

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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1:54 pm, May 29, 2018

In the Matter of:

X-Change Financial Access LLC

Respondent.

CFTC DOCKET NO. 18-13

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

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that X-Change Financial Access LLC (“XFA” or “Respondent”) violated Section 4g of the Commodity Exchange Act (“Act”), 7 U.S.C. § 6g (2012), and Commission Regulations (“Regulations”) 1.31(a)(1), 1.35 (a)(1) and (b)(5)(v)(C), and 166.3, 17 C.F.R. §§ 1.31(a)(1), 1.35(a)(1), (b)(5)(v)(C), 166.3 (2017). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondent engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Section 6(c) and (d) of the Commodity Exchange Act Making Findings, and Imposing Remedial Sanctions (“Order”) and acknowledges service of this Order.¹

¹ Respondent consents to the use of the findings of fact and conclusions of law in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party or claimant, and agrees that they shall be taken as true and correct and be given preclusive effect therein, without further proof. Respondent does not consent, however, to the use of this Order, or the findings or conclusions herein, as the sole basis for any other proceeding brought by the Commission or to which the Commission is a party or claimant, other than: a proceeding in bankruptcy or receivership; or a proceeding to enforce the terms of this Order. Respondent does not consent to the use of the Offer or this Order, or the findings or conclusions in this Order, by any other party in any other proceeding.

III.

The Commission finds the following:

A. SUMMARY

Between at least January 2013 and January 2014 (“Relevant Period”), XFA failed to diligently supervise its employees concerning accounts owned or controlled by its client, who was the associated person (“AP”) and founder of a commodity trading advisor (“CTA”) and commodity pool operator (“CPO”). The CTA/CPO’s AP and founder (“Client”) managed commodity futures accounts for numerous individual customers as well as a commodity pool (“Pool”). During the Relevant Period, the Client executed bunched orders on behalf of customer and proprietary accounts through an XFA floor broker (“Broker”) and subsequently sent allocation instructions to the Broker. The Client used post-execution allocation to engage in an unlawful scheme to the Client’s benefit and to the detriment of certain of the Client’s customers. During the Relevant Period, XFA had no written policies or procedures concerning the post-execution allocation of bunched orders and did not train its staff on their obligations regarding the handling of such bunched orders. As a result, the Broker processed the Client’s allocations despite various red flags indicating that the Client was not complying with Commission regulations governing such allocations.

In addition, during the Relevant Period, the National Futures Association (“NFA”) issued two Member Responsibility Action (“MRAs”) against the Client and the CTA/CPO prohibiting the Client from soliciting funds or withdrawing money from managed accounts, and ultimately, banning the Client from trading. Despite the MRAs, of which the Broker and XFA supervisory personnel were aware, the Client was still able to allocate trades to a new account in the name of the Client’s spouse (“Spouse Account”), and the Broker executed trades in the Spouse Account after the trading ban took effect. XFA’s failure to identify the relationship between the Client and the Spouse Account, which enabled the Client to circumvent the MRAs and delayed detection of the Spouse Account by regulators, demonstrated the insufficiency of XFA’s policies and procedures regarding compliance with regulatory actions.

Through these actions, Respondent failed to diligently supervise the handling of its customer accounts, in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2017).

Finally, although XFA retained the IMs between the Client and its Broker, some of which contained bunched orders or post-execution allocation instructions, XFA failed to preserve the timestamps on the IMs. XFA’s failure to properly preserve these records violated Section 4g of the Act, 7 U.S.C. § 6g (2012), and Regulations 1.31 and 1.35(a)(1) and (b)(5)(v)(C), 17 C.F.R. §§ 1.31, 1.35(a)(1) and (b)(5)(v)(C) (2017), which require an FCM to maintain complete records of all transactions relating to its business of dealing in commodity interests, including orders subject to post-execution allocation, and to preserve electronic records in native file format.

B. RESPONDENT

X-Change Financial Access LLC is an Illinois limited liability company with its principal place of business in Chicago, Illinois. At all relevant times, XFA was registered with

the Commission as an FCM. XFA withdrew its registration as an FCM in February 2016 and is now registered as an introducing broker.

C. FACTS

Regulation 1.35(b)(5), 17 C.F.R. § 1.35(b)(5) (2017), permits eligible account managers (“EAMs”), including CTAs, to enter bunched orders on behalf of multiple customers² and allocate them to individual or pooled accounts no later than the end of the trading day. To be eligible for post-execution allocation, bunched orders must be allocated as follows: (1) CTAs are required to provide FCMs with allocation instructions “as soon as practicable after the entire transaction is executed, but in any event no later than . . . sufficiently before the end of the day the order is executed to ensure that clearing records identify the ultimate customer for each trade”; (2) allocations must be “fair and equitable,” with no accounts receiving consistently favorable or unfavorable treatment; and (3) the allocation methodology must be “sufficiently objective and specific to permit independent verification of the fairness of the allocations using that methodology.” 17 C.F.R. § 1.35(b)(5)(i)(A), (b)(5)(iv)(A)-(C).

Through the Broker, the Client executed round-turn trades³ during the same trading day in S&P 500 options on futures on behalf of individual customers, the Pool, and accounts in which the Client or the Client’s associates had a personal interest. After calculating gains and losses on the trades, the Client would send allocation instructions to the Broker, who would then give up the allocated trades to another FCM for clearing. Taking improper advantage of post-execution allocation, the Client disproportionately allocated profitable trades to the accounts in which the Client or the Client’s associates had a proprietary interest, and unprofitable or less profitable trades to the customer accounts or the Pool account.

Regulation 1.35(b)(5) places an affirmative obligation on FCMs to monitor for unusual allocation activity and to make a reasonable inquiry into the matter if an FCM has actual or constructive notice of fraudulent allocations. *See* Account Identification for Eligible Bunched Orders, 68 Fed. Reg. 34,790, 34,792 (June 11, 2003); *see also* NFA Notice 9029. During the Relevant Period, XFA did not have any policies or procedures concerning the post-execution allocation of bunched orders and did not train its staff on their responsibility to monitor for

² *See* Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278, 21,286 (Apr. 9, 2012); *see also* Adaptation of Regulations To Incorporate Swaps, 77 Fed. Reg. 66,288, 66,311 (Nov. 2, 2012) (discussing purpose of Regulation 1.35 with respect to bunched orders). Under Regulation 1.35(b)(5), EAMs placing orders for a single account must still provide that account number at the time of order entry. *See* NATIONAL FUTURES ASS’N, NFA Interpretive Notice 9029, *NFA Compliance with Rule 2-10: The Allocation of Bunched Orders for Multiple Accounts*, n.3, <https://www.nfa.futures.org/rulebook/rules.aspx?RuleID=9029&Section=9> (“NFA Notice 9029”).

³ A round-turn trade is a completed transaction involving both a purchase and a liquidating sale, or a sale followed by a covering purchase.

unusual allocation activity.⁴

The Client's use of post-execution allocation did not comply with Regulation 1.35(b)(5). The Client routinely allocated bunched orders to a single account and often submitted allocation instructions hours after execution and close to the end of the trading day—red flags that should have been noticed by the Broker or other XFA supervisory personnel. Furthermore, the Client did not use an objective allocation methodology designed to ensure the fairness of the allocations, which allowed the Client to treat certain accounts with preference. Finally, for over three months during the Relevant Period, XFA failed to preserve the timestamps for the instant messages between the Client and its Broker, many of which contained the Client's bunched orders and/or post-execution allocation instructions.

On September 4, 2013, NFA issued an MRA against the Client and the CTA/CPO for conduct unrelated to the allocation scheme. This MRA, of which the Broker and XFA supervisory personnel were aware, prohibited the Client and the CTA/CPO from soliciting funds from customers, or disbursing funds from any account they owned or controlled, without NFA approval. Several weeks later, the Client began allocating bunched orders to the Spouse Account. Although the Client informed the Broker that he was allocating to a new account, XFA did not add the Spouse Account to the give-up agreement with the clearing FCM, likely delaying XFA's and the FCM's identification of the relationship between the Client and the Spouse Account.

On January 16, 2014, NFA issued a second MRA prohibiting the Client and the CTA/CPO from placing trades for any pools they operated or accounts that they owned or controlled, except for the liquidation of existing positions. XFA supervisory personnel also received notice of this MRA. Nonetheless, on three days following the ban, the Broker executed trades for the Spouse Account, which was being operated by the Client, and thus the trades were placed in violation of the trading ban. During the Relevant Period, XFA did not have a policy or system in place to monitor accounts owned or operated by clients subject to regulatory orders.

IV.

LEGAL DISCUSSION

A. Failure To Supervise

Regulation 166.3, 17 C.F.R. § 166.3 (2017), requires that every Commission registrant (except APs who have no supervisory duties) “diligently supervise the handling by its partners, officers, employees and agents” of all activities relating to its business as a registrant. *See In re FCStone, LLC*, CFTC No. 15-21, 2015 WL 2066891, at *2 (May 1, 2015). Regulation 166.3 imposes upon a registrant an affirmative duty to supervise its employees and agents diligently by establishing, implementing and executing an adequate supervisory structure and compliance program. *In re Vision Financial Markets*, CFTC No. 13-36, 2013 WL 5376144, at *2 (Sept. 24,

⁴ XFA's policies and procedures regarding bunched order allocations have been updated since the Relevant Period.

2013). For a registrant to fulfill its duties under Regulation 166.3, it must both design an adequate program of supervision and ensure that the program is followed. *In re GNP Commodities, Inc.*, CFTC No. 89-1, 1992 WL 201158, at *17-19 (Aug. 11, 1992), *aff'd sub nom. Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993).

A violation of Regulation 166.3 is an independent violation for which no underlying violation is necessary. *FCStone*, 2015 WL 2066891, at *3; *In re FC Stone, LLC*, CFTC No. 13-24, 2013 WL 2368539, at *6 n.13 (May 29, 2013); *In re Forex Capital Mkts. LLC*, CFTC No. 12-01, 2011 WL 4689390, at *3 (Oct. 3, 2011); *In re First National Trading Corp.*, CFTC No. 92-17, 1994 WL 378010, at *10 (July 20, 1994) (citing *In re Paragon Futures Ass'n*, CFTC No. 88-18, 1992 WL 74261, at *13 (Apr. 1, 1992)). Consequently, a violation of Regulation 166.3 is established by showing either that: (1) the registrant's supervisory system was generally inadequate, or (2) the registrant failed to perform its supervisory duties diligently. *FCStone*, 2015 WL 2066891, at *3 (citing *In re Murlas Commodities*, CFTC No. 85-29, 1995 WL 523563 (Sept. 1, 1995)); *Paragon*, 1992 WL 74261, at *14 (concluding that the "focus of any proceeding to determine whether Rule 166.3 has been violated will be on whether [a] review [has] occurred and, if it did, whether it was 'diligent'").

Under Regulation 166.3, a registrant has a "duty to develop procedures for the 'detection and deterrence of [CEA violations] by its agents.'" *Samson Refining Co. v. Drexel Burnham Lambert, Inc.*, CFTC No. 82-R448, 1990 WL 282783, at *11 (Feb. 16, 1990). Thus, a registrant's failure to develop proper procedures for the detection of wrongdoing, standing alone, can evidence the lack of an adequate supervisory system. See *CFTC v. Sidoti*, 178 F.3d 1132 (11th Cir. 1999); *In re Open E Cry*, CFTC No. 12-24, 2012 WL 10259805, at *6 (June 7, 2012). Whether a registrant has met its supervisory duties is a fact-intensive determination. See, e.g., *GNP Commodities*, 1992 WL 201158, at *17. Evidence of violations that "should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly" is probative of a failure to supervise. *Sidoti*, 178 F.3d at 1137.

During the Relevant Period, XFA was registered with the Commission as an FCM. As such, XFA had a duty to monitor the Client's accounts for unusual allocation activity. During the Relevant Period, the Client frequently allocated orders to only one account, submitted allocation instructions many hours after execution, and did not have a give-up agreement in place for the Spouse Account, to which the Client allocated trades on a post-execution basis. Furthermore, XFA failed to have procedures in place, or train employees, regarding the post-execution allocation of bunched orders. In addition, XFA did not have procedures governing compliance with regulatory orders, such as MRAs, concerning accounts owned or operated by its clients. Collectively, these deficiencies evidence XFA's failure to diligently supervise the handling by its employees of its business as a Commission registrant, in violation of Regulation 166.3.

B. Failure To Maintain and Produce Records

Section 4g of the Act and Regulation 1.31 together require FCMs to keep all books and records required by the Act for a period of five years from the date of the record. 7 U.S.C. § 6g(a)-(d) (2012); 17 C.F.R. § 1.31(a)(1), (b)(3) (2017). In addition, Regulation 1.35(a)(1)(iii),

17 C.F.R. § 1.35(a)(1)(iii) (2017), mandates that an FCM “[k]eep full, complete, and systematic records (including all pertinent data and memoranda) of all transactions relating to its business of dealing in commodity interests” and “[k]eep all . . . written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading and prices that lead to the execution of a transaction in a commodity interest,” including those communications transmitted by instant message. Finally, Regulation 1.35(b)(5)(v)(C) requires FCMs that carry accounts eligible for post-execution allocation to maintain records regarding these orders, including, where applicable, the account manager’s written allocation instructions. *See Account Identification for Eligible Bunched Orders*, 68 Fed. Reg. at 34,793.

A failure to retain and promptly produce required records for inspection to Commission staff constitutes a violation of Section 4g of the Act and Regulations 1.31 and 1.35. *See, e.g., In re GNP Commodities*, CFTC No. 89-1, 1992 WL 201158, at *15 (Aug. 11, 1992) (FCM violated recordkeeping requirements of Section 4g of the Act and Regulations 1.31 and 1.35 by failing to retain and produce to Commission records of trades allocated post execution); *In re Woods*, CFTC No. 15-02, 2014 WL 5089105, at *3-4 (Oct. 8, 2014) (consent order) (IB violated recordkeeping requirements of Section 4g of the Act and Regulations 1.31 and 1.35 by failing to retain and produce to Commission instant message records of communications with clients relating to commodity futures and options transactions, and documenting the times orders were received). Commission registrants are strictly liable for recordkeeping violations, for which a showing of scienter is not required. *In re DiPlacido*, CFTC No. 01-23, 2008 WL 4831204, at *37 (Nov. 5, 2008), *aff’d sub nom. DiPlacido v. CFTC*, 364 Fed. Appx. 657 (2d Cir. 2009).

Between October 28, 2013 and January 31, 2014, XFA failed to preserve timestamps for all instant message communications between the Broker and the Client, many of which led to the execution of commodity futures transactions and/or contained the Client’s allocation instructions. Thus, XFA violated Section 4g of the Act and Regulations 1.31(a)(1) and 1.35(a)(1) and (b)(5)(v)(C).

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, during the Relevant Period, Respondent violated Section 4g of the Act, 7 U.S.C. § 6g (2012), and Regulations 1.31(a)(1), 1.35(a)(1) and (b)(5)(v)(C), and 166.3, 17 C.F.R. §§ 1.31(a)(1), 1.35(a)(1), (b)(5)(v)(C), 166.3 (2017).

VI.

OFFER OF SETTLEMENT

Respondent has submitted the Offer in which it, without admitting or denying the findings and conclusions herein:

A. Acknowledges receipt of service of this Order;

- B. Admits the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;**
- C. Waives:**
- 1. The filing and service of a complaint and notice of hearing;**
 - 2. A hearing;**
 - 3. All post-hearing procedures;**
 - 4. Judicial review by any court;**
 - 5. Any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer;**
 - 6. Any and all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2012) and 28 U.S.C. § 2412 (2012), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Commission's Regulations, 17 C.F.R. pt. 148 (2017), relating to, or arising from, this proceeding;**
 - 7. Any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-53, 110 Stat. 847, 857-74 (codified as amended in scattered sections of 5 U.S.C. and 15 U.S.C.), relating to, or arising from, this proceeding; and**
 - 8. Any claims of Double Jeopardy based on the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;**
- D. Stipulates that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Respondent has consented in the Offer;**
- E. Consents, solely on the basis of the Offer, to the Commission's entry of this Order that:**
- 1. Makes findings by the Commission that Respondent violated Section 4g of the Act, 7 U.S.C. § 6g (2012), and Regulations 1.31(a)(1), 1.35(a)(1) and (b)(5)(v)(C), and 166.3, 17 C.F.R. §§ 1.31(a)(1), 1.35(a)(1), (b)(5)(v)(C), 166.3 (2017);**
 - 2. Orders Respondent to cease and desist from violating Section 4g of the Act, 7 U.S.C. § 6g (2012), and Regulations 1.31(a)(1), 1.35(a)(1) and (b)(5)(v)(C), and 166.3, 17 C.F.R. §§ 1.31(a)(1), 1.35(a)(1), (b)(5)(v)(C), 166.3 (2017);**
 - 3. Orders Respondent to pay a civil monetary penalty of one hundred fifty thousand dollars (\$150,000) plus post-judgment interest; and**
 - 4. Orders Respondent and its successors and assigns to comply with the conditions**

consented to in the Offer and as set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept the Offer.

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Respondent shall cease and desist from violating Section 4g of the Act, 7 U.S.C. § 6g (2012), and Regulations 1.31(a)(1), 1.35(a)(1) and (b)(5)(v)(C), and 166.3, 17 C.F.R. §§ 1.31(a)(1), 1.35(a)(1), (b)(5)(v)(C), 166.3 (2017).
- B. XFA shall pay a civil monetary penalty of one hundred fifty thousand dollars (\$150,000) (“CMP Obligation”) plus post-judgment interest. If the CMP Obligation is not paid in full within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2012).

Respondent shall pay the CMP Obligation within ten (10) days of the date of entry of the Order by electronic funds transfer, U.S. postal money order, certified check, bank cashier’s check, or bank money order. If payment is to be made other than by electronic funds transfer, then the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

MMAC/ESC/AMK326
Commodity Futures Trading Commission
Division of Enforcement
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
(405) 954-6569 office
(405) 954-1620 fax
9-AMC-AR-CFTC@faa.gov

If payment is to be made by electronic funds transfer, Respondent shall contact Marie Thorne or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the CMP Obligation with a cover letter that identifies the paying Respondent and the name and docket number of this proceeding. The paying Respondent shall simultaneously transmit copies of the cover letter and the form of payment to the Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

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

1. Public Statements: Respondent agrees that neither it nor any of its successors and assigns, agents or employees under its authority or control, shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Respondent's: (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondent and its successors and assigns shall undertake all steps necessary to ensure that all of its agents and/or employees under its authority or control understand and comply with this agreement.
2. Cooperation with the Commission: Respondent shall cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement, and any other governmental agency in this action, and in any investigation, civil litigation, or administrative matter related to the subject matter of this action or any current or future Commission investigation related thereto.
3. Partial Satisfaction: Respondent understands and agrees that any acceptance by the Commission of any partial payment of Respondent's CMP Obligation shall not be deemed a waiver of their obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.
4. Change of Address/Phone: Until such time as Respondent satisfies in full its CMP Obligation as set forth in this Consent Order, Respondent shall provide written notice to the Commission by certified mail of any change to its telephone number and mailing address within ten (10) calendar days of the change.

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

By the Commission.



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: May 29, 2018