MARKET SURVEILLANCE RULE ENFORCEMENT REVIEW OF THE NEW YORK MERCANTILE EXCHANGE AND THE COMMODITY EXCHANGE

Division of Market Oversight
October 11, 2016

NYMEX-COMEX Market Surveillance Rule Enforcement Review
Target Period: March 1, 2014 through March 1, 2015

I. Rule Enforcement Review Scope

The Division of Market Oversight ("Division") of the Commodity Futures Trading Commission ("Commission" or "CFTC") has conducted a rule enforcement review of the market surveillance program of the New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX"; collectively, the "Exchanges").[1] The Exchanges are wholly-owned subsidiaries of CME Group, Inc. ("CME Group").[2] As discussed in Sections II and III below, the majority of trading volume on both Exchanges occurs via electronic trading on Globex, the Exchanges' electronic trading platform, with additional trading volume occurring via pit and "ex-pit" trading, in accordance with Exchange rules. The Division's review of the Exchanges' market surveillance program covered the period from March 1, 2014 through March 1, 2015 ("target period"). The Division reviewed the Exchanges' compliance with Core Principle 2 (*Compliance With Rules),*[3] Core Principle 4 (*Prevention of Market Disruption*),[4] and

[1] Rule enforcement reviews, and the resultant reports prepared by the Division, are intended to present an analysis of an exchange's compliance capabilities during the period under review. Such reviews deal only with exchange programs directly addressed in the review and do not assess all programs, Core Principles, or Commission regulations. The Division's analyses and conclusions are based, in large part, upon the Division's evaluation of a sample of market surveillance files and other exchange documents. This evaluation process, in some instances, identifies specific issues with particular exchange compliance programs or methods, but is not designed to uncover every instance where an exchange fails to effectively comply with the Core Principles or Commission regulations.

This report, and the analyses and conclusions herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The Division's analyses and conclusions in this report are limited to the Exchanges.

[2] NYMEX became a wholly-owned subsidiary of CME Group when CME Group purchased it in 2008. As part of the same transaction, CME Group also acquired COMEX, which had operated as a subsidiary of NYMEX since 1994. Each of the four CME Group exchanges (NYMEX, COMEX, Chicago Mercantile Exchange ("CME"), and Chicago Board of Trade ("CBOT")) is separately registered as a designated contract market ("DCM") under the Commodity Exchange Act.

[3] Core Principle 2 - *Compliance With Rules*: (A) In general – The board of trade shall establish, monitor, and enforce compliance with the rules of the contract market, including: (i) Access requirements; (ii) The terms and conditions of any contracts to be traded on the contract market; and (iii) Rules prohibiting abusive trade practices on the contract market. (B) Capacity of contract market. The board of trade shall have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the contract market. (C)

Core Principle 5 (*Position Limitations or Accountability*)[5] under Section 5(d) of the Commodity Exchange Act (the "Act"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,[6] and the regulations codified in Commission Regulations §§ 38.153, 38.155, 38.158 (related to Core Principle 2), 38.250-254 (related to Core Principle 4), and 38.300-301 (related to Core Principle 5), which relate to an Exchange's market surveillance program.[7] This rule enforcement review does not address the Exchanges' Exchange for Related Positions ("EFRP") procedures, which the Division is reviewing via a separate examination.

To evaluate the Exchanges' market surveillance program, and its compliance with Core Principles 2, 4, and 5 and Commission Regulations §§ 38.153, 38.155, 38.158, 38.250-254, and 38.300-301, Division staff interviewed compliance officials and staff from the Exchanges' Market Regulation Department ("MRD") and received a demonstration of the automated surveillance systems used by the Exchanges to conduct market surveillance. The Division also analyzed responsive documents produced by Exchange staff, including the following:

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

[4] Core Principle 4 - *Prevention of Market Disruption*: The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including: (a) methods for conducting real-time monitoring of trading; and (b) comprehensive and accurate trade reconstructions.

[5] Core Principle 5 - *Position Limitations or Accountability:* To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.

[6] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank Act"). Title VII of the Dodd-Frank Act became effective on July 16, 2011.

[7] On May 10, 2012, the Commission issued its Final Rules, *Core Principles and Other Requirements for Designated Contract Markets*, 77 Fed. Reg. 36612 (June 19, 2012) ("New DCM Regulations"), which became effective on October 17, 2012, to codify rules in lieu of guidance and acceptable practices for certain Core Principles, including Core Principles 2, 4, and 5. Because the New DCM Regulations were in effect for the entirety of the target period, the Division reviewed the Exchanges' market surveillance program for compliance with the New DCM Regulations.

- the Exchanges' market surveillance procedures manual and guidelines;
- automated computer reports and other documents generated by the Exchanges' market surveillance tools;
- market surveillance investigation logs and files;
- organizational charts and summaries of personnel and staffing; and
- minutes of disciplinary committee, Board of Directors, and Regulatory Oversight Committee meetings held during the target period.

The Division analyzed the Exchanges' market surveillance program to determine whether the program complies with the Core Principles and Commission regulations stated above, whether there are any deficiencies in the program, and whether the Division should make any recommendations regarding the program. For purposes of rule enforcement review reports, a *deficiency* is an area where the Division believes an exchange is not in compliance with a Commission regulation and must take corrective action, and a *recommendation* concerns an area where the Division believes the exchange should improve its compliance program.

As set forth below, the Division found that the Exchanges maintain experienced market surveillance staff and an adequate market surveillance program to demonstrate compliance with Core Principles 2, 4, and 5, and Commission Regulations §§ 38.153, 38.155, 38.158, 38.250-254, and 38.300-301. The Division did not identify any deficiencies. The Division made one recommendation for improvement, discussed in Section III (B) below.

The Division provided the Exchanges with an opportunity to review and comment on a draft of this report on September 9, 2016. On September 14, 2016, Division staff conducted an exit conference with Exchange officials to discuss the report's findings and recommendations.

II. Products and Trading Volume During the Target Period

Total trading volume at NYMEX and COMEX during the target period was 431,917,865 and 80,457,877 contracts, respectively. On NYMEX during the target period, electronic trading via Globex represented approximately 79 percent of total volume, pit trading represented approximately one percent of total volume,[8] and "ex-pit" trading represented approximately 20 percent of total volume.[9] On COMEX during the target period, electronic trading via Globex represented approximately 91 percent of total volume, pit trading represented approximately four percent of total volume, and "ex-pit" trading represented approximately five percent of total volume. In the 12-month period following the target period (March 1, 2015 through March 1, 2016), total trading volume at NYMEX and COMEX was 520,447,024 and 85,023,309 contracts, respectively.

NYMEX offered 568 products traded during the target period, and COMEX offered 29 products traded during the target period. The four most heavily traded contracts on NYMEX accounted for over 70 percent of total volume on the Exchange: Light Sweet Crude Oil Futures accounted for 37 percent; Natural Gas Henry Hub futures accounted for 17 percent; RBOB Gasoline Futures accounted for eight percent; and New York Harbor ULSD Futures accounted for eight percent.

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[8] CME Group announced on February 4, 2015 that it would close most of its futures trading pits in Chicago and New York by July 2, 2015 (which date falls after the end of the target period). CME Group stated that floor-based S&P 500 futures market will remain open on CME Group's Chicago trading floor. Options on futures contracts, which continue to trade actively on both the floor and the screen, will also remain open on both trading floors except for the DJIA ($10) and NASDAQ-100 open outcry equity index options markets, which are designed to deliver into floor-based futures contracts. For more information, see: http://investor.cmegroup.com/investor-relations/releasedetail.cfm?ReleaseID=894826

[9] CME Group defines "ex-pit transactions" as including Exchange of Futures for Related Positions (EFRPs) and block trades. For more information, see: https://www.cmegroup.com/education/files/Ex-Pit-Transactions.pdf

The four most heavily traded contracts on COMEX accounted for over 97 percent of total volume on the Exchange: Gold Futures accounted for 51 percent; COMEX Copper Futures accounted for 19 percent; Silver Futures accounted for 17 percent; and Gold Options accounted for 10 percent.

The Exchanges launched 76 new products during the target period. The three most significant new products in terms of volume are: COMEX Gold Kilo Futures, launched on January 26, 2015; NYMEX Crude Oil Weekly Option- week 1, launched on April 14, 2014; and NYMEX Crude Oil Weekly Option- week 2, also launched on April 14, 2014. During the one-year period following the target period (March 1, 2015 to March 1, 2016), total trading volume for these three products was 62,775 contracts, 51,823 contracts, and 36,436 contracts, respectively.

III. Summary of Findings and Recommendations

A. Findings without Recommendations

1. *Compliance Staff and Resources (Core Principle 2, Commission Regulation § 38.155)*[10]

- The Division found that the Exchanges maintain sufficient market surveillance staff to demonstrate compliance with Core Principle 2 and Commission Regulation § 38.155. Market surveillance responsibilities at the Exchanges are carried out by the Market Surveillance Department ("MS"), which is a part of the Market Regulation Department ("MRD"). The MS staff consists of 24 staff members. MS is headed by the Exchanges' Director of Market Surveillance, who in turn reports to the Executive Director of Global Market Surveillance.

- Of the 24 MS staff members, 14 members devote 100 percent of their time to the Exchanges, one member (the Director of Market Surveillance) devotes 95 percent of his time to the Exchanges, eight members (including the Executive Director of Global Market Surveillance) devote 50 percent of their time to the Exchanges,

[10] See items 7 and 8 below for a discussion of Core Principle 2, Commission Regulations §§ 38.153 and 38.158.

and one member devotes 15 percent of his time to the Exchanges. In each case, additional time is devoted to other CME Group exchanges.

- MRD is headed by the Exchanges' Chief Regulatory Officer ("CRO"), who devotes 50 percent of his time to the Exchanges.

2. *Prevention of Market Disruption and General Requirements (Core Principle 4, Commission Regulations §§ 38.250-251)*

- The Division found that the Exchanges maintain an adequate market surveillance program to comply with Core Principle 4 and Commission Regulations §§ 38.250-251 (and as discussed below, Commission Regulations §§ 38.252-254, Core Principle 5 and related Commission Regulations §§ 38.300-301, and Commission Regulations §§ 38.153 and 38.158).

- The primary tools used by the Exchanges to collect and evaluate daily market activity are the Sophisticated Market Analysis Research Technology ("SMART") and the Exchanges' Large Trader System. The information on Large Trader is obtained from computer-generated reports, and is used by MS to identify possible price manipulation or price distortion and to conduct surveillance of expiring contracts. The Large Trader System generates a number of alerts and exception reports, including a Position Detail Report, Intraday Over the Limit Report, and Volume and Open Interest Report.

3. *Additional Requirements for Physical-Delivery Contracts (Core Principle 4, Commission Regulation § 38.252)*

- The Division found that the Exchanges have adequate procedures to demonstrate compliance with Commission Regulation § 38.252. When reviewing physically-delivered contracts, MS examines the composition of the market and evaluates substantive changes in that composition. MS seeks to proactively identify the potential for concentration or congestion that could indicate manipulative conduct, or otherwise threaten the orderly functioning of the market. Analysts monitor supply and demand fundamentals, the basis relationships between the cash price and the futures price, and spread relationships in order to identify market conditions or pricing anomalies that may pose risks to orderly market settlement.

- MS analysts develop expertise on market participants and their trading strategies in the markets they oversee. They document the historical trading patterns in Expiration Summary Files and Quarterly Accountability Research Files, which are shared with all MS staff. Prior to the spot month, analysts mainly track position concentrations and pricing to identify market participants, and understand their trading strategies and trading history, in order to detect potential issues in the monitored contract before the front active month arrives.

- On a daily basis, MS analysts employ the Exchange Large Trader, SMART, and Regulatory Application for Processing In-memory Data ("RAPID") systems and applications to track the positions and trading activity of market participants. MS seeks to detect positions and trading patterns that may pose a threat to orderly and competitive markets, in both intraday and end-of-day time frames. Analysts monitor underlying market fundamentals and prices of products related to futures contracts by monitoring news, government reports, trade periodicals, and academic studies.[11] Analysts also contact market participants to obtain market outlook, trading intentions, and market knowledge. In order to detect market anomalies, MS analysts monitor market prices, volume, open interest, and trading activity.

4. *Additional Requirements for Cash-Settled Contracts (Core Principle 4, Commission Regulation § 38.253)*

- The Division found that the Exchanges have adequate procedures to demonstrate compliance with Commission Regulation § 38.253. Just as described in § 38.252 above, when reviewing cash-settled contracts, MS examines the composition of the market and evaluates substantive changes in that composition. MS seeks to proactively identify the potential for concentration or congestion that could be indicative of manipulative conduct or otherwise threaten the orderly functioning of the market. The same tools described above are used by MS analysts to monitor the expiration of cash-settled contracts.

- For products that are cash-settled, analysts also focus on understanding the derivation of the cash pricing mechanism, and whether the mechanism can be manipulated to impact the value of futures positions. Analysts compare market data assembled from internal and external sources when examining whether the cash pricing mechanism is subject to manipulation. MS documents its findings in Expiration Summary Files and Quarterly Accountability Research Files.

5. *Ability to Obtain Information (Core Principle 4, Commission Regulation § 38.254)*

- The Division found that the Exchanges have adequate rules to obtain information from market participants.[12] Rule 536.H (Retention of Records) provides that each member and member firm, and employees of the foregoing, must keep full, complete and systematic records, including records created or transmitted

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[11] Among other reports and news sources, MS analysts gather information about the markets by reviewing reports prepared by the U.S. Energy Information Administration and other research and consulting resources.

[12] Both NYMEX and COMEX follow the same Rulebook, which is referred to as the NYMEX Rulebook on the CME Group website. All references to "Rule" in this rule enforcement review refer to this Rulebook. See: http://www.cmegroup.com/rulebook/NYMEX/

electronically, of all transactions in accordance with Commission Regulation § 1.35. Rule 418 (Consent to Exchange Jurisdiction) and related rules provide the Exchanges the authority to collect this information.

6. *Position Limitations and/or Accountability (Core Principle 5, Commission Regulations §§ 38.300-301)*

- Subject to the recommendation below under Commission Regulation § 38.301 (regarding the Exchanges' hedge exemption application process), the Division found that the Exchanges have adequate rules and procedures related to position limits and accountability levels.

  - Rule 559 (Position Limits and Exemptions) governs position limits and the hedge exemption application process. The position limit levels are set forth in Chapter 5 in the Rulebook (see the Position Limit, Position Accountability and Reportable Level Table in the Interpretations & Special Notices Section), and programmed into the Large Trader System for Over the Limit (OTL) reports. The Large Trader Intraday OTL report identifies potential violations of intraday position limits, which are the same as end of day limits.

  - Rule 560 (Position Accountability) governs position accountability levels, and sets the Exchanges' regulatory authority to address positions that pose a potential threat to orderly trading. If MS identifies an account of concern, staff will contact the clearing member as deemed appropriate to obtain further information.

7. *Capacity to Detect and Investigate Rule Violations (Core Principle 2, Commission Regulation § 38.153)*

- MS utilizes a third-party case management application to track the initiation and resolution of disciplinary matters. This application also serves as the document repository for all completed complaint, research, audit, investigation, arbitration and disciplinary files.

- MS opens a complaint when it receives a referral from an external source, such as a regulatory agency like the Commission, or a market participant. Complaints that cannot be substantiated are closed out administratively, while those that merit further review are elevated to the level of a case (investigation).[13]

- MS can issue warning letters for certain reporting infractions identified when MS is investigating complaints or preparing research files.

[13] The Exchanges refer to a "case" and "investigation" interchangeably in their records and procedures documents.

- Research files are prepared on a monthly or quarterly basis. MS analysts record their daily surveillance activities in the files, along with the contract surveillance they conduct over the course of an individual contract's life span. Research files also house the position accountability logs, and the monthly EFRP program and Large Trader program reviews. In addition, the files are used to track the surveillance of individual market participants by analysts, along with MS recommendations regarding such surveillance.

- Most research files are recurring programmatic repositories containing contract surveillance materials reviewed by analysts over the course of a contract life cycle, and are therefore typically closed with no action. During the target period, 140 research matters originating from research files were closed by MS. None of the 140 matters were elevated to cases. Of the 140, 132 were non-EFRP related. Of the 132 non-EFRP research matters, 122 were closed with no disciplinary action. The other 10 matters were not elevated to cases but did result in disciplinary actions by MS, which are discussed in more detail in Section IV.

8. *Investigations and Investigation Reports (Core Principle 2, Commission Regulation § 38.158)*

- MS maintains a Case Management Procedures document, which outlines the differences between a research file, complaint, and case. MS elevates matters to the case level when there is a potential that a violation has occurred, and further investigative work is required. Any potential position limit violations, transfer trade violations, or manipulation attempts are opened as cases. If MS identifies any other instances in which there is a potential for a violation, it will also open a case.

- If MS determines that a rule violation may have occurred, MS can refer the matter to the CME Group Enforcement division ("CME Enforcement") or the Reporting Infractions Committee (pursuant to Rule 512). If a case is referred by MS to CME Enforcement, CME Enforcement can then close the case administratively, refer it back to MS for further investigation, or refer it to an Exchange disciplinary committee, such as the Probable Cause Committee (PCC) or the Business Conduct Committee (BCC).

- There were 102 non-EFRP market surveillance cases closed during the target period. Division staff reviewed 51 of the 102 closed cases (50%), and found the files to contain the appropriate trading documentation and records, transcripts of interviews (when appropriate), and correspondence. The Division found the quality of the investigative work in the closed cases reviewed to be thorough and complete. MS investigators adequately collected, reviewed, and analyzed relevant data. In addition, the Division found that the Exchanges' decisions whether or not to pursue disciplinary action were appropriate, and the cases were closed in a timely manner.

B. Findings with Recommendations

1. Position Limitations and Accountability (Core Principle 5, Commission Regulation § 38.301)

- Rule 559 (Position Limits and Exemptions) states that in order to obtain an exemption from position limits, a person must: (1) Provide a description of the exemption sought, including whether the exemption is for bona fide hedging positions (as defined in CFTC Regulation §1.3(z)(1)), risk management positions, or arbitrage/spread positions. Furthermore, under Rule 559, a person must: (9) Agree to promptly submit a supplemental statement to the Market Regulation Department whenever there is a material change to the information provided in the most recent application. During the target period, the Exchanges conducted nine "spot checks" of existing exemptions. The Division believes, however, that the Exchanges should consider implementing a formal review process such that MS can confirm that, when a market participant has a position larger than the level of a position limit, the market participant's position is consistent with an approved exemption (whether for bona fide hedging positions, risk management positions, or arbitrage/spread positions), as indicated in their exemption application. Without such a process, there is no way for the Exchanges to proactively verify that the strategy described on an exemption application is followed once the exemption is granted.

  - **Recommendation: The Exchanges should consider implementing a formal review process by which MS can verify that a market participant who has a position larger than a position limit is, in fact, making use of an exemption, consistent with the strategy described in their exemption application.**

The accompanying Compliance Matrix in Section IV below includes a thorough analysis of the Exchanges' compliance with Core Principles 2, 4, and 5 under Section 5(d) of the Act, and the regulations codified in Commission Regulations §§ 38.153, 38.155, 38.158 (related to Core Principle 2), 38.250-254 (related to Core Principle 4), and 38.300-301 (related to Core Principle 5).

NYMEX-COMEX MARKET SURVEILLANCE RER

Target Period: 3/1/14 – 3/1/15

Compliance Matrix

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
§ 38.155 Compliance staff and resources (market surveillance) (a) Sufficient compliance staff. A designated contract market must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. The designated contract market's compliance staff also must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 38.158(b) of this part. (b) Ongoing monitoring of compliance staff resources. A designated contract market must monitor the size and workload of its compliance staff annually, and ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate level of compliance resources and staff, the designated contract market should consider trading volume increases, the number of new products or contracts to be	Market surveillance responsibilities at the Exchanges are carried out by the Market Surveillance Department ("MS"), which is a part of the Market Regulation Department ("MRD"). The MS staff consists of 24 staff members. MS is headed by the Exchanges' Director of Market Surveillance, who in turn reports to the Executive Director of Global Market Surveillance. The Division found that the Exchanges maintain sufficient MS staff to conduct market surveillance. • MS staff analyst experience ranges from one to 30 years. The median tenure is almost seven years in length. • The Director of Market Surveillance reviews investigations prepared by MS staff analysts, assesses surveillance matters, and evaluates and administers disciplinary actions such as warning letters and settlements. The Director of Market Surveillance joined the Exchanges in 2007, and works out of the New York office. • The responsibilities of the Executive Director of Global Market Surveillance include hiring analysts, conducting annual MS employee performance evaluations, and assigning and monitoring the timeliness of MS work. The current Executive	None

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
listed for trading, any new responsibilities to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.	Director of Global Market Surveillance has been employed by the CME Group for over 30 years, and oversees both the New York and Chicago offices. • Of the 24 MS staff members, 14 members devote 100 percent of their time to the Exchanges, one member (the Director of Market Surveillance) devotes 95 percent of his time to the Exchanges, eight members (including the Executive Director of Global Market Surveillance) devote 50 percent of their time to the Exchanges, and one member devotes 15 percent of his time to the Exchanges. In each case, additional time is devoted to other CME Group exchanges. MRD is headed by the Exchanges' Chief Regulatory Officer ("CRO"), who devotes 50 percent of his time to the Exchanges. The CRO is primarily responsible for overseeing MRD's performance of its self-regulatory responsibilities, including management of the Exchanges' market surveillance, audit trail, trade practice surveillance, disciplinary, and dispute resolution programs. The ROC evaluates MS staff levels and resources via an annual report that considers, among other items, MS staff turnover, qualifications, and compensation.	
Core Principle 4 Prevention of Market Disruption		
§ 38.250 Core Principle 4 The board of trade shall have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the	See discussion below addressing Commission Regulations §§ 38.251-254.	None

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
delivery or cash- settlement process through market surveillance, compliance, and enforcement practices and procedures, including: (a) Methods for conducting real-time monitoring of trading; and (b) Comprehensive and accurate trade reconstructions.		
§ 38.251 General requirements A designated contract market must: (a) Collect and evaluate data on individual traders' market activity on an ongoing basis in order to detect and prevent manipulation, price distortions and, where possible, disruptions of the physical-delivery or cash-settlement process;	<u>Collecting and Evaluating Data to Detect and Prevent Manipulation and Price Distortions</u> The primary tools used by the Exchanges to collect and evaluate daily market activity are the Sophisticated Market Analysis Research Technology ("SMART") and the Large Trader System. The information on Large Trader is obtained from computer-generated reports, and is used by MS to identify possible price manipulation or price distortion and to conduct surveillance of expiring contracts. Relevant alerts and exception reports maintained on Large Trader include:	None
(b) Monitor and evaluate general market data in order to detect and prevent manipulative activity that would result in the failure of the market price to reflect the normal forces of supply and demand; (c) Demonstrate an effective program for conducting real-time monitoring of market conditions, price movements and volumes, in order to detect abnormalities and, when necessary, make a good-faith effort to	• **Position Detail Report** – allows analysts to review participant positions and position changes, and identify historical participant or market trends; • **Over the Limit and Batch Over the Limit Reports** – identifies participants with aggregate positions in excess of defined speculative limits or position accountability levels; • **Intraday Over the Limit Report** – identifies participants with aggregate	

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
resolve conditions that are, or threaten to be, disruptive to the market; and (d) Demonstrate the ability to comprehensively and accurately reconstruct daily trading activity for the purposes of detecting trading abuses and violations of exchange-set position limits, including those that may have occurred intraday.	positions in excess of defined speculative limits or position accountability levels at any time during a trading day; • **Watch Over the Limit Report** – identifies participants with aggregate positions that are potentially in excess of defined speculative limits or position accountability levels; • **Position Accountability Report** – identifies participants with aggregate positions that are potentially in excess of defined speculative limits or position accountability levels based on ownership and control relationships disclosed on CFTC 102 Forms; • **Misreporting Report** – identifies instances of potential under-reporting or over-reporting of positions or open interest by firms; • **Look Back/Look Forward Report** – identifies relative market participant trends and provides context to position activity over a period of time; • **Volume and Open Interest Report** – provides total volume, high and low prices, initial and final open interest, and settlement prices for selected contracts; and • **Volume and Open Statistics Report** – identifies contracts whose volume or open interest levels deviate from established historical averages. <u>Summary of Monitoring Tools and Procedures</u> Before new products are launched, MS works with the	

CFTC Regulation	Findings Regarding the Exchanges’ Compliance	Deficiencies/ Recommendations
	Exchange Research Department to determine that the products are not readily susceptible to manipulation. On a daily basis, MS analysts utilize the Large Trader Look Back/Look Forward Report (described above) to monitor changes in open interest positions and percentages. This Report is also used to evaluate and verify information on supply levels contained in a report that tracks underlying warrant holders (the Delivery Certificate Report). For financially-settled contracts, MS staff cross-references position concentrations to the underlying index. Staff typically tracks the underlying deliverable supply and demand inventories by having conversations with participants and suppliers on a daily basis, to determine whether liquidity issues could make the market vulnerable to manipulation. MS staff examines volume and open interest on a daily basis to track and aggregate positional data for market participants, detect trends and potential violative trading activity, and monitor delivery patterns. MS documents its findings in Expiration Summary Files and Quarterly Accountability Research Files. MS closed 98 Expiration Summary Files and six Quarterly Accountability Research Files during the target period. Division staff reviewed 45 of the Expiration Summary Files and the six Quarterly Accountability Research Files, and found that the surveillance data and related findings they contained were sufficiently detailed and complete. Globex, the Exchanges’ electronic trading platform, has ‘stop spike logic’ which prevents excessive price movements caused by cascading stop orders. Globex introduces a momentary pause in trade matching when triggered stops	

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
	would cause the market to trade outside predefined values. Globex's 'velocity logic' function is designed to detect market movement of a predefined number of points either up or down within a predefined time. Velocity logic introduces a momentary suspension in matching by transitioning the futures instrument(s) and related options into the Reserved/Pause State. If a stop spike or velocity logic event occurs on the Exchange, the CFTC is automatically alerted through email. <u>Real-Time Monitoring of the Market</u> The Exchanges monitor the markets in real-time on a daily basis. Analysts in the three core asset class groups (Petroleum, Metals, and Natural Gas) monitor their markets through third-party data feeds, such as Bloomberg. These feeds provide price and volume information, news events, and economic reports that impact the analysts' markets and comparable contracts traded on other exchanges. In addition, the CME Global Command Center, which provides market operations and customer service desk support for electronic trading, shares relevant information on market aberrations with MS staff. MS supplements its real-time monitoring with more detailed surveillance of market positions, which is usually performed on a T+1 basis. MS analysts review the markets on a real-time basis using CME E-Quotes, which has a real-time price and volume charting system, as well as a real-time Dow Jones news feed. MS analysts utilize the real-time view of trade data in Regulatory Application for Processing In-memory Data ("RAPID") system for deeper analysis. The RAPID system analyzes the Globex trading engine in real-time and analyzes matched trade activity for every active firm/account in real-time. The system generates alerts ("RAPID Live Alerts")	

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
	whenever an account deviates from its established volume or position averages, or exceeds defined product-specific thresholds for position or volume. During the target period, 1,137 RAPID Live Alerts were generated for the Exchanges. Although the Exchanges do not maintain an alert log, they do archive all RAPID Live Alerts and review them on a case by case basis to examine, for example, potentially unusual volume or position anomalies. MS reviews RAPID Live Alerts in conjunction with other tools such as RAPID, SMART, Large Trader and CME E-Quotes. MS documents findings arising from this review in Expiration Summary Files and Quarterly Accountability Research Files (described above). MS also utilizes the Market Activity Surveillance System ("MASS") to monitor live Globex market data and analyze price and volume changes in real-time. MASS generates contract-level alerts whenever an instrument deviates from defined thresholds. <u>Resolving Disruptive Market Conditions</u> The Chief Regulatory Officer or his delegate may order any of the following actions, upon a good faith determination that there are substantial reasons to believe that such immediate action is necessary to protect the best interests of the Exchange: (1) any party may be denied access to any or all CME Group markets; (2) any party may be denied access to the Globex platform; (3) any party may be denied access to any other electronic trading or clearing platform owned or controlled by CME Group; or (4) any Member may be immediately removed from any trading floor owned or controlled by CME Group.	

CFTC Regulation	Findings Regarding the Exchanges' Compliance	Deficiencies/ Recommendations
	The Business Conduct Committee ("BCC") and the Clearing House Risk Committee ("CHRC") also have the authority to suspend or deny access on an emergency basis under Rules 402.C (BCC Emergency Actions) and 403.C (CHRC Emergency Actions), respectively. There were no emergency terminations or emergency suspensions of market participants for market surveillance matters during the target period.	
§ 38.252 Additional requirements for physical-delivery contracts For physical-delivery contracts, the designated contract market must demonstrate that it: (a) Monitors a contract's terms and conditions as they relate to the underlying commodity market and to the convergence between the contract price and the price of the underlying commodity and show a good-faith effort to resolve conditions that are interfering with convergence; and (b) Monitors the supply of the commodity and its adequacy to satisfy the delivery requirements and make a good-faith effort to resolve conditions that threaten the	When reviewing physically-delivered contracts, MS examines the composition of the market and evaluates substantive changes in that composition.[14] MS seeks to proactively identify the potential for concentration or congestion that could indicate manipulative conduct, or otherwise threaten the orderly functioning of the market. Analysts monitor supply and demand fundamentals, the basis relationships between the cash price and the futures price, and spread relationships in order to identify market conditions or pricing anomalies that may pose risks to orderly market settlement. MS analysts develop expertise on market participants and their trading strategies in the markets they oversee. They document the historical trading patterns in their market in Expiration Summary Files and Quarterly Accountability Research Files, which are shared with all MS staff. Prior to the spot month, analysts mainly track position concentrations and pricing to identify market participants, and understand their trading strategies and trading history, in order to detect	None

[14] The highest volume physically-delivered contracts traded on the Exchanges during the target period were as follows: (1) NYMEX – Crude Oil Futures, Henry Hub Natural Gas Futures, and RBOB Gasoline Futures; and (2) COMEX – Gold Futures, Copper Futures, and Silver Futures.

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adequacy of supplies or the delivery process.	potential issues in the monitored contract before the front active month arrives. On a daily basis, MS analysts employ the Exchange Large Trader, SMART, and RAPID systems and applications to track the positions and trading activity of market participants. MS seeks to detect positions and trading patterns that may pose a threat to orderly and competitive markets, in both intraday and end-of-day time frames. Analysts track underlying market fundamentals and prices of products related to futures contracts by monitoring news, government reports, trade periodicals, and academic studies. Analysts also contact market participants to obtain market outlook, trading intentions, and market knowledge. In order to detect market anomalies, MS analysts monitor market prices, volume, open interest, and trading activity. Additional information follows below regarding MS's surveillance of the supply of metals and energy products. • Metals. Metals depositories and warehouses are required to report the following information regarding their stocks on a daily basis: the total quantity of registered metal stored at the facility; the total quantity of eligible metal stored at the facility; and the quantity of registered and eligible metal received and shipped from the facility. (See NYMEX Rule 703.A (DESIGNATION AND OBLIGATIONS OF METAL SERVICE PROVIDERS).) Information regarding metal stock inventory is publicly posted on the CME Group website on a daily basis, via stock reports for registered and eligible material. MS tracks the deliverable supply based on these reports. • Energies. MS tracks deliverable supply using weekly	

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	position information produced by the U.S. Energy Information Administration. Rule 716 (DUTIES OF CLEARING MEMBERS) stipulates that clearing firms are responsible for ensuring their clients can take/make delivery. MS analysts detect and investigate rule infractions by participants and intermediaries related to delivery, and make recommendations to their managers as to whether to open a formal case, continue to monitor, or close the matter. MS may conduct heightened surveillance for a number of reasons, including any of the following: unusual concentrations of positions; unusual initiation, change or liquidation of positions; price differentials; price volatility; anomalies in price, basis, spread pricing, volume, or open interest; supply shortages or large demand interest in the underlying; complaints from market participants; political or governmental crises; or news stories that raise concern. MS would conduct heightened surveillance with the goal that none of the above conditions would disrupt the market or unduly affect a contract's settlement or delivery. During the target period, MS identified three expirations in which it conducted heightened surveillance in order to promote an orderly expiration. These expirations involved (i) concentrated positions, (ii) a shortage of the underlying, and (iii) low inventory of the deliverable supply. To address the low inventory of the deliverable supply, MS reduced the spot-month position limit in one of the contracts. In connection with its analysis of the expiration of physical-delivery contracts during the target period, Division staff	

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	reviewed the surveillance procedures, written files, and systems used by MS to conducted surveillance in order to promote an orderly expiration. MS documents its findings in Expiration Summary Files and Quarterly Accountability Research Files. MS closed 98 Expiration Summary Files and six Quarterly Accountability Research Files during the target period. Division staff reviewed 45 of the Expiration Summary Files, including the Expiration Summary Files of the three expirations for which MS conducted heightened surveillance, and the six Quarterly Accountability Research Files. Division staff found that the surveillance data and related findings they contained were sufficiently detailed and complete. The Division did not identify any issues involving the expiration of physical-delivery contracts during the target period.	
§ 38.253 Additional requirements for cash-settled contracts (a) For cash-settled contracts, the designated contract market must demonstrate that it: (1) Monitors the pricing of the index to which the contract will be settled; and (2) Monitors the continued appropriateness of the methodology for deriving the index and makes a good-faith effort to resolve conditions, including amending contract terms where necessary, where there is a threat of market manipulation, disruptions, or distortions.	Just as described in § 38.252 above, when reviewing cash-settled contracts, MS examines the composition of the market and evaluates substantive changes in that composition. MS seeks to proactively identify the potential for concentration or congestion that could be indicative of manipulative conduct or otherwise threaten the orderly functioning of the market. The same tools described above in § 38.252 are used by MS analysts to monitor the expiration of cash-settled contracts. For products that are cash-settled, analysts also focus on understanding the derivation of the cash pricing mechanism, and whether the mechanism can be manipulated to impact the value of futures positions. Analysts compare market data assembled from internal and external sources when examining whether the cash pricing mechanism is subject to manipulation. MS documents its findings in Expiration Summary Files and Quarterly Accountability Research Files, which are discussed	None

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(b) If a contract listed on a designated contract market is settled by reference to the price of a contract or commodity traded in another venue, including a price or index derived from prices on another designated contract market, the designated contract market must have rules or agreements that allow the designated contract market access to information on the activities of its traders in the reference market.	above. In connection with its analysis of the expiration of cash-settled contracts during the target period, Division staff reviewed 45 of the Expiration Summary Files and six Quarterly Accountability Research Files. Division staff found that the surveillance data and related findings they contained were sufficiently detailed and complete. The Division did not identify any issues involving the expiration of cash-settled contracts during the target period.	
§ 38.254 Ability to obtain information (a) The designated contract market must have rules that require traders in its contracts to keep records of their trading, including records of their activity in the underlying commodity and related derivatives markets, and make such records available, upon request, to the designated contract market.	The Exchanges maintain two primary rules that provide the Exchanges with the authority to obtain information from market participants, and require those participants to retain their records: • Rule 418 (Consent to Exchange Jurisdiction) – Any Person initiating or executing a transaction on or subject to the Rules of the Exchange directly or through an intermediary, and any Person for whose benefit such a transaction has been initiated or executed, expressly consents to the jurisdiction of the Exchange and agrees to be bound by and comply with the Rules of the Exchange in relation to such transactions, including, but not limited to, rules requiring cooperation and participation in investigatory and disciplinary processes. There were no instances during the target period in which a market participant contested an Exchange's jurisdiction over the market participant. • Rule 536.H (Retention of Records) - Each member and member firm and employees of the foregoing	None

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	must keep full, complete and systematic records, including records created or transmitted electronically, together with all pertinent data and memoranda, of all transactions relating to its business of dealing in commodity interests and related cash or forward transactions in accordance with CFTC Regulation 1.35. Written and electronic records must be retained for a minimum of five years in permanent form. Oral communications required to be recorded pursuant to CFTC Regulation 1.35(a) must be retained for a minimum of one year past the date on which the oral communication occurred. Oral communications recorded by the Exchange will be maintained by the Exchange for a minimum of one year past the date on which the oral communication occurred. All records required to be retained shall at all times be open to inspection by Exchange staff or any representative of the CFTC or the United States Department of Justice. Rules 401 (Chief Regulatory Officer) and 406 (Probable Cause Committee ("PCC")) allow MRD and the PCC to obtain relevant records pursuant to Rule 418. Rule 432.L.1 (General Offenses) makes it a violation of Exchange rules to fail to: answer questions, appear before any investigative committee or hearing, or produce any records requested by authorized Exchange staff.	
(b) A designated contract market with participants trading through intermediaries must either use a comprehensive large-trader reporting system (LTRS) or be able to demonstrate that it can obtain position data from other sources in order to conduct	As noted above with respect to the Exchanges' compliance with § 38.251, the Exchanges maintain daily large trader information in the Large Trader System. The Large Trader System allows MS to identify position limit violations, review position accountability, monitor position adjustments, and	

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an effective surveillance program.	track the accuracy of data reported by market participants. The system also serves as the central regulatory repository for identification of market participants and trading accounts, by aggregating information received from CFTC Form 102 and reporting information required to be submitted under Rule 561 (Reports of Large Positions).	
Core Principle 5 Position Limitations or Accountability		
§ 38.300 Core Principle 5 To reduce the potential threat of market manipulation or congestion (especially during trading in the delivery month), the board of trade shall adopt for each contract of the board of trade, as is necessary and appropriate, position limitations or position accountability for speculators. For any contract that is subject to a position limitation established by the Commission, pursuant to section 4a(a), the board of trade shall set the position limitation of the board of trade at a level not higher than the position limitation established by the Commission.	Rule 559 (Position Limits and Exemptions) governs position limits and the hedge exemption application process. The position limit levels, which can be set up to 25 percent of the deliverable supply, are set forth in Chapter 5 in the Rulebook (see the Position Limit, Position Accountability and Reportable Level Table in the Interpretations & Special Notices Section), and programmed into the Large Trader System for Over the Limit (OTL) reports. The Large Trader Intraday OTL report identifies potential violations of intraday position limits, which are the same as end of day limits. As of May 10, 2016, 1,136 NYMEX/COMEX contracts were subject to position limits (includes options and futures which exercise into contracts with position limits) and 1,154 contracts were subject to accountability levels. <u>Requirements for Exemption Requests</u> Applicants for exemptions from position limits pursuant to Rule 559 must provide information on ownership (i.e., all principal owners of the applicant by percent of ownership), clearing firms and accounts in which positions will be maintained, the risk management/trading department with authority over trading activity of the applicant, and the exemption level requested, among other information.	**Recommendation: The Exchanges should consider implementing a formal review process by which MS can verify that a market participant who has a position larger than a position limit is, in fact, making use of an exemption consistent with the strategy described in their exemption application.**

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	Applicants also agree to certain written conditions, including that the Exchange may condition or revoke an exemption based on the applicant's business needs, financial status and integrity, or on the liquidity, depth and volume of the market for which an exemption is sought. In addition, Rule 559 states that in order to obtain an exemption from position limits, a person must: (1) Provide a description of the exemption sought, including whether the exemption is for bona fide hedging positions (as defined in CFTC Regulation §1.3(z)(1)), risk management positions, or arbitrage/spread positions. Furthermore, under Rule 559, a person must: "Agree to promptly submit a supplemental statement to the Market Regulation Department whenever there is a material change to the information provided in the most recent application." During the target period, the Exchanges conducted nine "spot checks" of existing exemptions. The Exchanges should consider implementing a formal review process such that MS can confirm that market participants who have positions above the level of position limits are, in fact, trading consistent with their exemption for bona fide hedging positions, risk management positions, or arbitrage/spread positions, as indicated in their exemption application. Without such procedures, there is no way for the Exchanges to proactively verify that the strategy described on an exemption application is followed once the exemption is granted. <u>Review of Exemption Requests</u> Applications for exemptions from position limits are submitted to the MS Hedge Team in connection with the following events: (i) during the annual renewal cycle (a	

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	calendar year beginning when the exemption was last granted); (ii) as a result of exceeding a position limit; or (iii) when a customer proactively requests an exemption prior to exceeding a position limit. Exemptions from position limits may be granted based on cash market exposure in the underlying commodity (or a related commodity), swap exposure, risk management, or arbitrage purposes. The MS Hedge Team is composed of staff that routinely process market participants' requests to exceed position limits for hedging purposes. During the target period, the Exchanges received 344 hedge exemption applications. MS approved 139 (40%) at the level requested, approved 196 (57%) at a level less than requested, and denied nine (3%). Division staff reviewed 16 hedge exemptions, and found them to contain sufficiently detailed information submitted by the applicants to support their requests for the granting of an exemption of the position limits, along with appropriate justifications and sufficient documentation by MS in approving or denying the requests. In particular, during the target period, the Exchanges received 33 post-facto hedge exemption applications as a result of applicants exceeding a position limit (see clause ii above). MS approved 19 of these as requested, and approved 11 for less than requested. The other three post-facto exemption requests resulted in disciplinary sanctions for position limit violations under Rule 562. Rule 562 (Position Limit Violations) describes the processes that occur when position limits are exceeded. During the target period, MS closed 55 investigations involving potential violations of Rule 562. This resulted in disciplinary sanctions in 23 cases, involving 24 respondents. The sanctions	

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	consisted of 11 warning letters issued by MS, 11 fines issued by the BCC, and one case (involving two respondents) in which the BCC issued a fine to one respondent and a warning letter to the other. MS also closed 30 cases by approving hedge exemptions, closed one investigation with no action, and closed one investigation with no violation found.[15]	
§ 38.301 Position limitations and accountability A designated contract market must meet the requirements of parts 150 and 151 of this chapter, as applicable.	Rule 560 (Position Accountability) governs position accountability levels, and sets the Exchanges' regulatory authority to address positions that pose a potential threat to orderly trading. As noted above, the position limit and position accountability levels are set forth in Chapter 5 of the Rulebook and programmed into the Large Trader System for Over the Limit (OTL) reports. If MS identifies an account of concern, staff will contact the clearing member as deemed appropriate to obtain further information. This may be triggered by the size or type of the position, a market participant holding a significant portion of open interest, uncharacteristic trading, or changes to market fundamentals. During the target period, MS reached out to market participants in 42 instances in which market participants exceeded position accountability levels (10 at COMEX and 32 at NYMEX). MS responded by conducting additional monitoring and took other actions, which included monitoring the positions on an intra-day basis, contacting the market participant for further information, and directing the	None

[15] Note that although the Exchanges have separated cases closed with "no action" and cases closed with "no violation found" in their records, the Exchanges informed Division staff that the two dispositions are functionally the same—i.e., no violation was found in cases closed with "no action".

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	participant to not increase or to reduce positions.	
Regulations §§ 38.153 and 158		
§ 38.153 Capacity to detect and investigate rule violations A designated contract market must have arrangements and resources for effective enforcement of its rules. Such arrangements must include the authority to collect information and documents on both a routine and non-routine basis, including the authority to examine books and records kept by the designated contract market's members and by persons under investigation. A designated contract market's arrangements and resources must also facilitate the direct supervision of the market and the analysis of data collected to determine whether a rule violation occurred.	<u>General Document Management Procedures</u> MS utilizes a third-party case management application to track the initiation and resolution of disciplinary matters. This application also serves as the document repository for all completed complaint, research, audit, investigation, arbitration and disciplinary files. If a complaint is elevated to the case level, the complaint file is closed and a new case file must be created in the case management application.[16] The two files are then linked. <u>Complaints- General Procedures</u> MS opens a complaint when it receives a referral from an external source, such as a regulatory agency like the CFTC, or a market participant. Complaints that cannot be substantiated are closed out administratively, while those that merit further review are elevated to the case level. For example, a CFTC referral or request is typically first logged as a complaint, and if the matter merits further review, it will be elevated to a case. When a complaint is elevated to a case, the case will be cross-referenced with the original complaint within the system, or cross-referenced to another open case if the two matters are related. MS can issue warning letters for certain reporting infractions identified when MS is investigating complaints or preparing research files.	None

[16] Note that the Exchanges refer to a "case" and "investigation" interchangeably in their records and procedures documents.

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	<u>Research Files- General Procedures</u> Research files are prepared on a monthly or quarterly basis. MS analysts record their daily surveillance activities in the files, along with the contract surveillance they conduct over the course of an individual contract's life span. Research files also house the position accountability logs, and the monthly EFRP program and Large Trader program reviews. In addition, the files are used to track the surveillance of individual market participants by analysts, along with MS recommendations regarding such surveillance. MS analysts will record any contact they have with a market participant in the files. Most research files are recurring programmatic "repositories" containing contract surveillance materials reviewed by analysts over the course of a contract life cycle. As a result, they are typically closed with no action. Any potentially violative trading activity discovered in the preparation of these files would usually result in a separate investigation.	
§ 38.158 Investigations and investigation reports (a) Procedures. A designated contract market must establish and maintain procedures that require its compliance staff to conduct investigations of possible rule violations. An investigation must be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of	<u>Resolution of Complaints</u> During the target period, 57 complaints were closed by MS, of which 21 originated from routine CFTC requests for additional information on market participants, 35 originated from requests from clearing firms to transfer trades[17] or customer accounts, and one was a customer complaint. *Resolution*. During the target period, no complaints resulted in disciplinary actions by MS, or were elevated to	None

[17] On May 29, 2015, following the end of the target period, the Exchanges began designating transfer trade requests as research matters, rather than complaints.

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information by the designated contract market that indicates a reasonable basis for finding that a violation may have occurred or will occur.	cases. *Timeliness*. The average length the 57 closed complaints remained open was 22 days. One matter, involving a denied transfer trade request, remained open for over 60 days (specifically, 67 days); and one complaint remained open for over 100 days (specifically, 102 days). The majority of the other 55 complaints (52 of 55, or 95%) were closed in 30 days or less. Division staff reviewed 28 of the 57 closed complaints (49%). Division staff found that MS researched complaints and documented its findings in a sufficiently thorough manner, and closed them in a timely fashion. <u>Resolution of Research Matters Originating from Research Files</u> During the target period, 140 research matters originating from research files were closed by MS. None of the 140 matters were elevated to cases. Of the 140, 132 were non-EFRP related. *Resolution*. Of the 132 non-EFRP research matters, 122 were closed with no disciplinary action. As noted above, most research files contain only recurring programmatic repositories prepared on a monthly or quarterly basis, and are therefore typically closed with no action. The other 10 matters were not elevated to cases but did result in disciplinary actions by MS. These matters involved 11 rather than 10 respondents, because one matter had two respondents. MS issued warning letters to five respondents, and referred	

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	matters involving another six respondents to the Reporting Infractions Committee[18] for violations of Rules 811 (Position Change Data) and 854 (Concurrent Long and Short Position). This Committee issued fines ranging from $1,000 to $7,500 against the six respondents. Division staff reviewed 72 of the 132 closed non-EFRP research matters (55%), and found them to be sufficiently detailed repositories of the research and other contract surveillance that MS analysts conduct over the course of an individual contract's life span. Division staff found that the research matters were closed in a timely manner, and that the sanctions imposed on the 11 respondents discussed above were adequate for the violations involved. *Timeliness*. The average length the 132 research matters remained open was 146 days. Of the 132 research matters: 18 (13%) were open for 30 to 60 days; 30 (23%) were open for 61 to 120 days; 42 (32%) were open for 121 to 180 days; 42 (32%) were open for 181 to 365 days; and none was open for more than 366 days. <u>Case/ Investigation- General Procedures</u> MS maintains a Case Management Procedures document, which outlines the differences between a research file, complaint, and case (investigation). The Case Management Procedures document also describes the requirements for each, in terms of conducting investigations and logging and closing matters. MS also maintains written procedures for various programs (including position limit and position	

[18] See Rule 512.

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	accountability), which are reviewed annually and updated, if necessary. MS elevates matters to the case level when there is a potential that a violation has occurred, and further investigative work is required. Any potential position limit violations, transfer trade violations, or manipulation attempts are opened as cases. If MS identifies any other instances in which there is a potential for a violation, it will also open a case. If MS determines that a rule violation may have occurred, MS can refer the matter to the CME Group Enforcement division ("CME Enforcement"), or the Reporting Infractions Committee (see Rule 512). If a case is referred by MS to CME Enforcement, CME Enforcement can then close the case administratively, refer it back to MS for further investigation, or refer it to an Exchange disciplinary committee, such as the Probable Cause Committee (PCC) or the Business Conduct Committee (BCC). As discussed below, if a case is closed with any type of disciplinary action, such as the issuance of a warning letter or a referral to CME Enforcement, the MS analyst conducting the investigation must prepare a formal Investigative Report containing all information relevant to the case. This report must be approved by authorized MS personnel at the manager or director level. If no violation is detected, a case can be closed out administratively by MS with a close-out memo. The chart below summarizes the resolution of cases closed during the target period. The Division's findings regarding the adequacy of the investigations in connection with the closed cases also appear below.	

Case/Investigation Chart (see discussion below)[19]				
	Resolution	**Number of Cases**	**Number of respondents**	**Amount of fines**
A	No action taken[20]	33	33	None
B	No violation found	3	3	None
C	Post-facto approved hedge exemptions[21]	30	30	None
D	Warning letters issued by MS	19	20	None
E	Referred by CME Enforcement to BCC; closed with fines (no warning letters)	14	14	Fines totaling $402,500; $176,234 in disgorgements of profits
F	Referred by CME Enforcement to BCC; closed with a fine for one respondent and warning letter for the other respondent	1	2	$15,000 fine; $4,020 disgorgement of profit
H	Referred by MS to Reporting Infractions Committee; closed with fine	1	1	$2,500 fine
J	Physical delivery matter closed without action (no violation found)	1	2	None
	Total	102	105[22]	

[19] Any complaints, research matters, or other matters not elevated to "case" status by MS are not reflected on this chart.

[20] Although the Exchanges have separated cases closed with "no action" and cases closed with "no violation found" in their records, the Exchanges informed Division staff that the two dispositions are functionally the same—i.e., no violation was found in cases closed with "no action".

[21] These exemptions were approved pursuant to the following procedure in Rule 559: "A person who establishes an exemption-eligible position in excess of position limits and files the required application with the Market Regulation Department shall not be in violation of this rule provided the filing occurs within five (5) business days after assuming the position except in circumstances where the Market Regulation Department requires a person to file prior to the fifth business day. In the event the positions in excess of the limits are not deemed to be exemption-eligible, the applicant and clearing firm will be in violation of speculative limits for the period of time in which the excess positions remained open." Post-facto exemption requests received pursuant to Rule 559 are always opened by MS as cases. As noted above, during the target period, the Exchanges received 33 post-facto exemption requests. MS approved 19 of these as requested, and approved 11 for less than requested, for a total of 30 post-facto approved hedge exemptions. The other three post-facto exemption requests resulted in disciplinary sanctions for position limit violations under Rule 562 (Position Limit Violations).

[22] The cases described above involved 73 unique respondents, and 105 total respondents; some respondents were involved in more than one case.

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§ 38.158 Investigations and investigation reports (cont.) (b) Timeliness. Each compliance staff investigation must be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by compliance staff.	<u>Timeliness of Case Resolutions</u> There were 102 non-EFRP cases closed during the target period, which resulted in the dispositions described in the chart above. Division staff reviewed 51 of the 102 closed cases (50%), and found the files to contain appropriate documentation, including trading records, transcripts of interviews (when appropriate), and correspondence. The documentation was signed, and provided sufficient explanation for the closing of the case, whether through an investigative report involving a disciplinary action, or through a close-out memo, each of which are discussed below. Of the 102 closed cases, 96 (94%) were closed in less than one year. On average, the cases remained open for 105 days. The six cases that were open for more than one year included mitigating factors which justified the cases being open for this length of time, including the complexity of investigations in manipulation cases, the number of documents that were requested or interviews involved, or the necessity for translations or interpreters for foreign language customers. Fifteen of the closed cases (involving 16 respondents) were referred through CME Enforcement to the Business Conduct Committee (see chart above, Rows E and F). All 16 respondents involved received disciplinary sanctions from the BCC: 15 fines ranging from $5,000 to $47,500, and one fine coupled with a warning letter. The sanctions were issued for violations of Rules 562 (Position Limit Violations), 716 (Duties of Clearing Members), and 811 (Position Change	

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	Data).	
(c) Investigation reports when a reasonable basis exists for finding a violation. Compliance staff must submit a written investigation report for disciplinary action in every instance in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report must include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; compliance staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.	<u>Investigative Reports – Violation</u> MS must prepare an Investigative Report whenever it takes a disciplinary action (e.g., warning letter, referral to CME Enforcement, issuance of a fine, etc.). An Investigative Report will typically include exhibits such as account statements, relevant correspondence with respondents, system alerts and investigation reports compiled by staff, delivery instructions, and applicable forms filed by respondents. The Investigative Report must identify the relevant dates, product(s), and individual(s), in order to provide an objective description of the activity under review. The Investigative Report must also address the applicable Exchange rule(s) involved, any prior disciplinary history for any respondents, any conclusions by MS, and/or recommendations for CME Enforcement or any disciplinary panels (such as the Probable Cause Committee or Business Conduct Committee) that may consider the matter. These procedures are documented in MS's Case Management Procedures. MS prepared 62 Investigative Reports during the target period, of which Division staff reviewed 14 (23%). The Division found the quality of the investigative work in the Investigative Reports reviewed to be thorough and complete. MS investigators adequately collected, reviewed, and analyzed relevant data. In addition, the Division found that the Exchanges' decisions to pursue disciplinary action were appropriate, and the cases were closed in a timely manner.	

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(d) Investigation reports when no reasonable basis exists for finding a violation. If after conducting an investigation, compliance staff determines that no reasonable basis exists for finding a violation, it must prepare a written report including the reason(s) the investigation was initiated; a summary of the complaint, if any; the relevant facts; and compliance staff's analysis and conclusions. (e) Warning letters. No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.	Investigative Reports – No Violation MS must prepare close-out memos when closing out complaints, or any cases that did not identify a violation or result in a referral to CME Enforcement. Close-out memos must identify the issue and explain why it is being closed with no further actions. Close-out memos must also be approved by authorized MS staff. These procedures are documented in MS's Case Management Procedures. MS prepared 137 close-out memos during the target period, of which Division staff reviewed 51 (37%). The Division found the quality of the investigative work in the close-out memos reviewed to be thorough and complete. MS investigators adequately collected, reviewed, and analyzed relevant data, and completed the close-out memos in a timely manner. Warning Letters Twenty cases closed during the target period generated warning letters. MS staff issued warning letters in 19 cases, representing 20 individual respondents (see chart above, Row D). In addition, the BCC issued one warning letter (along with a fine) in a matter referred to the BCC via CME Enforcement (see chart above, Row F). Eleven of the 20 cases that generated warning letters involved Rule 562 (Position Limit Violation); four involved Rule 716 (Duties of Clearing Members); one involved Rule 432 (General Offenses); one involved Rule 559.F (Position Limits and Exemptions – NYMEX Last Day Financial Natural Gas Contracts); one involved Rule 703 (DESIGNATION AND OBLIGATIONS OF METAL SERVICE PROVIDERS); one involved Rule 150106 (DELIVERY PROCEDURES – NY Harbor ULSD Futures); and one case, with two respondents, involved both Rules 432 and 716.	

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	Division staff reviewed seven of the 20 cases in which warning letters were issued (35%). MS staff determined that these cases typically involved simple administrative or clerical errors and very low overages, which MS determined did not disrupt the market or unduly impact settlements of contracts. The Division found the quality of the investigative work to be thorough and complete, and the investigations were closed in a timely manner. The Division also found that the warning letters issued were appropriate for the violations involved. Consistent with the requirements of the Exchanges' Case Management Procedures Manual, no respondent received more than one warning letter for the same rule violation during the target period. <u>Division findings</u> In conclusion, and as noted above, there were 102 non-EFRP cases closed during the target period. Division staff reviewed 51 of the 102 closed cases (50%), and found the files to contain the appropriate trading documentation and records, transcripts of interviews (when appropriate), and correspondence. The Division found the quality of the investigative work in the closed cases reviewed to be thorough and complete. MS investigators adequately collected, reviewed, and analyzed relevant data. In addition, the Division found that the Exchanges' decisions whether or not to pursue disciplinary action were appropriate, and the cases were closed in a timely manner.	