

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



**Division of Market Oversight
December 14, 2012**

**RULE ENFORCEMENT REVIEW OF
ICE FUTURES U.S.—DISCIPLINARY PROCEDURES**

Commodity Futures Trading Commission- Division of Market Oversight

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I. Introduction

The Division of Market Oversight (“Division”) has completed a rule enforcement review of the disciplinary program at ICE Futures U.S. (“ICE Futures” or “Exchange”).¹ The Division’s review focused on new Core Principle 13 (*Disciplinary Procedures*) for boards of trade that are designated contract markets. It requires boards of trade to “establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade...” The new core principle is codified in section 5(d)(13) of the Commodity Exchange Act (“Act”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Division’s review covered the period from November 1, 2010 to November 1, 2011 (“target period”).²

II. Methodology

To assess the Exchange’s compliance with Core Principle 13, Division staff interviewed senior members of ICE Futures’ Compliance Department (“Compliance” or “Compliance Department”) and reviewed numerous documents used by Compliance in fulfilling the Exchange’s self-regulatory responsibilities. Documents reviewed by Division staff included the following:

- The Exchange’s Compliance Department Manual, disciplinary rules, internal regulatory requirements summary, and other overviews of Exchange disciplinary procedures;
- organizational charts and summaries of personnel and staffing;

¹ The Exchange’s parent company, IntercontinentalExchange, operates three futures exchanges: ICE Futures U.S., ICE Futures Europe, and ICE Futures Canada.

² Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010) (“Dodd-Frank”). The Division’s review also incorporates elements of Section 5(d)(2) of the Act prior to its amendment by Dodd-Frank (“former Core Principle 2”). The Division believes that the disciplinary requirements of former Core Principle 2 were substantively similar to the requirements of new Core Principle 13.

- minutes of meetings of the Board of Directors, Business Conduct Committee (“BCC”) and the Regulatory Oversight Committee held during the target period;
- summaries of procedures designed to prevent conflicts of interest; and
- disciplinary investigation reports and settlement agreements.

The Division provided ICE Futures with an opportunity to review and comment on a draft of this report on November 13, 2012. On November 20, 2012, Division staff conducted an exit conference with Exchange officials to discuss the report’s findings and recommendations.

III. Summary of Findings and Recommendations

A. Findings.

- The Exchange maintains adequate disciplinary procedures. The Exchange has the authority to investigate potential rule violations, prosecute cases, and discipline members who are found to have violated Exchange rules. Respondents receive adequate notice of the charges against them and have sufficient opportunity to present their defenses. In addition, respondents have the right to be represented by counsel, to call witnesses, and to offer evidence.
- The Exchange maintains a small but highly experienced staff in its Compliance Department. The Exchange’s Vice President, Chief Compliance Officer and Assistant General Counsel, for example, have considerable experience with compliance functions, the Act, and Commission regulations. The Division believes that the number of Compliance personnel was sufficient for enforcement purposes during the target period.
- The Exchange’s primary disciplinary committee is the BCC. The BCC fulfills its responsibilities through subcommittees consisting of BCC members that are empaneled specifically for the matter they are to hear. There are two types of BCC subcommittees: “Charging Subcommittees” and “Hearing Subcommittees,” described in more detail in section VI(A) below.
- The Exchange has established procedures that are sufficient to identify and minimize potential conflicts of interest when appointing individuals to the BCC and to Charging Subcommittees and Hearing Subcommittees. These procedures include reviewing the background of individuals under consideration for such positions, discussing Exchange procedures designed to address conflicts of interest with these individuals, and advising BCC members that they should recuse themselves and not participate in any matter as to which they believe they cannot act fairly or impartially.

- A total of \$1,469,450 in fines, ranging from \$2,500 to \$400,000, was assessed by the Exchange against 25 respondents. A total of \$20,867.50 in customer restitution was assessed by the Exchange against three respondents in connection with three cases. A total of four respondents were suspended by the Exchange, for periods ranging from six weeks to one year. Three respondents were expelled by the Exchange, including one respondent previously suspended who was subsequently expelled due to non-payment of fines and restitution assessed by the Exchange.
- With the exception of the case involving wash trading discussed immediately below, the Division believes that the fines and customer restitution assessed by the Exchange are adequate in light of the violations asserted by the Compliance Department.
- The Exchange negotiated a settlement agreement in connection with a case involving wash trading³ without uncovering the extent of the wash trading activity by the respondent firm, or the degree of coordination between the respondent's software developers, traders and management.
 - In particular, the Exchange did not interview the employees/traders who conducted the wash trading, or discover the existence of a computer program that was designed by developers at the firm, with the approval of the firm's management, for purposes of facilitating wash trading.
- The 25 disciplinary cases reviewed include a number of examples in which the Exchange determined that employees of a respondent firm engaged in violative conduct, but the Exchange sanctioned only the firm, and did not also pursue sanctions against the employees.
 - The Exchange indicated that it did not pursue sanctions against employees that are not members of the Exchange, on the theory that the Exchange lacked jurisdiction over such employees.
 - The Exchange expanded its jurisdiction over employees that are not members of the Exchange (together with other individuals initiating transactions via the Exchange) pursuant to Exchange Trading Rule 4.00. The Exchange instituted Exchange Trading Rule 4.00 in response to §38.151(a) of the Act, which was implemented in July 2012 pursuant to the requirements of Dodd-Frank.⁴ Exchange Trading Rule 4.00 became effective on August 20, 2012, following the end of the target period.

³ Case # 2010-060.

⁴ 77 FR 36612 (June 19, 2012).

- The average length of time between the date each investigation was completed and the date the respondent's case was referred to the BCC was approximately 103 days.
- The investigation files and disciplinary committee minutes provided by the Exchange do not provide a complete record of the following:
 - A formalized record of Compliance's recommendations regarding settlement agreements, and the basis for Compliance's recommendations; and
 - The reasons for which, in a case involving a floor broker and his clerk who mishandled a customer order, Compliance recommended a lesser sanction to a Hearing Subcommittee than the one Compliance recommended at an earlier stage of the investigation.⁵
- Investigation reports produced by the Exchange frequently did not include the date on which the completed reports were approved by senior Compliance staff. The Division could not independently confirm how much time elapsed between final approval of a completed investigation report by senior staff, and the date the case was referred to the BCC.

B. Recommendations.

Although the Division believes that the Exchange maintains a generally adequate disciplinary program, the Division identified areas for improvement in response to certain findings listed above, and is making the following recommendations:

- Keep formal written records or disciplinary committee minutes of any recommendation made by Compliance to a Charging Subcommittee or a Hearing Subcommittee regarding a settlement offer, and the basis for Compliance's recommendation.
- If Compliance recommends a lesser sanction to a Subcommittee than Compliance recommended at an earlier stage of the investigation or disciplinary process, the Exchange's written records or disciplinary committee minutes should fully explain the reasons why Compliance determined the lesser sanction is now appropriate.
- In cases of violative conduct by employees of a firm with trading privileges on the Exchange, conduct thorough interviews with relevant employees to determine: which employees were involved in the violative conduct; the nature of their involvement; the extent of management's knowledge; and the degree, if any, of coordination between the employees and management.

⁵ Case # 2009-016.

- Enter into settlement negotiations only after interviewing all relevant employees and conducting a thorough investigation.
- Record the date in investigation reports on which the reports are approved by senior Compliance staff.
- Reduce the average time between the completion of an investigation report and the referral of the case to the BCC.

IV. Products and Trading Volume during the Target Period⁶

Total trading volume at ICE Futures during the target period was 109,287,954 contracts. The Exchange offered 90 different products for trading during target period, but four products alone accounted for approximately 70 percent of total volume: Russell 2000 Index futures accounted for 39 percent; Sugar No. 11 accounted for 24 percent; Sugar No. 11 options accounted for seven percent; and U.S. Dollar Index accounted for seven percent. Additional trading volume, open interest and product information is provided in Tables 1, 2 and 3, below.

⁶ Data in this Section IV was obtained from the Exchange.

Table 1 below lists the total Exchange volume and total number of products listed during the target period and during the 12 months prior to the target period (November 1, 2009 to November 1, 2010). Exchange volume is subdivided by open outcry volume, electronic trading volume, and off-exchange volume. As indicated below, during this two-year period, the number of products traded increased from 75 to 90 (20 percent), but the Exchange experienced relatively modest volume growth (from a total volume of 104,646,550 to 109,287,954 contracts).

Table 1.

	Time period	Volume (in contracts)	Open Outcry Volume	Electronic Volume	Off Exchange Volume (EFP, EFS, EOO, Block)	No. of Products Traded
Futures	11-01-09 to 11-01-10	91,047,644	766,618*	85,774,134	4,506,892	66
Futures	11-01-10 to 11-01-11	94,953,826	763,898*	88,939,284	5,250,644	81
Options	11-01-09 to 11-01-10	13,598,906	12,573,446	538,815	486,645	9
Options	11-01-10 to 11-01-11	14,334,128	11,568,894	1,841,083	924,151	9
Total	11-01-09 to 11-01-10	104,646,550	13,340,064	86,312,949	4,993,537	75
Total	11-01-10 to 11-01-11	109,287,954	12,332,792	90,780,367	6,174,795	90

* This open outcry futures volume is related to the futures component of option-futures combination trades that were executed in the options open outcry market.

Table 2 below lists the names, total trading volumes, and average monthly open interest for the Exchange’s five primary futures products (ranked by trading volume) during the target period. Exchange volume is subdivided by open outcry volume, electronic trading volume, and off-exchange volume. Trading in the Russell 2000 Index, the Exchange’s most heavily traded futures product, represented 39 percent of total Exchange volume during the target period.

Table 2.

Futures Product	Volume (in contracts)	Percentage of Total Exchange Volume⁷	Open Outcry Volume*	Electronic Volume	Off Exchange Volume (EFP, EFS, EOO, Block)	Avg. Month-End Open Interest
Russell 2000 Index	42,250,764	39%	7	41,130,774	1,119,983	396,558
Sugar No. 11	26,473,126	24%	435,863	24,289,906	1,747,357	583,476
USDx	7,710,706	7%	819	7,618,294	91,593	51,269
Cotton No. 2	5,786,657	5%	182,792	5,192,606	411,259	168,046
Coffee “C”	5,231,459	5%	110,930	4,779,620	340,909	120,384

* This open outcry futures volume is related to the futures component of option-futures combination trades that were executed in the options open outcry market.

⁷ As indicated in Table 1, total exchange volume during the target period was 109,287,954 contracts.

Table 3 below lists the names, total trading volumes, and average monthly open interest for the Exchange’s five primary options products (ranked by trading volume) during the target period. Exchange volume is subdivided by open outcry volume, electronic trading volume, and off-exchange volume. Trading in Sugar No. 11, the Exchange’s most heavily traded options product, represented seven percent of total Exchange volume during the target period.

Table 3.

Options Product	Volume (in contracts)	Percentage of Total Exchange Volume	Open Outcry Volume	Electronic Volume	Off Exchange Volume (EOO, Block)	Avg. Month-End Open Interest
Sugar No. 11	7,588,834	7%	6,346,897	824,328	417,609	774,223
Cotton No. 2	3,041,194	3%	2,486,942	286,908	267,344	358,121
Coffee “C”	2,711,144	2%	2,252,119	373,629	85,396	197,845
Cocoa	614,632	.6%	252,262	209,003	153,367	76,882
FCOJ	173,238	.16%	141,387	31,851	0	22,657

V. Staffing, Organization and Training

ICE Futures’ Compliance Department consisted of 16 fully dedicated personnel at the end of the target period.⁸ Compliance is led by a highly experienced Vice President of Market Regulation (“Vice President”),⁹ who also leads the Exchange’s Market Surveillance Department.

¹⁰ The Vice President’s responsibilities include, but are not limited to: presenting findings of

⁸ At the end of the target period of the most recent prior Exchange rule enforcement review, which covered the period from June 1, 2007 to June 1, 2008, the Compliance Department consisted of 12 fully dedicated personnel.

⁹ The Vice President joined the Exchange’s staff in September 2005. His 26 years of experience in futures compliance include 19 years with New York exchanges (COMEX, NYMEX, ICE/NYBOT) and seven years with various FCMs.

¹⁰ The Exchange’s Market Regulation Department is composed of two units: the Compliance Department and the Market Surveillance Department, both of which report to the Vice President. Members of the Market Surveillance Department may engage in investigations of rule violations related to market surveillance (e.g., position limit violations) that are referred to the BCC. In addition, members of the Market Surveillance staff may be present at the BCC meeting in which such investigations are discussed. References to “Compliance” and the “Compliance Department” below include members of the Market Surveillance staff acting in such capacity.

rule violations to Exchange disciplinary committees; overseeing the design of systems used to identify potential trading violations; and occasionally joining other Compliance staff in investigative interviews. The Vice President is assisted by the following individuals, in addition to an administrative coordinator:

- The Chief Compliance Officer (“CCO”),¹¹ whose duties include approving the opening and closing of investigations; assisting in the presentation of investigations to the Exchange’s BCC; consulting with the Vice President with respect to all summary fines for rule violations; assisting with the preparation of policy memoranda and responses to regulatory inquiries; and participating in investigative interviews.
- The Assistant General Counsel, Market Regulation (the “Assistant General Counsel”),¹² who spends the majority of his time on enforcement-related activities,¹³ such as reviewing Compliance matters and investigation reports, making presentations, and conducting litigation before Exchange disciplinary committees.
- The Compliance Systems Manager, who acts as a liaison to the Exchange’s IT department and responds to all of the Compliance Department’s IT-related requests.

The CCO described above supervises three other managerial staff, including a Managing Director of Compliance and two Compliance Managers. The Managing Director and Compliance Managers in turn supervise (in total) two senior investigators, four investigators, one senior compliance analyst/investigator and one senior investigator/auditor. The CCO and Compliance Department managers (together with the Assistant General Counsel) meet on a monthly basis to discuss progress on outstanding investigations. Members of the Compliance

¹¹ The CCO has 15 years of futures compliance experience, including 14 years at ICE/NYBOT.

¹² The Assistant General Counsel, Market Regulation has 11 years of futures compliance experience at ICE/NYBOT.

¹³ Although the Assistant General Counsel is involved in enforcement-related activities, the Exchange does not have any personnel that are specifically dedicated to enforcement.

Department also interact on a more frequent basis to discuss disciplinary matters, including investigations that may be referred for disciplinary action.

The Exchange's IT department, which is also referred to internally as the Data Warehouse team, is responsible for managing the database housing trade and order data. The Compliance Department's reporting tools derive trade and order information from this database. The IT department also develops and supports technology applications used by the Compliance Department. Other than the IT department, there are no divisions or departments within the Exchange that collect, maintain or disseminate information critical to compliance or enforcement activities.

The Exchange does not have a mandatory training requirement for Compliance staff. However, all members of the Compliance Department received on-the-job training and specific training in the technology applications used by the Compliance Department (ICECap and SMARTS) during the target period. In addition, various members of the Compliance Department attend the annual FIA Law & Compliance workshop.

The Division believes that the Compliance Department personnel are qualified and experienced, and that the number of personnel was sufficient for disciplinary purposes during the target period.

VI. Disciplinary Committees and Procedures

A. Overview.

The BCC is ICE Futures' primary disciplinary committee. The BCC fulfills its responsibilities through subcommittees consisting of BCC members that are empaneled specifically for the matter(s) they are to hear. There are two types of BCC subcommittees:

“Charging Subcommittees” and “Hearing Subcommittees” (described below).¹⁴ As indicated by its subcommittee structure, the BCC serves two functions: first, through Charging Subcommittees, it periodically reviews written reports prepared by the Exchange’s Compliance Department to determine whether rule violations may have occurred; second, through Hearing Subcommittees for contested matters, it conducts a full evidentiary hearing to determine whether rule violations did in fact occur. If a Charging Subcommittee determines that a rule violation may have occurred and the matter is contested by the respondent, then a Hearing Subcommittee will be empaneled by the Chairman of the BCC from the members of the BCC who did not serve on the Charging Subcommittee for that matter.¹⁵ After a full evidentiary hearing, the Hearing Subcommittee will determine whether a rule violation occurred, and issue sanctions if appropriate. Charging and Hearing Subcommittees are both authorized to accept settlement agreements.

Members of the BCC are appointed for one-year terms. Unless they choose to step down, members are typically reappointed at the end of the one-year period. BCC members that are also Exchange members receive \$250 compensation per meeting, while BCC members that are not Exchange members receive \$500 compensation per meeting.

B. Charging Subcommittee Procedures.

A Charging Subcommittee is chaired by either the Chairman or Vice Chairman of the BCC.¹⁶ Each Subcommittee is comprised of no less than seven individuals, such that four are members or employees of member firms and three are not members or employees of member firms.¹⁷ ICE Futures rules require that at least one member of a Charging Subcommittee be a

¹⁴ ICE Futures Disciplinary Rule 21.03.

¹⁵ ICE Futures Disciplinary Rule 21.08(a).

¹⁶ ICE Futures Disciplinary Rule 21.03(b).

¹⁷ Id.

“public committee member”.¹⁸ Prior to a Charging Subcommittee meeting, a copy of the investigation report is given to the respondent named in the report (the “Respondent”), and the Respondent is given the opportunity to provide Compliance staff with any written comments the Respondent wishes to have submitted to the Charging Subcommittee. Any comments so received are provided to the Charging Subcommittee along with Compliance’s written investigative report so that the Charging Subcommittee is able to consider both sides of the matter when the case is first presented.¹⁹

At the Charging Subcommittee meeting, Compliance staff will present the investigative report along with copies of any pertinent records, and answer questions from Charging Subcommittee members. The Charging Subcommittee will then deliberate and vote with Compliance staff in attendance. At this point in the proceeding, the Charging Subcommittee’s role is solely to determine whether a rule violation may have occurred. In considering this question, the Charging Subcommittee may also refer the matter back to Compliance for further investigation and reconsideration by the Charging Subcommittee at a later date. If the Charging Subcommittee concludes that a rule violation did not occur, the case is closed.

If, after the initial review of Compliance’s report, the Charging Subcommittee believes that a rule violation may have occurred, the Respondent is afforded the opportunity to personally appear before the Charging Subcommittee and informally present relevant evidence for it to consider.²⁰ After this presentation, the Charging Subcommittee deliberates and votes on whether a rule violation may have occurred. If the Charging Subcommittee concludes that a rule

¹⁸ ICE Futures Disciplinary Rule 21.03(b).

¹⁹ ICE Futures Disciplinary Rule 21.03(d).

²⁰ During a Charging Subcommittee meeting, Compliance will present its investigation report, and any written material provided by the Respondent, ex parte. The Charging Subcommittee will then determine if a reasonable basis exists that a rule violation may have occurred. If the Charging Subcommittee determines that a rule violation may have occurred, and the Respondent has elected to appear before the Charging Subcommittee, the Respondent is then called before the Charging Subcommittee and given the opportunity to present relevant evidence for it to consider.

violation may have occurred, it will ask Compliance for a recommendation of sanctions. After receiving this recommendation, the Charging Subcommittee can then refer the matter to Compliance staff with further instructions, enter into or approve a settlement agreement with the Respondent,²¹ or order that a Notice of Charges be issued by Compliance and refer the matter to a Hearing Subcommittee.²²

C. Notice of Charges and Answer.

A Notice of Charges must set forth the alleged rule violations. Within 20 days of the service of the Notice of Charges, the Respondent must prepare a written answer and request a formal hearing, via a Hearing Subcommittee.²³ The answer must expressly deny each allegation contained in the Notice of Charges. Any allegation that is not specifically denied will be deemed admitted by the Respondent pursuant to Exchange rules.²⁴ In addition, the failure to request a hearing within the 20 day period will be deemed a waiver of the Respondent's right to such a hearing.²⁵

D. Hearing Subcommittee Procedures.

A Hearing Subcommittee is selected by the Chairman of the BCC from the members of the BCC that did not review the written investigation report.²⁶ The panel will consist of either three or five members at the discretion of the Chairman.²⁷ ICE Futures rules require that at least one member of a Hearing Subcommittee be a "public committee member".²⁸ The Compliance

²¹ The settlement agreement may (subject to certain limitations) provide for penalties other than those recommended by Compliance staff.

²² ICE Futures Disciplinary Rule 21.03(e)(i)-(iii).

²³ ICE Futures Disciplinary Rule 21.06(a).

²⁴ ICE Futures Disciplinary Rule 21.06(c).

²⁵ ICE Futures Disciplinary Rule 21.06(d).

²⁶ ICE Futures Disciplinary Rule 21.08(a).

²⁷ ICE Futures Disciplinary Rule 21.08(a)(i)-(ii).

²⁸ ICE Futures Disciplinary Rule 21.08(a). See also ICE Futures Disciplinary Rule 21.00(e). A "public committee member" is an individual who would qualify as a public director, as that term is defined in Appendix B(15)(b)(2)(i) and (ii) of Part 38 of the CFTC Regulations.

staff and the Respondent are required to deliver to each other and the Exchange's Office of the General Counsel a statement listing the witnesses expected to be called at the hearing and the documents expected to be introduced into evidence, together with copies of such documents, by such date prior to the hearing as the Hearing Subcommittee may specify.²⁹ The Respondent is entitled to representation of his/her choosing before the panel.³⁰ No formal rules of evidence apply, and the Hearing Subcommittee is free to accept or reject any and all evidence it considers appropriate.³¹

E. Written Decision of Hearing Subcommittee.

The Hearing Subcommittee will issue a written decision after the conclusion of the hearing, setting forth its findings and, where it concludes that violations were committed, imposing sanctions. It may impose the sanctions described in the second paragraph of Section F. below.³² The decision of the Hearing Subcommittee constitutes the final decision of the Exchange, and becomes effective 15 days (or such longer time as the Hearing Subcommittee may specify) after a copy of the written decision of the Hearing Subcommittee is served on the Respondent.³³ The decision is not subject to appeal within the Exchange unless the sanction imposed is expulsion.³⁴ An order of expulsion contained in the decision of a Hearing Subcommittee may be appealed to the Appeals Committee of the Exchange pursuant to the procedures set forth in Exchange Disciplinary Rule 21.15.

²⁹ ICE Futures Disciplinary Rule 21.12(c).

³⁰ ICE Futures Disciplinary Rule 21.12(b).

³¹ ICE Futures Disciplinary Rule 21.12(d).

³² ICE Futures Disciplinary Rule 21.13(b)(v).

³³ ICE Futures Disciplinary Rule 21.16(b).

³⁴ ICE Futures Disciplinary Rule 21.15(a).

Pursuant to CFTC Regulation 9.11(a), all disciplinary actions, other than summary actions relating to decorum and attire, are reported to the National Futures Association within 30 days of the action becoming final.

F. Settlement Agreements.

Finally, ICE Futures disciplinary matters may also be resolved through settlement agreements reached at various stages of the disciplinary process. In matters not yet referred to the BCC, the Compliance Department may enter into written settlement agreements including, among other sanctions, fines of up to \$10,000 for each rule violation alleged, voluntary suspension of up to three months for each rule violation alleged, and expulsion. Any written settlement agreement with the Compliance Department shall be subject to the prior approval of a subcommittee of the BCC.³⁵ In any case in which the Compliance Department concludes that a member may have violated a rule involving the execution of, or the failure to execute, a customer transaction, the Compliance Department shall make a specific finding on whether the customer may have incurred any financial harm as a result of the violation, and may enter into a settlement agreement whereby the member agrees to make restitution to the customer, in addition to other potential sanctions.

In matters referred to the BCC, Exchange rules authorize a Charging Subcommittee to enter into a settlement agreement including a range of sanctions against a Respondent (with or without the Respondent admitting guilt). These sanctions include: a cease and desist order or a reprimand; a fine of up to \$100,000 per rule violation, plus the monetary value of any benefit received as a result of the alleged violation; a voluntary suspension of up to one year for each violation alleged; expulsion; a prohibition against executing customer orders; as part of a suspension or expulsion, a prohibition against being employed by another member as a floor

³⁵ ICE Futures Disciplinary Rule 21.02(d)(ii).

employee; and/or restitution to a customer for any financial harm resulting from the violation(s).³⁶ In the case of a non-member market participant, a settlement agreement may provide for the issuance of an order denying future access, directly or indirectly, to any Exchange markets for a specified period of time, and directing members to deny such access to the non-member market participant in accordance with the terms of such order.³⁷ If the Charging Subcommittee recommends issuance of a Notice of Charges, or the Respondent declines the terms of the settlement offered by the Charging Subcommittee, a Notice of Charges will be issued by the Compliance Department. Lastly, prior to the commencement of a hearing, a Hearing Subcommittee may approve the entry into a settlement agreement with the Respondent similar to those that may be reached by a Charging Subcommittee, with or without the Respondent admitting guilt.³⁸

After a Notice of Charges has been issued, a respondent may propose a settlement agreement to the Hearing Subcommittee. While the Compliance Department may negotiate a settlement after the Notice of Charges has been issued, the ultimate authority to approve a settlement agreement, following the issuance of charges, rests with the Hearing Subcommittee rather than the Compliance Department. The Hearing Subcommittee may accept a settlement agreement proposed by a respondent irrespective of whether Compliance supports the terms of the settlement. Nonetheless, whenever a respondent proposes a settlement agreement, Compliance staff will advise the Charging Subcommittee or Hearing Subcommittee, as applicable, whether Compliance supports or opposes the proposal.

G. Findings and Recommendations Regarding Exchange Recordkeeping Practices For Disciplinary Actions.

³⁶ ICE Futures Disciplinary Rule 21.03(e)(iv).

³⁷ ICE Futures Disciplinary Rule 21.03(e)(iv)(7).

³⁸ ICE Futures Disciplinary Rule 21.11.

As noted above, the Compliance Department advises Charging and Hearing Subcommittees regarding its support or opposition to settlement offers proposed by respondents. However, while the investigation files and disciplinary committee minutes provided by the Exchange and reviewed by the Division include occasional references to Compliance's recommendations, these materials do not provide a complete and formalized record of Compliance's recommendations regarding settlement agreements and the basis for these recommendations.

The investigation materials for case # 2009-016 demonstrate a related gap in Exchange recordkeeping. The materials do not explain why Compliance recommended to a Hearing Subcommittee a lesser sanction than the one Compliance recommended at an earlier stage of the investigation. This case involved a floor broker and his clerk who mishandled a customer order. Compliance determined that the broker and/or clerk stamped a blank order ticket, generated a fictitious order ticket, and/or destroyed a customer order ticket in an attempt to clear a customer order to the broker's account. The Notice of Charges issued by Compliance requests an order suspending the respondent for no less than three years.³⁹ The Charging Subcommittee proposed a suspension of one year. The case was ultimately resolved by a Hearing Subcommittee. The Compliance Department recommended to the Hearing Subcommittee, and the Hearing Subcommittee approved, a suspension of only six weeks via a settlement agreement.⁴⁰

The minutes of the Hearing Subcommittee do not sufficiently explain why the Compliance Department, which had previously recommended in the Notice of Charges that the respondent be suspended for no less than three years, determined that a six week suspension was

³⁹ The Notice of Charges issued by Compliance also requests an order directing the respondent to pay a fine of up to \$100,000 for each violation of Exchange rules.

⁴⁰ The settlement agreement also provided for a fine of \$50,000, the same amount proposed by the Charging Subcommittee in this case.

appropriate when the case was ultimately presented to the Hearing Subcommittee. The minutes state that the Compliance Department recommended the six week suspension for the following reason: “Basis [sic] his previously clean record, the Market Regulation Department agreed to reduce the time of the suspension.” In response to an inquiry by the Division regarding this case, however, the Exchange clarified that the Compliance Department also recommended the shorter suspension because evidentiary issues had recently arisen (including the availability of witnesses relevant to the matter) that presented significant trial risk. These evidentiary issues are not described in the Hearing Subcommittee minutes.

The Division makes the following recommendations in order to ensure that the Exchange sufficiently documents the recommendations made by Compliance and, in the event that Compliance recommends a lesser sanction to a Subcommittee than Compliance recommended at an earlier stage of the investigation or disciplinary process, the reasons why Compliance recommends such lesser sanction.

- **The Exchange keep formal written records or disciplinary committee minutes of any recommendation made by Compliance to a Charging Subcommittee or a Hearing Subcommittee regarding a settlement offer, and the basis for Compliance’s recommendation.**
- **If Compliance recommends a lesser sanction to a Subcommittee than Compliance recommended at an earlier stage of the investigation or disciplinary process, the Exchange’s written records or disciplinary committee minutes should fully explain the reasons why Compliance determined the lesser sanction is now appropriate.**

The Division’s final comments regarding the Exchange’s recordkeeping practices arise from the Division’s requests for documentation from the Exchange. The Division made an initial request for documentation from the Exchange in connection with this rule enforcement review, followed by a second request for all documentation produced between the date the

determination was made to send a case to the BCC and the date of the execution of a final settlement agreement. The Division's second request included an enumerated list of requested documents. The Exchange indicated that this additional documentation was not immediately available in the Exchange's records. The Exchange subsequently compiled and provided the requested documentation, although the documentation was not organized by case number.

The Division believes that, at a minimum, the Exchange should maintain easily accessible and organizable records of all email and other written correspondence between the Exchange and each respondent and/or its counsel. These records represent a subset of the documents enumerated in the Division's second request. During the November 20 exit conference, Exchange officials indicated that the Exchange does maintain easily accessible and organizable records of all email and other written correspondence between the Exchange and each respondent and/or its counsel; the other documents requested by the Division, however, were not easily accessible and organizable. Although the Division is not making a recommendation regarding the Exchange's recordkeeping practices in response to the Division's second document request, the Division reiterates its expectation that the Exchange will continue to maintain easily accessible and organizable records of all email and other written correspondence between the Exchange and each respondent and/or its counsel. The Division will evaluate the Exchange's recordkeeping practices in this regard as part of its next rule enforcement review.

VII. Conflicts of Interest; Composition of Charging Subcommittees and Hearing Subcommittees

Consistent with the acceptable practices for DCM Core Principle 16 (*Conflicts of Interest*),⁴¹ ICE Futures rules require that a “public committee member”⁴² sit on both the Charging Subcommittee and on the Hearing Subcommittee for a matter.⁴³ Exchange rules also require that both Charging Subcommittees and Hearing Subcommittees are composed of members who represent a diversity of futures industry products and business interests.⁴⁴

ICE Futures also employs procedures designed to identify and minimize potential conflicts of interest involving specific disciplinary matters. The Exchange obtains relevant background information regarding BCC members when they are first considered for appointment to the BCC, and when they are considered for appointment to either a Charging Subcommittee or a Hearing Subcommittee for a particular case. It also educates BCC members on the Exchange’s conflict of interest rules and policies.

A. Background Information on BCC Members.

After new members are initially appointed to the BCC, Compliance staff obtains relevant background information to assist staff in identifying potential conflicts of interest when constituting Charging Subcommittees or Hearing Subcommittees to hear particular cases. New BCC members are also informed that they should immediately update the Exchange if there are any significant changes to the background information previously furnished, such as a change of employer or an affiliation with a new market participant. Compliance staff periodically review membership records of Exchange members serving on the BCC to ensure that up-to-date background information has been filed. Non-Exchange members appointed to the BCC are

⁴¹ See §5(d)(16) of the Act.

⁴² See ICE Futures Disciplinary Rule 21.00(e). A “public committee member” is an individual who would qualify as a public director, as that term is defined in Appendix B(15)(b)(2)(i) and (ii) of Part 38 of the CFTC Regulations.

⁴³ ICE Futures Disciplinary Rules 21.03(b) and 21.08(a).

⁴⁴ Id.

asked to submit a CV both when they are appointed and on an annual basis. This information is used to update their background information and to identify potential conflicts of interest.

B. Explanation of Conflicts Policies to BCC Members.

Compliance staff explains the Exchange's conflict of interest policy to new BCC members as part of their orientation. Specifically, staff reviews Exchange Regulatory Requirement 6.05 ("Requirement 6.05") with each new BCC member. This requirement provides that no committee member may participate in deliberations or voting if such member: (i) is a named party in interest; (ii) is an employer, employee, fellow employee or guarantor of a named party in interest; (iii) is associated with a named party in interest through a broker association; (iv) has a family relationship with a named party in interest; or (v) has any other significant, ongoing business relationship with a named party in interest, excluding relationships limited to executing futures or options transactions opposite each other or to clearing futures or options transactions through the same clearing member. In addition to the foregoing, Compliance staff advises new BCC members that they should recuse themselves and not participate in any matter as to which they believe they cannot act fairly or impartially due to a relationship or circumstance not identified above. Periodically, Compliance staff summarizes Requirement 6.05 and the Exchange's conflict of interest policies at the beginning of a Charging Subcommittee meeting as a reminder for committee members.

C. Consideration of Conflicts During Charging Subcommittee Selection Process.

Prior to the selection of a Charging Subcommittee, senior Compliance staff identifies the relevant respondents who are the subjects of the investigation report(s) being presented for review by the Charging Subcommittee. Staff then examines the known background and relationships of all BCC members to determine if there are possible conflicts of interest with the

identified respondents. BCC members who appear to have a conflict of interest under Requirement 6.05, or who may otherwise have a known relationship that suggests they may be unable to act fairly or impartially, are eliminated from the selection process.

After compiling a list of eligible BCC members, senior Compliance staff contacts the Chairman of the BCC. In accordance with Exchange Disciplinary Rule 21.03, the Chairman selects four Exchange members or employees of Exchange members and three non-Exchange members, at least one of whom must qualify as a public committee member, for service on the Charging Subcommittee.

Charging Subcommittee members are provided with the investigation report(s) for the matters they will be reviewing one week prior to the scheduled meeting. This allows the Charging Subcommittee members time to review the investigation report(s) and inform Compliance staff if any potential conflict of interest exists that could not have been discerned from the information previously reported or otherwise available to Compliance. Any BCC member with a conflict of interest under Requirement 6.05, or who is otherwise unable to act fairly or impartially, is removed by staff from the Charging Subcommittee.

D. Consideration of Conflicts During Hearing Subcommittee Selection Process.

The General Counsel's Office initially determines the BCC members who are eligible to be selected by the Chairman for service on a Hearing Subcommittee. Any BCC members who served on the Charging Subcommittee that received or reviewed the investigation report that was the basis for the Notice of Charges are not eligible to serve on the Hearing Subcommittee and are eliminated. The General Counsel's Office examines the known background of the remaining eligible BCC members for possible conflicts of interest with the respondent(s) and advises the

BCC Chairman of the names of the members who are eligible to serve on the Hearing Subcommittee.

In accordance with Exchange Disciplinary Rule 21.08, the BCC Chairman appoints a three or five-person Hearing Subcommittee from the list of eligible BCC members. If a three-person panel is appointed (which is typically the case), the BCC Chairman selects two individuals who are members or employees of member firms, and one individual who qualifies as a public committee member. If a five-person panel is appointed, the BCC Chairman selects four individuals who are members or employees of member firms, and one individual who qualifies as a public committee member.

The General Counsel's Office subsequently contacts the BCC members selected to serve on the Hearing Subcommittee to address and rule out any potential conflict of interest. Any BCC member appointed to a Hearing Subcommittee with a conflict of interest under Requirement 6.05, or who is otherwise unable to act fairly or impartially, is removed and replaced.

Once a conflict-free Hearing Subcommittee is established, the Exchange provides the respondent(s) with the names and relevant background information of the BCC members who will be serving on the Hearing Subcommittee. If a respondent identifies a member with a conflict of interest, the respondent may object to that member's appointment and move to have the member replaced on the Hearing Subcommittee. The BCC Chairman determines whether or not such a replacement is warranted.⁴⁵

During the target period, Compliance staff identified potential conflicts of interest with respect to five individuals that were being considered for appointment to a Charging Subcommittee or Hearing Subcommittee. None of the five individuals were appointed to the

⁴⁵ ICE Futures Disciplinary Rule 21.09.

Subcommittee for which they were being considered. Compliance staff did not receive any requests from a respondent to remove an individual that had already been appointed to a Subcommittee due to an alleged conflict of interest.

VIII. Adequacy of Disciplinary Sanctions

A. Total Number of Disciplinary Cases and Respondents; Origin of Cases.

The Division reviewed 25 disciplinary cases in connection with this rule enforcement review, including all 20 disciplinary cases closed during the target period and an additional five cases closed after the target period.⁴⁶ The Compliance Department referred eight of the 25 cases to the BCC before the beginning of the target period,⁴⁷ 15 during the target period,⁴⁸ and two after the end of the target period.⁴⁹ All of the investigations related to the 25 cases were opened by the Compliance Department before the beginning of the target period.

The 25 cases involve 28 separate respondents (i.e., some cases involve multiple respondents).⁵⁰ Twenty cases were closed (with respect to 22 respondents) during the target period.⁵¹ Five cases were closed (with respect to eight respondents) after the end of the target period.⁵² Of the 25 cases reviewed, two were referred to a Hearing Subcommittee.⁵³ All of the cases reviewed by the Division were ultimately resolved pursuant to settlement agreements, with

⁴⁶ The Division's initiating letter requested disciplinary case files for all cases closed during the target period. The Exchange provided case files for each of the cases closed during the target period (20 cases). The Exchange also provided case files for five cases that were closed after the end of the target period. The Division considered all 25 case files provided by the Exchange in connection with this rule enforcement review, regardless of whether the cases were closed during or after the target period.

⁴⁷ Case #s 2007-018, 2007-022, 2007-096, 2008-069, 2009-016, 2009-071, 2010-044 and 2010-059.

⁴⁸ Case #s 2008-047, 2009-006, 2009-014, 2009-033, 2009-038, 2009-064, 2010-007A, 2010-018, 2010-023, 2010-038, 2010-046, 2010-056, 2010-060, 2011-018 and 2011-032.

⁴⁹ Case #s 2010-071 and 2011-003.

⁵⁰ Case #s 2009-006, 2009-014, 2009-038 and 2011-032 involved multiple respondents. In addition, one institution was a respondent in multiple case #s (2007-018, 2007-022 and 2008-069).

⁵¹ Case #s 2007-018, 2007-022, 2007-096, 2008-047, 2008-069, 2009-006 (two respondents), 2009-016, 2009-033, 2009-064, 2009-071, 2010-007A, 2010-018, 2010-023, 2010-038, 2010-044, 2010-056, 2010-059, 2010-060, 2011-018, and 2011-032 (two respondents).

⁵² Case #s 2009-014 (three respondents), 2009-038 (two respondents), 2010-046, 2010-071 and 2011-003. Note that the same institution was a respondent in case #s 2007-018, 2007-022, and 2008-069.

⁵³ Case #s 2009-014 (one respondent) and 2009-016.

the exception of one case⁵⁴ that was resolved by a unilateral decision of a Hearing Subcommittee, because the respondent did not file an answer to the charges.

Of the 25 cases reviewed: 19 were Exchange-generated;⁵⁵ three originated from self-reporting; two originated from a member complaint; and one originated through a customer complaint. Five of the 25 cases originated from open outcry trading activity; 15 originated from electronic trading activity; two originated from combined open outcry and electronic trading activity; and three⁵⁶ originated from activity unrelated to a trading venue.

B. Aggregate Fines, Customer Restitution, Expulsions and Other Sanctions.

ICE Futures assessed a total of \$1,469,450 in fines against 25 respondents; fines ranged from \$2,500 to \$400,000. To date, \$999,000.00 of this amount has been collected.⁵⁷ Fines were not assessed in two of the cases reviewed. A cease and desist order was issued in connection with one of the cases in which a fine was not assessed, and the respondent was expelled in connection with the other case, in lieu of a fine being assessed.⁵⁸

ICE Futures also assessed a total of \$20,867.50 in customer restitution against three respondents in connection with three cases.⁵⁹ Three separate customers were intended

⁵⁴ Case # 2009-014 (one respondent).

⁵⁵ Of these 19 cases: 15 resulted from a review of Exchange exception reports, including: cross-trades, wash trades, pre-arranged trades, block trades, spread trades, extended trades, and cleared trades; two were referred by the Exchange's Market Surveillance Department (2010-044 (reporting of inaccurate position and open interest data) and 2010-071 (maintaining a position in excess of a single-month limit)); one originated from a referral from the Exchange's Market Supervision Department (2009-006 (failure to report accurate position and open interest data)); and one originated from a review of Exchange financial data (2011-032 (failure to notify Exchange of a deficit account balance)).

⁵⁶ Case #s 2010-071 (speculative limit review); 2011-018 (ICE Clear US referral of an apparent failure to timely notify the Exchange and submit financial reports); and 2011-032 (self-reporting regarding deficit account balances).

⁵⁷ Fines assessed by the Exchange were either partially paid or not paid by respondents in the following case #s: 2009-006 (partial payment; the respondent's membership privileges were suspended due to non-payment); 2009-014 (non-payment; a respondent did not file an answer to the notice of charges, and was fined \$400,000 and expelled pursuant to a unilateral decision of a Hearing Subcommittee); and 2009-033 (non-payment; the respondent was expelled due to non-payment).

⁵⁸ Fines were not assessed in case #s 2007-096 (a cease and desist order was issued) and 2010-059 (respondent was expelled).

⁵⁹ Case #s 2009-038, 2009-014 (one respondent) and 2009-033. In addition, restitution to the Exchange of \$288,498.74 was assessed in case # 2010-060, as discussed below. This amount has been paid.

beneficiaries of the restitution assessed in these three cases. To date, one of these respondents has paid the restitution assessed (\$187.50),⁶⁰ while the other two respondents have not paid the restitution assessed (\$1,250 and \$19,430). The restitution of \$1,250 was assessed against a respondent that was also fined \$400,000 and expelled in connection with a unilateral decision by a Hearing Subcommittee (“Expelled Respondent #1”).⁶¹ The restitution of \$19,430 was assessed against a respondent who was originally suspended, and subsequently expelled due to non-payment of fines and restitution assessed by the Exchange (“Expelled Respondent #2”).⁶²

ICE Futures suspended a total of four respondents (including Expelled Respondent #2), for periods ranging from six weeks to one year.⁶³ Three respondents were expelled by the Exchange, including Expelled Respondent #1 and Expelled Respondent #2.⁶⁴

The Exchange also issued two warning letters (both in case #2008-047) for recordkeeping violations. One warning letter was issued to an individual broker, and the other to his firm.⁶⁵ It also issued a total of 23 cease and desist orders in the 25 disciplinary cases reviewed by Division staff, each of which was issued in connection with a settlement agreement.

C. Notable Disciplinary Cases During the Target Period.

⁶⁰ Case # 2009-038.

⁶¹ Case # 2009-014 (one of three respondents).

⁶² Case # 2009-033.

⁶³ The following case #s resulted in suspensions: 2009-006 (150 day suspension); 2009-014 (one year suspension); 2009-016 (six week suspension, discussed in section VI(G) above); and 2009-033 (nine month suspension). Note that there were three respondents in case # 2009-014. One was suspended, one was expelled (Expelled Respondent #1), and one was only fined.

⁶⁴ The respondents in case #s 2009-014 (one respondent, Expelled Respondent #1), 2009-033 (Expelled Respondent #2) and 2010-059 were expelled.

⁶⁵ Case # 2008-047 arose from a routine Exchange review of the cross trade report in the Cocoa market for the month of January 2008. The floor broker involved was alleged to have violated the Exchange cross trade rules. Based on the Exchange staff’s review, the broker failed to indicate the bracket period and the time of a cross trade on a trading card, and removed a quantity on a trading card. The Exchange issued a warning letter to the broker. In connection with its review, Exchange staff also reviewed all order tickets of the broker’s firm for Cocoa options for the same trade date (January 16, 2008). Staff determined that the broker’s firm did not meet Exchange record keeping standards, because it failed to include a unique account identifier on order tickets linking them to a specific customer. Consequently, the Exchange also issued a warning letter to the broker’s firm.

Expulsion of Respondents. As discussed above, three respondents were expelled by the Exchange. The case involving one of the expelled respondents (Expelled Respondent #1) is discussed in the following paragraph.⁶⁶ Another respondent (Expelled Respondent #2) was originally suspended and subsequently expelled, due to non-payment of fines and restitution assessed by the Exchange.⁶⁷ The case involving the third expelled respondent (#2010-059) arose from a referral from an Exchange member firm. The respondent in #2010-059 was alleged to have used the log-in identification assigned to another user to gain unauthorized access to an electronic trading system, and to have made frivolous bids and offers and executed fictitious sales and pre-arranged trades, among other violations. The respondent agreed to expulsion from the Exchange pursuant to a settlement agreement with a Charging Subcommittee. The expulsion was effective on December 14, 2010.⁶⁸

Largest Fines Assessed. Case # 2009-014 involved three natural person respondents, and arose from a member complaint. The cases with respect to two of the respondents were resolved pursuant to settlement agreements. A Notice of Charges was issued against the third respondent (Expelled Respondent #1), which alleged violations of various Exchange rules, including that the respondent executed non-competitive pre-arranged trades, sold option contracts for his personal account while holding an executable customer sell order for the same commodity, and withheld an order from the market for the convenience of himself or another Exchange member, among other violations. The respondent did not file an answer to the Notice of Charges or request a hearing within the requisite period, and was therefore deemed to have

⁶⁶ Case # 2009-014 (one of three respondents).

⁶⁷ Case # 2009-033.

⁶⁸ The CFTC filed a civil enforcement action against the respondent in #2010-059 on October 18, 2012. The CFTC complaint charges the respondent with engaging in prearranged and fictitious transactions in violation of the Commodity Exchange Act and trading non-competitively in violation of a CFTC regulation. The complaint also charges the respondent with making false statements about these transactions to representatives of ICE Futures US.

admitted all allegations contained in the Notice of Charges. Consistent with the recommendations in the Notice of Charges, a Hearing Subcommittee unilaterally determined that the respondent should be required to pay a fine of \$400,000 and customer restitution of \$1,250, and be expelled from Exchange membership. This was the largest fine assessed by the Exchange in connection with the 25 cases reviewed by Division staff.

Case # 2009-006 involved two respondents, one an institution and the other a natural person. The case arose from a referral by the Exchange's Market Supervision Department.⁶⁹ The institutional respondent was alleged to have failed to report accurate position and open interest data, and to have facilitated pre-arranged trades, among other violations. Pursuant to a settlement agreement with a Charging Subcommittee, the institutional respondent agreed to pay a \$300,000 fine. This was the second-largest fine assessed by the Exchange in connection with the 25 cases reviewed by Division staff.

The Two Cases Referred to Hearing Subcommittee. As discussed above, the case involving Expelled Respondent #1 (2009-014) was referred to a Hearing Subcommittee, because the respondent did not file an answer to the Notice of Charges or request a hearing within the requisite period. Case # 2009-016, the only other case reviewed that was referred to a Hearing Subcommittee, arose from a customer complaint. The case involved a floor broker (the case respondent) and his clerk who mishandled a customer order. Compliance determined that the broker and/or clerk stamped a blank order ticket, generated a fictitious order ticket, and/or

⁶⁹ The Exchange's Market Supervision Department ("MSD"), which is separate from the Market Regulation Department, is responsible for monitoring (on a real-time basis) all trades electronically executed on the Exchange. MSD is able to view all trading activities, including an order book displaying all order information, a deal book displaying all transactions, and the users and clearing members from both the buyer's and seller's perspective for any given Exchange contract. Additionally, MSD has the ability and responsibility to force users and clearing members off the system, kill individual orders, send out market notifications, and resolve error trades when necessary and/or appropriate under Exchange rules. MSD refers potential violations of Exchange rules to the Compliance Department for follow-up investigations and possible disciplinary action.

destroyed a customer order ticket in an attempt to clear a customer order to the broker's account. The Notice of Charges issued by Compliance requests an order suspending the respondent for no less than three years. The Charging Subcommittee offered a settlement that required the respondent to receive a one year suspension of his membership and agree to pay a fine of \$50,000. The respondent did not accept the offer of settlement, and asked to refer the matter to a Hearing Subcommittee. The Compliance Department recommended to the Hearing Subcommittee, and the Hearing Subcommittee approved, a revised settlement that required the respondent to receive a six week suspension of his membership and agree to pay a fine of \$50,000. Section VI(G) above discusses a Division recommendation related to this case.⁷⁰

Insufficient Exchange Investigation. Case # 2010-060 was initiated by Compliance after a review of the Exchange's cross wash-prearranged trade report disclosed several instances of potential wash trading by two employee traders of the respondent's firm during the period March-August 2010. The employees executed wash trades for the purpose of inflating the firm's monthly trading volume. By inflating the monthly trading volume, the employees were able to qualify the firm for rebates that were available through one of the Exchange's incentive programs. Due to the wash sales, the respondent firm received a total rebate that was \$288,498.74 more than the firm should have received for the period between March-August 2010.

The respondent firm approached the Exchange during the course of the investigation and requested a settlement. Although Compliance had requested to interview the employee traders that had engaged in wash trading, Compliance made the decision not to interview the employees because the respondent firm acknowledged the rule violations and offered to settle. The

⁷⁰ See page 18 for the relevant recommendation.

respondent firm negotiated a settlement agreement that was executed on February 15, 2011, whereby the respondent firm agreed to pay a \$100,000 fine. The respondent firm also reimbursed to the Exchange the \$288,498.74 excess rebate that the firm received for the period between March-August 2010.

Subsequent to execution of the settlement agreement in case # 2010-060, the Division learned that the wash trading activity by the respondent firm and its employee traders was more coordinated than the Exchange's limited investigation revealed. For example, the employees conducted the wash trading through a computer program developed within the firm at the direction of the firm's management. The Exchange's investigation report does not indicate that the Exchange uncovered the existence of this computer program during its investigation. The Division believes that if the Exchange had interviewed the employee traders, the Exchange may have uncovered the existence of the wash trading computer program and interviewed the in-house developers of the program. In turn, the Exchange may have uncovered the degree of coordination between developers, traders and firm management in orchestrating the wash trading activity. The Division therefore recommends the following:

- **In cases of violative conduct by employees of a firm with trading privileges on the Exchange, the Exchange should conduct thorough interviews with relevant employees to determine: which employees were involved in the violative conduct; the nature of their involvement; the extent of management's knowledge; and the degree, if any, of coordination between the employees and management. The Exchange should enter into settlement negotiations only once it has interviewed all relevant employees and conducted a thorough investigation.**

The goal of this recommendation is twofold: (a) to ensure, to the extent possible, that the Exchange identifies all instances of violative conduct by the respondent and/or its employees before entering into settlement negotiations; and (b) to avoid allowing the respondent to drive the negotiations by offering to settle quickly in the hope of preventing the Exchange from

uncovering other violative conduct. In this regard, the Division believes that the sanctions issued by the Exchange against the respondent firm in case # 2010-60 were insufficient in light of the facts now known, particularly the degree of coordination exercised within the firm to execute its wash trading strategy. Had the Exchange conducted a more complete investigation, as recommended above, and therefore taken cognizance of the coordination between developers, traders and firm management, the Division would have expected a more substantial fine than the \$100,000 that was issued.

Although the Exchange stated in the settlement agreement with the respondent firm that its employees had, on multiple occasions, executed wash trades and engaged in conduct detrimental to the best interests of the Exchange, the Exchange did not bring charges against these employees. The Exchange sanctioned only the respondent firm. The Exchange indicated that it did not bring charges against the employees because they were not members of the Exchange; the Exchange therefore concluded that it did not have jurisdiction over the employees.⁷¹

D. Sanctioning Employees Engaging in Violative Conduct—Jurisdictional Issues.

The 25 cases reviewed include a number of examples (including case # 2010-060, discussed in the preceding section) in which the Exchange determined that employees of a respondent firm engaged in violative conduct, but the Exchange sanctioned only the firm, and

⁷¹ As further discussed in the following section, the Exchange instituted Exchange Trading Rule 4.00 in response to §38.151(a) of the Act, which was implemented in July 2012 pursuant to the requirements of Dodd-Frank. Exchange Trading Rule 4.00 was made effective on August 20, 2012, following the end of the target period. In light of the Exchange's adoption of this Exchange Trading Rule, in the future the Division would expect the Exchange to exercise jurisdiction over firm employees in a similar type of case. The full text of Exchange Trading Rule 4.00 appears below.

Rule 4.00. Compliance with Rules and Consent to 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.

did not also pursue sanctions against the employees.⁷² For example, in case # 2010-038, the Exchange determined that, on multiple occasions, one or more employees of the respondent firm executed pre-arranged wash trades and engaged in conduct detrimental to the best interests of the Exchange. In case # 2010-023, the Exchange determined that an employee of the respondent firm executed pre-arranged trades on 16 occasions. In both case # 2010-038 and case # 2010-023, the Exchange sanctioned the respondent firm via a settlement agreement, but did not also pursue sanctions against the employee(s) that engaged in violative conduct. When asked by the Division to explain this practice, the Exchange indicated that it previously did not pursue sanctions against employees that are not members of the Exchange, on the theory that the Exchange lacked jurisdiction over such employees.

The Division believes that in the future, if the Exchange determines that one or more employees of a firm with Exchange trading privileges may have engaged in violative conduct, the Exchange should rely on newly adopted Exchange Trading Rule 4.00 to assert jurisdiction over such employees and take appropriate disciplinary action. If the employees refuse to participate in the investigation or disciplinary process, the Exchange should deny the employees access to the Exchange (or require their firm to deny them access), and refer the matter to the Commission.

IX. Timeliness of Disciplinary Case Resolution⁷³

Completion of Investigation Report to the BCC. The Exchange's records indicate that the average length of time between the date each investigation was completed and the date the

⁷² Case #s 2007-018, 2007-022, 2007-096, 2008-069, 2009-064, 2009-071, 2010-007A, 2010-038, 2010-046, 2010-056, 2010-060, and 2011-003.

⁷³ For purposes of Section VIII, each case number involving multiple respondents is treated as a single case (resulting in a total of 25 cases). The calculations in this Section IX, however, were performed separately with respect to each of the respondents, in order to accurately measure the time required to reach a settlement agreement with each party.

respondent's case was referred to the BCC was approximately 103 days. The shortest and longest amount of time between the date an investigation was completed and the date the respondent's case was referred to the BCC was three days and 407 days, respectively.

BCC to Settlement Agreement. All of the cases reviewed by the Division were ultimately resolved pursuant to settlement agreements, with the exception of one case⁷⁴ that was resolved by a unilateral decision of a Hearing Subcommittee, because the respondent did not file an answer to the charges. The Exchange's records indicate that the average length of time between the date each respondent's case was referred to the BCC and the execution of a settlement agreement was approximately 77 days. The shortest and longest amount of time between the date a respondent's case was referred to the BCC and the execution of a settlement agreement was seven days and 376 days, respectively.⁷⁵

Completion of Investigation Report to Settlement Agreement. Consolidating the preceding statistics, the average length of time between the date each investigation was completed and the execution of a settlement agreement was approximately 179 days. The shortest and longest amount of time between the date an investigation was completed and the execution of a settlement agreement was 24 days and 455 days, respectively.

Two cases, in which the respondents were alleged to have engaged in prohibited pre-execution communications, each took a total of 455 days between the date the investigation was completed and the execution of a settlement agreement.⁷⁶ Each case took 407 days between the completion of the investigation report and the referral of the case to the BCC, and 48 days between the referral of the case to the BCC and the execution of a settlement agreement. The

⁷⁴ Case # 2009-014 (one respondent, Expelled Respondent #1).

⁷⁵ Case #2009-016 took 376 days. This case was referred by the Charging Subcommittee to a Hearing Subcommittee.

⁷⁶ Case #s 2007-018 and 2007-022.

two cases are part of a group of five related cases. The two cases took an extended time to resolve because they were the first investigations in this group of five to be initiated by the Compliance Department (in September 2009), and were consolidated with related investigations that emerged later. The majority of the cases in this group of five related cases were simultaneously referred to the BCC on October 13, 2010.

The Exchange produced a log listing the date each investigation was completed by the Compliance Department, which allowed the Division to calculate the dates above. However, the investigation reports (“IRs”) produced by the Exchange frequently did not include the date on which the completed IRs were approved by senior Compliance staff. As a consequence, the Division could not independently confirm how much time elapsed between final approval of a completed IR by senior staff, and the date the case was referred to the BCC.

The Division believes that the date on which an IR is approved as final by senior Compliance staff is necessary to determine whether responsibility for any delays in processing a disciplinary case rests with the Compliance Department or the BCC. Improved recordkeeping will allow Division staff to independently determine whether any untimely disciplinary cases were caused by Compliance’s failure to refer a completed IR to the BCC on a timely basis or the BCC’s failure to schedule a Charging Subcommittee meeting promptly after receiving a referral from the Compliance Department. Accordingly, the Division recommends the following:

- **The Exchange should record the date in investigation reports on which the reports are approved by senior Compliance staff.**

Notably, the Division made this same recommendation in its prior rule enforcement review of the Exchange. The recommendation has not been adequately implemented in the interim.

Finally, Division staff encourages the Exchange to reduce the time required to resolve disciplinary cases. In particular, in light of the fact that the average length of time between the date each investigation was completed and the date the respondent's case was referred to the BCC was approximately 103 days, the Division recommends the following:

- **The Exchange should reduce the average time between the completion of an investigation report and the referral of the case to the BCC.**