



delegee(s) that there is probable cause for finding that a violation within the disciplinary jurisdiction of NYSE Arca Equities has occurred.

In order to resolve this matter, Schonfeld Securities, LLC (the “Firm”) and Steven B. Schonfeld (“Schonfeld”) (collectively, the “Respondents”) have submitted an Offer of Settlement and Consent (“**Offer of Settlement**” or “**Offer**”), executed by the Respondents on December 23, 2008. Such Offer of Settlement was submitted for the sole purpose of settling this disciplinary proceeding, without adjudication of any issues of law or fact, and without admitting or denying any allegations or finding referred to therein. With due regard to the stipulated facts and violations and the proposed sanction contained therein, a Hearing Officer on behalf of the Office of the General Counsel believes it is appropriate to accept the Settlement with respect to the File Number set forth above. This Offer of Settlement is made a part of this Decision by reference herein.

## **STIPULATION OF FACTS AND VIOLATIONS**

### **I. Summary**

The Firm, with the knowledge of Schonfeld, the Firm’s Chairman and principal, entered and executed prearranged round trip securities transactions (buy/sell and then sell/buy reversing trades) throughout the period January to March 2005 (the “Relevant Period”). These transactions had been prearranged with entities related to the Firm, Quantitative Trading Systems, LLC (“QTS”) and Opus Trading Fund, LLC (“Opus”). These trades were prearranged for the purpose of increasing the Firm’s net capital position in an attempt to enable the Firm to remain in net capital compliance. The Firm recorded the prearranged transactions without disclosing the nature of the transactions, namely, that the transactions would be reversed in a few days. Despite these prearranged transactions, however, the Firm still fell short of its net capital requirements on 25 days between January and March 2005. The Firm did not report any of these net capital deficiencies to the Securities and Exchange Commission (“SEC”), NYSE Arca Equities, or the Firm’s Designated Examination Authority (“DEA”), which at the time was the NASD.

Additionally, between June 2005 and January 2007, the Firm entered for execution on behalf of several Firm customers approximately 910 odd lot orders, totaling approximately 32,871 shares, that should have been aggregated into round lots.

Finally, the Firm and Schonfeld failed to adequately supervise the Firm’s personnel and business operations to maintain compliance with NYSE Arca Equities Rules and federal securities laws.

The foregoing conduct violated NYSE Arca Equities Rules 2.24, 4.1, 6.2(b), 6.15(b), 6.18(a), 7.38(c), 9.2(a) and (b)(4) as well as Rules 15c3-1, 17a-3, 17a-4, and 17a-11 promulgated pursuant to the Securities Exchange Act of 1934 (“Exchange Act”).

## **II. Jurisdiction and Background**

1. During the Relevant Period, the Firm was an Equity Trading Permit (“ETP”) Holder of NYSE Arca Equities<sup>1</sup> registered to transact business on the NYSE Arca Marketplace in accordance with NYSE Arca Equities Rules. As an ETP Holder, the Firm entered orders onto the NYSE Arca Marketplace and is subject to NYSE Arca Equities disciplinary jurisdiction for all orders it entered per NYSE Arca Equities Rule 10.1(a).
2. During the Relevant Period, Schonfeld was the principal and Chairman of the Firm, as well as the Chief Executive Officer and majority member of Schonfeld Group Holdings, LLC, a holding company that owns and controls, either directly or indirectly, not only the Firm, but also several additional entities, including but not limited to QTS and Opus.
3. During the Relevant Period, QTS and Opus were each registered broker dealers and member organizations of self regulatory organizations other than NYSE Arca Equities.
4. During the Relevant Period, NYSE Arca Equities Rules 2.24, 4.1, 6.2(b), 6.15(b), 6.18(a), 7.38(c) and 9.2(a) and (b)(4), as well as Exchange Act Rules 15c3-1, 17a-3, 17a-4, and 17a-11 promulgated under the Exchange Act, were each in full force and effect.
5. During the Relevant Period, Schonfeld was the person with the ultimate authority and control over all aspects of the Firm, including but not limited to its compliance with securities laws and regulations.

## **III. Prearranged Trading**

6. NYSE Arca Equities Rule 6.2(b) prohibits ETP Holders from engaging in conduct inconsistent with just and equitable principles of trade.
7. NYSE Arca Equities Rule 6.15(b) prohibits ETP Holders from engaging in prearranged trades, defined as making offers to sell coupled with an offer to buy back at the same or at an advanced price, or the reverse.
8. Broker-dealers are obligated under Section 15(c)(3) of the Exchange Act to maintain at all times a minimum amount of net capital. A brokerage firm’s required net capital is defined under Exchange Act Rule 15c3-1. As a prime

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<sup>1</sup> Prior to the closing of the merger between the New York Stock Exchange and Archipelago Holdings, LLC on March 8, 2006, the exchange now designated as NYSE Arca Equities was known as the Archipelago Exchange (“ArcaEx”), and was governed by the rules of PCX Equities, Inc. (“PCXE”). The applicable rules were not changed by the merger, and for convenient reference, this document consistently refers to the former ArcaEx as “NYSE Arca Equities” and the governing rules as “NYSE Arca Equities Rules,” even when referring to pre-merger periods.

broker, the Firm was required to maintain net capital of at least \$1.5 million. Net capital is generally calculated by deducting illiquid assets from a firm's net worth and further deducting certain percentages (known as "haircuts") of the market value of the securities held in the firm's proprietary accounts. Similarly, NYSE Arca Equities Rule 4.1 requires all ETP Holders that are subject to Exchange Act Rule 15c3-1 to maintain minimum net capital in accordance with the provisions of Exchange Act Rule 15c3-1.

9. During the Relevant Period, the Firm maintained large positions in certain securities in its proprietary accounts, which required a haircut charge<sup>2</sup>, thereby reducing its net capital. The Firm developed a plan to reduce these undue concentration haircut charges and increase its net capital by engaging in prearranged trades with Opus or QTS, which turned a proprietary long position into cash or covered a proprietary short position. In either case, the haircut charges were reduced and the Firm's net capital was increased. The trades occurred throughout the month, including at the end of the month before the Firm reported its net capital on its FOCUS Report. When at the end of the month, the trades would then be reversed at the beginning of the next month after the Firm reported its net capital.<sup>3</sup>
10. For instance, on Thursday March 24, 2005, the Firm sold to QTS approximately 180,000 shares of XYZ, a security which required a haircut charge on the Firm's FOCUS Report. The Firm sold the shares by placing numerous 20,000 share sell orders through the Arca Marketplace, while, in a coordinated effort, QTS entered identical orders to buy XYZ at the same time. As a result, 180,000 shares of the Firm's total position in XYZ were converted into cash, and the Firm's undue concentration haircut charge in XYZ was reduced, thereby increasing its reportable net capital. The following day, Friday, March 25, 2005, Schonfeld Securities filed its FOCUS Report with its DEA and, as a result of the foregoing XYZ trades, the FOCUS Report reflected that the Firm was in net capital compliance. The next trading day, Monday, March 28, 2005, QTS sold the 180,000 shares of XYZ back to Schonfeld Securities using the same coordinated trading plan to restore the 180,000-share long position back to the Firm.
11. Following this plan, the Firm executed prearranged trades (in which the original transaction was reversed in a subsequent transaction) with Opus and QTS throughout the Relevant Period with a total value of tens of millions of dollars being transferred back and forth between the entities (collectively, the

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<sup>2</sup> Exchange Act Rule 15c3-1 requires firms carrying a position in any single security that exceeds a specified percentage of the firm's net capital to take a specified "undue concentration" haircut charge that reflects the added risk the firm carries by maintaining the large, concentrated holding in that particular security.

<sup>3</sup> The Firm also engaged in these transactions at other times of the month to increase its net capital position.

“Prearranged Trades”) to avoid the required haircut charges in an effort to remain in net capital compliance.

12. Before executing the trading strategy that resulted in the Prearranged Trades, Firm employees informed Schonfeld that they planned to use cross trading to reduce the Firm’s undue concentration haircut charges and thereby improve the Firm’s net capital position. Having been made generally aware of the trading plan, Schonfeld did nothing to stop the Prearranged Trades.

#### **IV. Other Net Capital Violations**

13. Exchange Act Rule 15c3-1(c)(2)(i)(B)(1) requires all ETP Holders performing net capital calculations, as part of those calculations, to accurately mark to their market value all long and short positions in securities, commodities, and listed options.
14. NYSE Arca Equities Rule 4.1 requires ETP Holders to promptly notify NYSE Arca Equities if such ETP Holder’s net capital does not equal or exceed the appropriate minimum required by Rule 15c3-1. Similarly, Exchange Act Rule 17a-11 also requires the ETP Holder to provide the same notification to the SEC as well as to the ETP Holder’s DEA.
15. On 25 days during the Relevant Period, the Firm failed to meet its minimum net capital requirement under Exchange Act Rule 15c3-1. The Firm’s net capital deficits ranged from approximately \$1,500 up to \$13.9 million dollars. On at least some of these days, the Firm failed to meet its net capital requirement notwithstanding the Prearranged Trades, which improperly avoided the required undue concentration haircut charges.
16. The Firm did not report any of its net capital deficiencies during the Relevant Period to either NYSE Arca Equities, the SEC, or the Firm’s DEA, until approximately October 2007, over two years after the commencement of the NYSE Arca Equities investigation of these matters, when, in conjunction with the investigation, the Firm recalculated its net capital positions from the Relevant Period.
17. Throughout the Relevant Period, the Firm also erroneously calculated its net capital position by failing to accurately mark certain long and short positions to their market value on a timely basis.

#### **V. Books and Records Violations**

18. Exchange Act Section 17(a)(1) and Rules 17a-3 and 17a-4 thereunder, as well as NYSE Arca Equities Rule 2.24, require all ETP Holders to make, keep current, and preserve accurate books and records.
19. During the Relevant Period, the Firm recorded each leg of the Prearranged Trades in the Firm’s books and records as legitimate transactions, which was

inaccurate because it did not disclose the arrangement to reverse the transaction a few days later.

**VI. Odd Lot Violations**

20. NYSE Arca Equities Rule 7.38(c)(3) requires ETP Holders to aggregate odd lot orders into round lots when such orders are for the same account or for various accounts in which there is a common monetary interest.
21. NYSE Arca Equities Rule 9.2(a) requires every ETP Holder to use due diligence to learn the essential facts relative to, *inter alia*, every customer, every order, and every account accepted or carried by such ETP Holder.
22. NYSE Arca Equities Rule 9.2(b)(4) requires every ETP Holder to supervise diligently all accounts accepted or carried by such firms, including reviewing accounts periodically for any irregularities or abuses.
23. During June 2005 through January 2007, the Firm, on behalf of its correspondent customers, introduced for execution on NYSE Arca approximately 910 odd lot orders, totaling approximately 32,871 shares. On each occasion, a number of odd-lot orders were introduced for execution on behalf of the same customer in very close time proximity to each other, which could have been aggregated into round lots.
24. During this period, the Firm did not maintain surveillance procedures to prevent or detect the routing and execution of potentially violative odd lot customer orders that were being sent to NYSE Arca. During this same period, the Firm did have a surveillance procedure in place to monitor the routing and execution of customer odd lot orders that were being sent to other exchanges.

**VII. Failure to Supervise**

25. NYSE Arca Equities Rule 6.18(a) prohibits all ETP Holders from engaging in conduct in violation of federal securities laws and regulations or NYSE Arca Equities Rules, and requires all ETP Holders to supervise persons associated with it to assure their compliance with same.
26. During the Relevant Period, Schonfeld failed to adequately supervise the Firm's associated personnel in a manner that was reasonably designed to achieve compliance with NYSE Arca Equities Rules and/or federal securities laws and rules pertaining to prearranged trading and net capital requirements.
27. After he received prior notification about the plan to conduct the Prearranged Trades and its purpose, Schonfeld, the Firm's Chairman and principal, should have taken affirmative steps to determine whether the Prearranged Trades would violate NYSE Arca Equities and Exchange Act rules relating to prearranged trading and the Firm's net capital requirements. However,

Schonfeld failed to carry out his supervisory responsibilities and took no action to stop the improper trading activity and net capital violations.

28. During the Relevant Period, the Firm failed to adequately supervise the Firm's associated personnel in a manner that was reasonably designed to achieve compliance with NYSE Arca Equities Rules and/or federal securities laws and rules pertaining to:
  - a) prearranged trades;
  - b) net capital requirements;
  - c) books and records; and
  - d) odd lots.

### **VIII. Violations by the Firm**

29. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 6.15(b) by the Firm in that the Firm engaged in numerous but unquantified prearranged trades with entities related to the Firm.
30. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 6.2(b) in that the Firm contravened just and equitable principles of trade by engaging in the prearranged trades with entities related to the Firm on numerous but unquantified occasions for the purpose of increasing its net capital position in an attempt to enable the Firm to remain in net capital compliance.
31. The acts, practices and conduct described above constitute violations of Exchange Act Rules 15c3-1 and/or 17a-11 and/or NYSE Arca Equities Rule 4.1, in that the Firm:
  - a) violated its required minimum net capital level on 25 days;
  - b) failed to promptly notify NYSE Arca Equities, the SEC, and the Firm's DEA about any of the net capital violations; and
  - c) inaccurately calculated its net capital positions throughout the Relevant Period by using two-day-old market valuations.
32. The acts, practices and conduct described above constitute violations of Exchange Act Section 17(a)(1) and Rules 17a-3 and 17a-4 thereunder, as well as NYSE Arca Equities Rule 2.24, in that the Firm inaccurately recorded on the Firm's books and records the numerous but unquantified prearranged transactions without disclosing the true nature of the transaction, namely, that the transaction would be reversed shortly thereafter; and

33. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 7.38(c)(3) in that the Firm, on numerous occasions on behalf of Firm customers, entered on NYSE Arca approximately 910 odd lot orders that should have been aggregated into round lots for each customer.
34. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 9.2(a) in that the Firm did not use sufficient due diligence to learn essential facts relative to odd lot orders that it accepted from certain customers.
35. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 9.2(b)(4) in that the Firm failed to review certain accounts periodically for any irregularities or abuses pertaining to odd lot transactions on NYSE Arca.
36. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 6.18(a) by the Firm in that the Firm failed to adequately supervise its personnel in a manner reasonably designed to achieve their compliance with NYSE Arca Equities Rules and/or federal securities laws and regulations pertaining to:
  - a) prearranged trades;
  - b) net capital requirements;
  - c) books and records; and
  - d) odd lots.

**IX. Violations by Schonfeld**

37. The acts, practices and conduct described above caused violations of NYSE Arca Equities Rule 6.15(b) by the Firm in that Schonfeld allowed the Firm to engage in prearranged trades with other entities that he controlled on numerous but unquantified occasions.
38. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 6.2(b) in that Schonfeld contravened just and equitable principles of trade by allowing the Firm to engage in prearranged trading with related entities that he controlled on numerous but unquantified occasions for the purpose of increasing the Firm's net capital position in an attempt to enable the Firm to remain in net capital compliance.
39. The acts, practices and conduct described above constitute violations of NYSE Arca Equities Rule 6.18(a) by Schonfeld in that he, as the Firm's Chairman and principal, failed to adequately supervise the Firm's personnel in a manner reasonably designed to achieve their compliance with NYSE Arca

Equities Rules and/or federal securities laws and regulations pertaining to (i) prearranged trades; and (ii) net capital requirements.

**X. Other Factors Considered**

40. The Firm has taken various steps to enhance and improve its supervision of Firm employees to ensure that prearranged trading and other violations set forth above do not recur.

**SANCTIONS**

Respondent Schonfeld Securities, LLC is hereby censured by NYSE Arca Equities and fined \$900,000.00.

Respondent Steven B. Schonfeld is hereby censured by NYSE Arca Equities, fined \$200,000.00, suspended for 90 days from acting in a supervisory capacity and is required to retake and pass the Series 24 Examination in the event that he seeks to resume any supervisory role at the Firm or with another NYSE Arca Equities Firm.

The fine shall be invoiced and collected in accordance with NYSE Arca's standard billing and account practices, no later than 30 days of the date of this Decision.

Dated this 31st day of December, 2008

On behalf of the Office of the General Counsel,  
NYSE Arca, Inc.

Signature: \_\_\_\_\_

Peggy Kuo  
Chief Hearing Officer  
NYSE Regulation, Inc.