

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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PROCEEDINGS

In the Matter of:

**FCSTONE, LLC, and COMMODITY
OPERATIONS INC.,**

Respondents.

CFTC Docket No. 12-15
**ORDER INSTITUTING
PROCEEDINGS PURSUANT TO
SECTIONS 6(c) AND 6(d)
OF THE COMMODITY EXCHANGE
ACT, AS AMENDED, MAKING
FINDINGS AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that FCStone, LLC (“FCStone”) and Commodity Operations Inc. (“Commodity Operations”) (collectively “Respondents”) violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondents have engaged in the violations 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, Respondents have submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondents consent to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, as Amended, Making Findings and Imposing Remedial Sanctions (the “Order”) and acknowledge service of this Order.¹

¹ Respondents consent 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 Respondents do 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 in a proceeding in bankruptcy or to enforce the terms of this Order. Nor do Respondents 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.

III.

The Commission finds the following:

A. Summary

From at least August 2007 until February 19, 2008 (the “relevant period”) FCStone, a registered futures commission merchant (“FCM”), and Commodity Operations, then a registered introducing broker (“IB”) guaranteed by FCStone, failed to diligently supervise the account of a floor broker trading on ICE Futures US, Inc. (“ICE Futures”). The broker’s account was cleared by FCStone and had been introduced to FCStone by Commodity Operations. As a result of their failure to enforce their own compliance manual rules and procedures and their failure to diligently supervise, the floor broker was able repeatedly to put on positions which greatly exceeded the funds on deposit in his account and to trade while his account had a deficit balance. Accordingly, FCStone and Commodity Operations violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011).

B. Respondents

FCStone, LLC is an Iowa Limited Liability Company which has its principal place of business in Kansas City, Missouri. FCStone is a subsidiary of INTL FC Stone, Inc. FCStone has been registered with the Commission as a FCM since March 2000.

Commodity Operations Inc. was at all times relevant hereto a New York corporation with its principal place of business in New York, New York. Commodity Operations was registered with the Commission as an IB from April 1984 until it withdrew its registration in January 2010.

C. Facts

Commodity Operations becomes a guaranteed IB of FCStone and introduces Broker X’s account

On April 1, 2002, FCStone and Commodity Operations entered into a Clearing Agreement whereby they agreed to form a joint venture in which Commodity Operations became a guaranteed IB of FCStone. Under the Clearing Agreement, FCStone agreed to accept instructions from Commodity Operations for the creation of accounts for local traders on New York exchanges introduced by Commodity Operations and to clear commodity futures and options transactions executed by such traders.

Under the Clearing Agreement, Commodity Operations was required either to adopt “such rules, procedures and programs as shall enable [it] to provide commercially prudent service to Customers with regard to the opening and supervision of Customer accounts” or to “adopt the rules, procedures and programs of [FC]Stone.” Commodity Operations elected to adopt FCStone’s rules and procedures. Among the policies in FCStone’s Compliance Manual that were in effect during the relevant period were the following:

“Deficit trading is not permitted. APs [associated persons] should not accept orders for new trades on behalf of an under-margined customer account, other than trades which reduce the initial margin.”

“No customer will be given a loan for the purpose of financing margins on exchange contracts.”

On August 31, 2005, broker X, a floor broker on ICE Futures, opened an account with FCStone and authorized FCStone to purchase and sell commodity interests for broker X’s account in accordance with instructions from broker X or from broker X’s IB. Broker X was introduced to FC Stone by Commodity Operations. On the FCStone account opening agreement, broker X stated that he had an annual income of \$50,000 to \$100,000, and a net worth of less than \$25,000.

Broker X’s trading in August and December 2007

At the beginning of the day August 2, 2007, broker X’s account had a deficit balance of \$10,237.47, as a result of an open 49 lot spread position in Sugar No. 11 Futures Contracts that he acquired trading on ICE Futures the prior day. On August 2, 2007, broker X liquidated the 49 lot spread position, but also purchased and sold 290 non-liquidating futures contracts. FCStone accepted and cleared these non-liquidating trades even though broker X’s account was in deficit. As of the close of trading on August 2, 2007, the deficit balance in broker X’s account had increased to \$12,194.87.

On December 10, 2007, as a result of his trading that day broker X acquired a short position of 625 Sugar No. 11 Futures. This resulted in a margin call of \$406,250, which greatly exceeded the funds in broker X’s account, which had a deficit balance at the end of the day of \$14,984.47. Broker X met the margin call by liquidating the 625 lot position and making cash deposits to his account on December 11, 2007.

On December 12, 2007, broker X purchased and sold 2,052 futures contracts. Broker X ended the day with a flat position; however, his account had a deficit balance of \$71,206.77. Broker X did not trade for his account on December 13 and his account continued to have a deficit balance of \$71,206.77. On December 14, 2007, broker X deposited funds into his account, reducing his deficit balance to \$21,012.27.

At the start of the next trading day, December 17, broker X’s account continued to have a deficit balance of \$21,012.27. Notwithstanding this, broker X purchased and sold a total of 2,840 non-liquidating futures contracts on December 17, which FCStone accepted and cleared, which increased the deficit balance in broker X’s account to \$115,528.87. Broker X paid this deficit on December 18, 2007 by depositing \$116,000, which he acquired via a loan from Commodity Operations’ principal.

As a result of broker X’s trading activity, in December 2007 Respondents terminated his ability to enter trades under his own user name in ICE Futures US’s electronic trading system.

Nevertheless, Broker X continued to trade via the electronic system using another broker's log-in ID through February 19, 2008, of which Respondents were aware.

Broker X's trading on February 19, 2008

On February 19, 2008, broker X bought and sold a total of over 30,000 Sugar No. 11 Futures Contracts, ending the day with a short position of 3,960 contracts, which resulted in a margin call of \$2,973,000. FCStone was unaware of broker X's excessive trading while the trading was occurring, and did not learn of it until broker X informed FCStone of the 3,960 lot short position near the end of the trading day. Thereafter, FCStone liquidated the short position. Subsequently, following an investigation by ICE Futures' Compliance Department, FCStone and ICE Futures entered into a Settlement Agreement relating to broker X's trading, in which FCStone agreed to pay a fine of \$345,000.

As a result of broker X's trading on February 19, 2008, ICE Futures issued an order permanently denying him access to ICE Futures' markets and assessing a monetary penalty against broker X of \$200,000.

IV.

Legal Discussion

Commission Regulation 166.3, 17 C.F.R. Sec. 166.3 (2011) states:

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

A violation of Commission 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).

A violation of Regulation 166.3 is demonstrated by showing either that the registrant's supervisory system was generally inadequate, or that 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.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 (CFTC Aug. 11, 1992) (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). Under Commission Regulation 166.3, a registrant has a "duty to develop procedures for the detection and deterrence of possible wrongdoing by its agents." *Samson Refining Co. v. Drexel Burnhan 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.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,568 at 36,444 9CFTC Dec. 14, 1989)). Thus, “a showing that the registrant lacks an adequate supervisory system [standing alone] can be sufficient” to establish a breach of duty under Regulation 166.3. *In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,744 (CFTC Dec. 10, 1997). 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 Fin. Group Inc.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,179 at 45,635 *aff’d in relevant part, vacated in part and remanded sub nom. Sidoti v. CFTC*, 178 F.3d 1132 (11th Cir. 1999) (respondent failed to establish and maintain meaningful procedures for deterring and detecting fraud by its employees, and knew of specific incidents of misconduct but failed to take reasonable steps to correct the problems in violation of commission Regulation 166.3).

As described above, Respondents failed to implement appropriate supervisory procedures to supervise broker X’s trading, such that they did not detect that broker X was engaging in excessive trading far beyond his financial means, was repeatedly trading when his account was in deficit, and was entering trades in the exchange’s electronic system under the ID of another broker. In addition, Respondents failed to follow procedures they had in place, in particular the policies in FCStone’s Compliance Manual prohibiting deficit trading and prohibiting loans to finance margin.

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that Respondents violated Regulation 166.3, 17 C.F.R. § 166.3 (2011).

VI.

OFFER OF SETTLEMENT

Respondents have submitted an Offer in which they, without admitting or denying the findings herein:

- A. Acknowledge receipt of service of this Order;
- B. Admit 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. Waive:

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 they 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 (2010), relating to, or arising from, this proceeding;
 7. any and all claims that they 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;
- D. Stipulate that the record basis on which this Order is entered shall consist solely of the findings contained in this Order, to which Respondents have consented in the Offer;
- E. Consent, solely on the basis of the Offer, to the Commission's entry of this Order that:
1. makes findings by the Commission that Respondents violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011);
 2. orders Respondents to cease and desist from violating Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011) that they have been found to have violated;
 3. orders Respondents jointly and severally to pay a civil monetary penalty in the amount of \$260,000 plus post-judgment interest; and
 4. orders Respondents and their successors and assigns to comply with the conditions and undertakings consented to in the Offer and set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept their Offer.

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Respondents shall cease and desist from violating Commission Regulation 166.3, 17 C.F.R. § 166.3 (2011).
- B. Respondents shall jointly and severally pay a civil monetary penalty in the amount of \$260,000 within ten (10) days of the date of the entry of this Order (the "CMP Obligation"). If the CMP Obligation is not paid within ten (10) days of the date of entry of this Order, then post-judgment interest shall accrue commencing 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 (2006). Respondents 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 --- AMZ 340
E-mail Box: 9-AMC-AMZ-AR-CFTC
DOT/FAA/MMAC
6500 S. MacArthur Blvd.
Oklahoma City, OK 73169
Telephone (405) 954-5644

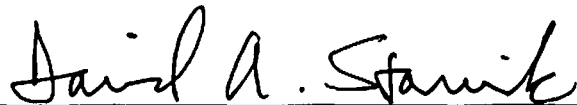
If payment is to be made by electronic transfer, Respondents shall contact Linda Zurhorst or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondents shall accompany payment of the CMP Obligation with a cover letter that identifies the paying Respondents and the name and docket number of this proceeding. The paying Respondents shall simultaneously transmit copies of the cover letter and the form of payment to: (1) Director, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581; (2) Chief, Office of Cooperative Enforcement, Division of Enforcement, Commodity Futures Trading Commission at the same address; and (3) Regional Counsel, Division of Enforcement, Commodity Futures Trading Commission, 140 Broadway, 19th Floor, New York, NY 10005.

- C. Respondents and their successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:

Public Statements: Respondents agree that neither they nor any of their successors and assigns, agents or employees under their 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 Respondents': (1) testimonial obligations; or (2) right to take legal positions in other proceedings to which the Commission is not a party. Respondents and their successors and assigns shall undertake all steps necessary to ensure that all of their agents and/or employees under their authority or control understand and comply with this agreement.

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

By the Commission.



David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: March 13, 2012