

UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION

In the Matter of

Interactive Brokers LLC,

Respondent.

: CFTC Docket No. 07-07
:
: **ORDER INSTITUTING PROCEEDINGS**
: **PURSUANT TO SECTIONS 6(c) AND 6(d)**
: **OF THE COMMODITY EXCHANGE ACT**
: **AS AMENDED, AND MAKING FINDINGS**
: **AND IMPOSING REMEDIAL SANCTIONS**

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I.

The Commodity Futures Trading Commission (the "Commission") has reason to believe that Interactive Brokers LLC ("IBL"), a registered futures commission merchant ("FCM"), has violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2006). Therefore, the Commission deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether IBL has engaged in the violation set forth herein, and to determine whether an order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, IBL has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Without admitting or denying the findings of fact and conclusions of law in this Order, IBL acknowledges service of this Order, consents to the use of the findings in the Order in this proceeding and any other proceeding brought by the Commission or to which the Commission is a party.¹

III.

The Commission finds the following:

A. Summary

Between February 2003 through May 2005 (the "relevant period"), Kevin J. Steele ("Steele"), a Canadian citizen residing in Vancouver, British Columbia, used a commodity interest account maintained in his own name and carried by IBL, a registered FCM, to engage in

¹ IBL does not consent to the use of the Offer or this Order, or the findings to which it has consented in its Offer, as the sole basis for any other proceeding brought by the Commission other than a proceeding to enforce the terms of this Order. IBL does not consent to the use of the Offer or this Order, or the findings to which it has consented in its Offer, by any other party in this or any other proceeding. The findings made in this Order are not binding on any other person or entity named as a defendant or respondent in any other proceeding.

commodity pool fraud that defrauded Canadian, German and United States citizens of approximately \$8.1 million, unbeknownst to IBL.² None of the \$7.7 million deposited into Steele's IBL trading account were his own funds, and all deposits were wire transfers from third parties. Steele lost approximately \$4.3 million of the pool participants' funds trading, and he misappropriated at least \$3.1 million of their funds.

During the relevant period, IBL failed to supervise diligently its compliance employees' handling of the Steele account. IBL failed to respond adequately to warning signs that Steele was acting as an unregistered commodity pool operator ("CPO") and engaging in commodity pool fraud through the account he maintained at IBL. As a registered FCM, IBL is required to supervise diligently the handling by its employees of all commodity interest accounts carried by it. In failing to do so, IBL violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2006).

B. Respondent

Interactive Brokers LLC is a Connecticut limited liability company that maintains its principal business address at One Pickwick Plaza, Suite 200, Greenwich, Connecticut. IBL has been registered with the Commission as an FCM since December 2, 1994.

C. Facts

1. IBL's Procedures Allowed the Firm to Accept Third Party Checks and Wire Transfers.

IBL is an electronic, discount, on-line brokerage firm. Its customers direct their own trading, place their own orders and transmit those orders to IBL via the internet from their personal computers. On December 16, 2002, Steele opened his IBL commodity interest trading account electronically and, in account opening documents, represented that his account was a personal account and that "all funds sent to [IBL] for deposit into Customer's account belong to Customer." At that time, Steele represented that he was self-employed as a trader and that his liquid net worth was \$175,000.

From February 2003 through May 2005, Steele's account received 135 deposits, all of which were wire transfers from third parties totaling approximately \$7.7 million. Of the approximately 135 wire deposits, approximately 80 came from an entity named Abriel Asset Management ("Abriel"), 12 came from an entity named Custom House Currency Exchange ("Custom House"), and 43 came from 18 individuals, other than Steele, located in Canada, Germany and the United States.

IBL's procedure for acceptance of wire deposits required the account holder to complete and electronically transmit a deposit notification form, which gave the firm advance notice that a

² On May 25, 2005, the Commission filed an injunctive complaint against Steele in the U.S. District Court for the Northern District of Illinois, Case No. 05 C 3130. The complaint alleged, *inter alia*, that Steele had acted as an unregistered commodity pool operator and had engaged in pool fraud. On November 22, 2005, the court granted the Commission's Motion for a Default Judgment, entered a permanent injunction and, granted other ancillary relief, including \$7,409,194.75 in restitution and a civil monetary penalty of \$6.2 million.

wire deposit would be transmitted and specified the amount of the wire deposit. Once the wire deposit was received and the amount of the deposit matched the amount specified on the deposit notification form, IBL credited the deposit to the customer's account. Thus, during the relevant period, IBL's procedures permitted the firm to accept third party deposits in the form of wire transfers and checks and the firm did not have procedures reasonably designed to detect the deposit of third-party funds in an individual trading account at the time of Steele's fraud.

Over the life of his account, Steele lost approximately \$4.3 million trading and misappropriated approximately \$3.1 million of pool participants' monies by transferring funds from his IBL account into his personal bank account or by requesting that IBL issue checks to him. IBL's policy permitting the acceptance of third party wire deposits during the relevant period left the firm vulnerable to the possibility that an accountholder, such as Steele, may be acting as an unregistered CPO and engaging in commodity pool fraud through his IBL account.

2. Account Activity in Steele's IBL Trading Account

The frequency and magnitude of deposits and withdrawals to Steele's account, relative to his stated net worth, and the pattern of deposits followed by withdrawals were indicia suggesting that Steele might be operating as an unregistered CPO. On his account opening documents, Steele declared his liquid net worth to be \$175,000 and thereafter, he told IBL compliance staff that it had increased to \$300,000. During the first year Steele's account traded (February 2003 through March 2004), his account received third party deposits totaling over \$580,000, had withdrawals of approximately \$150,000, and sustained trading losses of approximately \$240,000. The foregoing account activity was an early warning signal that Steele may have been pooling funds of third parties. When confronted with this early warning signal, IBL compliance staff contacted Steele on three occasions, but never sought to contact the originators of any of the transfers into Steele's account.

During the entire relevant period, Steele's account had over 200 withdrawals totaling approximately \$3.4 million. Withdrawals ranged in size from \$1,000 to \$100,000. There were many instances where both wire deposits and withdrawals were made on the same day or a few days apart.

During the relevant time period, Steele's trading account received third party deposits totaling approximately \$7.7 million. A review of deposits and withdrawals from Steele's trading account indicates that by January 2005, Steele was typically depositing over \$100,000 per week and withdrawing approximately half of his weekly deposits in \$25,000 increments. For example, from January 2005 through May 2005, Steele deposited approximately \$4 million and withdrew approximately \$1.8 million. By at least early 2005, IBL's compliance procedures should have detected the possibility that Steele was pooling funds of third parties.

3. IBL's Contact with Steele

As noted earlier, during the relevant period, IBL compliance staff telephoned Steele on at least three occasions to inquire about the large number of withdrawals and deposits into his account, and because the firm's internal surveillance program identified Steele's account as an

account with losses in excess of Steele's net worth. On all of those occasions, IBL compliance employees accepted Steele's explanations as reasonable, without conducting any additional inquiry to independently verify the reason Steele systematically deposited monies in excess of his net worth and thereafter withdrew a large portion of those funds.

Each time an IBL compliance employee contacted Steele, IBL compliance staff reviewed the wire transfer documents for Steele's account, which detailed the source of funds into Steele's trading account. However, once Steele related to IBL staff that his income was derived from real estate transactions, IBL's compliance officer believed that no additional inquiry was required to ascertain why all of the funds deposited into Steele's trading account were from third parties. By the end of August 2004, Abriel, a third party, had wire transferred approximately \$1.3 million into Steele's account. Nevertheless, during the relevant period, IBL's compliance staff never asked Steele to explain his relationship to Abriel, to provide documentation confirming his relationship to Abriel, or to explain why Abriel was systematically transferring large sums of money into Steele's trading account.

Steele's trading account lost approximately \$1.9 million trading commodity futures from May 1, 2005 through May 19, 2005. Nevertheless, IBL compliance staff never contacted Steele during that time to determine how an individual with a liquid net worth of \$300,000 could sustain such massive trading losses.

D. Legal Discussion

Commission Regulation 166.3 imposes on each registrant (except an associated person who has no supervisory duties) an affirmative duty to "diligently supervise the handling by its ... employees and agents ... of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its ... employees and agents ... relating to its business as a Commission registrant." A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary. *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997); *In re First National Trading Corp.* [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142 at 41,786 (CFTC July 20, 1994), *aff'd without op.*, *Pick v. CFTC*, 99 F.3d 1139 (6th Cir. 1996); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 n.11 (CFTC August 11, 1992), *aff'd in part and rev'd in part sub nom.*, *Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993); and *In re Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC April 1, 1992).

For a registrant to fulfill its duty under Regulation 166.3, it must have both an adequate program of supervision and ensure that the program is followed. *In re GNP Commodities*, ¶ 25,360 at 39,219. A showing that a registrant lacks an adequate supervisory system can be sufficient to establish a violation of Regulation 166.3. *In re First National Trading Corp.*, ¶ 26,142 at 41,786. The lack of an adequate supervisory system can be established by showing that the registrant failed to develop proper procedures for the detection of wrongdoing. *CFTC v. Trinity Financial Group Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,179 at 45,635 (S.D. Fla. 1997), *aff'd in relevant part and vacated in part sub nom.*, *Sidoti v. CFTC*, 178 F.3d 1132 (11th Cir. 1999). IBL lacked an adequate supervisory system.

IBL failed to ensure that the firm had an adequate compliance system. As noted above, IBL failed to ensure that it knew the source of funds coming into Steele's account at the time those funds were received. The ability to determine if funds in customer accounts are coming from someone other than the accountholder is a necessary part of an adequate supervisory system. If an FCM fails to monitor the source of funds being deposited into customer accounts at the time such funds are received, its ability to detect illegal activity such as pool fraud or money laundering is impaired. IBL's procedures for determining the source of funds received through wire transfers were inadequate to meet its supervisory responsibilities.

Moreover, IBL's compliance officer and staff failed to recognize the problems in the firm's procedures even when they were confronted with "red flags" such as the numerous deposits and withdrawals into Steele's account, which far exceeded his net worth. While IBL's compliance personnel reviewed wire transfer documents for Steele's account prior to each telephone call to Steele, IBL failed to respond adequately to the warning signs of possible pool activity. By at least early 2005, IBL's compliance procedures should have detected the possibility that Steele was pooling funds of third parties.

IV.

OFFER OF SETTLEMENT

IBL has submitted an Offer of Settlement in which it acknowledges service of this Order and admits the jurisdiction of the Commission with respect to the matters set forth in the Order and waives: 1) the service and filing of a complaint and notice of hearing, 2) a hearing and all post-hearing procedures, 3) judicial review by any court, 4) any objection to the staff's participation in the Commission's consideration of the Offer, 5) all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000) and part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1, *et seq.* (2006), relating to, or arising from this action, and 6) any claim of double jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief.

IBL stipulates that the record basis on which this Order is entered consists of this Order and the findings in this Order consented to in the Offer. IBL consents to the Commission's issuance of this Order, which makes findings as set forth herein and orders that IBL: 1) cease and desist from violating Commission Regulation 166.3, 17 C.F.R. § 166.3 (2006); 2) disgorge \$175,000 in commissions earned by IBL from Steele's account and pay those funds to defrauded investors; and 3) comply with its undertaking as set forth in the Offer and incorporated in this Order.

V.

FINDINGS OF VIOLATIONS

Solely on the basis of IBL's consent, as evidenced by its Offer, and prior to any adjudication on the merits, the Commission finds that IBL violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2006).

VI.

ORDER

Accordingly, **IT IS HEREBY ORDERED THAT:**

- A. IBL shall cease and desist from violating Commission Regulation 166.3, 17 C.F.R. § 166.3 (2006);
- B. IBL shall disgorge \$175,000 ("Disgorgement Amount") in commissions earned by IBL from Steele's account. Within 10 business days from the date of entry of this Order, IBL shall pay the Disgorgement Amount to the Clerk of the Provincial Court of British Columbia, in care of Sandra Scott, Court Administrator, Provincial Court of British Columbia, Box 328, 415 Broadway Street, Nakusp, British Columbia VOG1RO, who will distribute the Disgorgement Amount to defrauded investors, pursuant to the court's ruling in *R. v. Steele*, 2006 BCPC 305, Nakusp Registry No. 3735 (June 19, 2006). IBL shall provide evidence of its payment of the Disgorgement Amount to the Director, Division of Enforcement, and the Office of Cooperative Enforcement, Division of Enforcement, at Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581;
- C. IBL shall comply with its undertaking set forth in the Offer that neither IBL, nor any of its agents or employees under its authority or control, shall take any action or make any public statement denying, directly or indirectly, any finding 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 IBL's (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party; and IBL shall take all steps necessary to ensure that its agents or employees, if any, understand and comply with this undertaking.

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

By the Commission:



Eileen Donovan
Acting Secretary to the Commission
Commodity Futures Trading Commission

Dated: July 17, 2007