

**UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION**

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9:26 am, Jan 26, 2017

IN THE MATTER OF:

**E*TRADE SECURITIES LLC AND
E*TRADE CLEARING LLC,**

CFTC DOCKET NO. 17 – 07

RESPONDENTS.

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

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that E*TRADE Securities LLC and E*TRADE Clearing LLC (“Respondents”) violated Section 4g(a) of the Commodity Exchange Act (the “Act”), 7 U.S.C. § 6g(a) (2012), and Commission Regulations (“Regulations”) 1.31, 1.35, and 166.3, 17 C.F.R. §§ 1.31, 1.35, and 166.3 (2016). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Respondents engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondents have submitted jointly an Offer of Settlement (“Offer”), which the Commission has determined to accept. Without admitting or denying any of the findings or conclusions herein, Respondents consent to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings, and Imposing Remedial Sanctions (“Order”) and acknowledges service of this Order.¹

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

III.

The Commission finds the following:

A. SUMMARY

Prior to January 24, 2014, Respondents failed to preserve and maintain certain audit trail logs for their customers. Such logs were compiled by a third-party vendor, which routinely destroyed the records after 10 days. Upon discovery of its vendor's document retention policy, on January 24, 2014, Respondents made efforts to recover missing audit logs; however, they were unable to locate, and lost, more than three years' worth of data, in violation of Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31 and 1.35, 17 C.F.R. §§ 1.31 and 1.35 (2016). Moreover, Respondents failed to implement policies and procedures to ensure the retention of these records, and failed to respond to a previous warning from its vendor that it did not preserve these records, in violation of Regulation 166.3, 17 C.F.R. § 166.3 (2016).

B. RESPONDENTS

E*TRADE Securities LLC ("E*TRADE Securities") has been registered as an Introducing Broker ("IB") since 2002, with headquarters at 233 S Wacker Dr., Willis Tower 40th Floor, Chicago, Illinois. Its registration as a Futures Commission Merchant ("FCM") is pending. E*TRADE Securities is a wholly-owned, indirect subsidiary of E*TRADE Financial Corporation ("E*TRADE Financial"), a Delaware corporation headquartered in New York.

E*TRADE Clearing LLC ("E*TRADE Clearing") has been registered as an FCM since February 2013, with headquarters at 233 S Wacker Dr., Willis Tower 40th Floor, Chicago, Illinois. E*TRADE Clearing's only customers are those directly introduced by E*TRADE Securities. It is also a wholly-owned indirect subsidiary of E*TRADE Financial.

C. FACTS

In January 2014, as part of an internal review, E*TRADE Securities and E*TRADE Clearing (collectively, the "E*TRADE entities") learned that they had not preserved certain of their customers' electronic audit trail logs, in keeping with the requirements of Section 4g(a) of the Act and Regulations 1.31 and 1.35, between October 2009 and January 25, 2014.

Throughout the relevant period, E*TRADE Securities used a third-party vendor to provide the front-end order entry system for all of E*TRADE Securities' futures customers. The third-party vendor generated audit trail logs on a monthly basis from this records system. E*TRADE Securities erroneously believed that the third-party vendor retained these logs, and that E*TRADE Securities could access them at any time, via a secure FTP web site. However, the third-party vendor retained these monthly logs for only 10 days. The third-party vendor previously warned E*TRADE Securities employees of its retention policy in emails dated November 2012. In those emails, the third-party vendor advised that it was E*TRADE Securities' responsibility to download and retain these files. E*TRADE Securities employees took inadequate action to preserve the audit logs after receiving this information from the third-party vendor.

Similarly, E*TRADE Clearing incorrectly believed that its recordkeeping requirements were satisfied because all of its documents were stored in an internal database. E*TRADE Clearing was mistaken, however: the database did not store audit logs. Accordingly, E*TRADE Clearing erroneously represented to the NFA in December 2013 that it was in compliance with all CFTC recordkeeping requirements. Both of the E*TRADE entities subsequently self-reported their recordkeeping violations to the Commission.

Beginning January 26, 2014, both E*TRADE entities ensured that audit logs were automatically downloaded on a daily basis from the third-party vendor's FTP site and preserved on the internal database. The E*TRADE entities also took steps to recover missing audit logs from the previous five years. However, E*TRADE Securities was unable to recover audit logs from October 2009 through October 31, 2011, and from June 20, 2012, through December 31, 2012. Both E*TRADE Securities and E*TRADE Clearing were unable to recover audit logs from March 1, 2013, through January 25, 2014.

An October 2014 internal E*TRADE audit of the E*TRADE Securities Derivatives Service Desk confirmed a "major" Rule 1.35 violation regarding the missing audit logs. During the relevant time period, neither E*TRADE Securities nor E*TRADE Clearing had written policies or procedures in place to comply with CFTC recordkeeping requirements.² In March 2015, more than a year after learning of its ongoing failure to retain audit logs, E*TRADE Securities updated its Manual to include specific references to CFTC Rule 1.35 recordkeeping requirements.

Similarly, E*TRADE Clearing's pre-2015 "Written Supervisory Procedures Futures and FOREX" Manual contained no reference to CFTC recordkeeping requirements. E*TRADE Clearing updated this Manual in 2015 to expressly require compliance with Rule 1.35. E*TRADE Clearing self-reported to the CFTC and the NFA that it did not retain the requisite audit logs between April 1, 2013, the effective date of its FCM registration, and January 2014.

The Commission recognizes Respondents' cooperation with the Commission in this matter.

IV.

LEGAL DISCUSSION

A. RECORDKEEPING VIOLATIONS

As an introducing broker and futures commission merchant, respectively, E*TRADE Securities and E*TRADE Clearing are required to comply with the recordkeeping obligations set forth in Section 4g(a) of the Act and Regulations 1.31(a) and 1.35(a). Section 4g "provides that every person registered as a futures commission merchant, introducing broker, floor broker, or floor trader shall keep books and records pertaining to transactions and positions of their customers and

² By comparison, E*TRADE Securities ensured that it retained audit trail records for certain securities orders, in keeping with other (non-CFTC) regulatory requirements. For such orders, the 2011, 2012, 2013, and 2014 Versions of E*TRADE Securities' Written Supervisory Procedures' Manual ("Manual") stated that "E*TRADE will retain and preserve [order audit trail] records for at least three years, the first two years in an easily accessible location."

commodities for future delivery, and shall make such records available for inspection by the Commission.” *Woods*, CFTC No. 15-02, 2014 WL 5089105, at *5 (Oct. 8, 2014) (citing 7 U.S.C. § 6g(a) (2012)) (consent order). Regulation 1.35 requires FCMs and IBs to keep “full, complete, and systematic records, together with all pertinent data and memoranda, of all transactions relating to its business of dealing in commodity futures.” Regulation 1.31 requires that such records be preserved for five years. *See* 17 C.F.R. § 1.35(a)(1) (2016). Moreover, if such records are preserved electronically, registrants must “[d]evelop and maintain written operational procedures and controls” to ensure the proper preservation of such records. 17 C.F.R. § 1.31(a)(3)(ii) (2016).

The failure to retain and promptly produce such records for inspection to Commission staff constitutes a violation of Section 4g and Regulations 1.31 and 1.35. *Woods*, 2014 WL 5089105, at *4-6, 8 (finding that an IB violated Section 4g of the Act and Regulation 1.35 by failing to preserve certain customer order records); *Forex Capital Mkts. LLC*, CFTC No. 12-01, 2011 WL 4689390, at *4-5 (Oct. 3, 2011) (holding that an FCM violated Section 4g of the Act and Regulation 1.35 by failing to promptly produce records requested by Division of Enforcement staff) (consent order). A violation of these record-keeping regulations does not require scienter. *Id.* (citing *GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,214 (Aug. 11, 1992), *aff’d in part and rev’d in part sub nom.*, *Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993)); *see also DiPlacido*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. ¶ 29,866 at 56,590 (CFTC Sept. 14, 2004), *aff’d* 364 F. App’x 657 (2d Cir. 2009).

As explained by the Commission:

The requirements of Regulations 1.31 and 1.35 are straightforward. Regulation 1.35(a) required [the registrant] to keep complete and systematic records, “together with all pertinent data and memoranda, of all transactions relating to its business of dealing in commodity futures, commodity options....” Further, the rule required [the registrant] to maintain copies of “all other records data and memoranda ... prepared in the course of its business....” *Id.* (emphasis added) ... The trade sequence reports clearly relate to [the registrant’s] business of dealing in commodity futures and were kept in the course of [the registrant’s] business. Failure to maintain them thus violates Regulations 1.31 and 1.35(a).

JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) 26,080 at 41,580 (CFTC May 12, 1994), *aff’d sub nom. JCC, Inc. v. CFTC*, 63 F.3d 1557 (11th Cir. 1995); *accord Woods*, 2014 WL 5089105.

The facts set forth above demonstrate that the E*TRADE entities failed to retain and preserve customer order audit logs between October 2009 and January 26, 2014. Although they have since recovered some of these logs, they have permanently lost more than three years of records. This failure to retain and preserve these records violated Section 4g(a) of the Act and Regulations 1.31(a) and 1.35(a).

B. SUPERVISION FAILURES

Both of the E*TRADE entities failed to develop appropriate procedures to ensure compliance with the recordkeeping requirements of Section 4g(a), in violation of Regulation 166.3. Before March 2015, neither of the E*TRADE entities included any reference to compliance with Section 4g or Regulations 1.31 and 1.35 in their internal compliance manuals. Moreover, before March 2015, neither E*TRADE entity had any systems in place to ensure that such records were preserved.

A violation of Regulation 166.3 is demonstrated by showing either that: (1) the registrant's supervisory system was generally inadequate; or (2) the registrant failed to perform its supervisory duties diligently. *Forex Capital Mkts.*, 2011 WL 4689390, at *3 (citing *Murlas Commodities*, CFTC No. 85-29, 1995 WL 523563, at *9 (Sept. 1, 1995); *GNP Commodities*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 (providing that, even if an adequate supervisory system is in place, Regulation 166.3 can still be violated if the supervisory system is not diligently administered); *Paragon Futures Ass'n*, CFTC No. 88-18, 1992 WL 74261, at *14 (Apr. 1, 1992) (concluding that the "focus of any proceeding to determine whether Rule 166.3 has been violated will be on whether [a] review [has] occurred and, if it did, whether it was 'diligent'"). A violation under Regulation 166.3 is an independent violation for which no underlying violation is necessary. *Forex Capital Mkts.*, 2011 WL 4689390, at *3.

Regulation 166.3 further provides that a registrant has a "duty to develop procedures for the 'detection and deterrence of [CEA violations] by its agents.'" *Samson Refining Co. v. Drexel Burnham Lambert, Inc.*, CFTC No. 82-R448, 1990 WL 282783, at *11 (Feb. 16, 1990) (quoting *Lobb v. J.T. McKerr & Co.*, CFTC No. 85R-185 (Dec. 14, 1989), slip op. at 25). While the absence of a written policy or formal training on every potential issue does not constitute a failure to supervise, Regulation 166.3 requires all registered FCMs and IBs to diligently supervise all activities of its officers, employees, and agents relating to its business. *FCStone, LLC*, CFTC No. 15-21, 2015 WL 2066891 (May 1, 2015). "A showing that the registrant lacks an adequate supervisory system, standing alone, can be sufficient" to demonstrate a violation of Regulation 166.3. *Id.* (citing *Paragon Futures Ass'n*, 1992 WL 74261, at *14). Evidence of violations that "should be detected by a diligent system of supervision, either because of the nature of the violations or because the violations have occurred repeatedly" is probative of a failure to supervise. *Forex Capital Mkts. LLC*, No. 12-01 (CFTC October 3, 2011) (quoting *Paragon Futures Ass'n*, 1992 WL 74261, at *14).

The E*TRADE entities violated Regulation 166.3 in two ways. First, the E*TRADE entities failed to implement any procedures to consistently retain audit trail logs required to be preserved by the Act. Second, E*TRADE Securities failed to follow up on warnings from its third-party vendor in November 2012 that the audit trail logs were not being preserved by the vendor. If E*TRADE Securities had an adequate supervisory system in place and properly supervised its employees regarding all of its recordkeeping requirements, it could have addressed its ongoing recordkeeping violations in November 2012. Instead, E*TRADE Securities failed to consider the issue and thus continued not preserving these records. The failure to address repeated violations of the Act also represents a violation of Regulation 166.3. *Woods*, 2014 WL 5089105, at *7 (citing *CFTC v. Sidoti*, 178 F.3d 1132, 1137 (11th Cir. 1999) (defendant was

liable for failure to supervise because he “knew of specific instances of [violations], yet failed to take reasonable steps to correct the problems”).

V.

FINDINGS OF VIOLATION

Based on the foregoing, the Commission finds that, during the Relevant Period, Respondents violated Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31, 1.35, and 166.3, 17 C.F.R. §§ 1.31, 1.35, and 166.3 (2016).

VI.

OFFER OF SETTLEMENT

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

- A. Acknowledge receipt of service of this Order;
- B. Admit the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;
- C. Waive:
 - 1. The filing and service of a complaint and notice of hearing;
 - 2. A hearing;
 - 3. All post-hearing procedures;
 - 4. Judicial review by any court;
 - 5. Any and all objections to the participation by any member of the Commission’s staff in the Commission’s consideration of the Offer;
 - 6. Any and all claims that they may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2012) and 28 U.S.C. § 2412 (2012), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Commission’s Regulations, 17 C.F.R. §§ 148.1-30 (2016), relating to, or arising from, this proceeding;
 - 7. Any and all claims that they may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and

8. Any claims of Double Jeopardy based on the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief;
- D. Stipulate that the record basis on which this Order is entered shall consist solely of the findings contained in this Order to which Respondents have consented in the Offer;
- E. Consent, solely on the basis of the Offer, to the Commission's entry of this Order that:
1. Makes findings by the Commission that Respondents violated Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31, 1.35, and 166.3, 17 C.F.R. §§ 1.31, 1.35, and 166.3 (2016);
 2. Orders Respondents to cease and desist from violating Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31, 1.35, and 166.3, 17 C.F.R. §§ 1.31, 1.35, and 166.3 (2016);
 3. Orders Respondents to pay two hundred eighty thousand dollars (\$280,000), plus post-judgment interest;
 4. Orders Respondents and their successors and assigns to comply with the conditions and undertakings consented to in the Offer and as set forth in Part VII of this Order.

Upon consideration, the Commission has determined to accept the Offer

VII.

ORDER

Accordingly, IT IS HEREBY ORDERED THAT:

- A. Respondents shall cease and desist from violating Section 4g(a) of the Act, 7 U.S.C. § 6g(a) (2012), and Regulations 1.31, 1.35, and 166.3, 17 C.F.R. §§ 1.31, 1.35, and 166.3 (2016).
- B. Respondents shall pay a civil monetary penalty in the amount of two hundred eighty thousand dollars (\$280,000) ("CMP Obligation"), plus post-judgment interest. Post-judgment interest shall accrue on the CMP Obligation beginning on the date of entry of this Order and shall be determined by using the Treasury Bill rate prevailing on the date of entry of this Order pursuant to 28 U.S.C. § 1961 (2012).

Respondents shall pay the CMP Obligation by electronic funds transfer, U.S. postal money order, certified check, bank cashier's check, or bank money order. If payment is to be made other than by electronic funds transfer, then the payment shall be made payable to the Commodity Futures Trading Commission and sent to the address below:

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

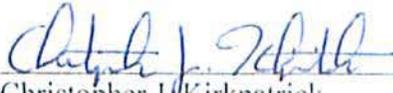
If payment is to be made by electronic funds transfer, Respondents shall contact Nikki Gibson or her successor at the above address to receive payment instructions and shall fully comply with those instructions. Respondents shall accompany payment of the CMP Obligation with a cover letter that identifies the paying Respondents and the name and docket number of this proceeding. The paying Respondents shall simultaneously transmit copies of the cover letter and the form of payment to the Chief Financial Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, D.C. 20581.

- C. Respondents and their successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:
1. Public Statements: Respondents agree that neither they nor any of their successors and assigns, agents or employees under their authority or control, shall take any action or make any public statement denying, directly or indirectly, any findings or conclusions in this Order or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Respondents': (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondents and their successors and assigns shall undertake all steps necessary to ensure that all of their agents and/or employees under their authority or control understand and comply with this agreement.
 2. Cooperation with the Commission: Respondents shall cooperate fully and expeditiously with the Commission, including the Commission's Division of Enforcement, and any other governmental agency in this action, and in any investigation, civil litigation, or administrative matter related to the subject matter of this action or any current or future Commission investigation related thereto.
 3. Partial Satisfaction: Respondents understand and agree that any acceptance by the Commission of any partial payment of Respondents' CMP Obligation shall not be deemed a waiver of their obligation to make further payments pursuant to this Order, or a waiver of the Commission's right to seek to compel payment of any remaining balance.

4. Change of Address/Phone: Until such time as Respondents satisfy in full their CMP Obligation as set forth in this Consent Order, Respondents shall provide written notice to the Commission by certified mail of any change to their telephone number and mailing address within ten (10) calendar days of the change.
5. Undertakings: To prevent similar problems in the future, Respondents agree to improve their recordkeeping procedures by (1) updating their policies and procedures regarding compliance with Section 4g(a) of the Act and Regulations 1.35 and 1.31; and (2) providing appropriate training to officers and employees regarding the Act's recordkeeping requirements.

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

By the Commission.



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Dated: January 26, 2017