

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of :
 :
BLACKROCK INSTITUTIONAL :
TRUST COMPANY NA, :
 :
Respondent. :
 :

CFTC Docket No: 12-13

Office of
Professional
Responsibility

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

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that BlackRock Institutional Trust Company NA (“BlackRock” or “Respondent”) violated Section 4c(a)(1) of the Commodity Exchange Act (“Act”), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, Title VII (the Wall Street Transparency and Accountability Act of 2010), §§ 701-774, 124 Stat. 1376 (enacted July 21, 2010) (“Dodd-Frank Act”), to be codified at 7 U.S.C. § 6c(a)(1), and Commission Regulation (“Regulation”) 1.38(a), 17 C.F.R. § 1.38(a) (2011). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondent engaged in the violations as set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondent consents to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Act,

Making Findings, and Imposing Remedial Sanctions (“Order”) and acknowledges service of this Order.¹

III.

The Commission finds the following:

A. SUMMARY

On February 23, 2010 and May 25, 2010, an employee of Respondent initiated and entered into two prearranged trades, which were fictitious sales pursuant to Section 4c(a)(1) of the Act and noncompetitive trades pursuant to Regulation 1.38(a). Both trades were executed on the floor of the Chicago Board of Trade (“CBOT”) and involved ten year U.S. Treasury Note Futures spreads (“ten year spreads”).²

B. RESPONDENT

Respondent is an investment management firm based in San Francisco, CA and is a wholly owned subsidiary of BlackRock, Inc. Pursuant to its business, Respondent trades various investment products, including ten year U.S. Treasury Note Futures. Respondent is registered with the Commission as a commodity trading advisor (“CTA”) and has been so registered since 1998.

C. FACTS

Respondent has a number of clients, a number of portfolios, and therefore a number of portfolio strategies. The portfolio strategies may differ from one another and call for opposing positions. For example, while some portfolio strategies may call for the purchase of ten year spreads at a given time, other strategies may call for the sale of those spreads at that same time.

¹ Respondent consents to the entry of this Order and to the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Respondent does not consent to the use of the Offer, or the findings or conclusions in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than a proceeding in bankruptcy or to enforce the terms of this Order. Nor does Respondent consent to the use of the Offer or this Order, or the findings or conclusions in this Order consented to in the Offer, by any other party in any other proceeding.

² As relevant to this matter, a spread transaction is a transaction that consists of two components or “legs”: the purchase of one contract month and the simultaneous sale of another contract month. For example, a trader who purchases a September 2011 ten year Treasury note future and simultaneously sells a December 2011 ten year Treasury note future engages in a spread transaction. A person who sells the near month and purchases a later month “sells the spread.” A person who purchases the near month and sells a later month “buys the spread.”

Thus, in the aggregate, Respondent may have at a given time an order to buy a certain quantity of ten year spreads, and another order to sell a certain quantity of those spreads.

A BlackRock employee developed a trading execution strategy with the underlying purpose that Respondent be on both sides of a ten year spread transaction. The employee would enter the two sides of the transaction, a buy order and a sell order, with two different futures commission merchants (“FCMs”) near the same time. The orders were to be executed in the pit. Both orders were for the same, large specific quantity. In addition, one of the orders was designated “all or none,” meaning that the order could only be filled in its entirety. By structuring the transaction in such a manner, Respondent’s intent was to cross its two orders.

On February 23, 2010, Respondent initiated an all or none buy order for 13,552 ten year spreads at a specific price with one FCM. Approximately a minute later, Respondent initiated a sell order for 13,552 spreads with another FCM. Respondent’s intent was for the orders to cross, and the orders did in fact cross.

On May 25, 2010, Respondent initiated a sell order for 11,642 ten year spreads with one FCM. Approximately a minute later, Respondent initiated an all or none buy order for 11,642 spreads at a specific price with another FCM. In addition, the BlackRock employee engaged in pre-execution communications with the account executive at the selling FCM. The BlackRock employee told the account executive to look for “all or nones,” as the BlackRock employee was also looking to buy the ten year spreads. The account executive then looked on the floor for an all or none bid with a quantity of 11,642. Upon identifying such a bid, the account executive sold to that specific bid. Respondent’s intent was for the orders to cross, and the orders did in fact cross.

IV.

LEGAL DISCUSSION

A. Respondent Entered into Prearranged Trades that Constituted Fictitious Sales in Violation of Section 4c(a)(1) of the Act.

Section 4c(a)(1) of the Act makes it unlawful “for any person to offer to enter into, enter into, or confirm the execution of . . . a fictitious sale.” The Act does not define what a “fictitious sale” is, but that term includes wash sales, accommodation trades, and prearranged trades. *In re Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,902-03 (CFTC Apr. 4, 1986). “[T]he central characteristic of . . . fictitious sales[] is the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market.” *Id.* at 31,902.

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 the 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).

A prearranged trade is a textbook example of a fictitious sale. “By determining trade information such as price and quantity outside the pit, then using the market mechanism to shield the private nature of the bargain from public scrutiny, both price competition and market risk are eliminated.” *In re Collins*, Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,903.

Both the February 23, 2010 transaction and the May 25, 2010 transaction were prearranged trades and therefore fictitious sales. They were the result of an “artificial” trading scheme created by the BlackRock employee and not “arms-length trading.” *In re Goldwurm*, 7 Agric. Dec. at 276. The BlackRock employee determined the quantity of the transactions outside the pit; his strategy involved pairing buy and sell orders for the same specific quantity. The BlackRock employee also determined the price outside the pit; the employee used an all or none bid with a specific price, with the knowledge that the paired sell order would meet that price. Through the trading strategy, the BlackRock employee was able to negate price competition; because the employee knew that the bid would be met by the paired sell order, the bid was immune to pricing pressure from the market. Moreover, the employee was able to negate market risk; an order was never truly at risk, since the employee knew that the opposing, paired order would meet that order. Finally, by designating the bid all or none, and with a large quantity, the employee was able to block other traders who might have otherwise partially filled that order. In addition, on May 25, 2010, the BlackRock employee engaged in pre-execution communications with the account executive at the selling FCM so that the FCM would sell to the correct all or none bid. This is additional evidence of the prearranged nature of that trade. In short, Respondent engaged in a strategy where its intent was to cross trades, and it was able to achieve that end. The February 23, 2010 transaction and the May 25, 2010 transaction were prearranged trades and therefore fictitious sales in violation of Section 4c(a)(1) of the Act.

B. Respondent Executed Noncompetitive Trades in Violation of Regulation 1.38(a).

Commission Regulation 1.38(a) requires that all purchases and sales of commodity futures be executed “openly and competitively.” The purpose of this requirement is to ensure that all trades are executed at competitive prices and that all trades are directed into a centralized marketplace to participate in the competitive determination of the price of futures contracts.

A noncompetitive trade is generally transacted in accordance with an express or implied agreement between the participants. *See, e.g., In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,652 (CFTC Jan. 25, 1991). A trade can be noncompetitive even if executed in the pit. *In re Buckwalter*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,683 (CFTC Jan. 25, 1991) (citing *Laiken v. Dep’t of Agric.*, 345 F.2d 784, 785 (2d Cir. 1965)). Prearranged trading is a form of noncompetitive trading in violation of Regulation 1.38(a). *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,213 at 35,003 (CFTC Apr. 14, 1988).

By entering into prearranged, noncompetitive trades on two occasions, Respondent violated Regulation 1.38(a).

C. Respondent is Liable for Its Employee's Acts and Omissions Pursuant to Section 2(a)(1)(B) of the Act and Regulation 1.2.

The BlackRock employee committed the above referenced acts in violation of Section 4c(a) of the Act and Regulation 1.38(a) while acting within the scope of his employment with Respondent. Pursuant to Section 2(a)(1)(B) of the Act, 7 U.S.C. § 2(a)(1)(B) (2006), and Regulation 1.2, 17 C.F.R. § 1.2 (2011), Respondent is liable for the acts and omissions of the employee and is therefore liable for violating Section 4c(a)(1) of the Act and Regulation 1.38(a).

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, on February 23, 2010 and May 25, 2010, Respondent violated Section 4c(a)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011).

VI.

OFFER OF SETTLEMENT

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

- A. Acknowledges receipt and service of this Order;
- B. Admits the jurisdiction of the Commission with respect to all the matters set forth in 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 (2006) and 28 U.S.C. § 2412 (2006), 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 (2011), 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, 857-68 (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;
- 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 to 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)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011);
 2. Orders Respondent and its successors and assigns to cease and desist from violating Section 4c(a)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011);
 3. Orders Respondent to pay a civil monetary penalty in the amount of two hundred fifty thousand dollars (\$250,000), plus post-judgment interest; and
 4. Orders Respondent and its successors and assigns to each comply with the undertaking 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)(1) of the Act, as amended by the Dodd-Frank Act, to be codified at 7 U.S.C. § 6c(a)(1), and Regulation 1.38(a), 17 C.F.R. § 1.38(a) (2011).
- B. Respondent shall pay a civil monetary penalty in the amount of two hundred fifty thousand dollars (\$250,000) within ten (10) days of the date of the entry of this

Order ("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 the Order pursuant to 28 U.S.C. § 1961 (2006). 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, Respondent shall make the payment payable to the Commodity Futures Trading Commission, and sent to the address below:

Commodity Futures Trading Commission
Division of Enforcement
ATTN: Accounts Receivables – AMZ-340
E-mail Box: 9-AMC-AMZ-AR-CFTC
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone 405-954-6569

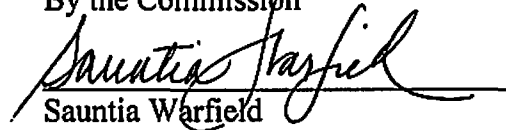
If payment is to be made by electronic transfer, Respondent shall contact Linda Zurhorst or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondent shall accompany payment of the CMP Obligation with a cover letter that identifies itself and the name and docket number of this proceeding. Respondent shall simultaneously transmit copies of the cover letter and the form of payment to: (1) the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581; and (2) the Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission at the same address.

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

Public Statements: Respondent agrees that neither it nor any of its successors, 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.

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

By the Commission

A handwritten signature in black ink, appearing to read "Sauntia Warfield", written over a horizontal line.

Sauntia Warfield

Assistant Secretary of the Commission
Commodity Futures Trading Commission

Dated: March 8, 2012