

III.

The Commission finds the following:

A. SUMMARY

Throughout the period from June 2010 through at least January 2014 (the “relevant period”), Newedge, a Futures Commission Merchant (“FCM”) registered with the Commission, acting through its agents, officers and employees, including certain account representatives, executed and confirmed the execution of, and reported to the Chicago Mercantile Exchange (“CME”) and Chicago Board of Trade (“CBOT”) numerous exchange of futures for physical transactions (“EFPs”)² in agricultural and soft commodities for and on behalf of its clients that are, are of the character of, or are commonly known as wash sales. These trades were for the same contract, quantity and same or similar price with the buyer and seller for each EFP under the same common control and ownership. Moreover, the trades were executed under circumstances where certain Newedge account representatives either knew that clients desired to net out futures positions across commonly owned and controlled accounts through the use of EFPs, or else failed to inquire why clients were routinely on both sides of the EFPs.

By this conduct, Newedge executed and confirmed the execution of wash trades in violation of Section 4c(a) of the Act. Moreover, because the EFPs were not done in accordance with the written rules of the CME and CBOT, they were not bona fide EFPs, and, therefore, Newedge caused prices to be reported, registered or recorded that were not true and bona fide prices, also in violation of Section 4c(a) of the Act. Further, by accepting and transmitting EFP orders that were not executed openly and competitively pursuant to exchange rules, but in a manner that avoided market risk and price competition that legitimate, competitive trading entails, Newedge executed noncompetitive trades for customers in violation of Commission Regulation 1.38(a).

During the relevant period, Newedge also failed to supervise diligently its employees’ handling of the transactions at issue and failed to have adequate policies and procedures designed to detect and deter the execution of wash EFP trades, in violation of Regulation 166.3.

In accepting Newedge’s Offer, the Commission recognizes Respondent’s cooperation during this investigation and corrective action taken to address the conduct and improve its supervisory systems and internal controls in order to detect and deter the improper use and mishandling of wash EFPs.

² An EFP is a privately negotiated transaction involving a simultaneous exchange of an exchange futures position for a corresponding cash position at a price difference mutually agreed upon – *i.e.*, one party buys the physical commodity and simultaneously sells (or gives up a long) futures contract while the other party sells the physical commodity and simultaneously buys (or receives a long) futures contract. *See* “Report on Exchanges of Futures for Physicals,” Division of Trading and Markets, Commodity Futures Trading Commission, October 1, 1987 at 13.

B. RESPONDENT

SG Americas Securities, LLC (“SGAS”) is a financial services firm based in New York and is registered as an FCM with the Commission. Effective January 2, 2015, SGAS merged with Newedge USA, LLC, a registered futures commission merchant, and SGAS was the surviving entity.

C. FACTS

Throughout the relevant period, Newedge, acting through its agents, officers and employees, including certain agricultural commodity account representatives, knowingly accepted, executed and confirmed the execution of EFP transactions for and on behalf of its clients that are, are of the character of, or are commonly known as wash sales. These trades were for the same contract, quantity and same or similar price. In addition, in each instance, it was the same beneficial owner or controller that was on both sides of the transaction. The clients entered into the EFPs with the intent to negate market risk and price competition and the transactions produced a financial nullity for the clients.

Newedge also reported the pricing of the futures side of those wash trades to the CME or CBOT and designated the trades as bona fide EFPs. The client who owned and controlled both sides of the transaction selected the price at which the EFP was done. On many occasions the futures price reported to the exchange was outside the day’s trading range.

With respect to one client, a Newedge account representative executed, confirmed, and reported the execution of wash EFP trades to the CBOT where the client held its long and short futures positions in separate accounts. The client owned and controlled both accounts. The client, in consultation with the Newedge account representative, routinely offset its short positions by its long positions prior to each of the annual delivery periods by executing an EFP. The Newedge account representative knew the client owned and controlled both trading accounts and knew the terms of the EFPs – *i.e.*, the contract, quantity and price.

In numerous other instances where other Newedge account representatives executed, confirmed, and reported the execution of wash EFPs trades to the exchange for clients, the Newedge account representatives either knew that the clients’ intention was to negate market risk and price competition or failed to inquire why the same controller or owner was on both sides of the transactions, or to note that the EFPs were at the same contract, quantity and price resulting in wash trades.

Prior to 2014, Newedge’s supervisory systems and internal controls were not adequate to detect and deter the processing and confirmation of wash sales designated as EFPs. Newedge did not have adequate internal controls, or policies and procedures addressing EFPs and the indicia of potential unlawful EFPs, including potential wash sales. Instead, Newedge relied upon its account representatives to independently react to and identify any potential EFPs by Newedge clients that might be improper or unlawful. Newedge also failed to adequately train its employees involved in the execution, confirmation and reporting of EFPs in understanding the requirements for executing bona fide EFPs.

As a result of these supervisory failures, for at least three and a half years, Newedge did not detect the noncompetitive execution of the futures contracts and improper designation of wash trades as EFPs. In 2014, after the CFTC Division of Enforcement began its investigation, Newedge implemented new policies and procedures intended to detect and prevent the execution of unlawful wash EFPs.

IV.

LEGAL DISCUSSION

A. Newedge Confirmed the Execution of Wash EFPs in Violation of Section 4c(a)

EFPs that are equal and offsetting in quantity and price, where the same entity, or beneficial owner or controller is on both sides of the transactions, constitute “wash sales” within the meaning of Section 4c(a) of the Act. *In re Noble Americas Corp.*, CFTC Docket No. 10-12, 2010 WL 1803817 (CFTC May 3, 2010) (Consent order).

Section 4c(a) of the Act makes it “unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction” that “is, is of the character of, or is commonly known to the trade as, a ‘wash sale’” 7 U.S.C. § 6c(a)(1)-(2) (2012). A wash sale is a form of fictitious transaction. *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. rep. (CCH) 24,213 at 35,003 (CFTC Apr. 14, 1988), *aff’d as to liability*, 872 F.2d 196 (7th Cir. 1989); *In re Goldwurm*, 7 A.D. 265, 274 (CEA 1948). Wash sales are harmful, in part, because they create illusory price movements in the market. *See Wilson v. CFTC*, 322 F.3d 555, 559 (8th Cir. 2003); *Reddy v. CFTC*, 191 F.3d 109, 115 (2d Cir. 1999). *See also CFTC v. Savage*, 611 F.2d 270, 284 (9th Cir. 1980) (wash sales may mislead market participants because they do not reflect the forces of supply and demand); *In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) 28,276 at 50,691 (CFTC Sep. 29, 2000) (wash sales are “grave” violations, even in the absence of customer harm or appreciable market effect, because “they undermine confidence in the market mechanism that underlies price discovery.”)

The liability of the customer initiating the wash sale depends upon evidence demonstrating that the customer intended to negate market risk or price competition. *Id.* at ¶ 50,685. Similarly, the liability of a participant in the wash sale requires a showing that the participant knew, at the time he chose to participate in the transaction, that the transaction was designed to achieve a wash result in a manner that negated risk. *In re Bear Sterns & Co.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,994 at 37,665 (CFTC Jan. 25, 1991). An account representative’s intent to knowingly participate in a wash sale may be inferred from his failure to undertake a reasonable inquiry in the face of facts suggesting his customer intended to avoid a bona fide market position. *In re Three Eight Corporation*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,749 at 40,445 (CFTC June 16, 1993). The fact that the same entity, or beneficial owner or controller, was on both sides of an EFP, standing alone, suggests an intent to avoid a price competition and market risk. Likewise, the fact that the EFP is for the same contract, quantity and same or similar price – *i.e.*, a wash result – reflects an intent to avoid market risk and price competition. An account representative’s failure to undertake an inquiry into the legitimacy of the EFP in the face of such facts can support an inference of knowing participation in wash sales. *Id.*

“Just as a customer has a duty not to initiate transactions with an intent to avoid a bona fide market position, . . . an FCM has a duty not to accept such orders and transmit them to the trading floor.” *Id.*, ¶ 25,749 at 40,445. Therefore, “[a] broker is responsible for evaluating the orders he receives for indications that his participation in the transaction is legally prohibited.” *Id.*; see also *Piasio*, ¶ 28,276 at 50,689 (an account executive has a duty to inquire about a customer’s intent when he receives simultaneous orders to buy and sell the same spread).

Here, Newedge, through the acts of account representatives and others, knowingly executed and confirmed the execution of wash EFP transactions for clients in agricultural and soft commodities where the buyer and seller for each EFP was under the same common control and/or ownership.³ By engaging in these wash EFPs, Newedge clients were able to avoid price competition and market risk. Accordingly, Newedge violated Section 4c(a) of the Act.

B. Newedge Caused Prices to be Reported, Registered, or Recorded at Non-Bona Fide Prices in Violation of Section 4c(a)

Section 4c(a) of the Act also makes it unlawful to offer to enter into, enter into, or confirm the execution of a commodity futures transaction that “is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price.” 7 U.S.C. § 6c(a) (2012).

Congress’ intent in enacting Section 4c(a) was to “ensure that all trades are focused in the centralized marketplace to participate in the competitive determination of the price of futures contracts.” *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,742 (CFTC Dec. 10, 1997) (quoting S. Rep. No. 93-1131, at 16-17 (1974)). In other words, Section 4c(a) was meant to “prevent collusive trades conducted away from the trading pits,” *Merrill Lynch Futures, Inc. v. Kelly*, 585 F. Supp. 1245, 1251 n.3 (S.D.N.Y. 1984), and “to outlaw insofar as possible all schemes of trading that are artificial and not the result of arms-length trading on the basis of supply and demand factors,” *In re Goldwurm*, 7 Agric. Dec. 265, 276 (1948). Here, Newedge reported prices to the exchanges that were determined off-exchange by a single person or entity that controlled both sides of the wash EFP transactions.

Even though an individual EFP, when executed between independent parties, results in the actual transfer of the cash commodity, and is supported by proper documentation, may be privately negotiated “ex pit” at any commercially reasonable price agreeable to the counterparties, a wash EFP is a non-bona fide transaction in violation of Regulation 1.38(a),

³ EFPs are a subset of transactions known as Exchange for Related Positions (“EFRPs”). CME and CBOT exchange rules set out the requirements for bona-fide EFRPs. With respect to who may be parties to a EFRP, the exchange require that the opposing accounts to an EFRP transaction must be (a) independently controlled accounts with different beneficial ownership; or (b) independently controlled accounts of separate legal entities with common beneficial ownership; or (c) independently controlled accounts of the same legal entity, provided that the account controllers operate in separate business units; or (d) commonly controlled accounts of separate legal entities provided that the separate legal entities have different beneficial ownership. For EFRP transactions between accounts with common beneficial ownership, the parties to the trade must be able to demonstrate the independent control of the accounts and that the transaction had economic substance for each party to the trade. See CME, CBOT, NYMEX & COMEX Market Regulatory Advisory Notice, (Rule 538) CME Group RA1006-5 (June 11, 2010).

thereby making the prices reported for such transactions also non-bona fide. *See In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993, at 37,653 (CFTC Jan. 25, 1991) (finding non-bona fide price in violation of Section 4c(a) of the Act where trades were non-bona fide in violation of Regulation 1.38). In fact, the prices reported on unlawfully executed noncompetitive trades are non-bona fide even if they accurately reflect the prices agreed upon by the parties and the current price for similar contracts traded on exchange. *Id.* In this case, because the EFPs were non bona fide, Newedge violated Section 4c(a) when it reported non-bona fide prices for the futures side of the wash EFPs to the CME and CBOT.

C. Newedge Violated Regulation 1.38(a)

Generally, Commission Regulation 1.38(a) requires that all purchases and sales of commodity futures be executed “openly and competitively.” This general requirement, however, “shall not apply to transactions which are executed noncompetitively in accordance with written rules of the contract market . . . specifically providing for the noncompetitive execution of such transactions.” EFPs are non-competitive off-exchange transactions. CME and CBOT Rule 538 only permits “Exchanges for Related Positions” – of which EFPs are a sub-set – under certain conditions. EFPs are permissible only if they are between two independent parties and involve privately negotiated and simultaneous exchange of a futures position for a corresponding and offsetting cash physical position. If a noncompetitive trade does not qualify for an exception to this exchange rule, it violates Regulation 1.38(a). *Williams v. Lind-Waldock & Co.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,111 at 45,237, 1997 WL 381248 (CFTC July 10, 1997); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360, at 39,217 (CFTC Aug. 11, 1992), *aff’d sub nom. Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993).

As explained, *supra*, Newedge, through its account representatives and others, processed and confirmed the execution of wash EFPs that did not meet the exchange requirements for noncompetitive trades. Therefore, Newedge violated Regulation 1.38(a).

D. Newedge Is Liable for Its Employees’ Acts and Omissions

The foregoing acts, omissions, and failures of Newedge’s account representatives and other employees occurred within the scope of their employment, office, or agency with Newedge; therefore, pursuant to Section 2(a)(1)(B) of the Act, as amended, 7 U.S.C. § 2(a)(1)(B), and Regulation 1.2, 17 C.F.R. § 1.2 (2015), Newedge is liable for those acts, omissions, and failures in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2006), and Commission Regulation 1.38, 17 C.F.R. § 1.38 (2015).

E. Newedge Lacked an Adequate Supervisory System and Compliance Programs to Detect and Deter Wash EFPs in Violation of Regulation 166.3

Commission Regulation 166.3 imposes on registrants an affirmative duty to supervise their partners, employees and agents diligently by establishing, implementing and executing adequate supervisory structures and compliance programs. “The duty to supervise . . . include[s] the broader goals of detection and deterrence of possible wrongdoing by [a registrant’s] agents.” *Lobb v. J.T. McKerr & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,568, at 33,444 (CFTC Dec. 14, 1989). “In appropriate circumstances, a showing that the registrant

lacks an adequate supervisory system can be sufficient to establish a breach of duty under Rule 166.3.” See *In re Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) 27,194 at 45,744 (CFTC Dec. 10, 1997). A violation under Commission Regulation 166.3 is an independent violation for which no underlying violation is necessary. *Id.*; see also *In re Paragon Futures Association*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,266 at 38,850 (CFTC Apr. 1, 1992). There is no requirement to charge an underlying violation of the Act. *In re First National Trading Corporation*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,142 at 41,786 (CFTC July 20, 1994) (“In appropriate circumstances, proof of an independent substantive violation is not a necessary element to establish a breach of the duty imposed by Rule 166.3.”), *aff’d without op.*, *Pick v. CFTC*, No. 95-3761, 99 F.3d 1139 (6th Cir. Oct. 26, 1996).

A violation of Regulation 166.3 is demonstrated by showing either that: (1) the registrant’s supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *In re Murlas Commodities*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485, at 43,161 (CFTC Sept. 1, 1995); *In re GNP Commodities, Inc.*, ¶ 25,360, at 39,219 (providing that, even if an adequate supervisory system is in place, Regulation 166.3 can still be violated if the supervisory system is not diligently administered); *Samson Refining Co. v. Drexel Burnham Lambert, Inc.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,596, at 36,566 (CFTC Feb. 16, 1990) (noting that, under Regulation 166.3, an FCM has a “duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents”) (internal quotation omitted). 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. *In re Paragon Futures Assoc.*, ¶ 25,266 at 38,850.

During the relevant period, Newedge lacked adequate internal controls and procedures to verify the validity of EFPs before they were cleared and reported to the CME and CBOT. Newedge also lacked adequate procedures and surveillance systems to identify trades incorrectly or improperly designated as EFPs. Finally, Newedge failed to provide adequate training to its employees who participated in the execution or processing of EFPs regarding the requirements for bona fide EFPs. As a result, Newedge failed to detect numerous wash EFPs between commonly owned and controlled client accounts.

Accordingly, Newedge failed to supervise its employees diligently, in violation of Commission Regulation 166.3.

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, during the Relevant Period, Newedge violated Section 4c(a) of the Act, 7 U.S.C. § 6c(a), and Regulations 1.38 and 166.3, 17 C.F.R. §§ 1.38 and 166.3 (2015).

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. §§ 148.1-30 (2015), 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, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), 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 4c(a) of the Act, 7 U.S.C. § 6c(a), and Regulations 1.38 and 166.3, 17 C.F.R. §§ 1.38 and 166.3 (2015);

2. Orders Respondent to cease and desist from violating Section 4c(a)(1) of the Act, 7 U.S.C. § 6c(a)(1), and Regulations 1.38 and 166.3, 17 C.F.R. §§ 1.38 and 166.3 (2015);
3. Orders Respondent to pay a civil monetary penalty in the amount of seven hundred fifty thousand dollars (\$750,000), plus post-judgment interest; and
4. Orders Respondent and their successors and assigns to comply with the conditions and undertakings 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 4c(a) of the Act, 7 U.S.C. § 6c(a) (2012), and Regulations 1.38 and 166.3, 17 C.F.R. §§ 1.38 and 166.3 (2015);
- B. Respondent pay a civil monetary penalty in the amount of seven hundred fifty thousand dollars (\$750,000), within ten (10) days of the date of entry of this Order (the “CMP Obligation”). 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 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:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Accounts Receivables
DOT/FAA/MMAC/AMZ-341
CFTC/CPSC/SEC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
(405) 954-7262 office
(405) 954-1620 fax
nikki.gibson@faa.gov

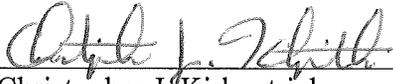
If payment is to be made by electronic funds transfer, Respondent shall contact Nikki Gibson or her successor at the above address to receive payment instructions and shall

fully comply with those instructions. Respondent(s) 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. Remediation: Respondent will continue to implement and improve its internal controls and procedures in a manner reasonably designed to detect potential wash EFP transactions submitted by clients. Specifically, Respondent undertakes to implement policies, procedures and training programs reasonably designed to prevent the execution, clearing and reporting to an exchange of non-bona fide EFPs.
 2. Compliance with Remediation Undertaking: Respondent shall submit a report to the Commission, through the Division of Enforcement, within 180 days, explaining how it has complied with the Remediation Undertaking set forth above in C.1. The report shall describe the internal controls, policies and procedures that have been designed and implemented to satisfy the Remediation Undertaking, along with a report on the status of the remediation efforts, completeness and quality assurance controls. The report shall contain a certification from a representative of Respondent's Executive Management that Respondent has complied with the Remediation Undertaking set forth above, and that it has established policies, procedures, and controls to satisfy the Remediation Undertaking set forth in the Order.
 3. Public Statements: Respondent agrees that neither it nor any of its successors or 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.
- D. 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 its 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.

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: September 28, 2016