

**RULE ENFORCEMENT REVIEW  
OF  
ICE FUTURES U.S.**



**Division of Market Oversight  
February 2, 2010**

# Table of Contents

I.	INTRODUCTION .....	1
II.	SUMMARY OF FINDINGS AND RECOMMENDATIONS.....	3
	A. Compliance Department Staff .....	3
	B. Audit Trail Program .....	4
	C. Trade Practice Surveillance Program.....	5
	D. Disciplinary Program.....	6
	E. Dispute Resolution Program .....	7
III.	CHANGES AT ICE FUTURES U.S. SINCE THE DIVISION’S LAST TRADE PRACTICE RULE ENFORCEMENT REVIEW .....	7
IV.	COMPLIANCE DEPARTMENT STAFF .....	8
	A. Staff During the Target Period .....	8
V.	AUDIT TRAIL PROGRAM .....	14
	A. Audit Trail—Electronic Trading.....	15
	1. Order Entry .....	16
	2. Identification of “Responsible Individuals” .....	17
	3. Identification of Firms and Traders .....	17
	B. Enforcement of Audit Trail and Recordkeeping Requirements in Electronic Trading ..	20
	C. Audit Trail for Open-Outcry Trading .....	22
	1. Open-Outcry Recordkeeping Requirements .....	22
	2. Trade Timing .....	23
	D. Enforcement of Open-Outcry Audit Trail and Recordkeeping Requirements .....	24
	1. Audit Trail Review Process .....	24
	2. Audit Trail “Saturation Reviews” During the Target Period .....	26
	3. Follow-Up Recordkeeping Reviews .....	28
	E. Safe Storage Capability.....	29
	F. Conclusions and Recommendations.....	30
VI.	TRADE PRACTICE SURVEILLANCE PROGRAM.....	32
	A. Automated Surveillance System.....	33
	1. CARS II, Crystal Reports and Infomaker .....	33
	2. Daily Exception Reports and Other Regular Reviews.....	35
	B. Floor Surveillance .....	36
	C. Trade Practice Investigations .....	37
	1. Number of Investigations During the Target Period.....	37
	2. Adequacy of Investigations.....	38
	3. Timeliness of Investigations .....	39

D. Conclusions and Recommendations .....	41
VII. DISCIPLINARY PROGRAM.....	42
A. Disciplinary Committees and Procedures.....	42
B. Adequacy of Disciplinary Sanctions.....	45
C. Timeliness of Disciplinary Procedures .....	47
D. Conclusions and Recommendations .....	48
VI. DISPUTE RESOLUTION PROGRAM.....	49
A. Customer Arbitration .....	49
B. Member-to-Member Arbitration.....	51
C. Arbitrations During the Target Period .....	52
D. Conclusions and Recommendations .....	52

## Rule Enforcement Review of ICE Futures U.S.

### I. INTRODUCTION

The Division of Market Oversight (“Division”) has completed a rule enforcement review (“RER”) of the audit trail, trade practice surveillance, disciplinary, and dispute resolution programs of ICE Futures U.S. (“ICE Futures” or “Exchange”). The review examined the Exchange’s compliance with five related core principles under Section 5(d) of the Commodity Exchange Act (“Act”) and Part 38 of the Commission’s regulations. It covered the period of June 1, 2007 through June 1, 2008 (“the target period”).<sup>1</sup>

The Division’s review focused on Core Principles 10 (*Trade Information*) and 17 (*Recordkeeping*), which relate to an exchange’s audit trail program for recording and safely storing trade information so as to help prevent customer and market abuses and facilitate enforcement of exchange rules; Core Principles 2 (*Compliance With Rules*) and 12 (*Protection of Market Participants*), which relate to an exchange’s program for enforcing its rules, conducting disciplinary proceedings, and protecting market participants from abusive practices; and Core Principle 13 (*Dispute Resolution*), which relates to an exchange’s arbitration program for market participants. Appendix B to Part 38 provides acceptable practices for demonstrating compliance with some of these core principles.<sup>2</sup>

---

<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 address only those programs directly identified 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 its evaluation of a sample of investigation and disciplinary case files, and other exchange documents. In some instances, the evaluation process identifies specific deficiencies in particular exchange investigations or methods, but it is not designed to uncover all instances in which an exchange does not effectively address 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 Division staff does perform some direct testing as a measure of quality control.

<sup>2</sup> Appendix B to Part 38 of the Commission’s regulations provides guidance concerning the core principles with which a designated contract market (“DCM”) must comply to maintain its designation. In addition, Appendix B provides acceptable practices for several of the core principles. Although the acceptable practices establish non-

As part of its review, Division staff interviewed senior members of ICE Futures' Compliance Department ("Compliance" or "Compliance Department"). Division staff also reviewed numerous documents used by Compliance in performing the Exchange's self-regulatory responsibilities. These documents included the following:

- computer reports and other documentation used routinely for audit trail enforcement and trade practice surveillance;
- documentation describing automated surveillance systems provided in CD-ROM format;
- trading card and order ticket reviews;
- inquiry and trade practice investigation files;
- inquiry, investigation, recordkeeping, audit trail, and disciplinary logs;
- minutes of disciplinary committee meetings held during the target period;
- disciplinary action files;
- arbitration log and arbitration case files; and
- compliance procedures manuals and guidelines.

The Division provided ICE Futures with an opportunity to review and comment on a draft of this report on December 11, 2009. On January 5, 2010, Division staff conducted an exit conference with Exchange officials to discuss the report's findings and recommendations.

---

exclusive safe harbors, they do not establish a mandatory means of compliance with the core principles. Appendix B provides acceptable practices for Core Principles 2, 10, 13 and 17. Acceptable practices are not set forth for Core Principle 12. In promulgating Part 38, the Commission reserved the authority to adopt acceptable practices for Core Principle 12 at a later date.

## II. SUMMARY OF FINDINGS AND RECOMMENDATIONS

### A. Compliance Department Staff

#### Findings

- During the target period, ICE Futures' Compliance Department consisted of 11 staff members, including the Vice President of Market Regulation, the Chief Compliance Officer, a Managing Director, a Compliance Manager, several Investigators, one attorney, and one administrative assistant.
- ICE Futures' Compliance staff is highly experienced in the futures industry and in futures compliance. However, the Division believes that the 11 staff members available to the Compliance Department during the target period were insufficient for ICE Futures to fulfill certain self-regulatory responsibilities in a timely manner. More specifically, the Division believes that additional staff would have helped ICE Futures to complete a "saturation" audit trail recordkeeping review between April 2006 and May 2008, and would also have helped it to close numerous trade practice investigations more quickly.
- The Division believes that ICE Futures should have acted proactively to ensure that its staff size was commensurate with its growing trading volumes and capable of managing the trading technology, organizational, and business changes occurring at the Exchange starting in late 2006. Additionally, the Division believes that ICE Futures will require additional Compliance staff to implement the electronic audit trail enforcement program recommended below.

#### Recommendations

- **Hire additional Compliance staff to ensure that the Exchange can fulfill all its self-regulatory responsibilities in a timely manner.**
- **Monitor the size and workload of the Compliance Department, and increase the number of staff appropriately as trading volumes increase, new responsibilities are assigned to Compliance, or internal reviews demonstrate that work is not completed in an effective or timely manner.**

## B. Audit Trail Program

### Findings

- ICE Futures maintains an audit trail program which records trade data in a manner that enables Compliance staff to identify customer and market abuses and provide evidence of rule violations.
- ICE Futures monitors member and member firm compliance with recordkeeping requirements for open-outcry trading through saturation audit trail reviews, which its internal guidelines require to be conducted every 12-18 months. However, ICE Futures failed to conduct a saturation review during the target period or at any time between April 2006 and May 2008. The Division believes that this reflects an understaffed Compliance Department, given other demands placed on staff and changes at the Exchange during the target period.
- Because ICE Futures did not conduct a saturation review during the target period, the Division instead examined ICE Futures' 2006 saturation review. The Division found that approximately 19% of the 4,262 trading cards and 6% of the 2,927 order tickets reviewed by ICE Futures failed to meet the Exchange's recordkeeping requirements. The Division also found that the sanctions levied against members who failed the 2006 saturation review (and individual follow-up reviews) typically included warning letters and summary fines in the \$100 to \$400 range.
- In September 2009, ICE Futures' board of directors amended the Exchange's rules such that the Compliance Department may now levy summary fines of up to \$10,000 and is not required to first issue a warning letter.
- For electronic trading, ICE Futures maintains a complete electronic record of all orders entered and all transactions executed, including the terms and time of entry for all orders, all order modifications, and all matched trades. This record enables ICE Futures to reconstruct electronic trading efficiently and effectively.
- ICE Futures' audit trail compliance program does not include a programmatic review of compliance with its electronic audit trail and recordkeeping rules that is comparable in rigor and scope to its saturation review program for open-outcry trades. The Division believes that the Exchange's current Compliance staffing levels are inadequate to implement and enforce such a program in a timely manner.
- ICE Futures has adequate procedures for safe storage of audit trail data. Data is backed up daily and stored at an off-site backup storage location.

### Recommendations

- **Ensure that open-outcry saturation recordkeeping reviews are conducted annually.**
- **Reexamine the open-outcry audit trail and recordkeeping compliance program with respect to trading cards and make adjustments to achieve a higher percentage of compliance. In this connection, the Compliance Department should use its enhanced**

**authority with respect to issuing summary fines to ensure that fines are a meaningful deterrent, especially with respect to repeat offenders.**

- **Augment the audit trail compliance and enforcement program to include a programmatic review of electronic audit trail and recordkeeping rules that is comparable in rigor and scope to the Exchange’s saturation review program for open-outcry trading.**

### **C. Trade Practice Surveillance Program**

#### **Findings**

- ICE Futures maintains a trade practice surveillance program that is administered by an experienced staff. It uses automated systems, physical floor surveillance, and special Daily Exception Reports to monitor its markets for potential trading violations and to conduct investigations.
- During the target period, ICE Futures closed 40 trade practice investigations (“TPIs”), including 32 involving floor trading and eight involving electronic trading. Thirteen of the closed TPIs were referred for disciplinary action. Twelve TPIs were closed by Compliance staff with no action. Another 12 TPIs were closed via staff warning letters. Three TPIs were closed via a combination of warning letters, a letter of censure, and two summary fines totaling \$600.
- ICE Futures’ TPIs closed during the target period were thorough and well documented, and investigation reports included sufficient analysis to support Compliance staff’s conclusions and recommendations. In addition, investigations were expanded to include additional trading dates or members where appropriate.
- The majority of TPIs closed during the target period were closed in less than a year. However, nine TPIs closed during the target period required between 14 and 28 months to close. An additional 10 TPIs opened prior to the target period remained open at its conclusion, for time periods ranging between 455 and 787 days.
- The Division thoroughly reviewed all 19 TPIs open longer than one year to determine whether any mitigating factors justified their prolonged open periods. In 12 instances, the Division found no apparent justification. The Division believes that ICE Futures’ inability to close TPIs in a timely manner is another indication of an understaffed Compliance Department during the target period.

#### **Recommendation**

- **Take appropriate measures to ensure that TPIs are completed in a timely manner.**



## D. Disciplinary Program

### Findings

- Disciplinary matters at ICE Futures are addressed by the Exchange's Business Conduct Committee ("BCC"), which operates via separate panels for assessing probable cause (Probable Cause Panel) and for adjudicating charges (Hearing Panel). Each panel typically includes seven individuals, including four Exchange members or employees of member firms and three non-members, at least one of whom is a public participant.
- ICE Futures has the authority to investigate possible rule violations, prosecute cases, and discipline members accordingly. Respondents in disciplinary matters receive adequate notice of the charges against them and have the opportunity to respond and present their defenses, including the rights to representation by counsel and to call witnesses.
- During the target period, the Compliance Department referred 18 TPIs to the BCC for disciplinary action, at which time the TPIs became disciplinary cases ("cases"). Thirteen of the 18 cases were closed during the target period, all of them via settlement agreements reached with the Probable Cause Panel. No trade practice cases were heard by a Hearing Panel during the target period.
- Five of the 13 trade practice cases closed during the target period were resolved by expelling three Exchange members. An additional eight closed cases resulted in fines totaling \$20,400, including \$500 for recordkeeping violations in one case; \$12,400 for substantive trade practice violations in six cases; and \$7,500 for unauthorized trading by a lessee in one case. In addition, four of the 13 cases resulted in customer restitution totaling \$3,820.
- Disciplinary cases during the target period were typically resolved in a timely manner. On average, cases were closed approximately 40 days after a respondent was served with an investigation report ("IR"). However, in the case of TPIs that were referred to the BCC, ICE Futures did not record the date on which completed IRs were approved by senior Compliance staff. This made it difficult to ascertain how much time elapsed between final approval of completed IRs by senior staff and initial BCC action on the matters, and where responsibility would lie if a matter was unreasonably delayed.

### Recommendation

- **Record the date on which completed investigative reports are approved by senior Compliance staff.**

## **E. Dispute Resolution Program**

### **Findings**

- ICE Futures provides adequate procedures for voluntary customer arbitration and mandatory member to member arbitration. Each party in an arbitration procedure has the right to appear personally, to be represented by counsel, to present facts and rebuttal evidence, and to present and examine witnesses and documents. Arbitration panels must issue their decisions within 60 days of the conclusion of their hearings.
- Eight matters were submitted to arbitration during the target period, of which two were completed. Division staff's review of the arbitration files found that each matter was handled in conformance with ICE Futures' arbitration rules. Two other arbitrations were settled prior to their hearing, and four arbitrations were stayed or were in other procedural stages during the target period.

### **Recommendation**

- **The Division has no recommendations in this area.**

## **III. CHANGES AT ICE FUTURES U.S. SINCE THE DIVISION'S LAST TRADE PRACTICE RULE ENFORCEMENT REVIEW**

ICE Futures has undergone significant changes since the Division last examined its audit trail, trade practice, disciplinary, and dispute resolution programs in May 2004 ("2004 Review").<sup>3</sup> During the 2004 Review, the Division evaluated the Coffee, Sugar, and Cocoa Exchange ("CSCE"), a predecessor of ICE Futures that operated as a distinct DCM and subsidiary of the New York Board of Trade ("NYBOT"). The 2004 Review covered the target period of June 1, 2002 to June 1, 2003. Significant events occurring at ICE Futures between the 2004 Review and the present review are summarized below.

In June 2004, NYBOT merged CSCE and another of its subsidiaries, the New York Cotton Exchange ("NYCE"), into a single DCM operating under the NYBOT name.<sup>4</sup> NYBOT was organized as a not-for-profit, member-owned, New York entity. In January 2007, NYBOT's structure changed further as

---

<sup>3</sup> The Division also completed an RER of the Exchange's market surveillance program in October 2005.

<sup>4</sup> The Division last reviewed NYCE's audit trail, trade practice, and disciplinary programs in an RER completed in September 2001. The Compliance Departments of CSCE and NYCE were merged in 1998.

it was acquired by Intercontinental Exchange, Inc., (“Intercontinental”) a publicly-traded, for-profit corporation based in Atlanta, Georgia. NYBOT formally changed its name to ICE Futures U.S. in September 2007. In addition to these changes, the Exchange has evolved in three other significant ways since the 2004 Review:

- **Volume growth.** CSCE’s total trading volume during the 12-month target period of the 2004 Review was 14,550,893 contracts, an average of 1,212,574 contracts per month. During the 12-month target period of this Review, the Exchange’s total volume in the coffee, sugar, and cocoa markets was 47,510,294 contracts, an average of 3,959,191 contracts per month. Over a five-year period, average monthly volume increased by over 226% in the same product categories. Similarly, the Exchange’s total annual trading volume in cotton futures and options grew from 3,908,297 contracts in 2002-2003 to 12,227,393 contracts during the current target period, an increase of almost 213%.<sup>5</sup>
- **Shift to predominantly electronic trading.** In 2007 and 2008, the Exchange moved quickly from pit-based, open-outcry trading to electronic trading across all markets. The transition occurred in three stages: the introduction of electronic futures trading in February 2007 (side-by-side with open-outcry); the end of all open-outcry futures trading in February 2008; and the introduction of electronic options trading in March 2008 (side-by-side with open-outcry options). Side-by-side options trading continued at the end of the target period.
- **Demutualization.** NYBOT was owned and operated as a mutually-owned, membership-driven exchange. Via its purchase by Intercontinental, however, the Exchange was demutualized, and today ICE Futures is wholly-owned by Intercontinental, a publicly-traded company.

#### IV. COMPLIANCE DEPARTMENT STAFF

##### A. Staff During the Target Period

During the target period, ICE Futures’ Compliance Department (“Compliance” or “Compliance Department”) consisted of 11 staff members. Compliance is led by a highly experienced Vice President of Market Regulation (“Vice President”),<sup>6</sup> who also leads the Exchange’s Market Surveillance and Market Supervision Departments.<sup>7</sup> The Vice President’s responsibilities include, but are not limited to:

---

<sup>5</sup> This statistic compares total futures and options volume in NYCE’s Cotton contract from June 2002 to May 2003 with ICE Futures’ Cotton contract from June 2007 to May 2008.

<sup>6</sup> The Vice President of Market Regulation joined the Exchange’s staff in September 2005. His 23 years of experience in futures compliance include 16 years with New York exchanges (COMEX, NYMEX, ICE Futures U.S./NYBOT) and seven years with FCMs.

<sup>7</sup> The Market Supervision Department (“MSD”) was established in connection with the introduction of electronic

presenting findings of rule violations to Exchange disciplinary committees; overseeing the design of systems used to identify potential trading violations by applying selection parameters to all transactions; and occasionally joining other Compliance staff in investigative interviews. The Vice President is assisted by the Chief Compliance Officer (“CCO”)<sup>8</sup> whose duties include approving the opening and closing of investigations; assisting in the completion of complex investigations; assisting in the presentation of investigations to the Exchange’s Business Conduct Committee; consulting with the Vice President with respect to all summary fines for rule violations; assisting with the preparation of policy memoranda and responses to regulatory inquiries; and participating in investigative interviews.

In addition to the Vice President and the CCO, there were an additional nine staff members in ICE Futures’ Compliance Department during the target period. These positions include a Managing Director who supervises a Senior Investigator/Floor Surveillance; a Senior Investigator; and a Senior Investigator/Auditor, who reports to both the Managing Director in the Compliance Department and to the Exchange’s Manager of Financial Surveillance. A second supervisory person in the Compliance Department is the Compliance Manager, who supervises two Investigators.<sup>9</sup> In addition, the Department also includes an attorney who holds the position of Assistant General Counsel, Market

---

trading at NYBOT, and had not existed while NYBOT was exclusively an open-outcry Exchange. MSD monitors real-time trading on the ICE electronic trading platform and interacts with customers when questions arise regarding issues such as system functionality and order status. When MSD was created, three Compliance Department staff members were transferred to MSD. One of those individuals was an investigator, one was a senior investigator, and the other individual was the then Managing Director of Market Regulation.

<sup>8</sup> The CCO has 12 years of experience in futures compliance, including 11 years with the Exchange.

<sup>9</sup> The Managing Director has 30 years of futures industry experience: 28 years at ICE/NYBOT/NYCE, and two years trading floor clerical experience. The Senior Investigator/Floor Surveillance has 18 years of futures industry experience: four years with ICE/NYBOT, and 14 years as a floor trader. The Senior Investigator has 8 years of Exchange compliance experience. The Senior Investigator/Auditor has 21 years of futures compliance experience: 17 years at ICE/NYBOT and four years at the National Futures Association. He reports to both the Managing Director in the Compliance Department and to the Exchange’s Manager of Financial Surveillance. Although the Manager of Financial Surveillance is part of the Compliance Department, he was not counted as part of the Department for purposes of this review because his work falls outside of the trade practice area. The Compliance Manager has 11 years experience in futures compliance: nine years at ICE/NYBOT, and two years at CFTC. Each of the two Investigators has one year of futures industry experience at ICE/NYBOT, and one year as a ring reporter in the Exchange’s trading pits.

Regulation,<sup>10</sup> and an Administrative Coordinator. Most Compliance Department employees are experienced individuals with long tenures at ICE Futures and its predecessors. As discussed below, the staff's skill is evident in the quality of the investigations examined by the Division in the course of this review.

The Compliance Department's workload during the target period was allocated based on specific Exchange markets. The Managing Director and his three reporting staff oversee the futures and options markets for cotton, frozen concentrated orange juice, and cocoa; and the options markets for currencies and indexes. The Compliance Manager and his two reporting staff oversee the futures and options markets for coffee and sugar; and the futures markets for currencies and indexes. Both the Compliance Manager and Managing Director assist Investigators in determining the initial focus and theory of an investigation, preparing an investigative plan, reviewing documents, and preparing and conducting investigative interviews. In addition, they participate directly in the investigative teams' fulfillment of the floor surveillance program. During the target period, both the Managing Director and the Compliance Manager each carried their own investigative caseloads in addition to their duties with respect to the Investigators whom they supervised.

#### **B. Changes in the Compliance Department since the 2002-03 Review**

Like the Exchange itself, ICE Futures' Compliance Department has undergone significant changes since the 2004 Review, including changes in its structure, staff members, and staff numbers. Most notably, the Compliance Department's size has been reduced from 16 to 11 staff members—a 31% reduction.<sup>11</sup> By comparing organizational charts from the current review and the 2004 Review, the Division determined that the following positions have been eliminated: an Assistant Vice President; a

---

<sup>10</sup> The Assistant General Counsel, Market Regulation has eight years of futures compliance experience at ICE/NYBOT.

<sup>11</sup> This does not include the Manager of Financial Surveillance, whose position is not included in either of the Compliance Department staff counts.

Manager of Special Investigations; one Investigation Manager; one Senior Investigator; and one Investigator.<sup>12</sup> As explained below, the Division believes that these staff reductions proved excessive. In addition to staff reductions, the Compliance Department faced additional challenges stemming from fundamental changes at ICE Futures during the target period and the months immediately preceding it. One challenge was the rapid transition to electronic trading in 2007-2008. In February 2007, Compliance began surveillance of electronic trading in futures, while simultaneously continuing surveillance of open-outcry trading in the same commodities (“side-by-side trading”). In February 2008, it began surveillance of electronic-only trading in futures. Finally, in March 2008, Compliance began surveillance of side-by-side trading in options. Each step required significant preparation by a Compliance Department that had previously focused exclusively on open-outcry markets. Moreover, the Exchange’s transition to electronic trading was accelerated due to competitive concerns. While it originally planned to introduce electronic trading in April 2007, pressure from other exchanges led ICE Futures to offer electronic trading two months ahead of schedule, on February 2, 2007. This accelerated deployment required Compliance to devote an extraordinary amount of time and effort to expedite the development of an electronic trading surveillance program and assist in the development of trading rules. A second challenge to the Compliance Department, in late 2006 and early 2007, arose from internal restructuring as the Exchange’s entire market regulation/compliance function was reorganized to create a new Market Supervision Department for real-time monitoring of electronic trading.<sup>13</sup>

The Division believes that these events placed a significant strain on the Compliance Department’s ability to fulfill important self-regulatory responsibilities in a timely manner. For example,

---

<sup>12</sup> During the 2004 Review, the Exchange employed three part-time Senior Investigators and two full-time Senior Investigators. During the current target period, the Exchange employed three full-time Senior Investigators and no part-time Senior Investigators. For ease of comparison, Division staff deemed that the addition of one full-time employee and the loss of three part-time employees constituted a net loss of one full-time employee. During the Division’s on-the-record interview of the Exchange, the Vice President of Market Regulation assured Division staff that the Exchange was actively recruiting an additional Senior Investigator. The Division confirmed that a new Senior Investigator was hired in November 2008.

<sup>13</sup> See footnote 7 for a description of the Market Supervision Department.

ICE Futures was unable to complete a saturation audit trail recordkeeping review during the target period, and allowed two years to elapse between the time it completed one saturation review (April 2006) and the beginning of its next saturation review in May 2008. In addition, the Division identified numerous trade practice investigations that were open for excessively long time-periods. Division staff reviewed nine closed investigations that took between 14 and 28 months to complete, and found that five were untimely based on the facts and complexity of the cases. Division staff made similar findings with respect to seven of 10 open investigations which, by the end of the target period, had been open between 15 and 26 months and remained open. The Division believes that additional Compliance staff could have helped the Exchange to complete these investigations and conduct and complete audit trail recordkeeping reviews in a timelier manner. As discussed below, the Division is also recommending that ICE Futures implement a new program to ensure compliance with electronic audit trail requirements. Such a program is likely to require staff resources beyond what is currently available to the Compliance Department.<sup>14</sup>

The Division recognizes that unforeseen events can redirect an exchange compliance staff's attention away from its routine work, and it understands that changes at ICE Futures beginning in late 2006 placed legitimate demands upon staff's time and energy. However, an exchange's compliance staff must not be so stretched under normal circumstances that unexpected occurrences are sure to have significant detrimental consequences throughout the compliance program. In the case of ICE Futures, the 226% increase in volume for coffee, sugar, and cocoa contracts between the 2002-03 and 2007-08 target periods, and a similar 213% increase in cotton volume, calls into question any reduction in Compliance staff in the intervening years. To the contrary, as ICE Futures undertook the changes in trading technology, internal organization, and ownership summarized above, the Exchange should have

---

<sup>14</sup> See Section V(B) for further detail regarding what the Division believes is necessary for an effective electronic audit trail review program.

prepared to mitigate any resulting strain on Compliance staff, including hiring additional staff as necessary.

The Division notes that ICE Futures' governance structure includes a regulatory oversight committee ("ROC") to mitigate conflicts of interest in self-regulation, as required by Section 5(d)(15) of the Act ("Core Principle 15"). The Exchange's Rules require the ROC to, among other things, "review and make recommendations with respect to the responsibilities, budget and staffing of the Market Regulation Department so that it is able to fulfill its self-regulatory responsibilities."<sup>15</sup> Based on its finding in this RER, the Division believes that ICE Futures' ROC should periodically inquire as to the timely completion of self-regulatory work by the Exchange's Compliance Department. In addition, the Division advises the ROC to monitor the Exchange's progress in implementing the recommendations in this report.

### **C. Conclusions and Recommendations**

ICE Futures' Compliance Department consists of highly experienced professionals with many years of employment at the Exchange and elsewhere in the futures industry. During the target period, the Compliance staff consisted of 11 individuals and was led by the Vice President of Market Regulation. The Division reviewed numerous examples of Compliance staff's work product, especially its trade practice investigations, and found that they typically were thorough and well done. At the same time, the Division found that investigations were sometimes not completed in a timely manner, and that the Exchange did not conduct a saturation audit trail review between April 2006 and May 2008. The Division believes that the delay in completing some investigations, and the lack of a saturation audit trail recordkeeping review in 2007, are both symptoms of an understaffed Compliance Department, a problem that ICE Futures should have remedied as soon as it became apparent.

---

<sup>15</sup> ICE Futures Rule 3.40(c)(i).



The Division also believes that ICE Futures should have acted proactively to ensure that its Compliance Department was appropriately staffed to manage the technological, organizational, and business changes that began in late 2006 without detriment to its regular regulatory work. In particular, the Division finds that the 11 staff members available to the Compliance Department during the target period were insufficient for the Exchange to fulfill certain self-regulatory responsibilities in a timely manner. This is particularly troubling given the significant increase in trading volume since the 2004 Review and the significant reduction in Compliance staff size since that Review.

Based on the foregoing, the Division recommends that the Exchange:

- **Hire additional Compliance staff to ensure that the Exchange can fulfill all its self-regulatory responsibilities in a timely manner.**
- **Monitor the size and workload of the Compliance Department, and increase the number of staff appropriately as trading volumes increase, new responsibilities are assigned to Compliance, or internal reviews demonstrate that work is not completed in an effective or timely manner.**

## **V. AUDIT TRAIL PROGRAM**

### **Core Principle 10 – Trade Information:**

**The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.**

### **Core Principle 17 – Recordkeeping:**

**The board of trade shall maintain records of all activities related to the business of the contract market in a form and manner acceptable to the Commission for a period of five years.**

Pursuant to the acceptable practices set forth in Appendix B to Part 38 of the Commission's regulations, an effective contract market audit trail should capture and retain sufficient trade-related information to permit contract market staff to detect trading abuses and to reconstruct transactions within a reasonable period of time. In addition, the contract market must create and maintain an

electronic transaction history database that contains information with respect to transactions executed on the contract market. An acceptable audit trail also must be able to track a customer order from time of receipt through fill allocation or other disposition, including all changes and cancellations. Further, an acceptable audit trail should include original source documents, transaction history, electronic analysis capability, and safe storage capability.

Original source documents include unalterable, sequentially identified records on which trade execution information is originally recorded, whether manually or electronically. A transaction history consists of an electronic history of each transaction, including all data that are input into the trade entry or matching system for the transaction to match and clear. These data should include the categories of participants for whom such trades are executed; timing and sequencing data adequate to reconstruct trading; and the identification of each account to which fills are allocated. An electronic analysis capability permits sorting and presenting data included in the transaction history so as to reconstruct trading and to identify possible trading violations, while safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, accidental erasure, or other loss.

Commission Regulation 1.31 governs the manner in which an exchange is required to maintain trade-related records. The Regulation mandates that all records required to be kept under the Act or Commission regulations be maintained for five years and be readily accessible during the first two years. However, trading cards, documents on which trade information is originally recorded in writing, and order tickets, must be retained in hard copy for five years.

#### **A. Audit Trail—Electronic Trading**

Futures contracts at ICE Futures are traded exclusively on the Exchange's electronic trading system ("ETS"), while options are traded both on the ETS and via open-outcry. The ETS creates a comprehensive audit trail for all electronic trades by automatically recording all messages entered into the system in a

database. The retained information includes all orders, order changes and order cancellations, all trades matched by the system, and the date and time of each message and matched trade, recorded to the nearest millisecond. The system does not permit any trader, member firm, or Exchange staff member to erase any order, order modification, or order cancellation.

The audit trail data for each electronic order includes the order's price, quantity, product, expiration month, customer type indicator ("CTI") code, order type (and order qualifier, stop price or trigger price, if applicable), order number, and account number, and, for options, a put or call indicator and strike price. All of this information must be entered before the ETS will accept an order.<sup>16</sup> For modified or cancelled orders, audit trail data includes a record of all of the terms of the modification or cancellation. For executed orders, the data also includes complete fill information.

### **1. Order Entry**

Orders may be entered into the ETS by clearing members, and by other entities and persons that the Exchange calls "Users." Users include floor traders and brokers; member and non-member futures commission merchants ("FCMs") that are guaranteed by clearing members; and customers of clearing members or guaranteed FCMs.<sup>17</sup> Both clearing members and Users have several options for connecting to the ETS, including "WebIce," an internet-based, front-end application provided by ICE Futures; proprietary "application program interfaces" ("API") approved by ICE Futures; or other application interfaces provided by third-party independent software vendors ("ISV") and approved by ICE Futures. In addition, if approved by their clearing members, Users may be granted "Direct Access" to the ETS, consisting of a direct electronic

---

<sup>16</sup> CTI codes are not entered by the person submitting the order, but the CTI code field is populated automatically based on the account number entered into the order screen.

<sup>17</sup> Floor brokers may enter orders in all Exchange contracts for their proprietary accounts, but may only enter orders for customer accounts in contracts authorized by the Trading Membership or Trading Permit they hold.

connection over which that User's orders pass from the User's API directly to the trading system, without first passing through the clearing member's computer system and then connecting to the ETS.<sup>18</sup>

## **2. Identification of "Responsible Individuals"**

ICE Futures requires that clearing members and other Direct Access Users register one or more persons with the Exchange as Responsible Individuals ("RI") for all trades submitted via their connection to ETS. RIs are identified to ICE Futures via their Exchange-assigned "eBadge," and every order submitted to the ETS must include an eBadge number, regardless of whether or not the order is specifically submitted by the RI. An RI may have more than one eBadge assigned to him or her. RIs must have authority to modify or withdraw any order submitted under their eBadge, and must be able to identify immediately the source of any such order.<sup>19</sup> The eBadge number associated with an order becomes part of the order's electronic audit trail.<sup>20</sup> A primary or backup RI must be available to provide information to ICE Futures telephonically for any order submitted under an eBadge number.<sup>21</sup>

## **3. Identification of Firms and Traders**

### **a. Trader Log-in IDs**

Individual traders who enter orders into the ETS are identified in the electronic audit trail through a Log-in ID or through an Order Routing ID and a Log-in ID in combination. Log-in IDs, which consist of unique alpha-numeric characters, are issued directly by the Exchange to individual Users who have a Direct Access connection to the ETS via WebIce. Individual Users given Log-in IDs are known as Registered Operators

---

<sup>18</sup> Direct Access is desired by some Users because they do not want to incur the delay associated with routing their orders through the clearing member. Clearing members remain responsible for any orders placed by Direct Access Users that they guarantee and have the ability to place risk limits on such User's accounts through the account set-up on the ETS.

<sup>19</sup> ICE Futures Rules §§ 27.07(b), 27.02(vii), and 27.07.

<sup>20</sup> ICE Futures Rule § 27.07(e). When a trader identified by an Order Routing ID has logged in by means of that ID to any front-end system approved by the Exchange for use in entering electronic orders, the front-end system automatically populates the eBadge field for each order with the eBadge number associated with the Log-In ID under which the front-end system is connected to the ETS.

<sup>21</sup> ICE Futures Rule § 27.07(c).

("ROs"). They may include floor traders, clearing member employees, or individual clearing member customers approved by the clearing member for Direct Access. A RO obtains access to the ETS by logging in to WebIce under his or her unique Log-in ID, which the ETS automatically attaches to any order submitted by him or her. Thus, the electronic audit trail for every order submitted via WebIce by an individual with a Direct Access connection to the ETS includes a unique identifier of the person submitting the order.

#### **b. Firm Log-in IDs**

ICE Futures issues firm Log-in IDs to clearing members and User firms that have Direct Access and connect to the ETS via an ISV interface or a proprietary API. A component of this Log-in ID identifies the firm connecting to the ETS, and the clearing member or Direct Access firm must in turn designate an RI who is accountable for use of the ID. Firm Log-in IDs are not intended to identify the employees or automated trading systems actually entering orders. Accordingly, ICE Futures Rule 27.09(a) requires that each employee who accesses the ETS on behalf of a clearing member or Direct Access firm must have their own unique Log-in ID issued by the Exchange. In practice, however, while some employees have individual Log-in IDs, as required, others are uniquely identified by a combination of the firm Log-in ID plus a unique, personalized Order Routing ID.<sup>22</sup>

#### **c. Order Routing IDs**

Order Routing IDs are unique alphanumeric identifiers for employees of Direct Access firms, including clearing members and the customers to which they extend access through their connection to the ETS. An employee or customer will have an Order Routing ID if he or she does not have a unique, exchange-issued Log-in ID. Part of an Order Routing ID, called the Authorized Trader ID, identifies the individual trader involved, while another part, called the Authorized Member ID, identifies the firm (if any) that employs the

---

<sup>22</sup> In discussions with Exchange staff, the Division noted that ICE Futures' practices for uniquely identifying persons placing orders on the ETS do not meet the letter of Rule 27.09(a). While Exchange staff represented that the combination of individual Log-in IDs, firm Log-in IDs and/or Order Routing IDs successfully identify persons placing orders on the ETS, the Division believes that ICE Futures' rules should reflect its actual ID practices. The Division will monitor the Exchange's progress in amending Rule 27.09(a) and any other rules required to accurately reflect its ID practices.

individual trader. Unlike the other IDs discussed above, Order Routing IDs are issued not by ICE Futures, but rather by the firm providing Direct Access for the trader's orders.<sup>23</sup> Where orders are submitted by an automated trading system, the firm providing Direct Access for the system's orders assigns an Order Routing ID to the individual who operates and controls the system.

An Order Routing ID—unlike a Log-in ID—is not required for the ETS to accept an order. However, the ETS does include an Order Routing ID in the electronic audit trail when one is provided with the order. Furthermore, in practice, orders submitted by traders who do not have individual Log-in IDs always have Order Routing IDs attached to them, along with a firm Log-in ID. This is a function of the Exchange-approved ISV and proprietary APIs through which orders are placed. These programs populate the Authorized Trader ID field with an alphabetical or numeric code that identifies the trader who submitted the order. The electronic audit trail for every order submitted by an individual not holding an individual, Exchange-assigned Log-in ID thus still includes a unique identifier—the Order Routing ID—of the person who submitted the order.

Because Compliance Department staff can obtain the identity of an individual trader who does not hold a unique, individual Log-in ID by querying the clearing member or other Direct User firm involved regarding the Order Routing ID being used, ICE Futures believes it is unnecessary to require that every individual trader using the ETS have an identifier directly registered with the Exchange.

#### **d. Recordkeeping with Respect to Order Routing IDs**

ICE Futures maintains a record of the Log-in IDs it issues, and retains this record for at least five years as required by Commission regulations. Records of Order Routing IDs must be maintained as part of the audit trail record for a minimum of five years by the issuing firm. If the clearing member that guarantees the Order Routing ID holder's trades did not issue the Order Routing ID, it must also maintain a record of the

---

<sup>23</sup> For example, firm "Smith Trading" is a customer of Direct Access firm ABC. Smith Trading employs Mr. John Cotton, and has an individual customer named Mr. Bob Coffee, both of whom wish to place orders on ICE. Smith Trading will ask ABC to issue Order Routing IDs for Mr. Cotton and Mr. Coffee. ABC will provide Smith Trading with two such IDs, which Smith Trading will then provide to Mr. Coffee and Mr. Cotton.

Order Routing ID for five years. Finally, if the Order Routing ID was issued to an employee or customer of a firm that does not have Direct Access, that firm must also retain a record of the Order Routing ID for five years, as required by Commission regulations. All of these firms must be able to provide to the Compliance Department, upon request, the identity of the person to whom any particular Order Routing ID was assigned.<sup>24</sup>

#### **B. Enforcement of Audit Trail and Recordkeeping Requirements in Electronic Trading**

The Division found that, while ICE Futures periodically reviews compliance with its audit trail and recordkeeping requirements for open-outcry trading (discussed below), it does not conduct comparable audit trail and recordkeeping reviews for electronic trading. Such reviews are an essential component of an adequate DCM compliance program and continuing compliance with Core Principles 10 and 17. This is particularly true in view of electronic trading's now dominant role in futures trading, and in ICE Futures' case, where futures contracts now trade exclusively on the ETS. The Division recommends that ICE Futures move promptly to implement and enforce an electronic audit trail program.

A satisfactory program for timely review of compliance with electronic audit trail and recordkeeping requirements should include at least four components. First, ICE Futures should actively monitor its electronic audit trail data in order to detect potential audit trail violations. Potential areas of surveillance include Exchange rules with respect to the use of unique Log-in IDs and Order Routing IDs by market participants. Order and trading patterns suggestive of potential ID rule violations could include: a single ID submitting orders and/or trading for unusually long periods of time without interruption (when the ID belongs to a natural person); a single ID originating orders from distinct geographic locations in a relatively short period of time (*e.g.*, orders originating in London in the morning and New York City in the afternoon); and trading by an unusually large number of IDs on behalf

---

<sup>24</sup> In practice, when the Exchange needs to know the identity of a particular Order Routing ID holder, it first calls the clearing member involved, though it can also call the Direct Access User firm or other firm involved, if any.

of a single account. Other areas to be monitored in the audit trail could include the use of CTI codes and account numbers, including post-trade changes to CTI codes, use of multiple CTI codes with a single account, and frequent account number corrections or changes. In this regard, the Division commends ICE Futures for already conducting similar analysis in other contexts, for example, via the “Account Change” and “Mechanical Adjustment” reports discussed below.<sup>25</sup>

A second component of an electronic audit trail enforcement program should focus on periodic reviews of sample audit trail data from front-end systems used to transmit orders to the ETS, including ISV interfaces and proprietary APIs. In such a review, the Exchange should verify, for each order sampled, that all required data fields are populated, and that the order’s receipt and transmission in the ETS are properly recorded. The samples could also be used to verify that all firms and individuals required to do so by Commission regulations and ICE Futures Rules are retaining front-end audit trail data for five years, and have it readily available for the most recent two years.<sup>26</sup>

The third component of an electronic audit trail enforcement program consists of periodic reviews of compliance with audit trail requirements by clearing member firms and other firms that assign Order Routing IDs or similar IDs used to uniquely identify individuals and automated trading systems placing orders with the ETS. Such reviews should verify that Order Routing IDs and other unique identifiers are assigned appropriately and that current and accurate information is maintained regarding the registered user of each identifier. Similarly, ICE Futures should periodically review any Log-in or other IDs (*e.g.*, eBadges, Registered Operator, and Responsible Individual information, as appropriate) assigned or collected by the Exchange itself to ensure that its information is current and otherwise in compliance with Exchange rules.

---

<sup>25</sup> See Section VI(A).

<sup>26</sup> See Commission Regulations §§ 1.31 and 1.35, and Commission Advisory *Alternative Method of Compliance With the Written Record Requirements*, 62 Fed. Reg. 7675 (Feb. 20, 1997).



Finally, an electronic audit trail enforcement program should enable ICE Futures to identify firms and individuals that have not maintained generally high levels of compliance with all of the Exchange's electronic recordkeeping and audit trail requirements. It should also enable the Exchange to take appropriate disciplinary action and conduct appropriate follow-up review wherever deficiencies in compliance are found.<sup>27</sup>

Since the Exchange does not now have a program of electronic recordkeeping and audit trail reviews, the Division believes that development and execution of the necessary program will likely require the Exchange to increase the size of its Compliance Department staff. The Exchange should move promptly to assess the staffing needed for such a program, and add sufficient staff to ensure its prompt development and effective use.

### **C. Audit Trail for Open-Outcry Trading**

Open-outcry trading decreased in significance at ICE Futures during the target period. From June 1, 2007 through February 2008, futures contracts traded both in open-outcry and electronically, and options traded only via open-outcry. The futures floor closed at the end of February 2008, and options began trading side-by-side in March 2008. However, while the number of trades subject to an open-outcry audit trail has diminished significantly, the Division believes that the open-outcry audit trail should continue to receive vigorous attention from the Compliance Department.

#### **1. Open-Outcry Recordkeeping Requirements Order Tickets and Trading Cards**

Exchange rules require FCMs and introducing brokers ("IB") who receive customer orders to immediately prepare order tickets that include an account identifier, an order number, a timestamp

---

<sup>27</sup> When the Exchange develops such a program, it should also update its Compliance Handbook to ensure that the Handbook accurately and comprehensively reflects all of the Exchange's rules, policies, and compliance programs for electronic trading, something that the Division found the present Handbook does not do.

indicating when the order was received, and, in the case of an option order, a timestamp indicating the time the order is transmitted to the floor for execution. Similarly, ICE Futures members receiving customer orders on the Exchange floor must immediately prepare floor order tickets that include an account identifier, an order number, an entry timestamp indicating when the order was received on the floor, and an exit timestamp showing the time that a report of execution was made from the floor.<sup>28</sup>

With respect to trading cards, the Exchange requires floor members to promptly record all trade executions (for both personal and customer accounts) on single-sided, sequentially numbered trading cards provided by the Exchange. Trades must be recorded in non-erasable ink, in chronological order, and without skipping lines between trades. In addition, a separate trading card must be used for each bracket period, including the open, close, and post-close trading periods. Erroneous information must be crossed out by a single line and not be obliterated or otherwise made illegible. Each card must contain the following information for each transaction: executing floor broker and opposite floor broker; bracket code; date, quantity, delivery month, and price; and, for options contracts, strike price, premium, and whether a put or call. Cross trades must be clearly identified along with the time of their execution. Trading cards must be submitted to designated Exchange employees within 15 minutes of the end of each bracket period, and if any lines remain after the last trade recorded on a card before submission, they must be crossed through.

## **2. Trade Timing**

ICE Futures' automated Audit Trail System ("ATS") uses a multi-stage trade time reconstruction process to impute to each open-outcry trade a time of execution to the nearest minute. To reconstruct the execution time, ATS uses time and sequencing data entered by both buyers and sellers, including trading card and line sequence numbers; execution times required to be manually recorded; time and sales data; 30-

---

<sup>28</sup> ICE Futures Rule § 6.08.

minute bracket codes; and Trade Input System data. Based on that information, ATS determines various time spans or “windows” within which one side of each trade may have been executed. The ATS then uses a series of algorithmic trade data comparisons that matches both sides of a trade, further narrows time windows, and ultimately assigns a one-minute execution time for each trade.

Compliance Department staff use the imputed trade execution times reconstructed by the ATS, in combination with time and sales data and floor order timestamps to the second, to reconstruct the sequence of trading for investigative and evidentiary purposes. The imputed times are also integrated into the Exchange’s automated surveillance system that is used to identify potential trading abuses.

#### **D. Enforcement of Open-Outcry Audit Trail and Recordkeeping Requirements**

##### **1. Audit Trail Review Process**

To evaluate and enforce members’ compliance with the Exchange’s floor order ticket and trading card recordkeeping requirements, the Compliance Department conducts random reviews of floor order tickets and trading cards.<sup>29</sup> The Compliance Department Handbook calls for the Exchange to conduct an audit trail review of floor order tickets and trading cards for all open-outcry products every 12 to 18 months. When conducting a “saturation” review, as such reviews are commonly known, Compliance Department staff select a single trading day at random from the period since the previous review, and gather and examine all floor order tickets and trading cards prepared by all of the Exchange’s floor traders and member firms on that day in all open-outcry markets. To ensure that the recordkeeping compliance of all floor traders is examined, staff select another trade date for review of the records of any floor trader normally active on the floor who was not present on the date selected for the saturation review.

When reviewing trading cards, Compliance Department staff determines whether a trader’s cards are in sequential number order, and whether separate cards were used for each bracket period

---

<sup>29</sup> Since ICE is not a Designated Self-Regulatory Organization (“DSRO”) for any Commission registrants, it does not conduct back office order ticket reviews.

and opening or closing period. For each card, staff determines whether any lines were skipped between transactions; whether unused lines at the end of each card were properly crossed out; whether buy and sell transactions are recorded separately on separate lines where required; whether trades are recorded in non-erasable ink and sequential order; and whether all required information is present for each recorded trade.<sup>30</sup>

When reviewing order tickets, Compliance Department staff determine for each ticket whether the order was recorded in non-erasable ink; whether the order was time-stamped to the nearest minute both when the order was received and when its execution is reported; whether order changes or cancellations are also time-stamped; whether the order ticket is marked with an order number specific to that ticket; whether specific account identification is recorded; and whether required bunched order, block trade, or average price indicators are present, where appropriate.<sup>31</sup>

Staff records their findings for each trading card and order ticket examined in a spreadsheet, which is used to calculate the overall percentage of each trader's trade documents that are in compliance with Exchange rules.<sup>32</sup> In making this calculation, the Exchange gives greater weight to recordkeeping violations that could be used to enable substantive trading abuses such as prearranged trading or trading ahead of customer orders. Examples of such recordkeeping violations include, among other things, skipping lines or failing to use non-erasable ink on a trading card, or failure to timestamp an order ticket.

---

<sup>30</sup> See ICE Futures Rule § 4.26. The information required to be recorded for each trade includes identification of the executing floor trader and opposite floor trader; the time bracket code; the trade date; the time of execution to the nearest minute, if the trade is the first recorded on that trading card; for futures contracts, the quantity, delivery month, and price; for options, the quantity, option month, strike price, premium, and whether the trade is a put or a call; a cross trade indicator, where appropriate; indication that the trader has executed the transaction for another floor broker, where appropriate; identification of transactions made pursuant to ICE Futures Rules § 4.17 *Discretionary Account* or § 4.30(a)(ii) and (iii) *Correction of Errors*, where appropriate; and the signature or initials of an Exchange employee in cases where this is required.

<sup>31</sup> See ICE Futures Rules §§ 4.08, 4.26, 4.31.

<sup>32</sup> The spreadsheet used for review of trading cards is known as the Trading Card Review Input Form, and the sheet used for review of order tickets is called the Order Ticket Review Worksheet.

ICE Futures imposes summary fines on traders whose overall recordkeeping compliance percentage is less than 85%. During the target period, the Compliance Department was authorized to issue summary fines of up to \$1,000 following a warning letter for trading card and order ticket recordkeeping violations. However, in September of 2009, ICE Futures' board of directors amended the Exchange's rules such that the Compliance Department may now levy summary fines of up to \$10,000 and is not required to first issue a warning letter.<sup>33</sup> As before, the Compliance Department may also choose to refer a matter to ICE Futures' Business Conduct Committee rather than issue a summary fine. The Division commends the Exchange for amending its rules, and encourages the Compliance Department to make full use of its enhanced authority with respect to summary fines.

## **2. Audit Trail "Saturation Reviews" During the Target Period**

ICE Futures did not conduct a saturation audit trail review during the target period. Instead, after completing a review for trading records dated April 27, 2006, the Exchange did not initiate another saturation review until it began a review in progress during the target period for trade date May 12, 2008, more than two years after the previous review. ICE Futures explained it had suspended saturation reviews during the target period due to resource requirements associated with the acquisition of NYBOT by Intercontinental and the migration of futures products from open-outcry trading to electronic trading. The Division does not believe that this excuses the Exchange's failure to enforce its open-outcry recordkeeping requirements for essentially a two-year period. As explained previously, in Section IV(B), it is incumbent upon ICE Futures and all DCMs to maintain a compliance staff of sufficient size to manage unexpected market events, changes in products and technology, and business events, *while at the same time meeting their routine regulatory obligations*. In this regard, the Division notes that it does not fault the Compliance staff itself for failure to conduct a saturation review, but rather the limited

---

<sup>33</sup> ICE Futures Rule 21.02(e).

manpower with which they were required to operate. Furthermore, given that audit trail violations can be indicative of substantive trading violations, the Division believes that saturation reviews should be conducted annually rather than between every 12 and 18 months, as required in the Compliance Department Handbook.

For purposes of this RER, since no saturation audit trail review was conducted during the target period, the Division instead assessed the April 27, 2006 saturation review. In that review, the Compliance Department examined a total of 4,262 trading cards and 2,927 order tickets from 84 member firms and 44 independent brokers. With respect to trading cards, the Department found that 3,448, or approximately 81%, of the cards reviewed were in compliance with Exchange recordkeeping requirements. The Department issued 63 warning letters for trading card violations to first-time offenders, and assessed summary fines totaling \$700 to three traders for repeat violations. With respect to order tickets, the review found that 2,742, or approximately 94%, of the order tickets reviewed complied with Exchange recordkeeping requirements.<sup>34</sup> The Department issued ten warning letters for first-time offenses to each of eight member firms and two independent brokers, and assessed a \$100 summary fine against one independent broker for a second offense.<sup>35</sup> In this context, the Division believes that a fine of only \$100—particularly for a second offense—is wholly inadequate.

The Division is concerned about the fact that approximately 19%, or nearly one in every five, of the trading cards examined in the 2006 saturation review were not in compliance with Exchange recordkeeping requirements. Such a high non-compliance percentage suggests that members may not have understood the Exchange's trading card requirements, or that the penalties issued for violations of the Exchange's recordkeeping requirements were not sufficient to serve as effective deterrents. The Division believes that

---

<sup>34</sup> Ninety-nine percent of the order tickets reviewed contained unique account identifiers and required order terms, while 94% contained required entry and exit time stamps.

<sup>35</sup> In addition to conducting saturation audit trail reviews, ICE also reviews trading cards and order tickets obtained in the course of trade practice or market surveillance investigations for their compliance with Exchange recordkeeping requirements. In such instances, the same standards used in saturation reviews are applicable.

ICE Futures should reexamine its summary disciplinary program for all audit trail violations, and questions whether the Exchange's practice during the target period of levying warning letters and summary fines in the \$100 to \$400 range, was viewed by members as a "cost of doing business" rather than a deterrent. In this regard, the Division expects ICE Futures' Compliance Department to make full use of the new authorities granted to it by the Exchange's board of directors and issue summary fines large enough to quickly encourage members to improve their recordkeeping practices.

### **3. Follow-Up Recordkeeping Reviews**

The Compliance Department conducts follow-up recordkeeping reviews for each floor trader or firm that fails either a saturation recordkeeping review or an examination of trade documents in the course of a trade practice or market surveillance investigation, to determine whether that trader or firm has improved sufficiently to meet the minimum 85% threshold required by the Exchange. Such reviews are conducted within a short time after the preceding unsatisfactory review. During the target period, ICE Futures conducted seven follow-up reviews of member firms and floor traders who received summary sanctions as a result of the 2006 saturation review.<sup>36</sup> These reviews included examination of 202 trading cards prepared by 32 individual traders. With respect to trading cards, the Compliance Department found that twenty-one traders had improved their recordkeeping compliance and now met the required 85% threshold. Eleven traders whom the follow-up reviews examined were still not in compliance and were assessed fines totaling \$2,000. Six traders received fines of \$100 each, three received fines of \$200 each, and two received fines of \$400 each. The reviews also included examination of 64 order tickets prepared by six traders. Five of these traders were found to have improved and come into compliance. One trader still not in compliance was fined \$100. No follow-up reviews involving trade documents involved in investigations were conducted during the target period.

---

<sup>36</sup> Investigations Nos. 2007-047; 2007-048; 2007-049; 2007-098; 2007-099; 2007-100; and 2007-101.

As with saturation reviews, the Division believes that the fines levied in conjunction with follow-up recordkeeping reviews were insufficient to discourage recidivist behavior. The Division again expects the Compliance Department to make full use of its enhanced authority with respect to summary fines, including fines issued during follow-up recordkeeping reviews.

#### **E. Safe Storage Capability**

ICE Futures' audit trail data for both electronic and open-outcry trading is archived in a database maintained by Intercontinental, ICE Futures' parent company. The database is referred to as the ICE Futures U.S. Data Warehouse ("Data Warehouse") and is maintained in the Chicago area. All orders transmitted to the ETS and all data relating to matched trades are recorded and retained in this database in real-time as they are received throughout the trading day.<sup>37</sup> Upon its receipt in the Data Warehouse, the same data is transmitted in batches, with a delay of approximately six to ten minutes, to Intercontinental's backup data center near Atlanta, where it is retained in a database that mirrors the Data Warehouse.<sup>38</sup> In addition, Intercontinental creates daily and weekly backups of all Data Warehouse audit trail data on computer tape cartridges, which are sent off site every two weeks for storage at data backup sites maintained by the data backup provider contracted by ICE Futures, and located between 20 and 30 miles from the Data Warehouse. At all of these sites, all data is stored in a manner that protects it from unauthorized alterations, accidental erasure, or other loss.

Data for all orders resulting in matched trades is retained in the Data Warehouse for a minimum of five years, as required by Commission Regulations, and is immediately available to Compliance

---

<sup>37</sup> Matched trade data is also transmitted in real-time from the ETS to the Exchange's clearing system. Cleared trade data is retained in a separate clearing database, transmitted in real-time to Intercontinental's backup data center outside Atlanta, and retained in both locations for a minimum of five years.

<sup>38</sup> Intercontinental is currently in the process of upgrading its data backup systems. When this process is concluded, all data received in the Data Warehouse will be transmitted to the backup data center in real-time, rather than in delayed batches. Intercontinental expects that its data backup upgrades will be completed by the end of 2010.



Department staff from their desktop computers. Because data for non-executed orders exceeds the volume of matched trade data by multiple orders of magnitude, to a degree that can slow the Exchange's automated surveillance systems, such data is retained in the Data Warehouse for six months, and then purged from the database on a monthly basis and maintained thereafter through the Exchange's computer tape cartridge backup process, which retains all data on tape for a minimum of five years. Whenever such older, non-executed-order data is needed for surveillance or compliance purposes, it is restored from tape into a computer system testing environment at Intercontinental's Atlanta headquarters, from where it is available to Compliance Department staff from their desktop computers and can be produced in electronic format. The restoration process includes one business day for obtaining the relevant tapes from storage, plus the time necessary to restore the data into the test environment, which varies depending on the amount of data involved. In most cases, the entire process takes no more than two days.<sup>39</sup>

## **F. Conclusions and Recommendations**

The Division found that ICE Futures maintains a program for recording trade data in a manner that enables the Compliance Department to identify customer and market abuses and provide evidence of rule violations. For electronic trading, the Exchange's audit trail is captured in an electronic record that includes all messages entered into the ETS; the terms and time of entry for all orders; all order modifications; and all matched trades. This record allows the Compliance Department to reconstruct ETS trading efficiently and effectively. For open-outcry trading, the Exchange's ATS algorithmically imputes a time of execution to the minute which, along with time and sales data and floor order timestamps, allows Compliance Department staff to reconstruct the sequence of trading for investigation and evidentiary purposes.

---

<sup>39</sup> In Intercontinental's testing of the data restoration process, data restoration took approximately one hour for each month of data restored.

The Division also found that ICE Futures has a program for monitoring member and member firm compliance with recordkeeping requirements for open-outcry trading through routine audit trail reviews which enable detection and sanctioning of recordkeeping violations. However, the Division has serious concerns with several elements of the Exchange's audit trail program. First, while the Exchange does have a program for monitoring compliance with open-outcry recordkeeping requirements, it did not conduct a saturation audit trail recordkeeping review for approximately a two-year period although the Compliance Department Handbook calls for saturation reviews to be performed every 12 to 18 months. Given that audit trail violations can be indicative of substantive trading violations, the Division believes open-outcry saturation audit trail reviews should be conducted no less than annually. Second, the last saturation review that ICE Futures did perform, in 2006, revealed that approximately 19% of the trading cards examined were not in compliance with Exchange recordkeeping requirements. Such high non-compliance percentages suggest that members fail to understand the Exchange's trading card requirements or that the summary fines issued for trading card violations were insufficient to serve as an effective deterrent.

Under the Exchange's trading card and order ticket summary disciplinary program, summary fines are levied on members whose overall recordkeeping compliance percentage is less than 85%. During the target period, Exchange rules required it to issue warning letters for a first offense, and authorized subsequent summary fines of up to \$1,000. Actual fines were typically far lower. The Division believes that ICE Futures should reexamine its open-outcry recordkeeping compliance program with respect to trading cards, and take steps to achieve a substantially higher percentage of compliance. Such actions should include member education programs to ensure that all members are fully aware of the Exchange's regulatory requirements. In addition, ICE Futures Compliance staff should make full use of its new authority to issue significantly larger summary fines for recordkeeping and other violations. Fines must be punitive enough to effectively deter recidivist behavior.

Finally, the Division found that ICE Futures does not currently have programs to enforce compliance with its audit trail and recordkeeping requirements for electronic trading. Accordingly, the Division recommends that the Exchange promptly establish appropriate programs in both areas. The Division believes that doing so will likely require the Exchange to increase the size of its compliance staff.

Based on the foregoing, the Division recommends that the Exchange:

- **Ensure that open-outcry saturation reviews are conducted annually.**
- **Reexamine its open-outcry audit trail and recordkeeping compliance program with respect to trading cards and make adjustments to achieve a higher percentage of compliance. In this connection, the Compliance Department should use its enhanced authority with respect to summary fines to ensure that fines are a meaningful deterrent, especially with respect to repeat offenders.**
- **Augment its audit trail compliance and enforcement program to include a programmatic review of electronic audit trail and recordkeeping rules that is comparable in rigor and scope to its saturation review program for open-outcry trading.**

## **VI. TRADE PRACTICE SURVEILLANCE PROGRAM**

### **Core Principle 2 – Compliance with Rules:**

**The board of trade shall monitor and enforce compliance with the rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.**

### **Core Principle 12 – Protection of Market Participants:**

**The board of trade shall establish and enforce rules to protect market participants from abusive practices committed by any party acting as an agent for the participants.**

Pursuant to Appendix B to Part 38 of the Commission's regulations, a contract market's trade practice surveillance program should have the arrangements, resources, and authority necessary to perform effective rule enforcement. The arrangements and resources attendant to the program should facilitate the direct supervision of the contract market, including analysis of relevant data. Trade

practice surveillance programs can be carried out by the contract market itself or through delegation to a third party.

An acceptable program should have systems that maintain all data reflecting the details of each transaction executed on the contract market. In this regard, the program should include routine electronic analysis of transaction data to detect potential trading violations. The program also should provide for appropriate and thorough investigation of all potential trading violations brought to the contract market's attention, including member and Commission referrals and customer complaints. In addition, the program should have the authority to discipline, suspend, or terminate the activities of members or market participants pursuant to clear and fair standards.<sup>40</sup>

#### **A. Automated Surveillance System**

##### **1. CARS II, Crystal Reports and Infomaker**

ICE Futures uses three primary applications to detect and investigate potential trading violations in its electronic and open-outcry markets: the Compliance Audit and Review System II ("CARS II"), Crystal Reports ("Crystal"), and Infomaker. Each system serves a unique function within the Exchange's compliance program. CARS II is the principle surveillance system. It allows Compliance staff to compile, retrieve, sort, and filter trading information for the Exchange's electronic and open-outcry markets, including reports that support trade practice investigations and general compliance work. CARS II also provides access to order information for the Exchange's electronic markets. Specific CARS II reports include the Extended Trade Review-Daily Trade Register, which tracks the trading activity of a particular market or market participant over a period of time; the Electronic Order Review, which focuses on

---

<sup>40</sup> That aspect of Core Principle 2 that relates to the disciplining of members who violate Exchange rules is discussed below in Section VII. This section of the report addresses the Exchange's program for monitoring its markets for possible trading abuses and the investigation of any identified abuses.

orders submitted to the ETS; and the Electronic Order and Trade review, which identifies specific orders and the resulting trades.<sup>41</sup>

Crystal and Infomaker applications provide ad hoc reports by which Compliance staff can extract and organize information with respect to both electronic and open-outcry trading. Crystal is most commonly used by Compliance to create exception reports. Infomaker has certain customized reports within the application that allows Compliance staff to view floor brokers' trading information. Both systems help Compliance staff to identify potentially violative activity, including cross trades outside of Exchange rules, trading ahead, and post-execution, pre-clearing changes to completed trades.

Crystal and Infomaker are new additions to the Exchange's Compliance technology resources since the 2004 Review. During the target period, the cross trade and trading ahead reports generated by Crystal and Infomaker were an important component of the Exchange's trade practice inquiry and investigation program.<sup>42</sup> Of 115 total inquiries and investigations opened during the target period, 88 were opened based on review of Crystal and Infomaker cross trade and trading ahead reports.<sup>43</sup> Important Crystal and Infomaker reports include the Crystal "Potential Trading Ahead Report," which captures potential instances of trading ahead for ETS, open-outcry, and side-by-side trading. The Infomaker "Cross Trade Detail Report for ETS and Floor Trades" identifies potential instances of cross

---

<sup>41</sup> Other CARS II reports include the Trading Card Review, which permits staff to recreate trading cards electronically; the Daily Price Review; the Fast Market Review; and the Time and Sales Review.

<sup>42</sup> The Exchange distinguishes between inquiries and investigations based on a number of factors. Investigations are more formal in nature than inquiries. Certain matters, including customer complaints, CFTC referrals, and reviews arising from specific exception reports, are automatically opened as investigations. Inquiries arise from more *ad hoc* reviews by Compliance staff. Once a staff person has collected a baseline of evidence, he or she will meet with their supervisor and determine what additional steps to take, if any. As the matter is researched further and indications of potential wrong-doing increase, it transitions from inquiry to investigation.

<sup>43</sup> The Compliance Department's cross trade review program has been substantially enhanced since the 2004 Review. The Crystal and Infomaker reports address a Division recommendation in 2004 that the Exchange increase the number of large-size cross trades it investigates and develop procedures to examine brokers who execute a large number of small-size cross trades in liquid contract months. The Division also recommended that the Exchange develop an automated exception report to identify cross trades that meet Exchange criteria for further review.

trading between trades executed on the floor and trades executed electronically. It also captures potential instances of trading ahead for trades executed solely via ETS or open-outcry. Finally, the Crystal “Potential Cross Trade Exception Report-Electronic” captures instances where potential prearranged or wash trades are executed on the ETS. In accordance with Exchange rules, this report flags instances where trades result from orders entered within five seconds of one another and share one or more common criteria (*e.g.*, same ETS Log-in ID, same account number, same clearing member).

## **2. Daily Exception Reports and Other Regular Reviews**

In addition to the information and reports provided by CARS II, Crystal Reports, and Infomaker, ICE Futures also utilizes Daily Exception Reports (“DERs”) and other regular reviews as part of its surveillance program. DERs are generated daily and list trade information meeting pre-defined parameters. DER reports include the Mechanical Adjustment Report and the Account Change Report, which shows changes to electronic trades made prior to clearing. DERs are produced as searchable files that are transmitted daily to Compliance Department managers. Other regular reviews conducted by Compliance staff include the daily Block Trade Reporting Review and the weekly Trade at Settlement (“TAS”) Review.

The Block Trade Reporting Review is a daily examination of block trades to determine if they are reported to the Exchange within five minutes of execution.<sup>44</sup> The Mechanical Adjustment Report identifies trades that have been changed (post-execution) for the benefit of one market participant and to the detriment of another.<sup>45</sup> The report focuses on inconsistencies in the trade information provided

---

<sup>44</sup> ICE Futures Rule § 4.31 lists the Exchange’s block trade requirements. In addition to the Block Trade Reporting Review, Compliance examines a sample of block trades monthly to ensure that the parties to the trade are eligible contract participants and that minimum quantity thresholds are met.

<sup>45</sup> Mechanical adjustments are permissible to correct trade information (*e.g.*, quantity, price, contract month) that is input incorrectly into Exchange systems. A mechanical adjustment results in two new entries of trade data: one entry offsets the previously entered incorrect trade; the second entry is the trade with the corrected information. The Mechanical Adjustment Report focuses on potential abuses of the mechanical adjustment process.

for a cancellation or adjustment trade compared with the trade information captured for the original trade. Different “cuts” of the Mechanical Adjustment Report review different variables, including trade price, quantity, contract month, strike price, and CTI code.

The Trading at Settlement Review is a weekly review to identify instances where market participants take a position at TAS during the day and then potentially attempt to influence the settlement price on which the TAS trade is based by trading in the opposite side of the market during the settlement period.<sup>46</sup> For example, a market participant who buys TAS in a particular contract may try to lower the TAS price by selling contracts on the close, thereby potentially influencing the settlement price. The Account Change Report identifies any changes made by users to ETS trades prior to the trades clearing in the Post Trade Management System. Compliance staff looks for changes that are detrimental to customers such as large quantity account changes, changes that occur at odd hours, frequency of account changes with respect to certain accounts, patterns of similar account changes, and other suspicious account change activity. Specifically, the report identifies all instances where the CTI and/or account number is changed.

## **B. Floor Surveillance**

As explained above, ICE Futures ceased open-outcry trading in futures on February 29, 2008, thereby reducing floor surveillance’s overall importance in the Exchange’s trade practice surveillance program. However, futures trades were subject to floor surveillance from the start of the target period until the end of February 2008, and the Compliance Department continues to utilize floor surveillance to detect and deter potential rule violations in open-outcry options trading.

---

<sup>46</sup> Effective December 14, 2007, “Trading at Settlement” was implemented in the Cotton and FCOJ futures markets. Thereafter, TAS trading was implemented in other markets: the Russell 2000 Mini on December 21, 2007; Sugar #11, Coffee C, Cocoa, Russell 1000 Index, Russell 1000 Mini, and Russell 2000 Index on February 1, 2008.

When futures were traded on the floor, Compliance staff spent a substantial amount of time conducting floor surveillance. Presently, the Exchange's Senior Investigator/Floor Surveillance specifically supports the floor surveillance program for open-outcry options trading. The Senior Investigator/Floor Surveillance views the opening, midday trading, and the close for all options contracts. Other Investigators are assigned to this duty once a week, such that all Compliance staff members participate in floor surveillance, and all openings, midday trading, and closes are monitored. Based on observations and interactions with members on the floor, an Investigator conducting floor surveillance can either initiate a follow-up review or share his or her concerns with a Compliance manager. The manager will then assign a staff member to seek further information and investigate. The Compliance Department maintains a floor surveillance log which documents all floor surveillance activity, including time spent on the floor. No investigations based on floor surveillance were opened during the target period.

### **C. Trade Practice Investigations**

#### **1. Number of Investigations During the Target Period**

ICE Futures opened 41 trade practice investigations ("TPIs" or "investigations") during the target period. These 41 investigations included 30 TPIs that were generated internally from the Exchange's surveillance systems (*e.g.*, exception reports, block trade reviews, Market Supervision referrals) and 11 that were generated from external referrals and complaints. The 11 external referrals included 10 from customers, members, or other committees or departments of the Exchange, and one referral from the CFTC.

ICE Futures also closed a total of 40 investigations during the target period, including 13 TPIs that were both opened and closed during the target period. Thirty-two of the closed investigations involved floor trading and eight involved electronic trading. The Division reviewed all 40 closed



investigations for timeliness, adequacy, and documentation.<sup>47</sup> The Division's findings with respect to the 40 closed investigations are discussed below, including significant concerns with respect to the timeliness of numerous closed TPIs.

## **2. Adequacy of Investigations**

Division staff reviewed the adequacy of the 40 TPIs closed during the target period. Thirteen of the 40 investigations were referred to the Exchange's Business Conduct Committee for disciplinary action.<sup>48</sup> Twelve investigations were closed by Compliance Department staff with no action. Another 12 TPIs were closed via staff warning letters sent to 15 individuals and firms. These 15 letters were issued for: branch order ticket/recordkeeping violations (1); improper CTI codes (1); error notification violations (2); trading card/recordkeeping violations (3); cross trade violations (3); and floor order ticket/recordkeeping violations (5). The Compliance Department closed an additional TPI via a warning letter to an individual exchange member and a \$400 summary fine against a firm for order ticket violations. One TPI was closed via a \$200 summary fine to a firm when repeat order ticket violations were discovered in the course of a trade practice investigation where no violation was otherwise found. In this regard, the Division again notes the questionable deterrent value of such small summary fines, especially with respect to repeat offenders.<sup>49</sup> Finally, ICE Futures closed one TPI via a "letter of censure" to a firm over which the Exchange did not have disciplinary authority, but whose conduct the Exchange still wished to reprimand.

The Division found that ICE Futures' investigation files were typically well documented and included pertinent underlying trading documents, correspondence, computer reports, tape recordings

---

<sup>47</sup> During the target period, ICE also closed 31 trade practice inquiries without further action (*i.e.*, without elevation to investigation status). The Division reviewed a sample of 15 closed inquiries and found that the conduct and resolution of the inquiries was adequate.

<sup>48</sup> Disciplinary cases are discussed separately in Section VII of this report.

<sup>49</sup> The Division's recommendation with respect to summary fines is contained in Section V of this report.

of witness interviews, and summaries of the trading activity examined. When necessary, investigations were broadened in scope to look for patterns of violations. Investigations that were closed with no further action included a close-out memorandum. Files for investigations that were referred for formal disciplinary action included an investigation report and a memorandum containing recommendations with respect to charges. Investigation reports described the details surrounding investigations, including how the matter was initiated, the facts developed during the course of the investigation, summaries of interviews, and Compliance staff's analysis and conclusions. Relevant computer reports were typically attached. In sum, the Division is satisfied that ICE Futures conducts thorough investigations that include appropriate analysis.

### **3. Timeliness of Investigations**

Of the 40 trade practice investigations closed during the target period, nine (22.5%) required between 14 and 28 months to close. In addition, 10 investigations opened prior to the target period were still open when the target period ended, for time periods ranging from 455 to 787 days.<sup>50</sup> Taken together, these 19 TPIs raise serious concerns with respect to the Exchange's timely disposition of trade practice investigations. Accordingly, Division staff examined all 19 investigations in detail to determine whether there was any apparent justification for their prolonged open periods. In addition, staff continued to track the 10 open investigations beyond the end of the target period to ascertain their ultimate disposition. In this regard, the Division found that eight are now closed, but two remained open as of October 2009.<sup>51</sup>

---

<sup>50</sup> At the conclusion of the target period, these 10 investigations had each been open for the following lengths of time, in ascending order: 455 days; 461 days; 467 days; 562 days; 584 days; 587 days; 650 days; 658 days; 732 days; and 787 days.

<sup>51</sup> In October 2009, Division staff inquired as to the status of these 10 investigations. Staff found that: Investigation #s 2006-166 and 2006-154 were closed, with no action, after 895 and 911 days; Investigation # 2006-88 was closed, with a summary fine and warning letter, after 1052 days; Investigation # 2006-061 was closed, after 936 days, with a \$15,000 fine; Investigation # 2007-025 was closed, after 557 days, with a \$30,500 fine; Investigation # 2006-156 was closed, after 733 days, with \$2,092 fine and \$4,189 in customer restitution; and Investigation #

Division staff's analysis of the 19 trade practice investigations outlined above focused on several potentially mitigating factors, including 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 to be examined by Compliance staff. Based on these criteria, the Division believes that 12 of the 19 TPIs it reviewed were open for excessively long periods that were not justified by any factors intrinsic to the investigations. The Division also believes that the number of investigations open for excessively long time periods is another indicator that the Exchange requires additional Compliance staff to adequately fulfill its regulatory responsibilities.

During the on-site interview portion of this review, the Exchange explained that the delay in closing some investigations was attributable in part to changes at ICE Futures during the target period, including the transition to electronic trading, the merger with Intercontinental, and internal Compliance Department restructuring. This explanation, however, only highlights the difficulty which any under-resourced compliance department will have in meeting its responsibilities when faced with unexpected or unusual demands on its time and focus. The Division has already discussed the problem of insufficient Compliance staff at ICE Futures, which manifested itself in the Exchange's inability to complete a saturation audit trail recordkeeping review during the target period or to complete trade practice investigations in a timely manner. To be clear, this finding is not a criticism of the quality of the Compliance Department's work. Rather, the Division believes that the Exchange must hire additional staff to ensure that it can fulfill its regulatory responsibilities; implement new initiatives, such as the electronic audit program recommended above; and respond to special demands as they may arise.

---

2006-116 was closed, after 1,123 days, with a \$2,500 fine. Investigation # 2006-123 was closed with respect to two respondents, who paid fines of \$10,000 and \$4,000, respectively, but remained open (for 1,158 days as of October 22, 2009) with respect to a third respondent. Investigation #s 2007-018 and 2007-022 remained open as of October 22, 2009 (for 975 and 969 days, respectively) pending the resolution of a jurisdictional issue.

#### **D. Conclusions and Recommendations**

The Exchange maintains a trade practice surveillance program that is administered by an experienced staff. ICE Futures uses automated systems such as CARS II, Crystal, and Infomaker; physical floor surveillance; and special Daily Exception Reports to monitor its electronic and open-outcry markets and help investigate potential trading violations. Notably, the Exchange implemented a recommendation from the 2002-03 Review to examine more cross trades and develop automated reports to facilitate surveillance of cross trades.

The Compliance Department's program of investigations and inquiries provides for appropriate investigation of potential trading violations brought to the attention of Compliance staff, including member and Commission referrals and customer complaints. Throughout the target period, investigations were thorough and well documented, and investigation reports included sufficient analysis to support Compliance staff's conclusions and recommendations. In addition, investigations were expanded to include additional trading dates or members where appropriate. Investigation files included pertinent underlying trading documents, correspondence, computer reports, tape recordings of witness interviews, and summaries of the trading activity examined.

During the target period, the Exchange closed 40 trade practice investigations, including 32 involving floor trading and eight involving electronic trading. Investigations were generated from a variety of sources, with the largest number coming from department generated reports. Thirteen of the closed investigations were referred to ICE Futures' Business Conduct Committee for disciplinary action. Twelve TPIs were closed by Compliance Department staff with no action. Another 12 TPIs were closed via staff warning letters, and three TPIs were closed via a combination of warning letters, a letter of censure, and two summary fines totaling \$600.

Finally, although the majority of TPIs closed during the target period were closed in less than a year, the Division found a troubling lack of timeliness with respect to a substantial number of

investigations. Nine TPIs closed during the target period required between 14 and 28 months to close. An additional 10 TPIs opened prior to the target period were still open when the target period ended, by which they had been open for time periods ranging from 455 to 787 days. The Division thoroughly reviewed all 19 investigations to determine whether any mitigating factors internal to them justified their prolonged open periods. In 12 instances, the Division found no apparent justification. The Division believes that ICE Futures' inability to close trade practice investigations in a timely manner reflects its inadequate Compliance staffing levels during the target period.

Based on the foregoing, the Division recommends that the Exchange:

- **Take appropriate measures to ensure that investigations are completed in a timely manner.**

## **VII. DISCIPLINARY PROGRAM**

### **Core Principle 2 – Compliance with Rules:**

**The board of trade shall monitor and enforce compliance with rules of the contract market, including the terms and conditions of any contracts to be traded and any limitations on access to the contract market.**

Core Principle 2 requires, among other things, that an exchange have the authority to discipline, suspend, or terminate the activities of members or market participants pursuant to clear and fair standards. Consequently, an acceptable compliance program should provide for prompt and effective disciplinary action for any violation that is found to have been committed.

### **A. Disciplinary Committees and Procedures**

The Business Conduct Committee ("BCC") is ICE Futures' primary disciplinary committee. It acts through two distinct panels: the Probable Cause Panel ("PCP"), which determines whether there is a reasonable basis to believe that an alleged rule violation may have occurred, and the Hearing Panel, which conducts adjudicatory hearings for contested cases. Both panels are comprised of individuals

selected by the panel Chairman. Panel members are not permitted to sit on both the PCP and the Hearing Panel for the same matter.

Each BCC panel typically includes seven individuals, including four Exchange members or employees of member firms and three non-members, at least one of whom is a public participant. ICE Futures rules also require that both panels be composed of members who represent a diversity of futures industry business interests so as to ensure fairness. If there is a need to convene a Hearing Panel, the BCC Chairman has the discretion to appoint either a three or five-person panel. Three-person Hearing Panels include two members or employees of members and one non-member, while five-person Panels include four members or employees of members and one non-member.<sup>52</sup>

Once the Compliance Department completes an investigation report and determines to bring a matter before the BCC, the investigation becomes a “disciplinary case” and a multi-step disciplinary process begins. First, during an initial PCP meeting, the Compliance Department presents its case *ex parte* and the PCP makes a determination as to whether there is a reasonable basis to believe that a rule violation may have occurred. If the PCP finds such a basis, then, during the same meeting, the respondent has the opportunity to present evidence informally. Following the respondent’s presentation, the PCP decides whether to reconfirm its initial determination that a reasonable basis exists for finding that a rule violation occurred. If the PCP reconfirms its determination, it may offer the respondent a settlement, or refer the matter directly to a Hearing Panel by authorizing the Compliance Department to issue a Notice of Charges. The PCP also has the authority to request that the Compliance Department investigate the matter further.<sup>53</sup> In all cases where a Notice of Charges is issued, respondents must request a hearing within 20 days or the right to a hearing is deemed waived. In

---

<sup>52</sup> ICE Futures Rule 21.08(a).

<sup>53</sup> ICE Futures Rule 21.03

addition, if a respondent fails to file an answer within 20 days, such failure is considered an admission to all of the allegations set forth in the Notice of Charges.<sup>54</sup>

If charges are issued and a case is not settled, then the final step in a disciplinary case is a hearing before the Hearing Panel. In every instance, the respondent has the right to be represented by legal counsel, to present witnesses and documentary evidence, to cross-examine witnesses, and to access evidence in the possession of the Exchange. Cases are prosecuted by the Compliance Department which bears the burden of proof. No formal rules of evidence apply. Upon reaching a decision by majority vote, the Hearing Panel must produce a written opinion that includes a summary of the allegations contained in the Notice of Charges, a summary of the respondent's answer, a brief summary of the evidence, and a statement of findings and conclusions with respect to each charge. Panel members discuss the reasons for their decision with the Assistant General Counsel who ultimately writes the decision, which is then circulated and confirmed by each Panel member.

If the Hearing Panel finds a respondent guilty of any charge, the written decision must include the specific rule that the respondent was found to have violated. In addition, if the violation involved the execution of a customer transaction, the Hearing Panel must make a specific finding as to whether the customer incurred financial harm. The decision also must contain an order stating the penalty imposed. The penalty imposed may include any of the following: (1) a cease and desist order or a reprimand; (2) a fine not exceeding \$100,000 for each rule violation plus the monetary value of any benefit received as a result of the violation; (3) a suspension of up to one year for each rule violation; (4) expulsion; (5) as part of a suspension or expulsion, an agreement that the respondent may not be employed by another member as a floor employee; and (6) restitution to injured customers.<sup>55</sup> Appeals from a Hearing Panel's decision are permitted only to challenge an expulsion from membership.

---

<sup>54</sup> ICE Futures Rule 21.06(b).

<sup>55</sup> ICE Futures Rules 21.11, 21.12, and 21.13.

Finally, ICE Futures disciplinary matters may also be resolved through settlement agreements reached at different stages of the disciplinary process. In matters not yet referred to the PCP, the Compliance Department may enter into written settlement agreements including fines of \$10,000 for each rule violation alleged, voluntary suspensions of up to three months for each rule violation alleged, and expulsion.<sup>56</sup> After a matter has been referred to the PCP, the PCP may enter into written settlement agreements with respondents including fines of \$25,000 for each rule violation alleged, voluntary suspension of up to one year for each rule violation alleged, a prohibition against executing customer orders, and expulsion.<sup>57</sup> Lastly, prior to the commencement of a hearing, a Hearing Panel may enter into settlement agreements similar to those that may be reached by PCPs.<sup>58</sup>

## **B. Adequacy of Disciplinary Sanctions**

During the target period, the Compliance Department referred 18 trade practice investigations to the BCC for disciplinary action.<sup>59</sup> Thirteen of these 18 cases were also closed during the target period, all of them via settlement agreements reached with PCPs. No trade practice cases were heard by a Hearing Panel during the target period. The 13 closed cases included one involving unauthorized brokering of customer orders by a lessee; two involving recordkeeping violations; three involving practices inconsistent with just and equitable principles of trade; and seven involving substantive trade practice violations that included trading ahead and trading against customer orders, misallocation of customer orders, non-competitive trading, and improper cross-trades. Division staff reviewed all 13 cases for adequacy of sanctions and timeliness.

---

<sup>56</sup> ICE Futures Rule 21.02(d)(ii).

<sup>57</sup> ICE Futures Rule 21.03(e)(iv). The Division notes that, effective November 16, 2009, the Exchange amended Rules 21.03 and 21.11 so that PCPs have the authority to make settlement offers in which the size of the maximum monetary fine per rule violation has been increased from \$25,000 to \$100,000—thereby making their authority in the context of a settlement agreement commensurate with the maximum sanction that can be imposed after a hearing in which the respondent is found to have committed rule violations.

<sup>58</sup> ICE Futures Rule 21.11.

<sup>59</sup> Some cases involved more than one member.



The 13 closed cases reviewed by staff resulted in the expulsion of three Exchange members, fines totaling \$20,400, and customer restitution totaling \$3,820.<sup>60</sup> The \$20,400 in fines was levied against seven respondents in eight separate cases.<sup>61</sup> These fines included \$500 for recordkeeping violations in one case; \$12,400 for substantive trade practice violations in six cases; and \$7,500 for unauthorized trading by a lessee in one case. The remaining five cases were resolved through the expulsion of three Exchange members, as explained below. In addition, four of the 13 cases also resulted in customer restitution, including restitution in two of the cases where Exchange members were expelled.

Four of the 13 trade practice cases closed during the target period arose through investigations based on customer complaints. The four cases resulted in the expulsion of three members. Case numbers 2005-084, 2006-097, and 2006-120 involved a floor broker who was the subject of three separate customer complaints which the Exchange received between June and August 2006. The Exchange's investigation revealed several potential violations by the broker, including misallocation of customer trades and failure to reconcile error trades. In order to resolve these three cases and other matters pending against him, the broker agreed to an expulsion from Exchange membership and a five-year bar to seeking re-admittance. Customer claims were resolved through separate arbitration proceedings in Case #s 2005-084 (\$118,131) and 2006-120 (\$100,000) and a privately negotiated settlement in Case # 2006-097 (\$6,300).

Case # 2007-104 also arose through an investigation based on a customer complaint. The Exchange's investigation revealed seven potential instances of trading ahead of customer orders by a

---

<sup>60</sup> Not included in the customer restitution total is the reimbursement of \$3,750 for trades that were improperly allocated. During a Compliance Department investigation, a member recognized the discrepancy and reimbursed the customer. The matter was considered by the BCC on a date outside of the target period. Also not included in the customer restitution total is \$6,300 paid by a member as part of a customer settlement that occurred outside of the Exchange's disciplinary process.

<sup>61</sup> Some respondents appear in more than one case.

floor broker, and an apparent failure to supervise by the member firm that employed him. The broker was also the subject of Case/Investigation # 2005-162, which involved indirectly taking the opposite side of customer orders, trading ahead of customer orders, accommodation trading, and other violations. At the BCC level, the subject broker and his accommodator, another Exchange floor broker, agreed to a settlement which resolved both cases and permanently expelled them from Exchange membership. Both cases resulted in customer restitution, including \$1,000 in Case # 2007-104 and \$1,520 in Case # 2005-162.

Based on its review of all 13 closed cases referred to the BCC, the Division believes that ICE Futures maintained an adequate disciplinary program during the target period.

### **C. Timeliness of Disciplinary Procedures**

After careful review, Division staff determined that the Exchange's disciplinary cases were typically resolved in a timely manner. However, the Division's analysis was complicated by ICE Futures' recordkeeping practices. In the case of investigations that were referred to the BCC, the Exchange did not record the date on which completed investigation reports ("IRs") were approved by senior Compliance staff. Instead, it recorded the initial BCC hearing date as the date on which an investigation was closed. As a consequence, the Division could not determine how much time elapsed between final approval of a complete IR by senior staff and the date of the initial BCC hearing on the matter.

The Division believes that the date on which an IR is approved as final by senior Compliance staff is necessary to determine whether responsibility for any delays in processing a disciplinary case rests with the Compliance Department or the BCC. Improved recordkeeping will allow Division staff to determine whether any untimely disciplinary cases were caused by Compliance's failure to refer a completed IR to the BCC on a timely basis or the BCC's failure to schedule a PCP promptly after receiving a referral from the Compliance Department. Accordingly, the Division recommends that the Exchange date its investigation reports when they are deemed complete by senior Compliance Department

management.

Division staff was able to ascertain certain information with respect to the timeliness of the disciplinary process. ICE Futures' records indicate that, on average, it took approximately 40 days, commencing with the date a respondent was served with the investigation report, for each of the 13 cases to be closed via a settlement agreement. The shortest and longest amount of time between the serving of an investigation report and the execution of a settlement agreement was 7 and 63 days, respectively. The Exchange's records also indicate that, on average, it took about 20 days, from the date the PCP received the case, for each of the 13 cases to be closed via a settlement agreement. The shortest and longest amount of time between the PCP's receipt of the case and the execution of the settlement agreement was 2 and 36 days, respectively.

#### **D. Conclusions and Recommendations**

Based upon its review, the Division found that ICE Futures maintains adequate disciplinary procedures. The Exchange has the authority to investigate possible rule violations, prosecute cases, and discipline members who are found guilty. Respondents receive adequate notice of the charges against them and have sufficient opportunity to present their defenses. In addition, respondents have the right to be represented by counsel, to call witness, and to offer evidence.

During the target period, the Compliance Department referred 18 trade practice cases to the PCP, 13 of which also closed during the target period. All 13 cases were resolved through PCP settlement agreements. They resulted in the expulsion of three Exchange members, \$20,400 in fines, and \$3,820 in customer restitution. On average, the 13 closed cases took approximately 40 days to close, measuring from the date the respondent was served with the investigation report. However, to facilitate a more precise analysis of the timeliness of disciplinary procedures, the Division believes that the Exchange should include in its case logs the dates on which investigations are completed.

Based on the foregoing, the Division recommends that the Exchange:

- **Record the date on which completed investigative reports are approved by senior Compliance staff.**

## **VI. DISPUTE RESOLUTION PROGRAM**

### **Core Principle 13-Dispute Resolution:**

**The board of trade shall establish and enforce rules regarding and provide facilities for alternative dispute resolution as appropriate for market participants and any market intermediaries.**

Pursuant to Core Principle 13, an exchange is required to provide customer dispute resolution mechanisms that are fair, equitable, and available on a voluntary basis. Customers should have the opportunity to have their claims heard and decided by an objective and impartial decision maker. In addition, each party should have the right to counsel and be provided with adequate notice of claims presented against him or her and an opportunity to be heard on all claims, defenses, and counterclaims. The process should provide for a prompt hearing, as well as prompt, written, final settlement awards that are not subject to appeal within the exchange. The parties also should be notified of the fees and costs that may be assessed. Finally, if an exchange provides procedures for the resolution of member-to-member disputes (not involving customers), the procedures for resolving such disputes must be independent of and not interfere with the resolution of customers' claims or grievances.

### **A. Customer Arbitration**

ICE Futures customers are afforded voluntary dispute resolution through the Exchange's arbitration rules, ICE Futures Rules 20.00 through 20.08. The rules provide customers the opportunity to have their claims or grievances against a member or its employees heard by a panel of disinterested persons selected by the Chairman of the Arbitration Committee.

Any customer desiring to submit a matter for arbitration must submit a completed Notice of Arbitration ("Notice") within two years of the claim or grievance arising. The Notice must include the

name and address of the party or parties against whom the claim is being asserted, its nature and substance, the relief requested, and the factual and legal bases alleged to underlie such relief. The Notice must be accompanied by payment of a non-refundable arbitration fee ranging from a minimum of \$100 for claims up to \$5,000 to a maximum of \$1,150.00 plus one-half percent for claims in excess of \$100,000.

Upon receipt of a completed Notice and appropriate arbitration fee, ICE Futures serves copies on all named respondents, who have 20 days to file an answer setting forth their positions with respect to the alleged claims or grievances. Any allegation not denied is deemed admitted. The answer also may set forth any counterclaims that arise out of the transaction or occurrence that is the subject of the customer's claim or grievance. Customers have 20 days to respond to any such counterclaims.<sup>62</sup>

Once all answers have been received, the Chairman of the Arbitration Committee appoints an arbitration hearing panel of disinterested persons, and selects a panel Chairman, to decide the claim or grievance.<sup>63</sup> The panel members are drawn from a pool of volunteers that consists of both Exchange members and non-members. During the target period, three-person panels were used if the relief requested did not exceed \$100,000; five-person panels were used for larger claims. If neither the alleged claims nor counterclaim totaled \$5,000, the Chairman of the Arbitration Committee could, at his sole discretion, determine that the matter would be resolved on the basis of written submissions alone by a sole arbitrator. In September 2008, ICE Futures' arbitration rules were amended to provide for three-person panels in all proceedings except for those determined by a sole arbitrator.

---

<sup>62</sup> ICE Futures Rule 20.03(a)(ii).

<sup>63</sup> When filing a Notice, the customer must elect whether he or she would like to have the claim heard by a "mixed panel," where at least a majority of the panelists are not members or associated with any member of a contract market or otherwise associated with a contract market. If arbitration is between members, there is no requirement that the arbitration panel be composed only of members; the panel's composition is determined by the Chairman of the Arbitration Committee and can consist of various types of volunteers.

Arbitration proceedings are held at a time and place determined by the hearing panel. Each party has the right to be represented by counsel. In addition, each party has the right to appear personally at the hearing; prepare and present relevant facts and rebuttal evidence; examine the other parties; examine any witnesses appearing at the hearing; and examine all relevant documents presented in connection with the claim or grievance, or any defense or counterclaim.<sup>64</sup>

A hearing panel must issue a written decision within 60 days following the conclusion of a hearing. Exchange rules provide that the panel may grant any remedy or relief it deems just and equitable, including the award of the arbitration fee and interest. Any costs incurred as a result of having a panel are borne by the member unless the panel finds that the customer acted in bad faith in initiating or conducting the proceeding.

#### **B. Member-to-Member Arbitration**

ICE Futures' member-to-member arbitration procedures are similar to those for customer arbitration. Disputes between Exchange members must be settled by Exchange arbitration when the dispute involves an "allowable claim." Allowable claims are generally those that arise directly from (1) any futures or option transaction executed, or to be executed, on or subject to the rules of the Exchange or (2) any cash transaction directly related to a futures or option transaction executed on or subject to the rules of the Exchange. Members do not have the option to elect a mixed panel to hear their claim.<sup>65</sup> Any award not complied with within the time specified is enforceable in accordance with ICE Futures' Arbitration Rule 20.08 or by Exchange disciplinary proceedings.<sup>66</sup> Member-to-member arbitrations are independent of customer-to-member arbitrations and may not interfere with or delay them.

---

<sup>64</sup> ICE Futures Rule 20.03(a)(vii).

<sup>65</sup> ICE Futures Rule 20.03(a)(i).

<sup>66</sup> Rule 20.08 provides procedures for instances where a Member fails to pay an arbitration award to another Member. After a hearing held within five business days after notice is given to the defaulting Member, the Member can be suspended until such time as he complies with the award. If the suspension continues for 30 days,

### **C. Arbitrations During the Target Period**

Eight matters were submitted for arbitration during the target period. Division staff's review of the arbitration files found that the disputes were handled in conformance with the Exchange's arbitration rules and procedures. Four of the eight arbitrations were resolved during the target period, including two that were withdrawn after the parties reached settlements. Two more arbitrations were resolved via hearing panel awards in favor of the claimant. Finally, four arbitrations arising from a related series of events were stayed or pending at the conclusion of the target period.

### **D. Conclusions and Recommendations**

The Division finds that ICE Futures' arbitration rules provide for fair and equitable procedures for the resolution of customer and member disputes. Customers have the opportunity to have their claims heard by disinterested panels, including panels where a majority of the panelists are not members or associated with any member of a contract market, or otherwise associated with a contract market. Each party also receives adequate notice of the claims presented against it, has the right to counsel, and has an opportunity to present all claims, defenses, and counterclaims. In addition, ICE Futures' arbitration procedures require a prompt hearing and authorize prompt, written, awards by panels with authority to issue awards or any remedy or relief they deem just and equitable.

ICE Futures also provides adequate procedures for mandatory member-to-member arbitration, and for disciplinary action to enforce panel decisions. In addition, member-to-member arbitration is separate from and independent of customer claims submitted for resolution and does not interfere with or delay customer disputes. Four of the eight arbitrations filed during the target period were resolved through settlements or hearing panel awards. Another four were stayed or pending at the conclusion of the target period.

---

the Member may be expelled and his seat and shares sold with the proceeds applied as provided for in the Rules.

**Based on the foregoing, the Division has no recommendations in this area.**