

III.

FINDINGS

The Commission finds the following:

A. Summary

At various points from July 2005 through May 2008 (the “relevant period”), RCG failed to supervise diligently its employees’ handling of accounts held at RCG in the name of George D. Hudgins (“Hudgins”). In particular, RCG’s employees failed to enforce diligently RCG’s compliance procedures that required them to obtain certain customer information, *i.e.*, information about Hudgins’ identity, background, investment objectives, source of income, assets and other relevant information, after receiving certain warning signs. In addition, RCG’s employees failed to comply with RCG’s compliance procedures that required them to investigate and report activity regarding Hudgins’ accounts that they should have recognized as suspicious. During the period in question, RCG and its guaranteed introducing broker (“GIB”), together, received hundreds of thousands of dollars in commissions from Hudgins’ trading.

By not following its internal compliance procedures with respect to Hudgins’ accounts, RCG did not diligently supervise the handling by its employees of the commodity interest accounts it carried in Hudgins’ name in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2010).

B. Respondent

Rosenthal Collins Group, L.L.C. is an Illinois limited liability company formed on October 10, 1998 (as a successor to a limited partnership formed on February 22, 1974), with its principal place of business at 216 West Jackson Boulevard, Suite 400, Chicago, Illinois. RCG and/or its predecessors have been registered with the Commission as an FCM since January 1, 1979.

C. Facts

1. **The Hudgins Action**

RCG’s violations concerning its employees’ handling of the Hudgins’ accounts² came to light after the Commission filed a four-count complaint for injunctive relief on May 13, 2008 against Hudgins, d/b/a George D. Hudgins, L.L.C., for violating certain anti-fraud and registration provisions of

² In approximately December 2003, an introducing broker (“IB”) introduced Hudgins to RCG, where Hudgins opened the first of several trading accounts in his own name carried at RCG. On July 3, 2006, the IB became a GIB of RCG.

the Commodity Exchange Act (“Act”) and Regulations.³ That action concluded in a *Consent Final Order of Permanent Injunction, Civil Monetary Penalty And Other Equitable Relief* (“Consent Order”) entered by Judge Leonard Davis, Eastern District of Texas (“District Court”), on April 2, 2009.⁴ The Consent Order stated that from June 2001 through May 2008, Hudgins fraudulently induced members of the public to invest approximately \$88 million in a commodity pool that traded on-exchange commodity futures (“futures”) and options on futures (“options”) contracts in commodity trading accounts at RCG.

2. RCG Failed To Supervise Diligently Its Employees’ Handling Of Hudgins’ Accounts

a. Hudgins Made Key Assertions To RCG Regarding His Financial Profile

At the time that Hudgins opened his first RCG account, he executed RCG’s “account opening documents” and submitted them to RCG’s new accounts unit. On these documents, Hudgins stated, among other things, that he: had an annual income of over \$1 million, a net worth of \$5 to \$10 million, and \$3.9 million in bank and trading accounts; was trading solely for himself; had 15 years trading experience; and the money in his accounts was his own funds.

b. Hudgins’ Wiring and Trading Activity, Including His Significant Losses, Contradicted His Key Assertions In His Account Opening Documents

RCG’s compliance procedures impose on its employees a continuing duty to “know their customer,” *i.e.*, to obtain information about their customer’s identity, background, investment objectives, source of income, assets and other relevant information, especially when certain warning signs existed.

Through the course of Hudgins’ trading at RCG, the money flowing into and out of his accounts increased significantly. By way of example, for year 2004 Hudgins deposited into his RCG accounts approximately \$1.6 million. Thereafter, however, for years 2005, 2006, 2007 and 2008 Hudgins deposited into his RCG accounts more than \$9.8 million, \$10.1 million, \$8.6 million and \$6.1 million, respectively. These amounts, when taken together, vastly exceeded Hudgins’ stated annual income (\$1 million), net worth (\$5 to \$10 million), and cash in bank and trading accounts (\$3.9 million) as originally disclosed in Hudgins’ account-opening documents.

Simultaneously, Hudgins significantly increased his trading in his RCG accounts while he suffered substantial trading losses. By way of example, for years 2005, 2006, 2007 and 2008, Hudgins lost more than \$9.4 million, \$11.1 million, \$5 million and \$3 million, respectively, in his RCG accounts, for a total of \$30 million in losses by May 2008. These losses represented 300% of his original stated

³ See *CFTC v. George Hudgins, et al.*, Case No. 6:08cv187 (E.D. Tex. filed May 13, 2008) (Commission’s complaint charging Hudgins with violations of the anti-fraud provisions and registration requirements of the Act and Regulations) (hereinafter, the “Hudgins Litigation”).

⁴ The Consent Order, among other things, imposed restitution in the amount of approximately \$71 million, and a \$15 million civil monetary penalty.

net worth. Yet, notwithstanding his large trading losses, Hudgins had a noticeable disregard for those losses.

Despite these warning signs, RCG's employees failed to take diligent steps to ensure that they "knew" Hudgins.⁵

c. RCG's Employees Failed To Follow-Up on Numerous Red Flags Regarding Hudgins' Accounts

RCG's compliance procedures require that its employees immediately report to RCG's Compliance Department "any suspicious money transfers, non-economic transactions, and other activity outside of the ordinary course of business." Pursuant to RCG's compliance procedures, some of the "red flags" that may be indicative of suspicious activity in a customer's account include situations when "a customer has sudden, excessive wire activity into and out of his account" and/or "a customer exhibits a noticeable lack of regard for amount of commissions, profitability of trades, or level of fees."

After an RCG employee reports suspicious activity, RCG's compliance procedure requires that RCG's Compliance Department document, investigate and evaluate in writing all reports and, as appropriate, file a Suspicious Activity Report ("SAR") with regulatory authorities or law enforcement officials.

Despite the red flags in Hudgins' accounts, RCG's employees failed to follow-up by investigating those red flags and reporting the results to the appropriate authorities.

d. RCG and Its GIB Received Commissions From Hudgins

During the relevant period, RCG and its GIB, together, received hundreds of thousands of dollars in commissions from Hudgins' trading.

D. Legal Discussion

Regulation 166.3 requires that every Commission registrant (except Associated Persons who have no supervisory duties) must diligently supervise the handling of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents relating to its business as a Commission registrant. 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). A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary. *See, In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997).

⁵ When Hudgins opened a new account in 2006, he declared to RCG on a new account form that his net worth was \$10 million or greater and his annual income exceeded \$1 million. The GIB also reported to RCG certain information it said that it had obtained about Hudgins' financial circumstances.

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 Paragon Futures Assoc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 at 38,850 (CFTC Apr. 1, 1992) (“The focus of any proceeding to determine whether Rule 166.3 has been violated will be on whether [a] review [has] occurred and, if it did, whether it was diligent”). This is a fact intensive undertaking. *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 (CFTC Aug. 11, 1992) (“a proper determination of a FCM's supervisory diligence must remain sensitive to the particular facts and circumstances that influenced the design and execution of the system at issue”), *aff'd in part and rev'd in part sub nom. Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993).

Under Regulation 166.3, an FCM not only has a “duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents,” *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) (quoting *Lobb v. J.T. McKerr & Co.*, ¶ 24,568 at 36,444), but must ensure that these procedures are diligently administered. *GNP Commodities, Inc.*, ¶ 25,360 at 39,219 (even if an adequate supervisory system is in place, Regulation 166.3 can still be violated if the supervisory system is not diligently administered). 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. *Paragon Futures*, ¶ 25,266 at 38,850.

The evidence establishes that during the relevant period, RCG failed to supervise diligently the handling of Hudgins' accounts by its employees when they took insufficient action to obtain information about Hudgins' identity, background, investment objectives, source of income and assets and other relevant information notwithstanding that Hudgins lost \$30 million trading futures and options (for which losses he never showed appropriate concern) and deposited and/or wired over \$36 million in his RCG accounts, that vastly exceeded the net worth and annual income that Hudgins asserted in the RCG account opening documents. Further, RCG failed to diligently supervise its employees' handling of the Hudgins' accounts when they failed to investigate these suspicious activities regarding Hudgins' RCG accounts and report the results to the appropriate authorities.

By not following its internal compliance procedures with respect to Hudgins' accounts, RCG did not diligently supervise the handling by its employees of the commodity interest accounts it carried in Hudgins' name in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2010).

IV.

FINDINGS OF VIOLATIONS

Based on the foregoing, the Commission finds that RCG violated Regulation 166.3, 17 C.F.R. § 166.3 (2010).

V.

OFFER OF SETTLEMENT

RCG has submitted the Offer in which it acknowledges service of this Order, admits the jurisdiction of the Commission with respect to all matters set forth in this Order and 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 (2006) and 28 U.S.C. § 2412 (2006), and/or Part 148 of the Regulations, 17 C.F.R. §§ 148.1-30 (2010), 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 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.

RCG stipulates that the record basis on which this Order is entered consists solely of this Order and the findings in this Order to which RCG consented in its Offer. RCG consents to the Commission's issuance of this Order, which makes findings as set forth herein and orders that RCG and its successors and assigns (1) cease and desist from violating Regulation 166.3, 17 C.F.R. § 166.3 (2010); (2) pay a civil monetary penalty in the amount of seven hundred eighty thousand dollars (\$780,000), plus post-judgment interest, within ten (10) days of the date of the entry of this Order; and (3) comply with its undertakings consented to in the Offer and set forth below in Part VI. of this Order, including its undertaking to disgorge \$618,526, of which \$416,942 represents commissions earned by RCG during the relevant period with the remainder representing commissions earned by the GIB of RCG, plus post-judgment interest, within ten (10) days of the date of the entry of this Order.

Upon consideration, the Commission has determined to accept RCG's Offer.

VI.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

A. RCG shall cease and desist from violating Regulation 166.3, 17 C.F.R. §166.3 (2010).

B. RCG shall pay a civil monetary penalty in the amount of seven hundred eighty thousand dollars (\$780,000), plus post-judgment interest, within ten (10) days of the date of the entry of this Order. Post judgment interest shall accrue beginning eleven days after 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. RCG shall pay this penalty 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 by

other than electronic funds transfer, 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: Marie Bateman AMZ-300
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone: 405-954-6569

If payment by electronic funds transfer is chosen, RCG shall contact Marie Bateman or her successor at the above address to receive payment instructions and shall fully comply with those instructions. RCG shall accompany payment of the penalty with a cover letter that identifies RCG and the name and docket number of this proceeding. RCG shall simultaneously transmit copies of the cover letter and the form of payment to: 1) the Director, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street, N.W., Washington, DC 20581, and 2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission, at the same address. In accordance with Section 6(e)(2) of the Act, 7 U.S.C. § 9a(2) (2006), if this amount is not paid in full within fifteen (15) days of the due date, RCG shall be prohibited automatically from the privileges of all registered entities, and, if registered with the Commission, such registration shall be suspended automatically until it has shown to the satisfaction of the Commission that payment of the full amount of the penalty, with interest thereon to the date of the payment, has been made.

C. RCG and its successors and assigns shall comply with the following undertaking as set forth in its Offer:

1. RCG shall pay disgorgement in the amount of \$618,526, plus post-judgment interest, within ten (10) days of the date of the entry of this Order. Post judgment interest shall accrue beginning eleven days after 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.

RCG shall make its disgorgement in the name of "George G. Hudgins LLC Receivership," and shall send such disgorgement payment by electronic funds transfer, or by U.S. Postal money order, certified check, bank cashier's check, or bank money order, under cover letter that identifies RCG and the name of the docket number of this proceeding, to Kelly M. Crawford, the District Court appointed receiver in the Hudgins Litigation, at the address below:

Kelly M. Crawford
Scheef & Stone, L.L.P.
500 North Akard Street
Suite 2700

Dallas, Texas 75201.

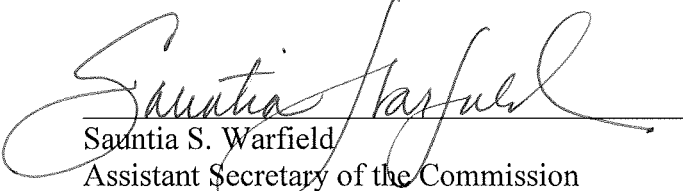
RCG shall simultaneously transmit copies of the cover letter and the form of payment to (a) the Director, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581, and (b) the Chief, Office of Cooperative Enforcement, Division of Enforcement at the same address.

The Receiver shall distribute these disgorgement funds to persons defrauded by Hudgins consistent with the District Court's Final Order Adjudicating Claims issued December 15, 2008.⁶

2. Neither RCG 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 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 RCG's: (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. RCG and its successors and assigns shall undertake all steps necessary to ensure that all of its agents and employees under its authority and/or control understand and comply with this undertaking.

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

By the Commission


Sauntia S. Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: September 30, 2010

⁶ See *supra* page 1 and note 1.