

TRADE PRACTICE
RULE ENFORCEMENT REVIEW
The New York Mercantile Exchange and
The Commodity Exchange



Division of Market Oversight

November 21, 2014

I. Rule Enforcement Review Scope

The Division of Market Oversight (“Division”) has completed a rule enforcement review of the trade practice surveillance program of the New York Mercantile Exchange, Inc. (“NYMEX”) and the Commodity Exchange, Inc. (“COMEX”) (the “Exchanges”), wholly-owned subsidiaries of CME Group, Inc.¹ The review focused on compliance with two core principles under Section 5(d) of the Commodity Exchange Act (“Act” or “CEA”),² as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)³ and Part 38 of the Commission’s regulations.⁴ The Division’s review focused on Core Principles 2 (*Compliance With Rules*)⁵ and 12 (*Protection of Markets and Market Participants*),⁶ and

¹ Rule enforcement reviews prepared by the Division are intended to present an analysis of an exchange’s overall compliance capabilities during the period under review. Such reviews deal only with programs directly addressed in the review and do not assess all programs or core principles. The Division’s analyses, conclusions, and recommendations are based, in large part, upon the Division’s evaluation of a sample of investigations 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.

The findings and recommendations in this rule enforcement review are limited to the Exchanges and their respective products. This rule enforcement review, and the findings and recommendations herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission.

² 7 U.S.C. 1 et seq.

³ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

⁴ On May 10, 2012, the Commission issued its Final Rules, Core Principles and Other Requirements for Designated Contract Markets, 77 Fed. Reg. 36612 (June 19, 2012) (“New DCM Regulations”), which became effective on October 17, 2012. Among other things, the New DCM Regulations adopted rules for Core Principles 2 and 12, including rules which codified previous guidance and acceptable practices for these core principles. Because both the New DCM Regulations and their predecessors were in effect during the target period, the Division reviewed the Exchanges’ trade practice surveillance program for compliance with the substantive standards of Core Principles 2 and 12 both before and after the New DCM Regulations, as applicable.

⁵ Core Principle 2 – Compliance with Rules:

- A. IN GENERAL – The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including-
 - i. access requirements
 - ii. the terms and conditions of any contracts to be traded on the contract market; and
 - iii. rules prohibiting abusive trade practices on the contract market.

Commission regulations §§ 38.150; 151(a); 151(c); 152, 153, 155, 156, 158; and 650–651.⁷ The Division’s review of the Exchanges’ trade practice surveillance program covered the period from July 1, 2012 to June 30, 2013 (“target period”).⁸

In conducting this review, Division staff interviewed officials and staff from the Exchanges. The Exchanges also provided a demonstration of the electronic systems that they use to perform trade practice surveillance. The Division reviewed numerous documents produced by the Exchanges’ staff, including the following:

- policies and procedures used to conduct trade practice surveillance;
- investigation documents and associated work product for a sample⁹ of the research files, complaints (“pre-case matters”) and cases related to potential trade

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- B. CAPACITY OF CONTRACT MARKET – The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.
 - C. REQUIREMENT OF RULES – The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this subsection, including the capacity to carry out such international information-sharing agreements as the Commission may require.

⁶ Core Principle 12 – Trade Information:

The board of trade shall establish and enforce rules—

- A. to protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and
- B. to promote fair and equitable trading on the contract market.

⁷ See Appendix B for a table of Core Principles and Regulations Reviewed. Commission regulations 38.151(b), 38.157, and 38.159 were not reviewed directly because this review focused only on regulations related to trade practice surveillance. In addition, the Division’s review of § 38.151(c) was limited in scope to suspensions and revocations of access imposed in connection with trade practice matters that were closed during the target period. Because the substantive requirements of Core Principle 12 that relate to trade practice surveillance are similar to those of Core Principle 2, the Division has evaluated compliance with Core Principle 2 and the selected regulations listed herein rather than conduct a separate review of Core Principle 12 and its associated regulations, Commission regulations 38.650-651.

⁸ The Exchanges’ trade practice surveillance program was previously reviewed in the Division’s August 30, 2011 rule enforcement review, which covered the target period from January 1, 2009 to December 31, 2009.

⁹ Division staff reviewed the entirety of each research file, complaint file, and case file produced by the Exchanges. To ensure a sufficient sample size, the Division reviewed at least half of each category of trade practice matters closed during the target period (88 of 136 research files, 41 of 82 complaints, and 30 of 47 cases).

practice violations (“trade practice-related”) that were closed during the target period;¹⁰

- minutes of meetings of the Board of Directors and the Market Regulation Oversight Committee (“MROC”) held during the target period; and
- reports from the Exchanges’ tracking system for the disposition of trade practice matters.

The Division analyzed the Exchanges’ trade practice surveillance program to determine whether the program was in compliance with the core principles and Commission regulations stated above during the target period, and whether there are any deficiencies with, or recommendations for, the program. For purposes of this report, a *deficiency* is an area where the Division believes the Exchanges are not in compliance with a Commission regulation and must take corrective action, and a *recommendation* concerns an area where the Division believes the Exchanges should improve their compliance program. As set forth below, the Division found that the Exchanges generally demonstrated compliance with Core Principles 2 and 12, and Commission regulations 38.150; 151(a); 151(c); 152, 155, 156, and 650–651. The Division found one deficiency and made one recommendation under Commission regulation 38.158, and made three recommendations under Commission regulation 38.153.

The Division provided the Exchanges an opportunity to review and comment on a draft of this report on October 9, 2014. On October 15, 2014, Division staff conducted an exit conference with officials from the Exchanges to discuss the report’s findings and recommendations.

¹⁰ See Section II for an overview of research files, complaints, and cases. In Appendix A, see the analysis under § 38.153 for a description of research files and complaints (both of which are pre-case matters), and the analysis under § 38.158 for a description of cases.

II. Summary of Findings, Recommendations, and Deficiencies

A. Findings without Recommendations or Deficiencies

1. Rulebook and jurisdiction (Core Principle 2, Commission regulations 38.150, 38.151(a), 38.152)
 - The NYMEX Rulebook (“Rulebook”) applies to both NYMEX and COMEX. The Division found that the Rulebook extends jurisdiction to members and market participants and prohibits the trade practice violations enumerated in Commission regulation 38.152.
2. Staff and technology (Core Principle 2, Commission regulations 38.155, 38.156)
 - The Division found that the Exchanges maintain sufficient compliance department staff to conduct trade practice surveillance in compliance with Core Principles 2 and 12. The Exchanges’ trade practice surveillance program is conducted by 59 employees in the Investigations Group (“Investigations”) within the Market Regulation Department.
 - The Division found that the Exchanges’ automated trade practice surveillance tools comply with Commission regulation 38.156. The Exchanges’ primary automated trade practice surveillance database and analytic tool is the SMART system, which enables pattern detection and ad-hoc review of electronic and open-outcry trades. The Exchanges also use Large Trader, a database application that tracks positions in accounts that are reportable due to large positions, and RAPID, a system which provides live and historical views into electronic trades.
3. Capacity to detect and investigate rule violations (Core Principle 2, Commission regulation 38.153)¹¹
 - The Exchanges’ trade practice surveillance work is divided between “research files,” “complaints” (pre-case matters) and “cases.” Research files are generated by program teams that seek to identify a particular subset of violations (e.g. cross trades or money passes) that occurred within a particular month or quarter by reviewing automated alerts and conducting ad-hoc queries. Complaints are received from sources within the Exchanges or external sources by phone, written message, or in-person communication. For each complaint, investigators review trade and order data, retain audio and video data, and send information requests as necessary to verify the facts alleged. Research files, complaints and cases are conducted by Investigations staff in Market Regulation.

¹¹ See below for recommendations related to Commission regulation 38.153.

- Subject to the recommendations identified below related to Commission regulation 38.153 regarding spoofing and the timeliness of research files, the Division found that the Exchanges adequately conducted research files during the target period. In each research file reviewed, investigators thoroughly analyzed whether conduct warranted case initiation or case referral, and research processes in the files reviewed were thoroughly documented.
 - Subject to the recommendation regarding the timeliness of complaints related to Commission regulation 38.153, the Division determined that the Exchanges adequately conducted complaints during the target period. Investigators identified and retained information relevant to complaints, including messaging and order data, and thoroughly analyzed whether complaints warranted case initiation or case referral in each complaint reviewed. Each reviewed complaint was thoroughly documented in complaint closeout memoranda.
4. Investigations and investigation reports (Core Principle 2, Commission regulation 38.158)
- Cases are conducted by Investigations staff, who review material from the underlying research file or complaint in addition to other relevant data, such as messaging information, trade data, audit trail information, and audio/visual data (e.g. sound and/or video recordings). Investigators collect documents from market participants and conduct interviews with relevant persons.
 - Subject to the deficiency identified regarding the timeliness of cases pursuant to 38.158, the Division found that the Exchanges adequately conducted cases during the target period. The Division found the quality of the investigative work in the cases reviewed to be thorough and complete. Questions by investigators to market participants were well-informed based on research into the circumstances of each reviewed case. Investigators adequately collected, reviewed, and analyzed relevant data, including messaging data and transactional data. In addition, the Division found that the Exchanges' decisions whether or not to pursue disciplinary action were appropriate in the cases reviewed.

B. Findings with Recommendations

1. Investigations and investigation reports (Core Principle 2, Commission regulation 38.158)
- The Exchanges maintain records of all research files, complaints, and cases in Legal Files, a database application. Although Legal Files broadly identifies the source of each potential violation (customer complaint, CME referral, research group which identified the potential violation), the

database lacks fields that track relationships between categories of potential violations (i.e. the originating complaint or research file number for cases, or the resulting case number for complaints or research files that are referred to cases).

- **Recommendation: The Division recommends that the Exchanges implement a system which would enable Market Regulation staff to efficiently track the connections between originating complaints, originating research files, and cases, and thereby identify the source of time delays.**

2. Capacity to detect rule violations (Core Principle 2, Commission regulation 38.153)

- The Exchanges' "messaging" research program and other internal programs identified few spoofing cases during the target period. Of the ten cases opened during the target period involving potential spoofing, eight were initiated from complaints. One spoofing case was initiated from the "indicative opening price" research program, and one spoofing case was initiated as a result of an internal CME referral. The "messaging" research program, which was initiated in January 2013 to identify spoofing and other problematic messaging behaviors, did not result in the initiation of any spoofing cases during the target period. The messaging research program began conducting regular reviews in April 2013, and after the target period it did initiate two spoofing cases based on activity during the target period.

- **Recommendation: The Division recommends that the Exchanges continue to develop strategies to detect spoofing.**

- During the target period, the Exchanges closed 136 trade practice-related research files. The average duration of these 136 research files was 222 days. The Division is concerned with the length of time the Exchanges take to complete research files. If problematic behavior from a particular month is undetected within a research file for several months and a case is not promptly initiated, case resolution is ultimately delayed.

- **Recommendation: The Division recommends that the Exchanges reduce the time they take to complete research files.**

- The Exchanges closed 82 trade practice-related complaints during the target period. Of these closed complaints, the average length of time that complaints were open was 109 days. Fifty complaints remained open for longer than 60 days. The Division is concerned with the length of time the Exchanges take to complete complaints. If problematic behavior identified in a complaint remains undetected for an extended time and a

case is not promptly initiated, case resolution is ultimately delayed, which makes repeated transgressions more likely to occur.

- **Recommendation: The Division recommends that the Exchanges reduce the time they take to complete complaints.**

C. Findings with a Deficiency

1. Investigations and investigation reports (Core Principle 2, Commission regulation 38.158)

- During the target period, the Exchanges closed 47 trade practice-related cases. As explained in detail in Appendix A, the average length of time cases were open was 253 days. Thirteen cases remained open for more than 365 days but less than 730 days. One case remained open for 730 days or more. Of the 14 cases that were open for more than 365 days, the Division identified one case without sufficient mitigating circumstances to justify the length of time the case was open. Commission regulation 38.158(b) requires that investigations be completed in one year or less, absent mitigating circumstances.
 - **Deficiency: As required by Commission regulation 38.158(b), the Exchanges must complete investigations in one year or less, absent mitigating circumstances.**

Additional details regarding the facts and analysis relevant to the Division's review are contained in the Compliance Matrix in Appendix A.

Appendix A Compliance Matrix

CFTC Regulation	Findings Regarding Exchanges' Compliance	Deficiencies and Recommendations
Core Principle 2 – Compliance with Rules		
§ 38.150 Core Principle 2	<u>Rulebook</u> The NYMEX Rulebook (“Rulebook”) applies to both NYMEX and COMEX.	No deficiencies or recommendations.
§ 38.151 ¹² (a) Jurisdiction	The Exchanges extend jurisdiction to members and market participants through Rule 418 of the Rulebook.	No deficiencies or recommendations.
§ 38.152 Abusive trading practices prohibited	Chapters 4 and 5 of the Rulebook prohibit the trade practice violations enumerated in Commission regulation 38.152. ¹³	No deficiencies or recommendations.
§ 38.155 Compliance staff and resources	<p>The Exchanges’ regulatory program is administered by the Market Regulation Department, which is also responsible for regulatory programs of other CME Group exchanges, including Chicago Mercantile Exchange Inc. (“CME”), Board of Trade of the City of Chicago Inc. (“CBOT”), and the Swap Execution Facility Division of the CME (“CME SEF”). Market Regulation, made up of employees from CME and NYMEX, provides regulatory services to CME Group entities pursuant to a regulatory service agreement.</p> <p>The Division found that the Exchanges maintain sufficient compliance department staff to conduct trade practice surveillance. Employees in the Investigations Group (“Investigations”) within the Market Regulation Department are responsible for identifying trade practice violations. As of September 2014, the Investigations Group consisted of 59 individuals who were responsible for identifying trade practice violations: two Executive</p>	No deficiencies or recommendations.

¹² Commission regulation 38.151(b) was not reviewed directly because this review focused on regulations related to trade practice surveillance. The Division’s review would have been expanded to cover 38.151(b) if relevant issues had been identified in the course of reviewing other subparts of 38.151 or other regulations.

¹³ See NYMEX Rules 500, 539, 432(B), 432(G); and 575.

	<p>Directors, 46 Chicago-based Investigation staff (including three trading floor investigators), and 13 New York-based Investigations staff (including one trading floor investigator).¹⁴</p> <p>New York-based Investigation staff members are primarily dedicated to NYMEX and COMEX issues, including trade practice surveillance of NYMEX and COMEX, whereas Chicago-based Investigation staff members are primarily dedicated to CME, CBOT, and CME SEF products. However, research program and complaint teams made up of staff from both the New York and Chicago offices review research files and complaints across CME Group entities.</p>	
<p>§ 38.156 Automated trade surveillance system</p>	<p>The Exchanges use three automated systems to conduct trade practice surveillance:</p> <ul style="list-style-type: none"> • SMART: Primary automated trade practice surveillance database / analytic tool. Integrates trade and order records of cleared transactions for electronic trades (Globex) and open outcry trades. Runs batch processes on data to detect trading patterns for individualized review by investigators. Also allows investigators to conduct ad-hoc searches and analyses of trading data. • Large Trader: Database application that contains all positions in accounts that become reportable due to large positions. Populated by information provided by trading firms on a daily basis. Contains a market participant database which lists names of owners or controllers of accounts identified on Form 102. Supplemented by identification data from the Exchanges' Fee System, which contains data on accounts registered for a fee incentive. • RAPID: Provides live or historical views into Globex, including orders, modifications, cancellations, fill confirmation, and a view of the order book at a given time. Contains a live alert system. 	<p>No deficiencies or recommendations.</p>

¹⁴ In addition to consisting of employees dedicated to identifying trade practice violations, the Investigations Group also consists of the Data Investigations sub-group (formerly Data Quality Assurance), which is responsible for reviewing compliance with electronic and open outcry audit trail and recordkeeping requirements.

<p>§ 38.153 Capacity to detect and investigate rule violations</p>	<p><u>Detecting rule violations</u></p> <p>The Exchanges’ trade practice surveillance program is divided between pre-case matters (research files and complaints) and cases. The Investigations Group can issue warning letters directly from research and complaints as well as from cases, and warning letters are the most severe sanction that the Investigations Group can impose. For trade practice violations,¹⁵ sanctions greater than warning letters can only be imposed after cases are referred to Enforcement,¹⁶ through a settlement with Enforcement or through disciplinary decision. Research files, complaints, and cases are tracked individually in Legal Files, a database application.¹⁷</p> <p><u>Collecting information and documents</u></p> <p>Rule 401 provides the Chief Regulatory Officer (“CRO”) with the authority to collect information from all persons subject to the jurisdiction of the Exchanges. In addition, Rule 401 empowers the CRO to require persons to produce books and records and to answer questions regarding alleged rule violations. This authority is delegated to the Market Regulation Department.</p>	<p>See below, under “Pre-Case” for recommendations related to research files and complaints.</p>

¹⁵ Cases which involve trading floor infractions (i.e. use of obscenity on the trading floor or physical altercations) can be referred directly from Investigations (without the involvement of Enforcement) to the Floor Conduct Committee, which has the authority to issue fines pursuant to NYMEX Rule 514.

¹⁶ Market Regulation’s Enforcement Group, and related staffing, processes, and timeliness of concluding enforcement investigations and cases, are addressed in a separate rule enforcement review.

¹⁷ See the analysis under § 38.158 for a description of Legal Files and a related recommendation.

	<p style="text-align: center;"><u>Pre-case</u></p> <p style="text-align: center;">Research files</p> <p><u>Research File Procedures</u> Thirteen research program teams are each dedicated to identifying a subset of violations. Division staff reviewed policies related to each research program.</p> <ul style="list-style-type: none"> ○ <u>Money Pass Program</u>: Seeks to identify transactions made for the purpose of transferring funds between accounts. ○ <u>Rule 527/DTOS¹⁸ Program</u>: Seeks to identify instances in which floor brokers assign a trade to a personal account that was ineligible for assignment or otherwise improperly and directly take the opposite side of a customer’s order. ○ <u>Block Trade Program</u>: Seeks to identify block trades that were not executed in conformance with the requirements of Exchanges’ Rule 526, including the requirements that only eligible contract participants may enter into block trades and that sellers ensure that block trades are reported to the Exchanges within five minutes of the transaction. ○ <u>Globex Cross Trade Program</u>: Monitors for orders for different beneficial owners that are intentionally crossed on Globex without satisfying the competitive execution requirements of Exchanges’ Rules 533, 539, and 531. ○ <u>Indicative Opening Price Program</u>: Seeks to identify improper conduct during pre-opening period. <ul style="list-style-type: none"> ● During the target period, the Indicative Opening Price Program led to the initiation of one case involving potential spoofing. 	
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¹⁸ DTOS stands for “directly taking the opposite side of a transaction.”

	<ul style="list-style-type: none"> ○ <u>Messaging Program</u>: Seeks to identify Globex orders that have been “placed without the intent to execute a bona fide transaction” and other “disruptive” messaging activity, including spoofing.¹⁹ <ul style="list-style-type: none"> ● The Exchanges’ “messaging” research program and other internal programs identified few spoofing cases during the target period. Of the ten cases opened during the target period involving potential spoofing, eight were initiated from complaints. One spoofing case was initiated from the “indicative opening price” research program, and one spoofing case was initiated as a result of an internal CME referral. The “messaging” research program, which was initiated in January 2013 to identify spoofing and other problematic messaging behaviors, did not result in the initiation of any spoofing cases during the target period. The messaging research program began conducting regular reviews in April 2013, and after the target period it did initiate two spoofing cases based on activity during the target period. ○ <u>Pit Cross / DTOS Program</u>: Seeks to identify, in open outcry trading, orders which were not executed competitively and orders which have been assigned improperly. ○ <u>Research Program</u>: Seeks to “identify potential trade practice abuses and rule violations through unstructured surveillance focusing on areas not covered by specific surveillance programs.” <ul style="list-style-type: none"> ● Prior to January 2013, the Research program was responsible for detecting disruptive messaging activity, including spoofing. ○ <u>Settlements Program</u>: Seeks to identify trading intended to 	<p><u>Recommendation</u></p> <p>The Division recommends that the Exchanges continue to develop strategies to detect spoofing.</p>
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¹⁹ Separately, the CME Group Global Command Center (“GCC”) manages a Messaging Efficiency Program that imposes fees on executing firms that exceed specified ratios of messages to traded volume. The purpose of the Messaging Efficiency Program is to “encourage responsible messaging practices, ensure efficient market operations, allow for broad market participation and foster high quality, liquid markets.”

	<p>influence settlement prices of any contract.</p> <ul style="list-style-type: none"> ○ <u>Trading at Settlement Program</u>: Seeks to identify trading intended to influence settlement/marker prices for three types of contracts, as applicable: Trading at Settlement (TAS) contracts, Matched Order (MO) eligible contracts, and Trading at Market (TAM) contracts. ○ <u>Wash Trade Program</u>: Seeks to identify wash trades. ○ <u>Trading Ahead Program</u>: Seeks to identify instances in which transactions are executed for proprietary accounts before a customer order is executed. ○ <u>Transfer Trade Program</u>: Seeks to verify that positions are properly transferred between accounts on the books of a single clearing member or to another clearing member. <p>Research groups focus on trading or messaging data from either a single month or a single quarter. Research files may cover one or multiple CME Group exchanges, but the counts below reflect research files that involved NYMEX or COMEX. All programs examine data on a monthly basis, except for the Research Program, which examines data on a quarterly basis. A research file is opened for each time period. For each research file, investigators review automated alerts and conduct ad-hoc queries, both of which cover the behavior of numerous market participants. Initially, investigators run computerized exception reports with set parameters. Investigators can narrow parameters using ad-hoc queries to focus on particular trades or market participants.</p> <p><u>Disposition of Research Files</u></p> <p>While research files are ongoing, problematic behavior identified in the course of the research file involving particular market participants can be opened as new cases or can be referred to existing cases if sufficiently related. Specifically, each time problematic behavior is discovered that the reviewing investigator and the research file team-leads believe warrants further inquiry, a case is initiated. If the underlying activity relates to an existing case that had</p>	
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	<p>been opened previously, a referral is made to that existing case. In addition, warning letters can be issued directly from research files.²⁰</p> <p>When investigators have finished reviewing data for the time period applicable to a research file (i.e. a month or a quarter), the research file is closed with a closeout memorandum and an accompanying spreadsheet. The spreadsheet describes the methodology of review taken by each investigator working on the research file and lists all case initiations and referrals to existing cases that were made while the research file was open. Investigators or team leads sign off on closeout memoranda.</p> <p><u>Research Files Opened During Target Period</u>²¹</p> <p>The Exchanges opened 229 trade practice-related research files during the target period. COMEX inquiries accounted for 113 of the research files opened (49 percent), NYMEX inquiries accounted for 112 (49 percent), and multiple-exchange inquiries accounted for four (two percent).</p> <p>Of the 229 research files opened, 59 were closed during the target period. From these 229 files, based on activity on the Exchanges,²² 23 warning letters were issued, two cases were initiated (from which no referrals to Enforcement were made during the target period), and two referrals were made to existing cases (from which no referrals to Enforcement were made during the target period).</p>	
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²⁰ When evaluating whether to issue a warning letter, the Exchanges consider the degree of harm caused by the offense, the perceived likelihood of recidivist behavior, the prior history of the potential respondent, and the quantity and quality of evidence that could be obtained showing that a rule violation has occurred.

²¹ In this subsection, the Division tracked the source and disposition of research files that were opened, rather than closed, during the target period in order to focus on market activity that occurred during the target period. The Division believes this tracking methodology is appropriate for this subsection based on the length of time that research files remain open and the Exchanges' policy of initiating cases while research files are ongoing.

²² As mentioned above, research files may involve activity that occurred at multiple CME Group exchanges in addition to NYMEX or COMEX. As a result, depending on the source of the activity (i.e. NYMEX/COMEX or another CME Group exchange) that is found to warrant case referral or initiation, a research file may lead to a NYMEX case, a COMEX case, a case at another CME Group exchange, or a combination thereof. The counts in this paragraph track NYMEX and COMEX cases only. Warning letter counts only include warning letters based on activity occurring on NYMEX or COMEX.

	<p><u>Timeliness of Research Files</u></p> <p>The Exchanges closed 136 trade practice-related research files during the target period, 79 of which had been opened prior to the target period. Of these 136 research files, the average duration was 222 days. The average duration of monthly reviews was 229 days, with 78 monthly research files having been open for longer than 180 days. The average duration of quarterly reviews was 122 days, with no quarterly research files having been open for longer than 180 days. Although the Division understands that cases can be initiated before a research file is closed, the Division is concerned with the length of time the Exchanges take to complete research files. If problematic behavior from a particular month is undetected within a research file for several months and a case is not promptly initiated, case resolution is ultimately delayed, and repeated transgressions are more likely to occur.</p> <p><u>Conduct of Research Files</u></p> <p>Division staff reviewed 88 of the 136 trade practice-related research files that were closed during the target period (65 percent). Based on this review and subject to the recommendation identified above regarding spoofing and the timeliness of research files, the Division found that the Exchanges adequately conducted research files during the target period. In each research file reviewed, investigators thoroughly analyzed whether conduct warranted case initiation or case referral. Research processes in the files reviewed were thoroughly documented in closeout memoranda and associated spreadsheets.</p> <p><u>Warning Letters</u></p> <p>As noted above, of the 229 trade practice-related research files opened during the target period, the Exchanges issued 23 warning letters (to 23 respondents) directly from research files. In its review of these warning letters, the Division identified no instances in which warning letters were issued to the same entity for the same violation within a twelve month period.</p>	<p><u>Recommendation</u></p> <p>The Division recommends that the Exchanges reduce the time they take to complete research files.</p>
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	<p style="text-align: center;"><u>Pre-case</u></p> <p style="text-align: center;">Complaints</p> <p><u>Complaint Procedures</u></p> <p>Complaints are received from internal (CME Group) sources or external sources by phone, written message, or in-person communication. Once received, complaints are logged and tracked in Legal Files.²³ Complaint team leads assign received complaints to investigators. Investigators review trade and order data, retain audio and video data, and send information requests as necessary to verify the facts alleged in complaints. Complaints may involve activity that occurred on one or multiple CME Group exchanges; all the counts below reflect complaints that involved NYMEX or COMEX.</p> <p><u>Disposition of Complaints</u></p> <p>Complaints are closed in one of several ways. Where no evidence of a rule violation is found, complaints are closed with no action and a closeout memorandum is drafted. Where investigators have verified the facts of a complaint and have identified and preserved relevant evidence that suggests that a rule has been violated, a closeout memorandum is drafted and the complaint is referred to a new case, or if the underlying activity relates to an existing case or complaint that had been opened previously, an existing case or complaint. Market Regulation can also issue warning letters directly from complaints.</p> <p>Closeout memoranda are drafted by investigators and reviewed by complaint team leads. Similarly, decisions to refer complaints made by investigators are subject to the review of the complaint team leads.</p> <p><u>Complaints Opened During Target Period</u></p> <p>The Exchanges opened 81 trade practice-related complaints during the target</p>	
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²³ See the analysis under § 38.158 for a description of Legal Files and a related recommendation.

	<p>period, 16 of which had been opened prior to the target period. Of the 81 trade practice complaints that were opened during the target period, 71 were closed during the target period. NYMEX complaints accounted for 46 (57 percent) of the opened complaints, COMEX for 31 (38 percent), and multiple-exchange complaints accounted for four (five percent). The majority of complaints (50, 62 percent) were received from external sources (identified customers, identified members, or anonymous individuals), whereas 31 complaints (38 percent) were received from other CME Group departments.</p> <p>Allegations of disruptive trading practices were the most common type of complaint opened during the target period, accounting for 25 complaints (31 percent). Other common categories of complaints included stop spike reviews, which accounted for 11 complaints (14 percent); spoofing, which accounted for eight complaints (10 percent); complaints related to block trades, which accounted for seven complaints (nine percent); and bust / adjust reviews, which accounted for four complaints (five percent); and flickering, which accounted for 3 complaints (four percent).</p> <p><u>Complaints Closed During Target Period</u></p> <p>The Exchanges closed 82 trade practice-related complaints during the target period, 41 of which were reviewed by the Division. Of these closed complaints, based on activity on the Exchanges,²⁴ ten cases were initiated (none of which were referred to Enforcement during the target period), ten referrals to existing cases or complaints were made, and one was closed through the issuance of a warning letter.</p> <p><u>Timeliness of Complaints</u></p> <p>As noted above, the Exchanges closed 82 trade practice-related complaints</p>	<p><u>Recommendation</u></p> <p>The Division recommends that the</p>
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²⁴ As mentioned above, complaints may involve activity that occurred at multiple CME Group exchanges in addition to NYMEX or COMEX. As a result, depending on the source of the activity (i.e. NYMEX/COMEX or another CME Group exchange) that is found to warrant case referral or initiation, a complaint may lead to a NYMEX case, a COMEX case, a case at another CME Group exchange, or a combination thereof. The counts in this paragraph track NYMEX and COMEX cases only. Warning letter counts only include warning letters based on activity occurring on NYMEX or COMEX. In addition, the Commission and/or National Futures Association referral counts track only referrals that involved activity at NYMEX or COMEX.

	<p>during the target period. Of these closed complaints, the average length of time that complaints were open was 109 days. Sixty-two complaints remained open for longer than 45 days, 50 of which were open longer than 60 days. Among the 50 cases that took longer than 60 days to close, the most common two types of complaints were disruptive trading practices, accounting for 13 complaints (27 percent), and stop spikes, accounting for 12 complaints (25 percent).</p> <p>The Division is concerned with the length of time the Exchanges take to complete complaints. If problematic behavior identified in a complaint remains undetected for an extended time and a case is not promptly initiated, case resolution is ultimately delayed, which makes repeated transgressions more likely to occur.</p> <p><u>Conduct of Complaints</u></p> <p>Division staff reviewed 41 of the 82 trade practice-related complaints that were closed during the target period (50 percent). Based on this review, Division staff determined that the Exchanges adequately conducted complaints during the target period. Investigators identified and retained information relevant to complaints, including messaging and order data, and thoroughly analyzed whether complaints warranted case initiation or case referral in each complaint reviewed. Each reviewed complaint was thoroughly documented in complaint closeout memoranda.</p> <p><u>Warning Letters</u></p> <p>Of the 82 trade practice-related complaints closed during the target period, one warning letter (to one respondent) was issued directly from complaints. The Division found no instances in which the Exchanges issued warning letters to the same individual for committing the same violation within a twelve month period.</p>	<p>Exchanges reduce the time they take to complete complaints.</p>
<p>§ 38.158 Investigations and investigation reports</p>	<p><u>Case Procedures</u></p> <p>Cases are initiated from research files and complaints. When a case is initiated, it is assigned a case number and one or more investigators.</p>	

	<p>Investigators review material from the underlying research file or complaint. In addition, investigators collect and analyze other relevant data, including messaging information, trade data, audit trail information, and audio/visual data (e.g. sound and/or video recordings). Information is collected from market participants through document requests. Investigators conduct interviews with relevant persons; supervisors in the Investigations Group may be present depending on the complexity of the case. Enforcement staff may attend if the case is expected to be referred to Enforcement.</p> <p>The Exchanges maintain records of all research files, complaints, and cases in Legal Files, a database application. Among other information, the database tracks the file name, status, open date, close date, exchange (NYMEX or COMEX), venue (Electronic, Open Outcry, Privately Negotiated Transactions, OTC), the product family (Energy, Metals, Other), and the type of potential violation.</p> <p>Although Legal Files broadly identifies the source of each potential violation (customer complaint, CME referral, research group which identified the potential violation), the database lacks fields that track relationships between categories of potential violations. For cases, Legal Files lacks a field indicating the originating complaint or research file number. Similarly, for complaints and research files, Legal Files lacks a field indicating the case or cases to which the underlying matter was referred. Although connections between categories can be manually identified on a case-by-case basis by reviewing investigation documents, the absence of a field identifying such connections (or any other means of efficiently viewing such connections) prevents Market Regulation from viewing the entire history of potential violations and identifying, on a granular basis, the source of time delays.</p> <p><u>Case Disposition</u></p> <p>Cases are closed by investigators subject to the review by one or more supervisors in the Investigations Group. If no evidence of a rule violation is found, a case is closed with no-action. Where violations are found and Market</p>	<p><u>Recommendation</u></p> <p>The Division recommends that the Exchanges implement a system which would enable Market Regulation staff to efficiently track the connections between originating complaints, originating research files, and cases, and thereby identify the source of time delays.</p>
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	<p>Regulation seeks to impose a sanction greater than a warning letter, cases are referred to Enforcement.²⁵ In addition, warning letters can be issued by Market Regulation directly from cases.²⁶ In the event that the Exchanges lack jurisdiction over the subject of an investigation, a case is referred to the Commission and/or the National Futures Association. When cases are closed, an investigation report is drafted which compiles the facts of the case and an analysis of which rules were violated. Each report is initially drafted by an investigator, reviewed by a supervisor, then reviewed and approved by a Market Regulation director.</p> <p><u>Cases Closed During Target Period</u></p> <p>A total of 47 trade practice cases were closed during the target period, 36 of which had been opened prior to the target period. The majority of the closed cases involved NYMEX products alone (24 cases, 51 percent), whereas COMEX products accounted for 21 cases (45 percent). Two cases (four percent) involved products on multiple CME Exchanges.</p> <p>Cases involving cross trades were the most common type of case for the 47 cases closed during the target period, accounting for 10 cases (21 percent). Other categories of cases involved trading at settlement issues, which accounted for nine cases (19 percent); money pass for seven cases (15 percent); disruptive trading for six cases (13 percent), block trades for three cases (six percent); fraud for three cases (six percent), trading ahead for two cases (four percent), non-competitive trading for two cases (four percent), pre-arranged trading for two cases (four percent), floor trading infraction for one case (two percent), wash trading for one case (two percent), and priority of execution for one case (two percent).</p> <p>Of the 47 closed cases, the most common disposition was that the case was</p>	
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²⁵ Warning letters can also be issued after cases are referred to Enforcement. Cases which involve trading floor infractions (i.e. use of obscenity on the trading floor or physical altercations) can be referred directly from Investigations (without the involvement of Enforcement) to the Floor Conduct Committee, which has the authority to issue fines pursuant to NYMEX Rule 514.

²⁶ When evaluating whether to issue a warning letter, the Exchanges consider the degree of harm caused by the offense, the perceived likelihood of recidivist behavior, the prior history of the potential respondent, and the quantity and quality of evidence that could be obtained showing that a rule violation has occurred.

	<p>closed through the issuance of warning letter, which accounted for 16 cases (34 percent) involving 29 respondents. Fourteen cases (30 percent) were closed by being referred to Enforcement (involving 35 respondents); 13 cases (28 percent) were closed with no action (involving 16 respondents); three cases (six percent) were closed by being referred to the CFTC or the NFA (involving seven respondents); and one case (two percent) was referred to a Floor Conduct Committee hearing (involving one respondent).</p> <p><u>Timeliness of Cases</u></p> <p>As noted above, Investigations closed 47 trade practice-related cases during the target period. Counting from the time each case was initiated and ending the date the case was closed (or, for cases which were referred to Enforcement, the Enforcement referral date), the average length of time cases were open was 253 days. Seventeen cases were closed in 180 days or less. Sixteen were open for at least 180 days but less than 365 days. Thirteen cases remained open for more than 365 days but less than 730 days. One case remained open for 730 days or more. Of the 14 cases that were open for more than 365 days, the Division identified one case without sufficient mitigating circumstances to justify the length of time the case was open.²⁷ Commission regulation 38.158(b) requires that investigations be completed in one year or less, absent mitigating circumstances.</p> <p>The case initiation date used in the counts above does not reflect when the conduct that gave rise to the case occurred. Because the Division identified instances in which the underlying conduct preceded the case initiation date by a significant period of time, the Division also calculated case duration by incorporating the underlying conduct date. Using this methodology²⁸ (“extended case counting methodology”) the average duration of cases was 371 days. Twenty-three cases took more than 365 days to close, five of which took</p>	<p><u>Deficiency</u></p> <p>As required by Commission regulation 38.158(b), the Exchanges must complete investigations in one year or less, absent mitigating circumstances.</p>
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²⁷ Commission regulation 38.158(b) sets forth examples of mitigating circumstances that may reasonably justify an investigation being open for more than one year: “the complexity of an investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.”

²⁸ This paragraph begins counting cases from the time the underlying conduct occurred and ends with the date the case was closed (or, for cases which were referred to Enforcement, the Enforcement referral date).

	<p>730 days or more to close. While this method of counting is broad, the Division believes it illustrates the unduly long time between conduct and case closure that can be a byproduct of the Exchanges' trade practice program.</p> <p>In addition, the Division identified instances in which case resolution was significantly delayed simply by the length of time it took investigators to complete complaints or research files. Accordingly, for the 24 cases that began as complaints or research files among those closed during the target period, the Division also measured timeliness by counting from the complaint or research file open date. Using this methodology ("underlying matter case counting methodology") the average duration was 395 days. Seventeen cases took more than 365 days to close.</p> <p>Finally, the Division identified 18 cases that were open prior to the target period and which remained open after the conclusion of the target period ("aged cases"). Measured from the last day of the target period, the average duration of cases was 609 days. All 18 cases were open for more than 365 days, five of which remained open for at least 730 days.</p> <p>Based on the analysis above, the Division is concerned with the length of time the Exchanges take to complete cases. When a significant period of time elapses between the relevant conduct (or the initiation of the case or the underlying pre-case matter) and the date the case was closed (or referred to enforcement), problematic behavior may continue without being sanctioned, which makes repeated transgressions more likely to occur.</p> <p><u>Conduct of cases</u></p> <p>Division staff reviewed 30 out of the 47 cases that were closed during the target period (64 percent). Subject to the deficiency identified regarding the timeliness of cases, the Division found that the Exchanges adequately conducted cases during the target period. The Division found the quality of the investigative work in the cases reviewed to be thorough and complete. Questions by investigators to market participants were well-informed based on research into the circumstances of each reviewed case. Investigators adequately collected, reviewed, and analyzed relevant data, including</p>	
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	<p>messaging data and transactional data. In addition, the Division found that the Exchanges' decisions whether or not to pursue disciplinary action were appropriate in the cases reviewed.</p> <p>The Division found that the Exchanges maintain adequate documentation of their cases. The case files reviewed by Division staff contain relevant information, including emails between the Exchanges and market participants, relevant trading records, and relevant audio/visual recordings.</p> <p><u>Warning letters</u></p> <p>The Exchanges issued warning letters to 29 respondents based on cases closed during the target period.²⁹ In its review of these warning letters, the Division found no instances in which the Exchanges issued warning letters to the same individual for committing the same violation within a twelve month period.</p>	
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²⁹ This number does not include warning letters issued based on cases pursuant to the disciplinary process.

Appendix B

NYMEX/COMEX RULE ENFORCEMENT REVIEW TABLE OF CORE PRINCIPLES AND REGULATIONS REVIEWED

§38.150 Core Principle 2.

(a) In general. The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including:

(1) Access requirements;

(2) The terms and conditions of any contracts to be traded on the contract market; and

(3) Rules prohibiting abusive trade practices on the contract market.

(b) Capacity of contract market. The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market.

(c) Requirement of rules. The rules of the contract market shall provide the board of trade with the ability and authority to obtain any necessary information to perform any function described in this section, including the capacity to carry out such international information-sharing agreements, as the Commission may require.

§ 38.151 Access requirements.

(a) Jurisdiction. Prior to granting any member or market participant access to its markets, a designated contract market must require that the member or market participant consent to its jurisdiction.

...

(c) Limitations on access. A designated contract market must establish and impartially enforce rules governing denials, suspensions, and revocations of a member's and a person with trading privileges' access privileges to the designated contract market, including when such actions are part of a disciplinary or emergency action by the designated contract market.

§38.152 Abusive trading practices prohibited.

A designated contract market must prohibit abusive trading practices on its markets by members and market participants. Designated contract markets that permit intermediation must prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that must be prohibited by all designated contract markets include front-running, wash trading, pre-arranged trading (except for certain transactions specifically permitted under part 38 of this chapter), fraudulent trading, money passes, and any other trading practices that a designated contract market deems to be abusive. In addition, a designated contract market also must prohibit any other manipulative or disruptive trading practices prohibited by the Act or by the Commission pursuant to Commission regulation.

§38.153 Capacity to detect and investigate rule violations.

A designated contract market must have arrangements and resources for effective enforcement of its rules. Such arrangements must include the authority to collect information and documents on both a routine and non-routine basis, including the authority to examine books and records kept by the designated contract market's members and by persons under investigation. A designated contract market's arrangements and resources must also facilitate the direct supervision of the market and the analysis of data collected to determine whether a rule violation occurred.

§38.154 Regulatory services provided by a third party.

(a) Use of third-party provider permitted. A designated contract market may choose to utilize a registered futures association or another registered entity, as such terms are defined under the Act, (collectively, “regulatory service provider”), for the provision of services to assist in complying with the core principles, as approved by the Commission. Any designated contract market that chooses to utilize a regulatory service provider must ensure that its regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A designated contract market will at all times remain responsible for the performance of any regulatory services received, for compliance with the designated contract market's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(b) Duty to supervise third party. A designated contract market that elects to utilize a regulatory service provider must retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf. Compliance staff of the designated contract market must hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern. A designated contract market also must conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews must be documented carefully and made available to the Commission upon request.

(c) Regulatory decisions required from the designated contract market. A designated contract market that elects to utilize a regulatory service provider must retain exclusive authority in decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and the denials of access to the trading platform for disciplinary reasons. A designated contract market may also retain exclusive authority in other areas of its choosing. A designated contract market must document any instances where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the designated contract market chose a different course of action.

§38.155 Compliance staff and resources.

(a) Sufficient compliance staff. A designated contract market must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The designated contract market's compliance staff also must be sufficient to address unusual

market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in §38.158(b) of this part.

(b) Ongoing monitoring of compliance staff resources. A designated contract market must monitor the size and workload of its compliance staff annually, and ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate level of compliance resources and staff, the designated contract market should consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.

§38.156 Automated trade surveillance system.

A designated contract market must maintain an automated trade surveillance system capable of detecting and investigating potential trade practice violations. The automated system must load and process daily orders and trades no later than 24 hours after the completion of the trading day. In addition, the automated trade surveillance system must have the capability to detect and flag specific trade execution patterns and trade anomalies; compute, retain, and compare trading statistics; compute trade gains, losses, and futures-equivalent positions; reconstruct the sequence of market activity; perform market analyses; and support system users to perform in-depth analyses and ad hoc queries of trade-related data.

§38.158 Investigations and investigation reports.

(a) Procedures. A designated contract market must establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation must be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the designated contract market that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(b) Timeliness. Each compliance staff investigation must be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.

(c) Investigation reports when a reasonable basis exists for finding a violation. Compliance staff must submit a written investigation report for disciplinary action in every instance in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report must include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(d) Investigation reports when no reasonable basis exists for finding a violation. If after conducting an investigation, compliance staff determines that no reasonable basis exists for finding a violation, it must prepare a written report including the reason(s) the investigation was

initiated; a summary of the complaint, if any; the relevant facts; and compliance staff's analysis and conclusions.

(e) Warning letters. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

§38.650 Core Principle 12.

The board of trade shall establish and enforce rules:

- (a) To protect markets and market participants from abusive practices committed by any party, including abusive practices committed by a party acting as an agent for a participant; and
- (b) To promote fair and equitable trading on the contract market.

§38.651 Protection of markets and market participants.

A designated contract market must have and enforce rules that are designed to promote fair and equitable trading and to protect the market and market participants from abusive practices including fraudulent, noncompetitive or unfair actions, committed by any party. The designated contract market must have methods and resources appropriate to the nature of the trading system and the structure of the market to detect trade practice and market abuses and to discipline such behavior, in accordance with Core Principles 2 and 4, and the associated regulations in subparts C and E of this part, respectively. The designated contract market also must provide a competitive, open and efficient market and mechanism for executing transactions in accordance with Core Principle 9 and the associated regulations under subpart J of this part.