

Oversight of Futures Markets and Products

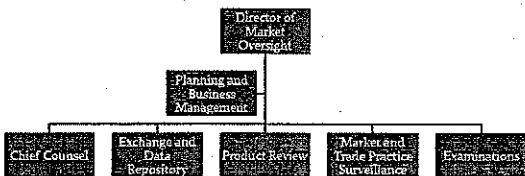
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Division of Market Oversight, CFTC

October 19, 2011
Chicago, Illinois

Functions of Market Oversight

- Exchange Designations and Review of Rules
- Product Reviews
- Market & Trade Practice Surveillance
- Rule Enforcement Reviews

Division of Market Oversight (DMO) Structure



Chief Counsel Office

- Staffed by attorneys
- Coordinates with other CFTC offices
 - Rulemakings
 - Enforcement actions
- Processes foreign terminal no action requests
- Prepares rulemakings related to market and product issues
- Deals with legal policy matters related to interpretation of rules, novel products, exchanges proposals, interpretations, no actions, etc.

Market Review:

Review of DCM, SEF and Data Repository Applications

- Validate compliance with designation criteria & core principles
 - Visit facility & assess capabilities
- Multi-divisional team approach
- Filings and comments posted on website
- Approval memo posted on website

Market Review:

New Rules and Rule Changes

- No prior approval required
 - Consistent with CFTC oversight role
- Exchange self-certification
 - File notice that rules comply with the Act and CFTC regulations
 - Include text of new or revised rules
 - No later than day before implementation
- One exception—material changes to “enumerated” agricultural futures

Market and Trade Practice Surveillance:
Market Surveillance


- Monitor reports of large trader positions
- Monitor deliverable supply/cash settlement, price relationships and other information
- Regular contacts with industry experts
 - Exchange surveillance
 - Market participants
- Weekly surveillance meetings
- Problems may lead to "jawboning," warning letters, emergency actions, referrals to the Division of Enforcement

Market and Trade Practice Surveillance:
Trade Practice Surveillance and Investigations


- Trade practice investigations
 - Independent check of fairness of trading
 - Referrals to the Division of Enforcement
- Trading ahead of customer orders/front running
- Trading against customer orders
- Marking the close
- Money passes

Contract Design

COMMERCIAL SUCCESS



Vs



REGULATORY SUCCESS

Factors for Commercial Success

- Price volatility
 - Satisfy a hedging need
 - Reason to speculate
- Large and active cash market
 - Lack of vertical integration or market concentration
 - Lack of governmental intervention
 - Sufficient data on supply, demand and cash prices
- Futures contract track assets held by hedgers
 - Homogenous cash commodity
 - Appropriate specification
- Long and short sides of the market have sufficiently different motives/risk profiles
- Contract is not susceptible or subject to manipulation

Factors for Regulatory Success

- Contract is not susceptible to manipulation
 - Adequate supplies
- Accessible supplies
 - Liquid markets
 - Lack of controlling interests
 - Access to and availability of delivery facilities
- Reflection of the cash market
 - Qualities and grades
 - Movements and flows
 - Delivery mechanisms

Defining Manipulation

- Ability to influence market prices (market power)
- Specific intent to create artificial prices
- Existence of artificial prices
- Manipulator caused artificial prices

Corners and Squeezes

- **Corner**—a situation where someone owns or controls enough of the commodity to manipulate its price, specifically when those who need the commodity have no alternative to acquire it



- **Squeeze**—a situation where there is a general lack of deliverable supplies or other conditions that make delivery difficult, thus forcing the short position holder to cover their position at higher prices



The Great Candy Bar Corner

- **The Futures Contract**
 - Party A agrees to sell Greg 1 candy bar for \$1 tomorrow
- **The Circumstances**
 - Party A has no candy bar
 - Party B has a candy bar to sell for 80 cents
 - Cost of getting candy bar from Party B to Party A is 20 cents for 2 day delivery and 50 cents for overnight delivery
 - Greg has a candy bar for sale
 - A local warehouse has candy bars to sell

Questions to Consider

- What are Party A's alternatives to satisfying the futures contract?
- What will it cost Party A to fulfill the contract?

Alternatives for Party A

- Alternative 1
 - Buy a candy bar from Party B and have it delivered overnight
 - Cost—80 cents + 50 cents = \$1.30
- Alternative 2
 - Buy the candy bar from Greg and deliver it back to Greg
 - Cost—\$1.30 Why?
- Alternative 3
 - Offset the futures contract by buying the contract back from Greg
 - Cost—\$1.30 Why?
- Alternative 4
 - Buy a candy bar from the local warehouse
 - Cost—\$1.30 Why?

Designing a Contract for Regulatory Success, or How to Build a Better Candy Bar Contract

- Contract is not susceptible to manipulation
 - Adequate supplies
 - Accessible supplies
 - Liquid markets
 - Lack of controlling interests
 - Reflection of the cash market
 - Qualities and grades
 - Movements and flows
 - Delivery mechanisms

Adequate Supplies

- Are there adequate supplies of the commodity at the delivery point?
- Are the supplies available throughout the year?
- At what times and at what pace do new supplies enter the market?

Accessible Supplies

- Liquid markets
 - Can buyers and sellers easily transact in the market?
- Controlling interest
 - Is the market free from controlling interests or is it dominated by a few players?
 - Who controls storage or transportation systems?
- Access to and availability of delivery facilities
 - Are conditions such that delivery facilities will be willing to participate

Reflection of the Cash Market

- Guideline #1 (Appendix to CFTC Part 40 Rules)
 - Acceptable practices from complying with Core Principles 3 and 5
 - Core Principle 3—contracts should not be susceptible to manipulation
 - Core Principle 5—the board of trade should adopt position limitations or position accountability for speculators, where necessary and appropriate
- Quality and grades
 - Commodity characteristics
 - Quality differentials
- Movement and flows
 - Delivery points/regions
 - Location differentials
 - Delivery facilities
- Delivery mechanisms
 - Delivery procedures
 - Delivery months
 - Transportation
 - Delivery instruments

Position Limits

- Spot-Month Limits
 - No greater than ¼ of estimated deliverable supply
- Individual non-spot and all-months combined limits
 - Base of 1000 for tangible non-energy contracts
 - Base of 5000 for energy or financials
 - Adjustments to levels based on open interest

Accountability Levels

- Requirement for traders to provide information about positions and consent to possible constraints on their position
 - 12 months after initial contract listing

Commodity	OI	Daily Vol	Cash Market Liquidity	Accountability
Financial	50K	100K	Very high	Information on Positions
Financial or Intangible	50K	25K	High	Information on positions and consent
Tangible	50K	5K	Liquid	Information on positions and consent, and spot-month limits

Trade Practice Surveillance

- Monitor exchange transactional data for violations
 - Wash trading
 - Prearranged trading
 - Accommodation trading
 - Customer fraud
 - Fictitious sales
 - Price distortion and manipulation
 - Trading ahead/against customers

Trade Practice Surveillance Program

Independent, direct surveillance of exchange-based trading by the CFTC

Exchange self-regulatory responsibility to detect and prevent trading abuses

Detecting Trading Abuses

- Fraud upon customers
 - Trading ahead, front running, misallocation of fills, bucketing and churning
- Fraud upon the market
 - Wash trading, bumping or marking the close and accommodation trading
- Review (automated) of individual trading activity
 - Suspicious patterns
 - Common trading partners
 - Related violations
 - Supporting documentation

RER Program

- Regular review for ongoing compliance.
- Examination of compliance over an extended period.
- Assessment of both general program and with respect to specific program areas.
- Opportunity for review and comment by the exchange.
- Recommendations and follow-up.

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RER Program

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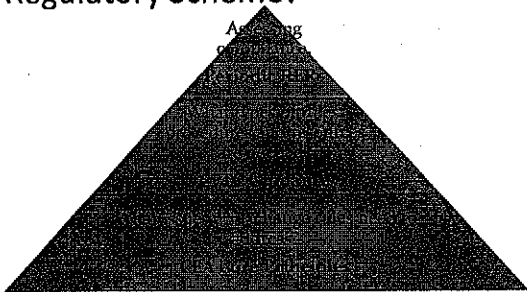
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Elements of an Effective Compliance Program

- Existence of effective rules and procedures.
- Adequate staffing and resources.
- Documentation of compliance efforts.
- Effective enforcement.

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Where do RERs fit into the Regulatory Scheme?



Accounting

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Designated Contract Market (DCM) Core Principles Subject to RERs

- Trade Practice Surveillance CPs
 - CP2: Compliance with Rules
 - CP10: Trade Information
 - CP12: Protection of Markets and Market Participants
 - CP18: Recordkeeping
- Market Surveillance CPs
 - CP4: Monitoring of Trading
 - CP5: Position Limitations or Accountability

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Core Principle 10
Trade Information

The board of trade shall maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

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Part 38 Guidance for Core Principle 10
Trade Information

Guidance—A designated contract market should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A designated contract market should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.

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Part 38 Acceptable Practices for Core Principle 10—Trade Information

Guidance—A designated contract market should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A designated contract market should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.

↓

Acceptable Practices—An acceptable audit trail should include...original source documents, including unalterable, sequentially identified records on which trade execution information is originally recorded, whether recorded manually or electronically. For each customer order (whether filled, unfilled or cancelled, each of which should be retained or electronically captured), such records reflect the terms of the order, an account identifier that relates back to the account(s) owner(s), and the time of order entry (For floor-based contract markets, the time of report of execution of the order should also be captured.).

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Part 38 Acceptable Practices for Core Principle 10—Trade Information

Guidance—A designated contract market should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A designated contract market should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.

Acceptable Practices—Safe storage capability provides for a method of storing the data included in the transaction history in a manner that protects the data from unauthorized alteration, as well as from accidental erasure or other loss.

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Part 38 Acceptable Practices for Core Principle 10—Trade Information

Guidance—A designated contract market should have arrangements and resources for recording of full data entry and trade details and the safe storage of audit trail data. A designated contract market should have systems sufficient to enable the contract market to use the information for purposes of assisting in the prevention of customer and market abuses through reconstruction of trading.

Acceptable Practices—An audit trail should include specialized electronic surveillance programs that permits sorting and presenting data included in the transaction history so as to reconstruct trading and to identify possible trading violations with respect to both customers and market abuse.

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Conducting the RER

- Preparations
 - Focus of the RER
 - Putting Together the RER Team
 - Document and Interview Requests
- The Rule Enforcement Review
 - Assessment of Staff Capabilities and Resources
 - Review of Office Structure and Procedural Guidelines
 - Document and Data Analysis
 - Analysis of Procedures
 - Interviews

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Closing Phases

- Perform analysis and draft recommendations.
- Share internally at Commission.
- Provide exchange with opportunity to review and comment.
- Conduct exit conference with exchange.
- Present final draft to Commission and release public report
- Follow-up with exchange on any recommendations for corrective actions.

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Reference Materials

- Public Rule Enforcement Reviews
 - www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleen.htm
- CFTC Regulations, Part 38 Appendix B
 - <http://www.cftc.gov/LawRegulation/index.htm>
- Exchange Rules
 - See Exchange Websites—e.g. www.cmegroup.com

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International Regulators Symposium

October 19th, 2011 Chicago, IL



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Director, Agricultural Market Surveillance

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FEDERAL REGULATION

- In 1974, Congress established the CFTC as an independent regulatory agency. Regulation of futures was moved from the U.S. Dept. of Agriculture to the CFTC, an independent Commission. CFTC has exclusive jurisdiction over futures.
- Congress overhauled the Commission's statutory mandate, when it enacted the Commodity Futures Modernization Act of 2000 and more recently with the Dodd-Frank Act of financial reform in July 2010.
- The CFTC has 5 Commissioners 1 of which serves as the Chairman. They are appointed by the President and confirmed by the Senate to serve staggered 5-year terms.
- No more than 3 Commissioners may be from the same political party.



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CFTC Mission

The Commodity Futures Trading Commission (CFTC) was created by Congress in 1974 as an Independent agency with the mandate to regulate commodity futures and option markets in the United States. The agency protects market participants against manipulation, abusive trade practices and fraud. Through effective regulation and oversight, the CFTC enables the markets to serve better their important functions in the Nation's economy – providing a mechanism for price discovery and a means of offsetting price risk.



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Growth of the U.S. Futures Industry

Futures and option volume over 5 times larger than 10 years ago

(Millions of Contracts)

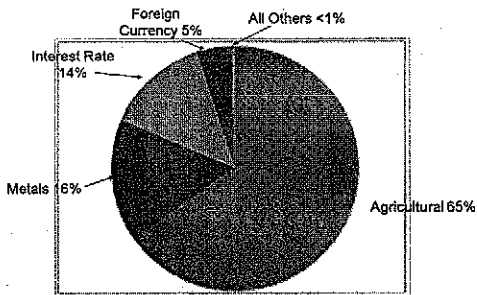
	1980	1990	2000	2010
Futures	92	277	491	2,765
Options on Futures	0	64	103	457
Totals	76	341	594	3,222

may not add due to rounding



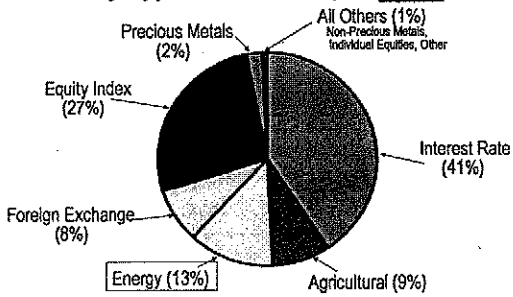
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U.S. Futures Trading Volume by Type of Commodity in 1980

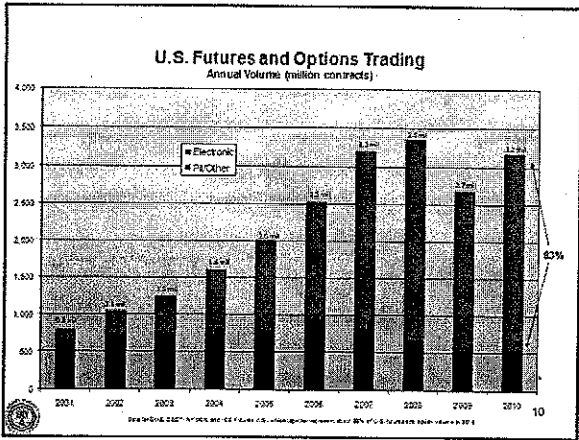


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U.S. Futures Trading Volume by Type of Commodity In 2010



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MISSION OF DMO

DIVISION OF MARKET OVERSIGHT

To foster markets that accurately reflect the forces of supply and demand for the underlying commodity and are free of abusive trading activity, thus helping to ensure that the markets perform the vital economic functions of price discovery and risk transfer (hedging)

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DMO: Market Surveillance

Monitors markets to detect and deter manipulation with no price bias

- Large-trader reporting
- Positions, deliverable supply, price relationships, and other information
- Weekly surveillance meetings
- Problems may lead to jawboning, warning letters, emergency actions, referrals to Division of Enforcement

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Layered Approach to Surveillance

- Exchange Level – monitors market participants, examines futures and cash markets daily, and enforces exchange rules.
- CFTC Level – monitors large traders' activities, examines key price relationships, and enforces CFTC regulations.
- FCM Level – monitors execution for compliance with rules and position limits.
- Customer or Trader Level – reports suspicious activity to exchange and/or CFTC.



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Surveillance Monitoring Program

- Price movements
- Changes in price relationships
- Open interest and volume
- Concentration of positions
- Trading liquidity and successive price changes
- Deliveries and deliverable supplies



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Market Monitoring Tools

- Reportable Levels – obtain daily large trader data on futures and options positions from clearing members.
- Position Limits – are enforced by the exchange, violators are subject to exchange discipline.
- Hedge Exemptions – for bona fide hedgers or commercial users, must apply and meet exchange requirements.



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I. Large Trader Data

- Examine All Large Positions that Could Pose a Threat of Market Manipulation
- Enforce Speculative Position Limits
- Monitor Trader Activity
- Understand Trading Behavior
- Identify Owners
- Provide Useful Information about Market Composition



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Reporting Firms

- Reporting firms are clearing members, futures commission merchants (FCM), and foreign brokers.
- They file daily reports with the CFTC showing futures and futures option positions at or above reportable levels.



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Reportable Levels

- Reportable levels vary across different futures contracts from as low as 25 contracts for small markets to as high as 3,000 contracts for large markets.
- Factors that determine the reportable levels are: total open interest and the size of positions held by traders, surveillance history of the market, and deliverable supplies (for physically settled markets).



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Types of Manipulation

(continued)

- Buying or selling in a manner calculated to **cause an abnormal effect upon prices**— includes pegging or capping the close.
- Issuing or causing to be delivered **false or misleading reports** of conditions that affect or tend to affect prices.



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Surveillance of Physical-Delivery Markets

- Futures contracts are most susceptible to manipulation when the deliverable supply on such contracts is small relative to the size of large positions as the contract approaches expiration.
- The more difficult and costly it is to augment deliverable supplies within the time constraints of the expiring futures contract's delivery terms, the more susceptible to manipulation the contract becomes.



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Surveillance Questions for Physical-Delivery Markets:

1. Are the positions held by the largest long trader(s) greater in size than deliverable supplies not already owned by such trader(s)?
2. Are the long traders likely to demand delivery? Is delivery their least costly means of acquiring the commodity?
3. To what extent are the largest short traders capable of making delivery?



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Questions for Physical-Delivery Markets (continued):

4. To what extent are shorts willing to make futures delivery? Is futures delivery their best market?
5. Does the futures price, as the contract approaches expiration, reflect the cash market value of the deliverable commodity?
6. Is the price spread between the expiring future and the next delivery month reflective of underlying supply and demand conditions in the cash market?



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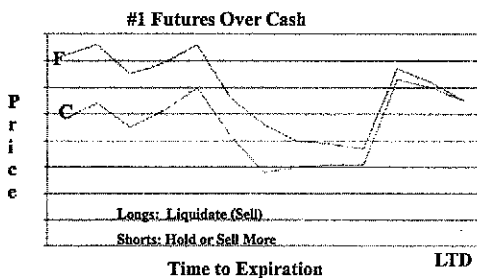
Futures-Cash Convergence

As a futures contract approaches expiration, normal economic forces will cause the futures price to converge with the cash price—that is, the basis will approach zero.



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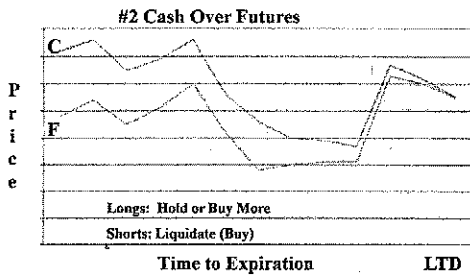
Futures-Cash Convergence



NOTE: Shorts can force convergence beginning on FND

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Futures-Cash Convergence



NOTE: Longs can not force convergence until LTD

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Surveillance of Cash-Settled Markets

- Focus on the integrity of the price series/index used to settle the contract
- Monitor size of futures positions vis-a'-vis its equivalent in the cash market

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Surveillance Questions for Cash-Settled Markets:

1. Is the futures price consistent with supply and demand factors?
2. How is the settlement cash price series behaving compared to similar cash prices?
3. Are the largest futures traders engaged in cash trades that affect the settlement cash price? that is, do the futures traders have an incentive to engage in losing cash trades in order to benefit a large futures position?

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Regulatory Response When Problems Develop—

Privately

- Jawbone trader/FCM/exchange
- Special call for information (especially from non-U.S. accounts)
- Work closely with exchange



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Regulatory Response When Problems Develop—

PUBLIC

- CFTC or exchange emergency action, such as:
 - margin increase.
 - required liquidation of positions.
 - extending the delivery period.
 - temporary closing a market.
- Referral to Division of Enforcement to investigate for manipulation.



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**Real World Example: Major Surveillance Concern
July 1989 Soybeans**

- Was there a deliberate attempt to corner or squeeze the July 1989 soybean futures contract?
- The answer is yet to be determined because of problems related to establishing the trader's intention.
- Under Dodd Frank – Disruptive Trading

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Some Basic Facts

- **Firm:** Ferruzzi Finanziaria S.P.A. (Ferruzzi) based in Italy held unusually large position in soybean futures during the spring and early summer of 1989.
- It owned more than 80% of all cash market soybeans that were available for delivery.
- As the contract approached expiration, the futures position were not being liquidated in an orderly manner, as required by exchange and CFTC regulations.



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What happened?

- These events led the Chicago Board of Trade (CBOT) to take emergency action to prevent a potential market disruption, with CFTC agreement.
- Ferruzzi denied allegations that it intended to manipulate the market.



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Ferruzzi's Position

- 22 million bushel long futures position
- 7 times the speculative position limit
- 5 times larger than any other market position
- 53% of the contract's open interest
- Owned more than 85% of all cash market deliverable soybeans.



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The Emergency Action

- On June 1, 12, 13, 14, 19, and 28, the CFTC urged Ferruzzi to buy in the cash market and liquidate its July futures.
- July 7, CBOT's Business Conduct Committee wrote asking for immediate and substantial reduction of its futures positions.
- July 10, Ferruzzi made known its intention to maintain its position.



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The Emergency Action (Cont.)

- CBOT took emergency action on July 12, (7 days before the last trading day) requiring anyone holding July 1989 soybean futures above 3 million bushels to liquidate their positions in an orderly manner prior to expiration.



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Hedging or Speculation?

- Earlier in May, CFTC revoked Ferruzzi's hedging exemptions, since it could no longer provide convincing evidence that its large futures positions represented bona fide hedging.
- Regardless, no market participant is allowed to maintain excessive market position that pose a threat to orderly futures liquidation.



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Some Lingering Thoughts

- Position did not make economic sense because local soybean prices were substantially lower than the futures price.
- From a commercial standpoint, a buyer should purchase the commodity where it is the cheapest.
- Soybeans remained in storage and not used for crushing needs as claimed, according to public records in late fall 1989.



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Conclusion

- CBOT and CFTC concluded that Ferruzzi was interested in owning futures contracts rather than the actual soybeans.
- September 15, 1989, Ferruzzi announced that three grain traders had resigned due to "differences over trading strategies," and the firm began reorganizing its international trading business.



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**Financial Market Surveillance Issues:
Detecting and Deterring Market Abuse
October 19, 2011**

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Overview

- Daily '01 reporting to the CFTC of large trader data from FCMs forms the foundation.
- Form 102 (or Form 40) reporting provides account identities.
- Aggregated positions subject to position limits.
- Summary information available to the public in Commitments of Traders.
- Large Trader Reporting system used by economists for market surveillance.
- Economists combine Large Trader information with publicly available market data for purposes of economic analysis.
- Expiring contracts are closely monitored for potential congestion or possible market manipulation.
- Summary briefings regularly provided to Commissioners.
- Apparent rule infractions referred to Division of Enforcement.

**Surveillance Questions: Physical
Delivery**

1. Are long futures concentrated with a few large traders?
2. Do positions represent significant portion of CTD notes and bonds?
3. Do longs have market power with respect to cash market securities?
4. What are the traders' intentions for delivery?
5. Is taking delivery the least costly means of acquiring the commodity?
6. Are the largest short traders capable of making delivery?
7. Are there other impediments to orderly contract liquidation present in the marketplace?

Surveillance Questions: Cash Settled

1. Is the futures price consistent with supply and demand factors?
2. How is the settlement cash price series behaving compared to similar cash prices?
3. Are the largest futures traders engaged in cash trades that affect the settlement cash price?
4. Do the futures traders have an incentive to engage in losing cash trades in order to benefit a large futures position?

CFTC Daily '01 reporting(see cftc.gov)

1. Report Type. This report format will be used to report three types of data: long and short futures and options positions, futures delivery notices issued and stopped, and exchanges of futures for physicals bought and sold. Valid values for the report type are "RP" for reporting positions, "DN" for reporting notices, and "EP" for reporting exchanges of futures for physicals.
2. Reporting Firm. A number assigned by the CFTC to identify reporting firms.
3. Account Number. A unique identifier assigned by the reporting firm to each special account. The field is zero filled with account number right-justified.
4. Report Date. The format is YYYYMMDD, where YYYY is the year, MM is the month, and DD is the day of the month.
5. Exchange. This is a two-character field used to identify the exchange on which a position is held.
6. Put or Call. Valid values for this field are "C" for a call option and "P" for a put option. For futures, the field is blank.
7. Commodity [1]. An exchange-assigned commodity code for the futures or options contract.
8. Expiration Date [1]. The date format is YYYYMMDD and represents the expiration date or delivery date of the reported futures or options contract. For date-specific instruments such as flexible products, the full date must be reported. For other options and futures, this field is used to report the expiration year and month for an options contract or a delivery year and month for a futures contract. The day portion of the field for these contracts contains spaces.
9. Strike price. This is a signed numeric field for reporting options strike prices. The strike prices should be right justified and the field zero filled. The right most character will represent both the value of that digit in the number and the sign of the number.

CFTC Form 102 (see cftc.gov)

The image shows a scan of the CFTC Form 102, which is a reporting form for futures and options positions. The form is divided into several sections, including a header with the CFTC logo and title, and a main body with various fields for reporting data. The form is partially filled out with handwritten information.

CFTC Form 40 also used for special accounts (see cftc.gov)

Largest Financial Contract Markets

CONTRACT	CONTRACT MARKET NAME	COMMODITY SUBGROUP NAME	CYCMAN	Open Interest
12741	3-MONTH EURO DOLLARS	Interest Rates - non U.S. Treasury	CME	17,537,780
1274A	S&P 500 STOCK INDEX	STOCK INDEX	CME	3,519,126
02602	10-YEAR U.S. TREASURY NOTES	Interest Rates - U.S. Treasury	CBT	2,495,641
04591	5-YEAR U.S. TREASURY NOTES	Interest Rates - U.S. Treasury	CBT	1,830,747
04591	2-YEAR U.S. TREASURY NOTES	Interest Rates - U.S. Treasury	CBT	1,896,243
04591	30-DAY FEDERAL FUNDS	Interest Rates - non U.S. Treasury	CBT	1,080,911
02601	U.S. TREASURY BONDS	Interest Rates - U.S. Treasury	CBT	894,969
12731	3-MONTH EURO DOLLARS	Interest Rates - non U.S. Treasury	NYLS	772,256
12741	S&P 500 STOCK INDEX	STOCK INDEX	CME	492,577
22977A	RUSSELL 2000 MICROEKFUTURE	STOCK INDEX	CFM	414,969
02604	LONG TERM U.S. TREASURY BONDS	Interest Rates - U.S. Treasury	CBT	210,683
208742	NASDAQ-100 STOCK INDEX (MIN)	STOCK INDEX	CME	333,461
12611	3-MONTH EURO DOLLARS ELX	Interest Rates - non U.S. Treasury	ELX	311,151
026741	EURO FX	CURRENCY	CME	215,420
14061	VIX FUTURES	OTHER FINANCIAL INSTRUMENTS	E	157,431
026741	CANADIAN DOLLAR	CURRENCY	CME	132,817
026741	JAPANESE YEN	CURRENCY	CME	132,809
026741	MEXICAN PESO	CURRENCY (NON-MAJOR)	CME	118,243
026741	AUSTRALIAN DOLLAR	CURRENCY	CME	111,017

All of 6/9/11, Source: CFTC IS System (all futures and options combined)

Market Participants

- 3-Month Eurodollar Time Deposit and 1-Month LIBOR
 - Banks, Finance Companies, Corporate Treasury, Swap Dealers
 - Others with exposure to bank lending rates
 - International customer base
- Treasury Contract Markets
 - Security broker-dealers pension funds,
 - Others participating in government debt trading
 - Also has many international users

Features of Contract Markets

- Eurodollar Time Deposit futures and 1-month LIBOR:
 - Cash settled to LIBOR Panel Survey
- U.S. Treasury Note and Bond Futures Contracts:
 - Physical delivery of basket of eligible securities via fedwire (Cheapest-to-Deliver)
 - Theoretical 6% coupon and conversion factors
 - Month long futures delivery period
 - Repurchase agreement (repo market) concerns

Supply

10-year Treasury Securities

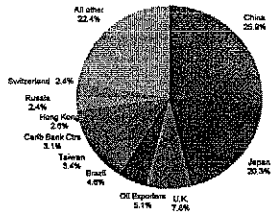
Coupon	Issue Date	Maturity Date	Cusip Number	Issuance (\$/billion)	Conversion Factors
2 7/8	03/31/11	03/31/26	912829D05	\$29.0	0.9338
2 5/8	05/20/11	05/20/26	912829D08	\$29.0	0.9205
2 1/8	05/15/10	05/15/25	912829D06	\$29.0	0.9570
2 3/4	05/21/11	05/21/26	912829D04	\$29.0	0.9872
2 3/8	06/30/11	06/30/26	912829D10	\$29.0	0.9912
4	08/15/02	08/15/17	912829D14	\$29.0	0.9502
3 3/4	11/17/08	11/17/18	912829D02	\$29.0	0.9729
2 3/4	03/13/09	03/13/19	912829D01	\$37.0	0.9811
2 1/8	05/15/09	05/15/19	912829D02	\$29.0	0.9264
2 5/8	02/17/09	02/17/19	912829D17	\$69.0	0.9544
2 3/8	11/15/02	11/15/17	912829D14	\$67.0	0.9251
3 5/8	02/16/10	02/16/20	912829D02	\$67.0	0.9432
3 1/2	05/17/10	05/17/20	912829D08	\$66.0	0.9354
2 5/8	03/10/10	03/10/20	912829D03	\$66.0	0.9726
2 3/8	11/15/10	11/15/20	912829D08	\$66.0	0.9878
2 1/8	02/15/11	02/15/21	912829D02	\$66.0	0.9332
2 1/8	05/15/11	05/15/21	912829D03	\$66.0	0.9341

Number of Cusips: 18/115
 Dollar Amount Eligible for Delivery: \$867.0

Source: OGE Group

Demand

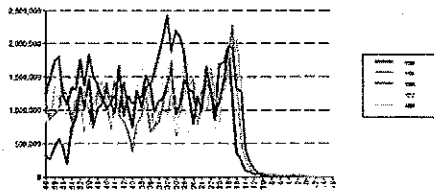
Foreign Holdings of U.S. Treasury Securities, June 2011, \$ billion



Source: Treasury Department

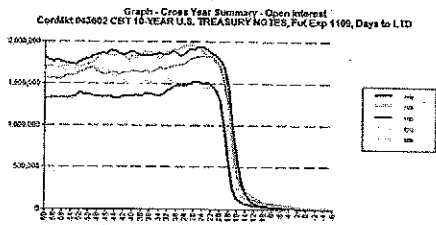
Surveillance of Expiring Contract Markets

Graph - Cross Year Summary - Volume of Trade
 ConMkt 043001 CBT 10-YEAR U.S. TREASURY NOTES, Put Exp 1109, Days to LTD



Source: CFTC IS System

Surveillance of Expiring Contract Markets



Surveillance: Red Flags

Other red flags or surveillance issues:

- Specialness in repo market
- Gross basis, carry and net basis
- Complaints to the Exchange or CFTC by market participants
- Stories in the industry publications
- Unusual spread relationships between nearby and deferred futures contracts

Surveillance Coordination

- Duplication and coordination with Exchanges
- Inter-Agency Working Group
 - CFTC contact biweekly with IAWG
 - NYFed
 - Fed Board of Governors
 - Dept of Treasury
 - SEC
- Summary briefings regularly provided to Commissioners
- Apparent rule infractions referred to Division of Enforcement

**U.S. Commodity Futures Trading Commission
International Symposium and Training
Program**

**Special Considerations
For OTC Clearing**

Wednesday, October 19, 2011

Panelists:

Kathryn Trkla, Partner, Foley & Lardner LLP
Kevin McClear, General Counsel, ICE Clear Credit LLC
Timothy Maher, Acting Director & Chief Compliance Officer, CME Clearing

1

Panelist Bios

2

KATHRYN TRKLA

Ms. Trkla joined Foley & Lardner LLP's Chicago office as a partner in 2000. Before that, she was Senior Vice President & Associate General Counsel at the Chicago Board of Trade (CBOT). She has over 25 years experience with the derivatives and securities industries, including work for exchanges (domestic and non-US), clearinghouses, brokerage firms, hedging service providers, professional trading firms, Institutional Investors and other clients. In addition to 11 years combined at the CBOT, she practiced as a partner at another Chicago law firm. During her CBOT tenure, Ms. Trkla represented the exchange at the annual meetings of the IOSCO Consultative Committee. In 1997-1998, she chaired a sub-committee of that Committee which prepared a report on best practices for the design of futures contracts and exchange market surveillance programs.

Ms. Trkla is a *cum laude* graduate of Northwestern University School of Law, and graduated with a B.A. in public affairs from the University of Chicago, where she was elected to Phi Beta Kappa. She is a member of the Derivatives & Futures Law Committee of the ABA Business Law Section and of the FIA Law & Compliance Division. She serves on the Advisory Board for the Kent State University Master of Science in Financial Engineering Program.

3

KEVIN McCLEAR

Mr. McClear is the General Counsel of ICE Clear Credit LLC. He also serves as the COO, General Counsel and Corporate Secretary of The Clearing Corporation, which he joined in 1999. From 1991 to 1999, Mr. McClear was with the Chicago Board of Trade's (CBOT) Legal Department. From 1989 to 1991, he traded futures and futures options as a member of the CBOT and MidAmerica Commodity Exchange. His floor experience includes trading and brokering of futures, futures options, intercommodity futures and options spreads, and complex volatility options spreads. While trading, he worked part-time for the law firm of Sliets and Martin, where he practiced general commodities law. Prior to joining the CBOT, Mr. McClear practiced law as a commercial litigator with the law firm of Hinshaw, Culbertson, Mohiman, Hoban and Fuller.

Mr. McClear holds a Juris Doctorate degree from Northwestern University School of Law and a Bachelor of Arts degree in Political Science from Denison University. He is a member of the American Bar Association, Chicago Bar Association (Futures and Derivatives Law Committee), and the Law and Compliance Division of the Futures Industry Association. He also has served as an arbitrator for the National Futures Association.

4

TIMOTHY MAHER

Timothy J. Maher is the Acting Chief Compliance Officer of CME Clearing. The Chief Compliance Officer of CME Clearing is responsible for developing, implementing and administering policies and procedures to ensure that CME Group and CME Clearing complies with the DCO Core Principles set forth in the Commodity Exchange Act and all other laws and regulations applicable to the operation of CME Group clearing services.

Mr. Maher has over twenty years experience in the exchange traded derivatives business serving in legal, regulatory, strategy and business development roles for the Chicago Board of Trade, Accenture, the Board of Trade Clearing Corporation, and Goldenberg, Hehmeyer & Company. He has a J.D. (1987) from the John Marshall School of Law and an MBA (1998) from the University of Chicago Booth School of Business.

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**Overview of
Regulation of OTC Clearing
Under the Dodd-Frank Act**

6

Overview of Regulation of OTC Clearing Under the Dodd-Frank Act

CFTC International Symposium & Training Program
October 19, 2011

Kathryn M. Trida, Partner

File Number: 1374-0114 Date Filed: July 20, 2011 Page: 1 of 20

Dodd-Frank Act Amendments to the Commodity Exchange Act and Federal Securities Laws

- The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (*Dodd-Frank* or *Dodd-Frank Act*) was signed into law on July 21, 2010.
- Dodd-Frank made substantial amendments to the Commodity Exchange Act (CEA) and federal securities laws, including the Securities Exchange Act of 1934 (*Exchange Act*), to establish a comprehensive framework for regulating over-the-counter (OTC) derivatives, covered by the statutory terms "swap" and "security-based swap."
- The Commodity Futures Trading Commission (CFTC) regulates swaps; the Securities and Exchange Commission (SEC) regulates security-based swaps. Both agencies jointly regulate "mixed swaps."
 - Security-based swaps are securities under the federal securities laws.
 - The CFTC regulates swaps on a broad-based index of securities, including credit default swaps (CDS) on a broad-based index of reference obligations or issuers.
 - The SEC regulates swaps on an individual security or narrow-based index of securities, including single-name CDS and CDS on a narrow index of reference obligations or issuers.
- Dodd-Frank amendments seek to migrate OTC derivatives to centralized clearing and trading through provisions authorizing the CFTC and SEC to designate types of swaps or security-based swaps that must be cleared.

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Dodd-Frank Implementation

- Most amendments were to take effect on the later of July 16, 2011, or, if a rulemaking is required, at least 60 days after the final rules are published.
 - CFTC and SEC rulemaking to fully implement Dodd-Frank is still ongoing.
 - The CFTC and SEC issued orders that postpone the effectiveness of many of the new statutory provisions for OTC derivatives that otherwise would have become effective on July 16.
- Effective July 16, 2011, Dodd-Frank repealed:
 - The statutory exemptions added to the CEA in 2000 covering OTC derivatives transactions (excluding those on agricultural commodities) between eligible contract participants.
 - Section 409 of the Federal Deposit Insurance Corporation Improvement Act, which required regulation of "multilateral clearing organizations" for OTC derivatives, but permitted oversight by alternative regulators, including the CFTC, the SEC or U.S. banking regulators.
- Effective July 16, 2011, under "deemed registered" provisions for clearinghouses:
 - A depository institution that cleared swaps as a multilateral clearing organization prior to enactment of Dodd-Frank was deemed registered with the CFTC as a DCO and with the SEC as a clearing agency.
 - A CFTC-registered DCO that cleared swaps prior to enactment of Dodd-Frank pursuant to an exemption from the SEC from clearing agency registration was deemed registered with the SEC as a clearing agency.
 - An SEC-registered clearing agency that cleared swaps prior to enactment of Dodd-Frank was deemed registered as a DCO with the CFTC.

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**Regulation of Swaps Clearinghouses
Under the Dodd-Frank Amendments to the CEA**

- Dodd-Frank provisions for cross-market fungibility for swaps:
 - DCO rules must provide for non-discriminatory clearing of DTC swaps and swaps executed on an unaffiliated futures exchange or swap execution facility, on a fungible basis.
 - But a DCO is not required to accept the credit exposure of another clearinghouse.
 - Cross-market fungibility does not exist for listed futures and options on futures; this represents a significant market structure difference in the regulation of swaps compared to futures and options on futures under the CEA.
- CFTC DCO Rulemaking:
 - The CFTC has published several rulemaking proposals that will impact regulation of DCOs. The primary releases that address compliance with the DCO core principles are:
 - Risk Management Requirements for Derivatives Clearing Organizations, 76 Fed. Reg. 3698 (Jan. 20, 2011) (Notice of Proposed Rulemaking).
 - Information Management Requirements for Derivatives Clearing Organizations, 75 Fed Reg. 78185 (Dec. 15, 2010) (Notice of Proposed Rulemaking).
 - The CFTC is scheduled to vote on final rules for DCO general provisions and core principles on Tuesday, October 18th.

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**Regulation of Clearing Agencies for Security-Based Swaps
Under the Dodd-Frank Amendments to the Exchange Act**

- A clearinghouse for *security-based swaps* must either:
 - Be registered with the SEC as a clearing agency; or
 - Receive an SEC exemption from clearing agency registration based on the SEC's determination that the clearinghouse is subject to "comparable, comprehensive supervision and regulation by" the CFTC or by its regulator in its home jurisdiction.
- As defined in § 3(a)(23)(A) of the Exchange Act, a clearing agency is:

"...any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates."

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**Regulation of Clearing Agencies for Security-Based Swaps
Under the Dodd-Frank Amendments to the Exchange Act**

- In the past, the SEC has found the following types of entities to be clearing agencies within the definition:
 - clearing corporations acting as central counterparties
 - securities depositories
 - securities matching services
- Given the breadth of activities that constitute securities clearing, to prevent evasion of the Dodd-Frank objectives, the SEC has proposed a rule clarifying that when a security-based swap is subject to mandatory clearing, transactions in the instrument must be submitted to a clearing agency that acts as a central counterparty through inter-positioning between the counterparties to the trade.

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**Regulation of Security-Based Swaps Clearinghouses
Under the Dodd-Frank Amendments to the Exchange Act**

- A clearing agency is subject to standards set out in § 17A of the Exchange Act, in particular § 17A(b)(3)(A)-(I), which apply generally to clearing of securities, including security-based swaps.
- The SEC is also authorized under § 17A(I) of the Exchange Act to establish standards that apply to a clearing agency that clears security-based swaps.
- The SEC has published several notices of rulemaking under Dodd-Frank that will impact regulation of clearing agencies.
 - The primary proposal addressing clearing agency standards is Release No. 34-64017, Clearing Agency Standards for Operation and Governance, 76 Fed. Reg. 14472 (March 16, 2011).

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**Clearing Intermediaries for
Swaps and Security-Based Swaps**

- **Swaps:** To provide market users with intermediated access to DCOs for swaps transactions, a firm must be registered with the CFTC as a futures commission merchant.
- **Security-Based Swaps:** To provide market users with intermediated access to clearing agencies for security-based swaps, a firm must be registered with the SEC as a broker-dealer or a security-based swap dealer.

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**Protection of Funds of Cleared
Swaps and Security-Based Swaps Customers**

- **Swaps:**
 - Dodd-Frank added provisions to the CEA for segregation of cleared swaps customer funds that follow closely (but not exactly) the existing CEA provisions for segregation of futures customer funds.
 - The CFTC has proposed rules that impose a segregation approach that differs in important respects from futures segregation, referred to as the "Complete Legal Segregation Model." As proposed:
 - In the event that a clearing member defaults due to the default of an underlying swaps customer, the DCO would essentially have to treat the defaulting swaps customer as a separate account, as a means to isolate the losses of that customer.
 - The DCO would not have any recourse to the funds of the non-defaulting customers of the defaulting clearing member to cover the losses of the defaulting customer.
 - The CFTC is considering an alternative where the DCO could have recourse to the funds of the non-defaulting customers, but only after applying other levels of its "waterfall" of financial resources.

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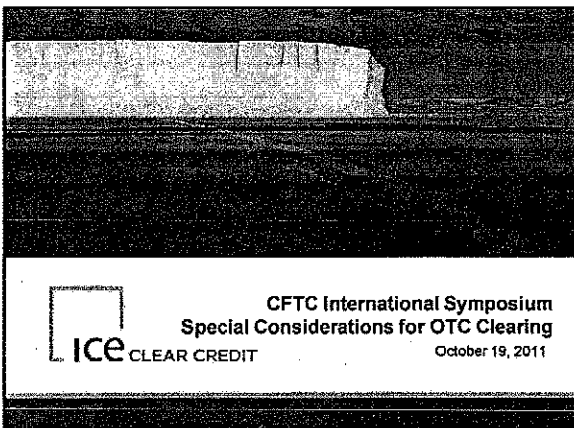
Protection of Funds of Cleared Swaps and Security-Based Swaps Customers

- Security-Based Swaps:
 - Dodd-Frank added comparable provisions to the Exchange Act providing for segregation of funds of cleared security-based swaps customers.
 - To date, the SEC has not proposed any rules to implement those provisions.
 - The provisions may be incompatible with current SEC rules governing how a registered broker-dealer holds funds and securities of its securities customers.

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Brief Overview of OTC Clearing Services Offered By ICE Clear Credit & CME Clearing

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ICE CLEAR CREDIT

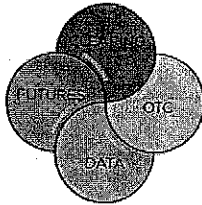
CFTC International Symposium
Special Considerations for OTC Clearing
October 19, 2011

ICE Introduction

IntercontinentalExchange (ICE) is the leading operator of integrated futures and over-the-counter (OTC) markets, clearing, processing and data services for global derivatives markets

- ICE established in 2000, (NYSE: ICE) market capitalization of \$8.05B*
- Member of S&P 500 and Russell 1000
- 3 futures exchanges and 2 OTC global markets across energy, agriculture, equity indexes, FX, and credit
- 5 clearing houses for futures and OTC markets in U.S., Europe & Canada
- Market participants in more than 70 countries
- Significant depth and investment in CDS market

ICE Integrated Marketplace



ICE CDS Expertise

- The ONLY company that has expertise in execution, post-trade processing, clearing and other operational and risk management processes specific to credit derivatives and corporate bonds
- Open platform architecture – each process is available individually and can connect to multiple alternative service providers
- Integrated solution offers an easier, more efficient execution and processing experience

CREDITX EXECUTION

- Top-tier CDS voice and electronic brokerage offering innovative services: credit event auctions and portfolio compression
- Will offer SEF execution services upon implementation of the new regulations, leveraging its highly successful existing technology platform

PROCESSING

- Post-trade platform connected to over 820 major CDS dealers, IBs and buy-side firms
- Helps clients meet new regulatory requirements for automation and standardization

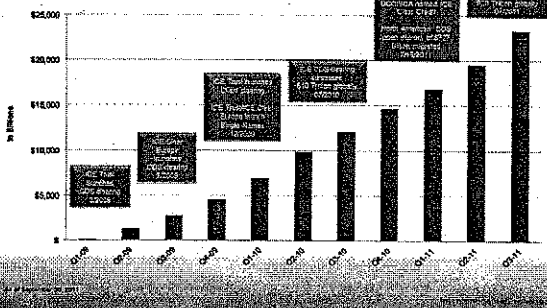
CLEARING

- ICE Clear Credit (formerly ICE Trust) launched March 2009, the first clearing house to process CDS transactions. ICE Clear Europe launched July 2009
- Only clearing houses with material open interest and experience with credit events and corporate actions

ICE CDS Milestones and Volume Cleared

Global Cumulative Volume

- Over \$23.3 Trillion notional cleared globally
- ICE Clear Credit cleared over \$5.4 Billion in client-related notional



IRS Product Rollout

CME is delivering a comprehensive global product scope that includes the 6 currencies that account for 94% of vanilla IRS* before the end of 2011

EXISTING PRODUCTS

- USD Funds/Float out to 31 years
- Flexible day month, business days, roll conventions and payment frequencies including stubs
- 1M, 3M and 6M LIBOR indices

2011 PRODUCT EXPANSION

• Maturity out to 50 years

EARLY 2012 PRODUCT EXPANSION

- Zero Coupon Swaps
- Amortizing Swaps
- FRAs
- Bank Swaps
- OTC
- Additional Currencies

OTHER FUTURE PRODUCTS

- Swaps, Caps, Floors, Additional Currencies, Cross-Currency Swaps, and Inflation Products

*Federal Reserve Publishing published this Bank of International Settlements, December 2010

CME Group

Key Features of CME Cleared OTC CDS

Designed to Align to Industry Commitments with Forward Looking Strategic Vision

Efficient Contracts

- Designed to mirror and be economically equivalent to bilateral OTC contracts
- T+1 settlements of upfront fee
- Daily portfolio-level position netting and compression

Customer Protection

- Account segregation thru the Cleared OTC Derivatives Sequestered account class
- Portability of positions and initial margin to solvent FCM pursuant to CFTC regulations & CME rules
- CME is the counterparty to every trade

Transparent Margin Regime

- Multi-factor portfolio margin methodology
- Consistent, transparent and replicable margin methodology applied to all customers
- CME CORE margin tool which easily, independently replicate the margin requirements

Valuations

- Daily mark-to-market published by 5pm ET
- Primary source is CME CDS Clearing Member submissions
- Secondary source includes third party data

Event Management

- Adherence to ISDA DC credit event and succession event determinations
- Hardwired to ISDA auction protocol
- Full trade life cycle management by CME

CME Group

Cleared OTC CDS Product Scope

34 Clearing Eligible North American Indices are Clearing Eligible

Product	Series	Status
CDX IG	Series 9 – 10 5, 7, and 10 year tenors	Clearing Eligible
	Series 11 – 17 3, 5, 7, and 10 year tenors	Clearing Eligible
CDX HY	Series 11 – 17 5 year tenor	Pending Regulatory Approval

North American CDS Single Names – Subject to Regulatory Approval

- Constituents of the CME Cleared CDS indices and other liquid single name CDS products
 - Phase 1 – Initial Rollout includes seven names from the Utilities sector
 - Phase 2 – CDX IG constituents
 - Phase 3 – CDX HY constituents

CME Group

OTC Clearing Risk-related Concerns

- Cleared OTC Product Valuation
- Cleared OTC Product Margin Methodology
- Cleared OTC Margin Collateral
- Customer Protection

CME Group

Transparent Valuation and Reporting - IRS

Customers have full visibility into CME Group's swap valuations

VALUATION OVERVIEW

- USD IRS positions will be marked to market once per day at 3pm EST
- Pricing inputs obtained from wire service feeds
- CME Group utilizes OIS discounting, monotone convex interpolation, and Bootstrap Generator to produce a Zero Coupon curve

PRICING INPUTS

- LIBOR: O/N, T/N
- FRA: 0 x 6
- CME Eurodollars – first 8 Quarterly Eurodollar contracts, convexity adjusted
- Par Swap Rates: 2Y – 10Y, 15Y, 20Y, and 30Y (5A, 3M LIBOR)

REPORTING

- CME Group provides customers with full transparency including direct access to daily reports showing curve inputs, daily discount factors, and valuations for each cleared swap position

CME Group

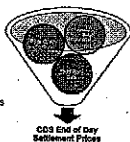
Transparent Valuation and Reporting - CDS

VALUATION OVERVIEW

- CDS positions marked-to-market once per day at approximately 4:30pm ET
- Pricing inputs rely primarily on Clearing Member submissions
- ISDA Standard CDS Model will be Used for Quota Spread to Uplifted Price Conversion

KEY INPUTS

- Clearing Members required to submit price levels for all clearing eligible products and tenors in which they or their customers hold open interest
- Required tenors: Full term structure
- Price quality auction process
- Third Party data



REPORTING

- End of day settlement price file published by 5pm ET
- Direct access to settlement price file showing valuations for each cleared CDS position, includes multiple price formats
- Settlement price file available with RED Code

CME Group

Margin Methodology

Computing Portfolio Margin Futures, Options, and General Products

- SPAN is a market simulation based Value At Risk system that has become the global standard for portfolio margining
- CME SPAN is the margining algorithm used for futures, options, and other products currently cleared by CME Clearing other than CDS and IRS
 - SPAN assesses the risk of a portfolio, by calculating the maximum likely loss that could be suffered by the portfolio based on parameters set by the margin-setting authority, usually an exchange or clearing organization
- 99% 1- to 2-day coverage standard (dependent on product)
- CME SPAN was developed by CME to effectively assess risk on an overall portfolio basis
- SPAN is the official Performance Bond mechanism of over 50 exchanges and clearing organizations world-wide, making it the global standard for portfolio margining
- SPAN's risk based margin requirements allows for effective margin coverage while preserving efficient use of capital
- The core of SPAN risk analysis is to simulate potential market moves and calculate the profit or loss on individual contracts given the market moves

CME Group

IRS Margin Methodology

Model Overview

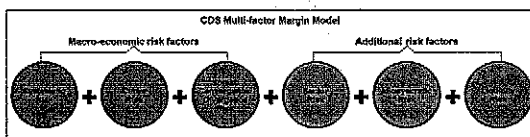
- CME Group utilizes a historical Value at Risk (VaR) model, based on a 99% confidence of a 5-day move using 5 years of historical data
- Net portfolio margining of cleared IRS positions isolates the true curve risk in a portfolio and assesses the appropriate margins to cover that risk
- Transparent to market participants, easy to replicate, and scalable to margin other IRS currencies and Futures

Margin Offsets Against Futures

- CME Group has the unique opportunity to offer unparalleled capital efficiencies via margin offsets of IRS positions against Eurodollar and Treasury Futures
- Dodd-Frank draft rules provide preliminary guidance on the process for providing these margin offsets for Customers, and CME is working to have this available mid-2012
 - Participants will have the ability to move selected futures contracts into their OTC Sequestered Account to strategically offset the risk in their swap portfolio and reduce margins
- Preliminary analysis shows significant savings for margin offsets:
 - IRS invoice swaps against corresponding Treasury Futures provide savings of up to 85%
 - IRS swaps against corresponding Eurodollar strips provide savings of up to 65%

CME Group

CDS Margin Regime

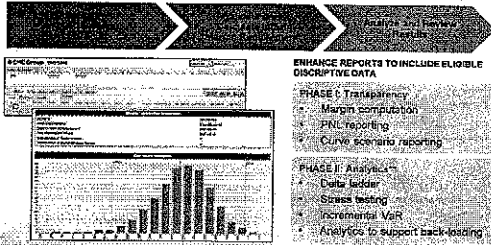


- Addresses six risk factors including the overall risk of credit market, portfolio risk, idiosyncratic risk, and liquidity risk
- Forecasts are presented as ranges with confidence intervals rather than as point estimates
- Isolates an asset's sensitivities to each risk factor
- Method is open, stable, and replicable
- CME CORE tool allows all CME and customers to easily and independently replicate the initial margin requirements

CME Group

Transparent Margins Through CME CORE

CME CORE (CME Online Risk Engine) enables customers to calculate and evaluate their initial margin requirements for IRS and CDS



ENHANCE REPORTS TO INCLUDE ELIGIBLE DESCRIPTIVE DATA

- PHASE I: Transparency**
- Margin computation
 - PNL reporting
 - Curve scenario reporting

PHASE II: Analytics

- Data loader
- Stress testing
- Incremental VaR
- Analytics to support back-loading

CME Group

Flexible Collateral for Initial Margin

CME Clearing accepts a broad array of collateral for the Customer OTC Account Class

Collateral	Haircut
US Cash	None
Non-US Cash (EUR, GBP, CAD)	5%*
Sovereign Debt of UK, Germany, France, Canada, and Sweden	5%-10.5% (maturity based)
US Treasury Debt	0.5%-8% (maturity based) Additional 1.5% for off-the-run
US Agency Debt	3.5%-7% (maturity based) Additional 1.5% for off-the-run
US Agency Mortgage Backed Securities	11%

* Haircut is only applied when cash is used to meet a margin requirement based in a different currency

Expansion of Acceptable Collateral

- CME Clearing is working with several major banks on a specialized collateral program that permits clearing firms to pledge collateral that CME does not accept directly
- This program will allow customers to post high quality corporate debt to their clearing firms to cover initial margin requirements, and these securities will be held in a tri-party account controlled by CME

CME Group

Superior Customer Protections

CME Clearing is the industry leader in protecting customers through the US FCM clearing model

CUSTOMER PROTECTION STANDARDS

- During its 113 year history as a US clearinghouse, CME Clearing has a flawless track record of protecting customers without a single loss of customer funds
- The same customer protection standards apply to cleared OTC derivatives as to exchange-traded futures
- Clearing Member Firms are monitored and audited for risk, capital adequacy, and compliance with customer protection rules and regulations
- Strong history of risk innovation, crisis management, and a deep understanding of issues related to customer protection in the US agency model
- Comprehensive approach towards default management, utilizing industry best practices, industry expertise, and default exercises to ensure readiness in a market crisis

ROBUST GUARANTY FUND

- Key layer of protection in the US Clearing market that serves as a "capital reserve" buffer during times of market stress and protects against systemic risk associated with catastrophic market events
- Sized to cover the simultaneous defaults of the 2 largest FCMs, according to the results of stress tests, which include all extreme historical events as well as "black swan" stress scenarios
- Allocated between different FCMs pro-rata according to the residual risk not covered by margins. This allocation mechanism further provides incentive to risk diversification across FCMs

CME Group

Financial Safeguards Overview

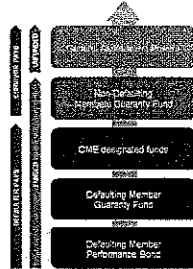
Monitoring
Real-time 24/6 daily monitoring of trading and market activity

Margining
Daily recalculation of performance bond requirements and collection of collateral

Financial Safeguards
Designed to ensure CME Clearing is able to perform on its obligations as a guarantor to its clearing members and to ensure clearing members perform on their obligations to CME Clearing

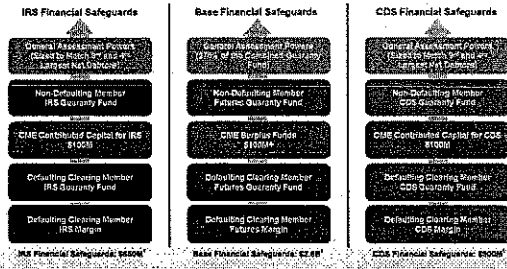
Guaranty Fund
Calculated based on clearing member firm activity levels including performance bond requirements, volume, notional, and settlement risk. Routine recalculations commensurate with market risk with minimum quarterly calculations for exchange-traded derivatives and monthly for cleared OTC products

Assessment Powers
Calculated to cover any remaining loss after consideration for guaranty fund and CME designated funds



CME Group

Financial Safeguards Structure



As of June 30, 2011. All Financial Safeguards include all Non-Member Safeguards as of June 30, 2011. © 2011 CME Group. All rights reserved. CME Group, CME, and CME Clearing are trademarks of CME Group, Inc. All other trademarks are the property of their respective owners.

CME Group

Customer Account Portability

Portability of customer positions and collateral is a cornerstone of CME customer protections

CUSTOMER CONTROLLED PORTABILITY "TRANSFERS"
Establishing and managing accounts at multiple clearing members

Clearing members are able to control the transfer of their customer's positions and collateral to the clearing member of their choice. This is the industry's first "transfer" service. The transfer process is controlled by CME. This is a matter of record and subject to audit.

PROVEN SUCCESS IN CUSTOMER PORTABILITY
Wholesale porting from stressed to solvent clearing members

In a recent porting exercise, CME facilitated the transfer of customer assets and collateral from a stressed clearing member to a solvent clearing member. This exercise demonstrated the effectiveness of CME's porting process. CME facilitates the transfer to ensure clear, secure, and verifiable records of customer positions and collateral. This is a matter of record and subject to audit.

- Portability is essential to customer protection, both in times of market stress and during the normal course of business
- CME's record of customer protection demonstrates efficient portability in times of market stress
- Portability is underpinned by CME Rule 853, governing transfers of trades

CME Group

Portfolio Margining

Dodd-Frank Regulatory Divide

CFTC regulates swaps including broad-based indicas (e.g., index CDS) and the SEC regulates security-based swaps including narrow-based indicas (e.g., single name CDS)

Segregated Accounts

Pursuant to CFTC and SEC regulations, customer-related CDS positions/margin must be segregated in separate OTC account origins

Dodd-Frank Solution

Dodd-Frank Section 713 (Portfolio Margining Conforming Changes) is the legislative solution to the regulatory divide that resulted from the enactment of Dodd-Frank

Commingling & Portfolio Margining

Dodd-Frank Section 713 provides that the SEC may grant an exemption to allow security-based positions/margin to be held in a portfolio margining account carried as a futures account subject to 4d of the CEA

Commodity Bankruptcy Treatment

Dodd-Frank Section 713 provides that the SEC shall exercise its authority to ensure that securities held in a portfolio margining account carried as a futures account receives commodity law bankruptcy treatment

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Multiple Regulators & Potential Designation of a Derivatives Clearing Organization as a Systemically Important Financial Market Utility

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OTC Clearing – Multiple Regulators

- CFTC
- SEC
- The Financial Stability Oversight Council
 - Systemically Important Financial Market Utilities
- FSA

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Regulatory and Industry Collaboration

US Regulatory Status

- CME is registered with the CFTC as a Derivatives Clearing Organization (DCO)
- CME deemed a registered Securities Clearing Agency (SCA), effective July 16, 2011, in accordance with certain provisions under Section 763(b) of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010
- Received no-action letter from the Division of Investment Management at the SEC, which permits CME Clearing member FCMs to hold property of 40 Act Funds as margin for CTC cleared ODS contracts, extended through December 31, 2011
- Expecting "systemically important" designation

UK Regulatory Status

- CME Clearing is a Recognized Overseas Clearing House (ROCH) with the UK Financial Services Authority
- CME Clearing Europe is a Recognized Clearing House (RCH) with the UK Financial Services Authority

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QUESTIONS

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1. What are the relevant factors that should be considered for deciding whether a type or class of swaps should be cleared?
2. Can clearing of certain swaps increase systemic risk or threaten the financial integrity of a clearinghouse?
3. Beyond margin and collateral posted by a defaulting clearing member, what types of financial resources should a clearinghouse have available to cover a default? What level of financial resources should a clearinghouse have available to cover a default by a clearing member?
4. Are there special challenges in managing the risk of default of a clearing member with respect to cleared swaps or security-based swaps compared to cleared futures? How should clearinghouses and regulators address those challenges?
5. What role should the regulator have in overseeing or participating in the management of a clearing member's default?

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U.S. Commodity Futures Trading Commission
International Symposium and Training Program

Regulation of Derivatives Products, Markets and Financial Intermediaries for
International Market Authorities

October 20, 2011

Crisis Management – Practice Session

Eileen T. Flaherty

Global Head of Compliance/FCP

Newedge Group

The following are hypothetical questions and are not based on any real firms or market situations.

1. THOSE EXCESS SPECULATORS

Everbright is a well-known commodity index fund located outside of your jurisdiction that maintains two funds based on two strategies: "Commodity Advantage," is a passive long only fund that maintains only long positions in diversified commodity futures traded worldwide, and "Commodity +," which is an actively traded fund seeking to take advantage of perceived anomalies in the commodities markets.

The prices of oil and grains begin to rise dramatically in your jurisdiction causing a dramatic increase in price in gasoline/petrol, bread, and rice. Although there are fundamental marketplace reasons that could support price rises, your local politicians are condemning the role of "speculators" in such price increases and demand that your agency "do something about it!" In response, you notice that Everbright maintains substantial long positions in both of its funds in crude, wheat, and rice futures that are traded on derivatives exchanges in your jurisdiction.

- A. What steps, if any, should you take in response to this situation?
- B. Do you have the jurisdiction to obtain any information?
- C. Are there any actions that your agency should, or could, take?
- D. Do your answers above change, if your Enforcement staff advised you that there is no evidence that Everbright is engaging in manipulative conduct, but solely maintains large positions?

2. THOSE LITTLE MANIPULATORS

Noname is a firm that trades in futures and securities and is regulated in your jurisdiction. Noname also conducts business in markets such as gemstones, over-the-counter electricity and natural gas derivatives that are not regulated by the recognized securities or futures regulator in your jurisdiction. The prices of electricity and natural gas in your jurisdiction have skyrocketed. In fact, the local power suppliers are not able to supply enough power to meet the needs of the consumers and businesses in the local jurisdiction. The political leader in the jurisdiction has declared a state of emergency. There are rumors that Noname and other trading firms are manipulating the prices of electricity and natural gas through the use of over-the-counter trading and this has caused the price spikes and shortages. As the securities and futures regulator in your jurisdiction, please address the following:

- A. Do you have any jurisdiction to investigate the rumors for these over-the-counter markets? Are these markets regulated to the same level as exchange traded markets? Should they be?

- B. What steps can you take to investigate these rumors?
- C. Can you request the books and records of Noname's business in these over-the-counter markets? Is Noname required to cooperate?
- D. Can you order Noname to cease trading in the over-the-counter markets pending an investigation?
- E. Does it matter that Noname's stock is listed on the securities exchange in your jurisdiction?
- F. Assume that Noname's main office is not within your jurisdiction, but Noname has a branch office in your jurisdiction. Noname's branch office is registered in your jurisdiction to conduct investment business. Do you have any authority or jurisdiction to investigate or request Noname's books and records with respect to its trading in gemstones, over-the-counter electricity, and natural gas that is not conducted from the branch office within your jurisdiction?

3. TOO BIG TO FAIL

Happy Exchange (HAPPEX) offers a 24-hour futures and securities electronic trading system. HAPPEX is so successful that it has tripled its volume within the past year. Publicly, the exchange is promoting its electronic system and its ability to handle all of the volume that its users demand. Privately, the exchange has serious concerns regarding the ability of the system to handle the level of trading and is concerned about a degradation of the system if the volume increases. As the regulatory authority in the jurisdiction where HAPPEX is located, please consider the following:

- A. Should the regulatory authority have any responsibility or obligation to review the functionality of an electronic system that is offered to users within its jurisdiction?
- B. Does it matter if the electronic system is offered by an exchange that is not located within your jurisdiction, but customers in your jurisdiction have access via direct terminals provided by HAPPEX or through order routing systems?
- C. Should any such responsibility be a one-time review or is it an ongoing responsibility?
- D. If the regulatory authority becomes aware of any constraints on the functioning of an electronic trading system that is offered to users within its jurisdiction, what steps can, or should, be taken?
- E. What if HAPPEX is a publicly held company? Would that change in any way the actions that your regulatory authority would take?
- F. Should the users of the system have recourse against HAPPEX for losses caused by the faulty system? Is this an issue to be resolved by the regulators?

4. LITTLE SECRETS

HAPPEX has a separate clearing organization, Happy Clearing Inc. (Happy Clearing), that clears those transactions executed on HAPPEX, as well as over-the-counter swaps. One of the reasons that Happy Clearing maintains its sterling reputation is that it has in place two significant safety features that it frequently advertises in its Foolproof Safeguards brochure. The first is default insurance which is underwritten by two of the world's largest leading insurers, Insurance Americans Guarantee and Floyds of Fondon. The second is a line of credit, which is available from two large international banks, Bank Nowhere and Bank Somewhere. The line may be drawn upon up to 10 billion dollars upon one hour notice. Assume that you are the regulatory authority for HAPPEX and Happy Clearing and learn that one of the insurers, and both banks, are experiencing financial setbacks that call their ability to perform into doubt. How should you advise?

- A. Does Happy Clearing have an obligation to inform its regulatory authorities?
- B. What actions should the regulatory authorities take?
- C. Does Happy Clearing have an obligation to inform its clearing members regarding the change in status of one of its insurers and/or the international banks?
- D. Does it, or HAPPEX, have an obligation to notify market users of HAPPEX?

- E. Does it have an obligation to arrange for alternative sources of insurance? What if the cost is prohibitive?
- F. Does it matter if HAPPEX Holdings (Parent company of HAPPEX and Happy Clearing) is a publicly held company whose shares are owned by public investors? Would that change in any way the actions of the regulatory authority in your jurisdiction?

5. HERE TODAY, GONE TOMORROW

Happy Clearing clears many types of financial instruments including futures, securities, foreign exchange and privately negotiated over-the-counter swap transactions. Happy Clearing also has several cross margin arrangements with other global clearing organizations. The clearing members of Happy Clearing include most large global financial institutions (through their affiliates). Happy Clearing has a robust risk management system and financial resources to withstand the default of its two largest clearing members. Things are going along just fine until you are out of town on business on October 20, 2011, and receive a call from a colleague that the markets have been so volatile, a foreign government is about to default and consequently multiple clearing firms of Happy Clearing are thought to be on the brink of default to Happy Clearing. Please advise on the following:

- A. Assume that Happy Clearing is located within your jurisdiction, what are the first steps that the regulator should take?
- B. Assume that Happy Clearing is not located in your jurisdiction, but many regulated financial firms under your jurisdiction have affiliates that are members of Happy Clearing; what, if any, actions can or should you take? What, if any, jurisdiction do you have to request information from Happy Clearing?
- C. What obligations does the regulatory authority with jurisdiction have to try to move the clearing member and customer's positions to another clearing organization or merely to liquidate the positions? What if there is not another clearing organization within your jurisdiction that is able to take over the clearing obligation of Happy Exchange?
- D. What obligation does the regulatory authority have to notify the market users or take additional steps?

6. FAILURES IN LIFE

Too Big to Fall Trading Company is a well-respected global registered futures, and over-the-counter derivatives securities firm. The firm has some proprietary traders, maintains clearing accounts and executes give-up business for institutional and individual customers. The firm is a clearing member either directly or through affiliates, of most recognized futures and securities exchanges around the world. Too Big has omnibus relationships in place for those exchanges on which it is not a clearing member. The firm has a 24-hour operation, which allows proprietary traders and customers to execute orders through various after-hours electronic trading systems. Assume that you are the regulatory authority for one of the Too Big affiliates and you receive an anonymous call at 2:00 a.m. to inform you that a customer that has an account with the Too Big affiliate has executed a series of trades that have resulted in a substantial loss and could jeopardize the financial ability of that affiliate. How would you address the following:

- A. Would you contact the Too Big affiliate within your jurisdiction? What if the firm tells you that these are merely rumors and that there are no problems?
- B. Should you consult with other regulatory authorities including in other jurisdictions where Too Big has affiliates?
- C. How do you, as a regulator, assess the situation with the whole market knowing that there is a concern?
- D. Assume that you contact the Too Big affiliate in your jurisdiction and they indicate there may be a problem, what are the steps to take? Will you coordinate efforts with regulators in the jurisdictions of other affiliates to determine if the problem is broader and to collectively determine a proper course of actions?

- E. What are those actions; i.e., move positions to another clearing firm, liquidation? What if there is a shortfall in margin and there will be collective losses across customers? What factors would help to decide?
- F. Are there additional, or different, steps that can be taken if certain of Too Big's affiliates located outside of your jurisdiction are fully solvent and have more than enough capital and the affiliate in your jurisdiction is on the verge of bankruptcy which will result in customer losses. Do you have any authority or jurisdiction to take action with respect to the affiliates outside of your jurisdiction. Would you contact other regulatory authorities in different jurisdictions to seek assistance?

7. IT COULD NEVER HAPPEN HERE

Assume that you are the regulator in a major city in one of the world's largest financial centers. You have just received notification that, due to an internal conflict and potential global unrest, all of the office buildings in the area must be immediately evacuated for the safety of the employees. The evacuation includes not only your office, but the main offices within the area of the major international financial firms. Fortunately, or unfortunately, all exchanges within the area are electronic and are not dependent on any of the local offices. In other words, the exchanges are able to continue trading.

- A. What are your responsibilities as a regulator to have back-up facilities to continue to monitor the markets from off-site locations?
- B. What obligations are imposed on the firms that you regulate to notify the regulator of the evacuation?
- C. Should regulatory authorities require firms to have formalized back-up plans as part of the registration process? Should the regulator review any such facilities as a condition of registration?
- D. Is the same true for exchanges, clearing organizations, and settlement banks?
- E. Is the regulator responsible to review and audit the back-up plans?

8. RUMORS

Ramaanth is a large and well known hedge fund that is located outside of your jurisdiction. However, since Ramaanth has been so successful in its investment returns, investors in your jurisdiction have likely invested in Ramaanth's hedge fund. It is well known that Ramaanth is highly leveraged in volatile mortgage-backed securities, energy futures, and over-the-counter credit default swaps. Ramaanth is the counterparty to most well-known international securities and derivatives firms in its over-the-counter transactions. The firm's principals are considered by some to be the world's greatest luminaries in the financial markets and, in fact, they have just published their own book "Brilliance Never Fails". On October 20, 2011, as you are out of the office on business (a brilliant symposium), you receive a message that there are rumors that Ramaanth has had significant losses that may impact its financial condition. In fact, the rumors are that Ramaanth is about to file for bankruptcy. The rumors further indicate that any such bankruptcy may have an effect on other well-known international securities and derivatives firms. Please consider the following:

- A. Since Ramaanth is located outside of your jurisdiction, are there any steps that you can take? What would they be?
- B. Assuming that investors in your jurisdiction may have invested in Ramaanth's hedge fund, but it is not located in your jurisdiction, can you obtain any information? What steps would you take? Is Ramaanth required to cooperate with you?
- C. Should you consult with governmental or regulatory authorities in other jurisdictions where you believe Ramaanth does business? Are these regulatory authorities obligated to provide you with any information?
- D. Do you, as the regulator, have any ability to assist investors within your jurisdiction to obtain their money back (assuming there is any)?

9. THE GLOBAL TRADING VILLAGE

Longing International Futures Exchange, a securities and futures exchange located within your jurisdiction, prides itself on being a leader in the development of new financial products to offer to market users. Longing has decided to create a new product called future/stock. The product will be individual futures contracts based on the most actively traded equity securities listed on exchanges around the world. Longing launches this new product which is incredibly successful from the first day of trading. The futures contracts are highly volatile and attract both institutional and individual customers. You are the regulatory authority for Longing and receive a call from the Stock Enterprise Commission (SEC) which is the regulatory authority, in another jurisdiction, for the exchange where many of the equity securities are traded. The Stock Enterprise Commission complains to you that the futures/stocks are being used to manipulate the underlying equity securities listed on the exchange that is in their jurisdiction. In fact, the Stock Enterprise Commission wants to launch an investigation regarding the practices at Longing regarding offering futures/stocks. Although you think that the Stock Enterprise Commission is really just annoyed that the market has been successful, please consider the following:

- A. Does the regulatory authority for Longing have an obligation to conduct an investigation of its own?
- B. Would this be done in coordination with the Stock Enterprise Commission?
- C. What are the obligations of the regulatory authority for Longing to cooperate and offer information regarding the users of futures/stocks traded on Longs to the Stock Enterprise Commission?
- D. Are there confidentiality concerns regarding sharing of this information?

The Investigative Process

Prepared by:
Rosemary Hollinger &
Melissa Glasbrenner



Preliminary Review and Information

- Review Complaint Source
- Check registration files
- Conduct Other Searches
- Obtain Documents
- Conduct Voluntary Interviews



First Steps

- Law: What does the law require?
- Facts: What are the facts?
- Is there a violation?
- What evidence do you need to show a violation?



Other Sources of Information

- o Mass FCM Contact Via E-mail or Mail
- o Exchanges
- o CFTC Sources
 - o Office-wide ENF e-mail
 - o Other Divisions



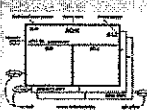
Other Sources of Information Available

- o Other Government Agencies
- o Commercial Databases
- o Google
- o Other country's regulators



Documents WE can Get

- o Account Opening Documents
- o Correspondence
- o Customer Complaints
- o Account statements
 - o Daily
 - o Monthly
- o Account Receipts/Disbursements
- o Trading Orders/Tickets
- o Back Office Computer runs



Types Of Written Requests

- ◊ Voluntary Productions
- ◊ Non-registrant
- ◊ Required
 - ◊ All registrants must make reports as required and keep books and records pertaining to trading
- ◊ Subpoena
 - ◊ Non-Registrants and Financial Institutions
 - ◊ Registrants for non-required records



Subpoena Power: What We Can Do With it

- ◊ Obtain Documents
- ◊ Take Testimony



The Procedure to get Subpoena Authority

- ◊ Staff prepares a memo
- ◊ Reviewed by staff in DC
- ◊ Reviewed by Commission who grants a formal order of investigation



Mechanics of Requesting Documents

- o Determine broad vs. narrow approach
- o Include Attachment with:
 - o Appropriate definitions, scope, etc.
 - o Description or type of documents sought
 - o Relevant time period defined
 - o Any limitations
 - o Data Delivery Standards

Documents that Typically Require a Subpoena

o Financial Institutions

- o Bank (5 Year Limit)
 - o Account Opening Documents
 - o Checking/Savings Account Statements
 - o Deposits/Withdrawal Items
 - o Cancelled Checks
 - o Cashier Checks etc.
 - o Charge Card Account Statements etc.



Additional Document Requiring Subpoenas

- o Telephone (18 Month Limit)
 - o To identify who an entity is calling
 - o How often being called
 - o Identify Internet Service Provider
- o Internet
 - o To identify the owner of a website
 - o Where it is domiciled



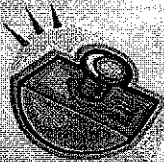
Additional Documents that May Require Subpoenas



- Federal Express
 - or other delivery type records
- Mortgage or Landlord
- Printed Advertisements
 - Newspapers
 - Magazines
- Radio or Television spots

Now That You've Got Documents What Do You Do?

- Review for completeness
 - Follow up for missing items
- Organize
- Number them



Now That You've Got Documents What Do You Do?

- Review the documents
- Share/discuss production with other team members
- Analyze the documents



Electronic Searches

- o Key search terms
 - o Get to know your system
 - o "Customer Account"
- o Search Metadata
- o Utilize Important Numbers
 - o Checks, dated emails, specific trades



Electronic Searches

Search Number	Number of Files	Number of Docs	Search Term(s)
0000	112,078	112,078	<Entire Database>
0001	290,950	66,923	account
0002	36,931	9,770	statement
0003	7,356	3,097	(account ADI statement)
0004	14,619	5,355	September
0005	18,117	382	Trade

Voluntary Interviews

- o Prepare by:
 - o Reviewing potential violations
 - o Determining the goals of your interview
 - o What facts/information are you trying to develop?
 - o Identifying persons who have knowledge of the subject and with whom you need to speak

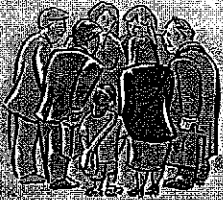


Witness Interviews

- o Informal and Voluntary
- o Formal and Voluntary—they don't have to answer questions
- o Formal and Compelled—they have to answer questions
- o Formal Interviews are recorded

Who Can be Present?

- o 1. Witness
- o 2. Commission staff
- o 3. Witness lawyer
- o 4. Court reporter



Representation by Counsel

- o 1. Witnesses can always be represented by a lawyer
- o 2. Potential conflicts
 - o Witness can always terminate testimony if an anticipated conflict arises during testimony



Why do we interview?

- To confirm what we know or think we know
- To get evidence we need
- To test our theories
- To preserve testimony

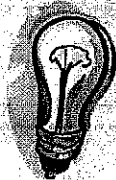


Why do we interview?

- To get facts
 - To learn things we don't know
 - To confirm things we think we know
 - To find out identity of other witnesses or location of documents

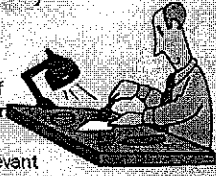
Structure of an Interview

- Start with general then specific;
- Logical flow and order;
- Follow-up when necessary:
technical answer,
unclear/evasive answer &
incomplete answer.
- Start friendly, end with the hard questions



Taking Testimony: Generally

- Be Prepared:
 - Know the facts;
 - Have a clear picture of where the investigator going; and
 - Collect and review relevant documents



Preparation

- Review any pertinent documents
 - Make copies of any significant documents witness authored or received
 - Start a Time Line or Chronology Chart of Significant Dates
- Prepare an outline of topics/questions before the interview
- Request additional documents the person may have related to the investigation



HOW TO PREPARE: GOALS

- Ask yourself:
 - Goal of testimony, and
 - Review relevant violations



Question Form

- Short
- Begin with who, what, when, where, why, how
- Describe & Explain



Time to Practice

- Get a partner
- Think of an accident you saw



First Round

- Goal is to find out every thing you can about the accident from your partner in 1 minute
- You can only ask questions that your partner can answer with yes or no.
- GO!


Second Round

- o Partner 2's turn
- o Goal is to find out everything you can about the accident in 1 minute, but you can only ask 1 question.
- o GO!

What did you learn?

Good Questions

- o Short
- o Begin with Who, What, When, Where, Why, How
- o Describe, Explain
- o This is the most important thing you can learn about (interviews)



Exercise 2

English	Language: _____
Who?	
What?	
When?	
Where?	
Why?	
How?	

What else is important?

- ∅ Don't use characterizations
- ∅ Don't use should, could
- ∅ Don't fight with the witness
 - ∅ But, make him answer your questions
- ∅ Establish chronology



Documents

- ∅ Refer to exhibits by number;
- ∅ Describe the exhibit and have witness agree;
- ∅ Inquire about life cycle of document



What is the Life Cycle of a Document?

- o Beginning (Birth)
- o Middle (Life)
- o End (Burial)

Ask witness the following:

- o Who prepared it;
- o When was it prepared;
- o Where was it prepared;
- o Why was it prepared;
- o How document was used; and
- o When it ceased to be effective



Wrapping Up

- o End with the hard stuff
- o Ask the witness if he wants to add or clarify anything
- o Tell the witness you may want to speak to him again.

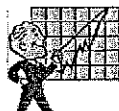




United States Commodity
Futures Trading Commission

Division of Enforcement
October 20, 2011
Chicago, Illinois

1



Presenter

Susan A. Berkowitz
Deputy Chief Counsel
Division of Enforcement

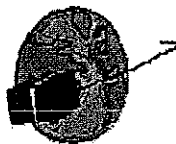
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International
Cooperative Enforcement

Office of the Chief Counsel

Phyllis Cela
Susan Berkowitz
Elizabeth Padgett
Ted Kneller
Mary Lutz
Stephanie Horne



3

Providing Assistance to Foreign Futures Authorities

- CFTC may, upon the request of a foreign futures authority, or a department or agency of a foreign government or political subdivision thereof, acting within the scope of its authority, furnish non-public information obtained in connection with the administration of the Act.

4

Providing Assistance to Foreign Futures Authorities

- Only if the CFTC is satisfied that the information will not be disclosed by such foreign futures authority, department or agency
- Except in connection with an adjudicatory action or proceeding brought under the laws of the foreign government or political subdivision and to which such foreign government, political subdivision, agency, department, or foreign futures authority is a party

5

Providing Assistance to Foreign Futures Authorities

- If the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, or is about to violate any laws, rules or regulations relating to futures or options matters that the requesting authority administers or enforces



6

Providing Assistance to Foreign Futures Authorities



- Underlying facts do not need to constitute a violation of US law
- CFTC need not have an "independent interest" in the matter to provide assistance

7

Providing Assistance to Foreign Futures Authorities



- In deciding whether to provide assistance, CFTC shall consider:
 - if requesting authority has agreed to provide reciprocal assistance to CFTC; and
 - If compliance with the request would prejudice public interest of U.S.

8

Common Cases Requiring International Assistance



- Trade Practice
- Manipulation
- Fraud or Deception
- Misappropriation
- Manipulative and Deceptive Trade Practices
- Registration and Fitness

9

How CFTC Can Provide Assistance

Use Investigation Authority:

- Inspection Powers
 - Voluntary statements with series of oral or written notices
 - Letters requesting information to registrants
 - Inspection powers of registrant's books and records (including trading records)



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How CFTC Can Provide Assistance

Use Investigation Authority:

- Public Information
 - Registration information
 - Reports that CFTC routinely collects
- Non-Public information
 - CFTC's investigation files
 - Non-public registrant information
 - Confidentiality concerns

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How CFTC Can Provide Assistance

Use Investigation Authority:

- Compulsory Powers – Subpoena Power
- To compel production of documents and statements
 - Bank records
 - Beneficial ownership records
 - Testimony



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How CFTC Can Provide Assistance



- Obtain Order of Investigation
- Subpoenas are not self-executing and must be enforced by an order obtained from the appropriate federal court
- May entail disclosure of existence and certain aspects of investigation

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Procedure To Obtain Assistance



- IOSCO MULTILATERAL MOU
- MOU or other cooperative arrangement
- Confidentiality Undertaking



14

When You Get It Depends... on What You Request



- If you are requesting
 - Registration information
- How we can assist
 - Information is in Commission files
 - Public
 - Readily available

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When You Get It Depends... on What You Request



- If you are requesting
 - A Briefing on a CFTC Investigation
 - Access to CFTC Investigative Files
- How we can assist
 - Information is in Commission files
 - Readily available

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When You Get It Depends... on What You Request



- MOU/MMOU partners
 - An informal request for a briefing
 - A formal Request for Assistance for files
- Others
 - Standard Request for Assistance
 - Need safeguards, assurances of confidentiality, use restrictions

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When You Get It Depends... on What You Request



- If you are requesting
 - Required Records
 - FCM/trade records
 - Beneficial owner records
- How we can assist
 - Available from regulated entities
 - We ask on your behalf

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When You Get It Depends... on What You Request



- MOU/MMOU partners
 - Request for Assistance
- Others
 - Standard Request for Assistance
 - Need safeguards, assurances of confidentiality, use restrictions

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When You Get It Depends... on What You Request



- If you are requesting
 - Bank records
 - Telephone records
 - ISP records
 - Testimony
- How we can assist
 - All require a subpoena
 - Takes longer

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When You Get It Depends... on What You Request



- MOU/MMOU partners
 - Request for Assistance
- Others
 - Standard Request for Assistance
 - Need safeguards, assurances of confidentiality, use restrictions

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Contact Us

Office of the Chief Counsel
Division of Enforcement
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
202-418-5000
OCCinternational@cftc.gov

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Questions and Discussion




23

TRADE PRACTICE
The Issue is Integrity
Presented by:
Rosemary Hollinger & Melissa Glasbrenner

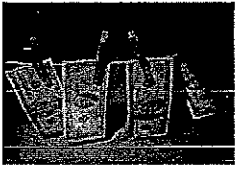
PRICE DISCOVERY MARKETS

- o Integrity at every level
 - Prices
 - Execution of Trades
 - Brokers who execute trades
 - Intermediaries



MARKET AND PRICE INTEGRITY

- o Manipulative Trade Practices
 - Marking the close
 - Playing the rules
 - Spoofing
 - Wash Sales



MANIPULATION

o Four-factor test to determine whether a respondent has manipulated prices:

- (1) The accused had the ability to influence market prices;
- (2) The accused specifically intended to do so;
- (3) The "artificial" prices existed; and
- (4) The accused caused the artificial prices.

ATTEMPTED MANIPULATION

o Intent to affect the market price
o Some overt act



NEW LAW—DODD FRANK

o Unlawful for any person, directly or indirectly to use or employ or attempt to use or employ, in connection with any swap, or contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate.

o Manipulation by false reporting

MARKING THE CLOSE

- o What is it?
- o How is it done?
- o What does it look like?
- o Why do it?
 - Physical contracts priced at settlement value
 - Options Expiration, but may effect other markets



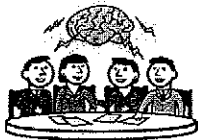
TRADING IN CONCERT

- o Example given was "an actor, alone or with others, behaves in such a way as to manipulate the established rules with regard to relaxing or tightening daily price limits (such as not trading for 5 days in order to raise the price range to 10%)



TRADING IN CONCERT

- o Express Agreement
- o Implied Agreement or Understanding
 - Common trading patterns or strategies
 - Common business, financial and social relationships
 - Common access to account and trading information



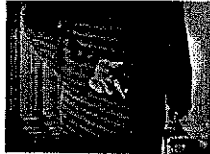
TRADING IN CONCERT: MORE FACTORS

- o Common financing (money transfers, loans)
- o Common intermediaries
- o Common recordkeeping
- o Relative inexperience of one or more traders
- o Family relationships



SPOOFING

- o Bidding without the intention of trading
- o How do you distinguish between trader who bids in good faith and one who is spoofing?
 - Intent
 - o Express
 - o Implied
 - o These cases are very difficult.



WASH SALES

- o "trades are intentionally undertaken for the purpose of giving the appearance that the trades have been executed, without positions being taken in the market or any actual change in the account holder's market position."



WASH SALES

- o Trader appears to be making independent decisions to buy and then sell (or sell and buy)
- o But in fact, his intention at the time he initiates the transaction is to both buy and sell the contract at the same or a similar price
- o To create a financial and position nullity



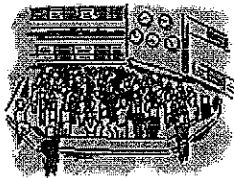
ELEMENTS OF WASH SALE

- Simultaneous buy & sell
- Structured to eliminate or minimize risk
- No intent to take bona fide market position



PRICE INTEGRITY

- o Open and Competitive Execution of Trades
 - Pre-Arranged/Non-competitive Trades
 - Bucketing : Indirect/Direct
 - Non-bona Fide Price
 - Fictitious Sales—ex-pit trades

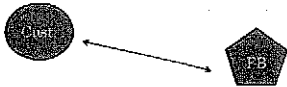


INTEGRITY IN EXECUTION

- o Trading Ahead
- o Disclosure of Order
- o Mis-allocation
- o Out-trades

TRADE EXECUTION ON THE FLOOR

- o Bucketing- broker trades opposite customer



TRADE EXECUTION ON FLOOR

- o Indirect Bucketing or ITOS (indirectly taking opposite side) and Accommodation Trading



WASH SALE

- o Simultaneous buy & sell

The diagram illustrates two simultaneous transactions. In the first, a triangle (representing a buyer) has an arrow pointing to a square (representing a seller). In the second, a square (representing a buyer) has an arrow pointing to a triangle (representing a seller).

WASH SALE

The diagram shows a triangle on the left and a square on the right, connected by a double-headed horizontal arrow, indicating a simultaneous exchange between the two parties.

- o When:

The diagram shows a triangle on the left, a square on the right, and a double-headed horizontal arrow between them, similar to the previous diagram.

FIRST SCENARIO

- o Manipulation on the Exchange floor
 - How do we investigate?

A large, dark, textured rectangular area, possibly representing a video recording or a heavily redacted image.

INVESTIGATIVE STEPS

- o Discussion....

INVESTIGATIVE STEPS


- o How is it detected in the first place?
- o Do not destroy letters to firms and exchange
- o Investigative Plan
- o Document requests
- o Economic Analysis
- o Interview Witnesses
- o Formal testimony

THE CHALLENGES

- o Audit Trail Problems
- o Witness recollection
- o Anything else?


SECOND SCENARIO

- o Electronic Trading
 - How do we investigate?




INVESTIGATIVE STEPS

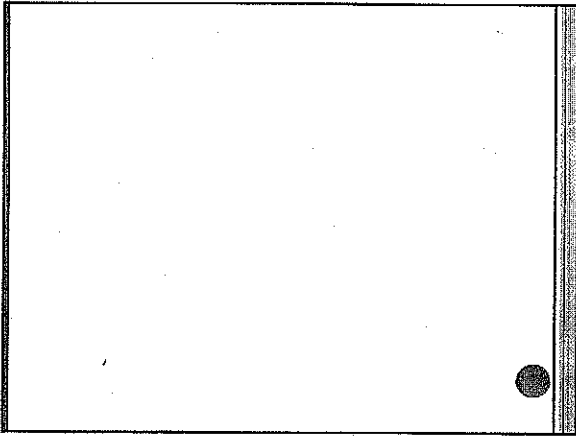
- o Discussion....



INVESTIGATIVE STEPS

- o How is it detected in the first place?
- o Do not destroy letters to firms
- o Investigative Plan
- o Document requests
- o Economic Analysis
- o Interview Witnesses
- o Formal testimony





HYPOTHETICALS FOR SESSION ON
OPERATIONAL AND COMPLIANCE ISSUES FACING THE OTC MARKETS
CFTC PROGRAM FOR INTERNATIONAL REGULATORS
CHICAGO, ILLINOIS
FRIDAY, OCTOBER 21, 2011

BACKGROUND

ABC BROKERAGE INC. ("ABC-U.S."), BASED IN NYC, IS REGISTERED AS A BROKER DEALER WITH THE SEC, AS A FUTURES COMMISSION MERCHANT WITH THE CFTC, AND IS A MEMBER OF FINRA, NFA AND ALL THE MAJOR U.S. SECURITIES AND FUTURES EXCHANGES. ABC HAS AFFILIATES AROUND THE GLOBE IN ALMOST EVERY MAJOR FINANCIAL CENTER THAT PROVIDES SIMILAR BROKERAGE, CLEARING AND EXECUTION SERVICES TO PERSONS AND FIRMS LOCATED IN THOSE COUNTRIES. ABC-U.S. OR ITS AFFILIATES IS THUS A MEMBER OF ALL OF THE MAJOR GLOBAL EXCHANGES AND CLEARING HOUSES. ABC-U.S. IS A WHOLLY-OWNED SUBSIDIARY OF ABC HOLDINGS, WHICH HAS ITS PRINCIPAL OFFICE LOCATED IN THE U.K. ABC FINANCE, BASED IN NYC, IS ENGAGED AS A DEALER INVOLVING ALL TYPES OF OTC DERIVATIVES, FORWARDS, OPTIONS AND OTHER COMPLEX TRANSACTIONS. ABC-UK, BASED IN LONDON, IS REGISTERED WITH THE UK FSA TO CONDUCT AN INVESTMENT BUSINESS INVOLVING ALL FINANCIAL PRODUCTS AND TRANSACTIONS. FOR PURPOSES OF THIS PANEL, ASSUME ALSO THAT THERE IS AN ABC-U.S. AFFILIATE LOCATED IN YOUR COUNTRY.

ABC-U.S.'S TWO PRINCIPAL OFFICERS ARE SIR GAROL DEFLOOR WHO HAS PRINCIPAL RESPONSIBILITY OVER ITS GLOBAL BROKERAGE BUSINESS AND LORD RENEE FILLERUP, WHO HAS PRINCIPAL RESPONSIBILITIES OVER ABC FINANCE AND ABC AFFILIATES AROUND THE GLOBE THAT ENGAGE IN OTC DERIVATIVES ACTIVITIES. ABC HOLDINGS, THE PARENT COMPANY OF ALL OF THE ABC AFFILIATES AROUND THE GLOBE, HAS AN EXECUTIVE COMMITTEE COMPRISED OF FIVE MEMBERS. BOTH DEFLOOR AND FILLERUP ARE MEMBERS OF THESE TWO EXECUTIVE COMMITTEES, INCLUDING THE ABC AFFILIATE LOCATED IN YOUR COUNTRY.

REGISTRATIONS

1. WHAT REGISTRATIONS, IF ANY, MUST **DEFLOOR** AND **FILLERUP** HAVE IN YOUR COUNTRY?
2. WHAT REGISTRATIONS, IF ANY, MUST THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY HAVE?

CUSTOMER ASSET PROTECTION

1. IN ORDER TO HOLD CUSTOMER FUNDS, MUST THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY OPEN A CUSTODIAN ACCOUNT WITH A BANK LOCATED IN YOUR COUNTRY OR CAN IT USE A CUSTODIAL BANK LOCATED IN A DIFFERENT COUNTRY?
2. MAY THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY COMBINE CUSTOMER ASSETS WITH ITS OWN ASSETS IN THESE BANK ACCOUNTS?
3. WHAT KIND OF ACCOUNTS MUST THE **ABC AFFILIATE** IN YOUR COUNTRY OPEN AT EACH CLEARING HOUSE LOCATED IN YOUR COUNTRY?
ANY UNIQUE DOCUMENTATION REQUIRED?

SWAP EXECUTION FACILITIES/EXCHANGES

ASSUME THAT **ABC FINANCE** HAS A TRADING PLATFORM THAT ALLOWS ITS SWAP CUSTOMERS TO PLACE REQUESTS FOR QUOTES. THE **ABC AFFILIATES** LOCATED IN YOUR COUNTRY ALSO USES THIS SAME PLATFORM BUT UNDER THEIR OWN NAME, KNOWN AS WHITE LABELLING.

1. MAY **ABC FINANCE** CONTINUE TO OFFER ITS TRADING PLATFORM WITHOUT REGISTERING IT UNDER ANY CATEGORY IN YOUR COUNTRY? ARE ANY REGISTRATIONS OR FILINGS REQUIRED FOR THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY?
2. WHAT ARE THE REQUIREMENTS, IF ANY, IN YOUR COUNTRY REGARDING HOW SWAPS MAY BE EXECUTED?

NET CAPITAL REQUIREMENTS AND CLEARING

1. WHAT ARE THE MINIMUM NET CAPITAL REQUIREMENTS OF THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY?
2. UNDER WHAT CIRCUMSTANCES MUST ANY OF THE **ABC AFFILIATES** BECOME A CLEARING MEMBER FIRM OF A CLEARING HOUSE LOCATED IN YOUR COUNTRY?
3. WHAT EXCEPTIONS, IF ANY, APPLY TO ANY APPLICABLE MANDATORY CLEARING REQUIREMENT IN YOUR COUNTRY?
4. CAN ANY OF THE **ABC AFFILIATES** LOCATED OUTSIDE YOUR COUNTRY OPEN AN OMNIBUS ACCOUNT WITH THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY?

INSOLVENCY ISSUES

1. IF **ABC-U.S.** FILES FOR BANKRUPTCY BUT **ABC FINANCE** DOES NOT, CAN **ABC FINANCE** CONTINUE TO TRADE SWAPS ON AN SEF? CAN THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY CONTINUE TO DO BUSINESS THERE OR WHAT ACTIONS WILL YOU TAKE AGAINST THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY IF ONE OF ITS AFFILIATES, **ABC-US**, IN THIS CASE, FILES FOR BANKRUPTCY?
2. IF A CUSTOMER TRADES U.S. FUTURES, NON-U.S. FUTURES, U.S. SWAPS AND NON-U.S. SWAPS THROUGH THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY, WILL THERE BE ANY DIFFERENCES AS TO HOW THESE ASSETS AND RELATED FUNDS WILL BE HANDLED IN THE EVENT OF A BANKRUPTCY OF THE **ABC AFFILIATE** LOCATED IN YOUR COUNTRY?
3. IF A MAJOR FINANCIAL INSTITUTION FILES FOR BANKRUPTCY IN YOUR COUNTRY, WHAT STEPS DO YOU TAKE TO NOTIFY REGULATORS IN OTHER COUNTRIES?

HIGH FREQUENCY TRADING, FRAUD AND ANTI-MARKET DISRUPTION

1. HOW DOES YOUR COUNTRY REGULATE HIGH FREQUENCY TRADERS?
2. WHAT ARE THE ELEMENTS OF PRE-TRADE CONTROLS THAT FINANCIAL FIRMS MUST HAVE IN YOUR COUNTRY BEFORE THEY CAN OFFER THEIR TRADING PLATFORMS TO PERSONS OR FIRMS LOCATED IN YOUR COUNTRY?

Commodity Futures Trading Commission
International Symposium for Regulators

Federal Reserve Bank of Chicago

October 21, 2011

Presenter: John Sanaghan, Associate, IFM*

Hail Freedonia

11:00 - 12:30

"A Hypothetical Case Study in Commodity
Trading, Regulators and Ethics"

**The Institute for Financial Markets (IFM), founded in 1989, is a nonprofit, industry-sponsored educational foundation. The IFM provides quality information and education to increase public understanding of the importance of financial markets and the financial service industry to the global economy; and to improve the technical competence of those in the industry who deal with the public. The Institute focuses its work in three primary areas - education, ethics and data.*

Hail Freedonia

"A Hypothetical Case Study in Commodity Trading, Regulators and Ethics"

Cast of Characters

Jacques Dory	CEO of Silver Lining Corp., Vice-chairman of the Commodity Exchange of Freedonia.
Basil Froth	Chief Trader, Silver Lining Corp.
Sandy Pilchard	Senior Floor Clerk, Silver Lining Corp.
Bill Mace	Director of Enforcement, Freedonia Financial Authority
Rosemary Flan	Investigator, Freedonia Financial Authority
Olivia Caper	Governor General, Freedonia Financial Authority

Introduction

Freedonia, a growing and prosperous country, is home to a large number of financial services companies and several successful securities, futures and options markets. All markets, trading and financial companies are regulated by the Freedonia Financial Authority and industry self-regulating organizations such as the Commodity Exchange of Freedonia.

Silver Lining Corporation, one of Freedonia's oldest and largest financial services companies, is active on the Commodity Exchange of Freedonia and the cash markets, especially in grains, fibers, cocoa and energy products. Jacques Dory is the CEO of Silver Lining and the vice chairman of the Commodity Exchange of Freedonia.

Snowfall last winter was unusually high in Freedonia's eastern mountain region and this spring brought torrential rains to the same area, causing water levels to rise in lakes and rivers. In March a mudslide destroyed a dam, suddenly releasing flood waters into the Freedonia River inundating large parts of the port city of Libertyville.

The morning after the flood the Commodity Exchange's board of directors called an emergency meeting to determine what to do about potential damage to the designated commodity delivery points in Libertyville and possible contamination of the physical stocks stored there. Libertyville's certified warehouses currently store half of Freedonia's cocoa beans. During a break in the Commodity Exchange board meeting, Jacques Dory called his company and spoke to Silver Lining's chief trader, Basil Froth.

Scene 1

Jacques Basil, how much physical cocoa do we have at the Libertyville delivery point?

Basil None. At the moment all of our cocoa is at the Port Tranquility delivery point.

Jacques That's what I thought, but I wanted to make sure before the Exchange board votes.

Basil What vote? Is there a problem?

Jacques Thankfully not for us. But because of the flooding in Libertyville I'm sure I can convince the Exchange board that we should declare a "*force majeure*" and suspend cocoa delivery to and from the Libertyville warehouses until the Exchange determines that the stored cocoa isn't waterlogged or contaminated. Re-certification will take a couple of weeks, I think. We'll take the official vote in a few minutes, but I'm sure they'll go along with my proposal.

Basil Wow! No one here thinks the flood was that severe. You know, this will squeeze cocoa futures big time, Jacques. This month's contract could go limit up today if the Exchange de-certifies the Libertyville stocks.

Jacques I know. The board will need to expand the daily price limit, but don't say anything to anyone before all this is announced. It's strictly confidential. The Exchange will issue a press release after the meeting—probably around 11:00 a.m. Understand? At 11:00 a.m. everyone else will know about the delivery problem, the de-certification and the expanded price limit.

-
- What ethical issues are raised in this scene?
 - In your jurisdiction, is anything that occurred in this scene a violation of law or regulation?
 - How might self-regulatory organization's (SRO's) Code of Ethics guide the conduct of the characters in this scene?
-

Narrator As soon as his conversation with Jacques Dory ended, Basil checked Silver Lining's cocoa futures position and then called his Clerk, Sandy Pilchard, on the Exchange floor.

Scene 2

Basil Sandy, this is Basil. At the open, buy 10,000 March cocoa contracts at the market.

Sandy At the market? Are you sure? 10,000 contracts probably will move the price big time, Basil.

Basil Don't worry about it.

Sandy But we're short 5,000 cocoa contracts right now as a hedge against our cash position. Are you sure you want to buy 10,000? That will unwind the . . .

Basil Forget the hedge, Sandy. Just get that order executed at the open, and call me back with the price.

- What ethical issues are raised in this scene?
 - In your jurisdiction, is anything that occurred in this scene a violation of law or regulation?
-

Narrator Silver Lining bought 10,000 March cocoa contracts and, as expected, at 11:00 a.m. the Exchange announced that its board of directors had de-certified the cocoa stock at the Libertyville delivery point and had raised the daily price limit. Almost immediately the March cocoa contract traded at its new limit.

After a few days rumors about Silver Lining's profitable trade in March cocoa reached the Freedonia Financial Authority, and the chief of enforcement, Bill Mace, called in one of his investigators, Rosemary Flan.

Scene 3

Bill I presume you've heard the rumor about Silver Lining.

Rosemary . . . That their CEO bought cocoa futures based on information that he learned as vice chairman of the Exchange? Yes, I heard. I think everybody has heard that rumor.

Bill Well, this time we're finally going to fry Jacques Dory to a crisp. I'm sick of hearing that Dory is a pillar of the industry and a model citizen. He made me look like a fool once but not this time. He's pond slime. I want you all over his case. No more excuses, no more dead-end investigations. We both know he's guilty, so do whatever it takes to get this guy. This time we're going to court with hard evidence. Go after Dory with everything we've got. Your job won't be safe until Dory is in jail.

Rosemary But Bill, even if he's guilty, Jacques Dory is too smart to leave a trail of hard evidence for us to find. There won't be any incriminating tapes or written documentation.

Bill I don't care. He didn't make that trade all by himself. Get me strong, credible witnesses inside Silver Lining. Make this happen, Rosemary, and make it fast. A big case like this will make or break your career—and mine.

-
- What ethical issues are raised in this scene?
 - In your jurisdiction, is anything that occurred in this scene a violation of law or regulation?
 - When is pressure on an employee to produce results excessive? How can this be prevented?
 - How might a regulator's Code of Ethics guide the conduct of the characters in this scene?
-

Narrator Rosemary knew that Sandy Pilchard was Silver Lining's senior Clerk at the Exchange, and Rosemary believed that if anyone was the key to verifying Jacques Dory's alleged involvement in the cocoa trade it would be Sandy. Very early the next morning, Rosemary arrived without warning at Sandy Pilchard's home and met with her in her kitchen as her worried and confused husband and children waited in the next room.

Scene 4

- Sandy Can't this wait until later today, Ms. Flan? We can meet at Silver Lining's offices and . . .
- Rosemary Trust me, Sandy. I'm only trying to help you. You can voluntarily cooperate right now by answering a few simple questions about your CEO, Jacques Dory, or else you, yourself, will become one of the targets of my investigation. Defending yourself would cost you a lot. Can you afford that?
- Sandy But Silver Lining has a company policy that all regulatory inquiries first must be referred to our firm's legal department. The company lawyers will arrange for you to get whatever information you need. I can't. . .
- Rosemary Trust me, Sandy, you don't want this to become a formal interrogation involving your lawyer and my prosecutors. Only criminals need lawyers. Imagine your picture in the newspapers and on T.V. with a lawyer by your side like you're some kind of crook. You have a wonderful family here, great little kids. Why humiliate your family just to protect Jacques Dory?
- Sandy But I didn't do anything wrong. I'm a Clerk, not a crook. I don't know anything about what Jacques Dory did or didn't do about that cocoa trade.
- Rosemary Sure you do, Sandy; you just don't realize it yet. Work with me here, and I'll help you remember everything you need to help me. Otherwise, well. . . it could get very, very ugly for you. You don't want it to look like you're obstructing an official investigation, do you?
- Sandy Okay, okay. What do you want from me?
- Rosemary It's simple. We know that the order to buy those 10,000 cocoa contracts came from Jacques Dory. Right now your chief trader, Basil Froth, is telling us everything he knows. We just need you to confirm that when Basil called you with the order he said it came directly from Dory. Understand? Directly from Dory. That's the truth. If you testify to that, I can protect you. If you don't, well. . . I can't promise anything. Just tell the truth.
-

- What ethical issues are raised in this scene?
 - In your jurisdiction, is anything that occurred in this scene a violation of law or regulation or contrary to an established Code of Ethics?
-

Narrator Even before Rosemary visited with Sandy, Basil Froth had asked to meet urgently with Rosemary's boss, Bill Mace, at the Freedonia Financial Authority.

Scene 5

Basil This conversation has to be totally off-the-record. Just an unofficial, friendly chat—right?

Bill I understand, Basil. Go ahead. We're all friends here. Feel free to say anything.

Basil I need immunity from prosecution, Mr. Mace. Without immunity I won't testify against Jacques Dory. And without my testimony you won't be able to prove a thing against him ever.

Bill Maybe. . .maybe not. We have a strong circumstantial case that Jacques Dory illegally disclosed material non-public information from the board meeting to you and that you used the information to make a very profitable trade in cocoa futures. I'm very close to having Dory and you both arrested and brought to trial.

Basil Don't be foolish. That cocoa trade accusation is trivial, a drop in the bucket. Mr. Mace, if you give me immunity I will give you evidence of a much bigger scandal involving Jacques Dory and other industry big shots going back years. And it's still going on today. They've all made huge fortunes using this scheme.

Bill Okay, I'm listening. If your story is as big as what you say I'll grant you immunity in exchange for your testimony, but only if you can prove it.

Basil What if I told you—hypothetically—that for the last three years Jacques Dory has been reporting false price and volume information on our cash transactions to the Freedonia Natural Gas Association. Silver Lining is a huge trader in natural gas. Dory and a few other big gas trading companies secretly have conspired among themselves to manipulate the Freedonia Natural Gas Price Index that the Association publishes each day.

Bill And then, Silver Lining trades natural gas futures ahead of the phony index numbers?

Basil Of course we do. Everyone knows that gas futures react to the cash market natural Gas Index. Whenever the market looks vulnerable Dory and one or two other firms are able to manipulate the index by coordinating their false price reports, and Silver Lining profits from the reaction in the cash market, from derivatives pegged to the Gas Index or by trading natural gas futures.

- What ethical issues are raised in this scene?
 - Is the offer of immunity from prosecution an ethical strategy? If so, when should it be used?
 - In your jurisdiction, is anything that occurred in this scene a violation of law or regulation or contrary to a model Code of Ethics?
-

Narrator A week after Rosemary Flan had met with Sandy Pilchard, and Bill Mace had met with Basil Froth, Jacques Dory was at a financial industry conference. He had arranged to have breakfast at the conference with Olivia Caper, the Governor General of the Freedonia Financial Authority.

Scene 6

Olivia Thanks for the invitation to breakfast Jacques. It's been months since I've seen you, but I have heard your name mentioned around the Authority a few times lately.

Jacques Really? Well, I'm sure they're only saying wonderful things about me. I seem to have admiring fans everywhere.

Olivia I'm sure that's it. I really don't know what the staff is investigating, Jacques, and even if I did know I really couldn't talk about confidential Authority business. I hope that's not why you invited me to breakfast.

Jacques Oh no, Olivia, not at all. I'd never put you in such an awkward position. Actually I wanted to talk to you about something completely different—the Commodity Exchange of Freedonia. You know I'm on their board of directors, of course.

Olivia Yes, of course, I believe you're the new vice chairman.

Jacques That's right. Next year I will be chairman. What you probably don't know is that our Exchange president, Wally Ginger, plans to take early retirement next year.

Olivia Really! That's a surprise. He's only been on the job a short time.

Jacques Two years. To be honest, Olivia, Wally is just not working out. He's not the leader we thought he'd be. I'm in charge of finding his replacement; someone who is strong, knowledgeable and respected throughout the industry.

Olivia I see. And have you found such a heroic and revered person?

Jacques I have. I think you would be the perfect Exchange president, Olivia. With my strong recommendation I know the Exchange board will make you an offer you can't refuse. If you're interested, that is.

Olivia Well, I'm not sure, Jacques, but it does sound interesting.

Jacques You can't say anything to anyone yet, of course. You'd have to stay in your present position with the Financial Authority until Wally Ginger announces his retirement sometime next year. Only a few of us on the Exchange board would know about our arrangement until then. That will give you and me plenty of time to work out your salary and benefits and such. Frankly, as long as there are no unpleasant surprises between now and the announcement the Board will give you whatever you want. You'll be set for life.

-
- What ethical issues are raised in this scene?
 - In your jurisdiction, is anything that occurred a violation of law or regulation or contrary to a model Code of Ethics?

