upon customer segregated funds beyond its actual interest therein. In so doing, JPMFI violated Section 4d(a)(2) of the Act and Regulations 1.20, 1.21, and 1.23

#### ***Untimely Computation of Segregation***

Regulation 1.32, 17 C.F.R. § 1.32 (2009), requires that each FCM must compute as of the close of each business day the amount of such customer funds required by the Act and the Regulations to be on deposit in segregated accounts on behalf of the FCM’s commodity and option customers and must complete this computation prior to noon on the next business day.

Because JPMFI did not compute its segregation obligations for June 1, 2007, prior to noon of June 4, 2007, JPMFI violated Regulation 1.32.

#### ***Untimely Notification of the Commission of Undersegregation***

Regulation 1.12(h), 17 C.F.R. § 1.12(h) (2009), requires, in relevant part, that whenever a FCM knows or should know that the total amount of its funds on deposit in segregated accounts on behalf of customers is less than the total amount of such funds required by the Act and the Regulations to be on deposit in segregated or secured amount accounts on behalf of such customers, the registrant must report such deficiency immediately by telephone notice, confirmed immediately in writing by facsimile notice, to the registrant’s designated self-regulatory organization and the principal office of the Commission in Washington, DC, to the attention of the Director and the Chief Accountant of the Division of Clearing and Intermediary Oversight.

Because JPMFI knew or should have known of its under-segregation deficiency in its segregated accounts by noon on June 4, 2007, but did not report this deficiency until June 6, 2007, JPMFI violated Regulation 1.12(h).

### *Failure to Supervise*

Regulation 166.3, 17 C.F.R. § 166.3 (2009), requires that every Commission registrant (except associated persons who have no supervisory duties) diligently supervise the handling by its partners, employees and agents of all activities relating to its business as a registrant. Regulation 166.3 imposes on registrants an affirmative duty to supervise their employees and agents diligently by establishing, implementing, and executing an adequate supervisory structure and compliance programs. In order to prove a violation of Regulation 166.3, it must be demonstrated that either: (1) the registrant's supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *In re Murlas Commodities*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485 at 43,161 (CFTC Sept. 1, 1995); *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC Apr. 1, 1992); *Bunch v. First Commodity Corp. of Boston*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352 at 39,168-69 (CFTC Aug. 5, 1992).

Under Regulation 166.3, a FCM has a "duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents." *Samson Refining Co. v. Drexel Burnham Lambert, Inc.* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,596 at 36,566 (CFTC Feb. 16, 1990) (quoting *Lobb v. J.T. McKerr & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,568 at 36,444 (CFTC Dec. 14, 1989)). Evidence of violations that "should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly" is probative of a failure to supervise. *Paragon Futures*, ¶ 25,266 at 38,850.

A diligent system of supervision should have detected that the transfer of funds from the segregated accounts on June 1, 2007, without an equivalent deposit of securities into the segregated accounts, would result in under-segregation of customer funds. As described above, JPMFI failed to diligently supervise the handling of customer funds held in segregation on June 1, 2007, and thus caused the under-segregation of customer funds that day. In so doing, it violated Regulation 166.3.

## IV.

### FINDINGS OF VIOLATIONS

As described above, JPMFI: (i) drew upon customer segregated funds beyond its actual interest therein, thus resulting in customer funds being commingled with its funds, (ii) did not compute its segregation obligations for June 1, 2007, prior to noon of June 4, 2007; (iii) did not report the under-segregation deficiency until June 6, 2007; and (iv) failed to diligently supervise the handling of customer funds held in segregation on June 1, 2007.

Based on the foregoing, the Commission finds that JPMFI violated Section 4d(a)(2) of the Act, 7 U.S.C. § 6d(a)(2) (2006), and Regulations 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3, 17 C.F.R. §§ 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3 (2009).

V.

**OFFER OF SETTLEMENT**

JPMFI has submitted the Offer in which it acknowledges service of this Order, admits the jurisdiction of the Commission with respect to all matters set forth in this Order and waives: (1) the filing and service of a complaint and notice of hearing; (2) a hearing; (3) all post-hearing procedures; (4) judicial review by any court; (5) any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer; (6) any and all claims that it may possess under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000), and Part 148 of the Regulations, 17 C.F.R. §§ 148.1, *et seq.*, relating to or arising from this proceeding; (7) any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act, Pub. L. 104-121, §§ 231-232, 110 Stat. 862 (1996), as amended by Pub. L. No. 110-28, 121 Stat. 112 (2007), relating to or arising from this proceeding; and (8) any claim of Double Jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief.

JPMFI stipulates that the record basis on which this Order is entered consists of this Order and the findings in this Order consented to which JPMFI consented in its Offer. JPMFI consents to the Commission's issuance of this Order, which makes findings as set forth herein and orders that: (1) JPMFI and its successors and assigns cease and desist from violating Section 4d(a)(2) of the Act, 7 U.S.C. § 6d(a)(2) (2006), and Regulations 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3, 17 C.F.R. §§ 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3 (2009); (2) JPMFI pay a civil monetary penalty in the amount of three hundred thousand dollars (\$300,000), plus post-judgment interest, within ten (10) days of the date of the entry of this Order; and (3) JPMFI and its successors and assigns comply with its undertakings consented to in the Offer and set forth below in Part VI.C of this Order.

Upon consideration, the Commission has determined to accept JPMFI's Offer.

VI.

**ORDER**

**Accordingly, IT IS HEREBY ORDERED THAT:**

- A. JPMFI shall cease and desist from violating Section 4d(a)(2) of the Act, 7 U.S.C. § 6d(a)(2) (2006), and Regulations 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3, 17 C.F.R. §§ 1.12(h), 1.20, 1.21, 1.23, 1.32 and 166.3 (2009).
- B. JPMFI shall pay a civil monetary penalty in the amount of three hundred thousand dollars (\$300,000), plus post-judgment interest, within ten (10) days of the date of the entry of this Order. Post judgment interest shall accrue beginning eleven days after the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of

entry of this Order pursuant to 28 U.S.C. § 1961. JPMFI shall pay this penalty by electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made by other than electronic funds transfer, the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

Commodity Futures Trading Commission  
Division of Enforcement  
ATTN: Marie Bateman AMZ-300  
DOT/FAA/MMAC  
6500 S. MacArthur Blvd.  
Oklahoma City, OK 73169  
Telephone: 405-954-6569

If payment by electronic funds transfer is chosen, JPMFI shall contact Marie Bateman or her successor at the above address to receive payment instructions and shall fully comply with those instructions. JPMFI shall accompany payment of the penalty with a cover letter that identifies JPMFI and the name and docket number of this proceeding. JPMFI shall simultaneously transmit copies of the cover letter and the form of payment to: 1) the Director, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street, N.W., Washington, DC 20581, 2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission, at the same address, and 3) Regional Counsel, Commodity Futures Trading Commission, Eastern Regional Office, 140 Broadway, 19<sup>th</sup> Floor, New York, NY 10005. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2) (2006), if this amount is not paid in full within fifteen (15) days of the due date, JPMFI shall be prohibited automatically from the privileges of all registered entities, and, if registered with the Commission, such registration shall be suspended automatically until it has shown to the satisfaction of the Commission that payment of the full amount of the penalty, with interest thereon to the date of the payment, has been made.

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

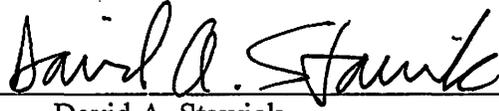
- 1) JPMFI shall take the necessary steps to monitor and enforce its rules and procedures, including those concerning transfers from and to its segregated accounts, to assure that those accounts remain properly funded and segregated;
- 2) JPMFI shall implement and enforce the following procedures in connection with handling of customer funds required to be segregated:
  - i. Before the close of each business day, 5:00 p.m. eastern time, JPMFI shall create a segregation projection report (the "segregation projection report") to determine the excess or deficit amount necessary to satisfy its obligations taking into account those cash and securities transactions that

are expected to impact excess segregated funds. In the event that the segregation projection report results in a preliminary deficit, JPMFI will draw upon existing lines of credit or transfer sufficient funds into segregation in order to ensure sufficient excess funds are maintained;

- ii. The segregation projection report shall include an explanation of any material differences (the lesser of \$50 million or 10%) in the day's forecast of excess segregation with the actual computation of segregation performed for that day;
  - iii. Before the close of each business day, 5:00 p.m. eastern time, JPMFI shall prepare a reconciliation of the change in excess funds in segregated accounts between the last two business days as reflected on the actual segregation computations (the "excess funds reconciliation report");
  - iv. The segregation projection report and the excess funds reconciliation report will include identifying information, including the date and time it was generated, the name of the person responsible for its contents and the name of the person who reviewed it;
  - v. JPMFI shall maintain these segregation projection reports and excess funds reconciliation reports in accordance with Regulation 1.31, 17 C.F.R. § 1.31 (2009);
- 3) JPMFI shall comply with the provisions of Regulation 1.12(h), 17 C.F.R. § 1.12(h) (2009), whenever a daily computation report of the amount on deposit in segregated and secured accounts on behalf of the FCM's commodity and option customers reports that the accounts are under-segregated regardless of subjective doubts as to the report's accuracy;
  - 4) Neither JPMFI nor any of its successors, assigns, employees, agents, attorneys or representatives shall take any action or make any public statement denying, directly or indirectly, any finding in this Order, or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect JPMFI's: (i) testimonial obligations; or (ii) right to take appropriate legal positions in other proceedings to which the Commission is not a party. JPMFI and its successors and assigns shall undertake all steps necessary to ensure that all of its employees, agents, attorneys and representatives under its authority and/or actual or constructive control understand and comply with this undertaking.
  - 5) The above procedures shall be in place and in use by JPMFI and all of its affiliate FCMs no later than 30 days from the date of this Order.

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

**By the Commission**

A handwritten signature in black ink, reading "David A. Stawick", is written over a horizontal line.

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission

Dated: September 9, 2009