

NYSE ARCA, INC.

HEARING BOARD DECISION 09-ARCA-01

February 10, 2009

SAVANT TRADING, LLC
OTP HOLDER

* * *

Violated Sections 15(c)(3) and 17(a) of Exchange Act, Rules 15c3-1, 17a-3 and 17a-5 thereunder, and NYSE Arca Options Rules 4.1 and 11.16(a) by improperly calculating required net capital and creating and maintaining inaccurate records with respect to net capital computations; violated Section 17(a) of Exchange Act and Rule 17a-5 thereunder, and NYSE Arca Options Rules 4.5 and 4.11(a) by filing inaccurate FOCUS Report; violated NYSE Arca Options Rules 11.3(a) and (b) by failing to obtain and review outside brokerage account statements of associated persons, including review for possible misuse of material, non-public information, failing to document such review at least quarterly, and failing to report such accounts on 2007 Annual Compliance Form; violated Exchange Act Rule 17a-3(12)(i) by failing to document required background checks prior to hiring associated persons; violated Section 17(a)(1) of Exchange Act, Rules 17a-4(b)(4) and 17a-4(f) thereunder, and NYSE Arca Options Rule 11.16(a) by failing to retain and preserve in required format electronic communications relating to business of Firm; violated NYSE Arca Options Rules 11.11(a) and (b) by failing to disclose to Exchange in writing required details and terms of expense sharing agreement and by failing to submit to Exchange Financial Arrangement Disclosure Form; violated NYSE Arca Options Rule 11.18 by failing to establish, maintain and/or enforce appropriate written policies and procedures for supervision and control, including separate system of follow-up and review regarding (a) execution and maintenance of agreements with clearing firm, to prevent net capital violations, (b) obtaining and reviewing of associated persons' outside brokerage account statements and reporting such accounts on Annual Compliance Form, (c) performance of background checks prior to hiring each associated person and (d) retention and review of all business electronic communications – Consent to censure and \$25,000 fine.

Appearances:

For Division of Enforcement
Steven Brostoff, Esq.
Virginia Harnisch, Esq.
Elyse D. Kovar, Esq.

For Respondent
Steven Crutchfield

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A Hearing Officer on behalf of the General Counsel of NYSE Arca, Inc. (“NYSE Arca”), considered an Offer of Settlement and Consent (“Offer of Settlement”) executed by Savant Trading, LLC (“Respondent”), an NYSE Arca OTP holder.¹

The 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. The Division of Enforcement of NYSE Regulation, Inc. does not contest the Offer of Settlement, and recommends its acceptance. With due regard to the stipulated facts and violations and the proposed sanction contained therein, the Hearing Officer believes it is appropriate to accept the Offer of Settlement and issues this Decision in accordance with NYSE Arca Options Rules. The Offer of Settlement is made a part of this Decision by reference herein.

STIPULATION OF FACTS AND VIOLATIONS

BACKGROUND AND JURISDICTION

1. The Firm became registered as an Options Trading Permit (“OTP”) holder with the Pacific Stock Exchange (currently known as NYSE Arca Options) in November 2004. The Firm was approved as a broker-dealer on June 6, 2005 and commenced conducting a market making business on July 11, 2006. The Firm has no customers and does not receive or hold customer funds or securities. The Firm acts as a Market Maker on the Chicago Board Options Exchange (“CBOE”) and conducts business as a proprietary equities and options trader using the facilities of NYSE Arca and CBOE.
2. On behalf of NYSE Arca Options, the Financial Industry Regulatory Authority (“FINRA”) Division of Member Firm Regulation (“MFR”) conducted a financial and operational compliance examination of the Firm in 2007. MFR sent a letter to the Firm dated August 20, 2007 with the findings of its examination (the “2007 FINOP Report”). Savant’s last prior FINOP examination was conducted by PCX Equities, which sent a letter to the Firm dated November 2, 2005 with the findings of its examination (the “2005 FINOP Report”).

¹ Prior to the closing of the merger between the New York Stock Exchange (“NYSE”) and Archipelago Holdings, LLC on March 7, 2006, the exchange now designated as NYSE Arca Options was known as the Archipelago Exchange (“ArcaEx”), and was governed by the rules of PCX, Inc. (“PCX”). The applicable rules were not changed by the merger, and for convenient reference, this document refers to the former ArcaEx as “NYSE Arca Options” and the governing rules as “NYSE Arca Options Rules,” even when referring to pre-merger periods.

3. By letter dated June 23, 2008, which the Firm received, the Division of Enforcement (“Enforcement”) of NYSE Regulation, Inc. notified the Firm that it was investigating the matters contained in the 2007 FINOP Report.

OVERVIEW

4. This matter primarily involves books and records and supervisory deficiencies disclosed during the period of review in the 2007 FINOP Report. The Firm’s violative activity included, among other matters: improper calculations of net capital; failure to obtain, review and adequately document its review of all outside brokerage account statements of certain associated persons and failure to disclose all such accounts on its 2007 Annual Compliance Form; failure to document required background checks prior to hiring certain associated persons; failure to retain and preserve certain electronic communications relating to the business of the Firm; and failure to reasonably supervise its business operations and associated persons’ activities to ensure compliance with applicable rules and regulations in the foregoing areas.

VIOLATIVE CONDUCT

Net Capital Requirements

5. Section 15(c)(3) of the Securities and Exchange Act of 1934, as amended (“Exchange Act”) and Rule 15c3-1 thereunder, Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-5 thereunder, and NYSE Arca Options Rules 4.1 and 11.16(a) obligate the Firm to maintain its net capital at a required level when securities transactions are effected and to maintain accurate books and records, including with respect to net capital computations. Exchange Act Rule 17a-5 and NYSE Arca Options Rules 4.5 and 4.11(a) require firms to periodically file FOCUS reports.
6. Under Exchange Act Rule 15c3-1(a)(6), market makers who do not effect transactions with anyone other than brokers or dealers, who do not carry customer accounts, who do not effect transactions in unlisted options, and whose market maker account transactions are effected through and carried in a market maker account cleared by another broker or dealer as provided in paragraph 15c3-1(a)(6)(iv) of the net capital rule may avoid haircuts, provided that an agreement (an “A-6 Agreement”) is executed and filed with the SEC and the relevant designated examination authority (“DEA”) for the market maker and its clearing firm.
7. NYSE Arca Options Rule 11.18(a) requires each OTP Holder or OTP Firm to supervise associated persons to assure compliance with federal securities laws and NYSE Arca Options Rules. NYSE Arca Options Rule 11.18(b) requires each OTP Holder or OTP Firm to “establish, maintain a system to supervise the activities of its associated persons and the operations of its business. Such system must be reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca Rules.” NYSE Arca Options Rule 11.18(c) requires each OTP Holder or OTP Firm to “establish, maintain, and enforce written procedures to

supervise the business in which it engages and to supervise the activities of its associated persons that are reasonably designed to ensure compliance with applicable federal securities laws and regulations, and with the NYSE Arca Rules.”

8. From on or about July 11, 2006, when the Firm commenced market making activities, to on or about June 7, 2007, the Firm did not have in place an A-6 Agreement with its clearing firm. However, the Firm took certain haircut exclusions as if the A-6 Agreement were in place. As a result, the Firm incorrectly computed its net capital during such period and was in net capital deficiency for 16 business days, from February 27, 2007 through March 20, 2007. The Firm’s inaccurate net capital calculations also resulted in inaccurate net capital reported in the Firm’s first quarter 2007 FOCUS Report, although there was no net capital deficiency as of the filing. The Firm qualified for an A-6 Agreement, and if an A-6 Agreement had been executed and filed, the Firm would have been in net capital compliance. However, the Firm failed to have adequate supervisory procedures in place to ensure that all required agreements were executed with its clearing firm prior to commencing market making activities.
9. In addition, the Firm failed to accrue at least \$18,274 of liabilities as of February 28, 2007, causing its net capital to be overstated.
10. Thus, the Firm violated Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3 and 17a-5 thereunder, and NYSE Arca Options Rules 4.1 and 11.16(a), by improperly calculating required net capital and creating and maintaining inaccurate books and records with respect to net capital computations. The Firm also violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder, and NYSE Arca Options Rules 4.5 and 4.11(a) by filing an inaccurate first quarter 2007 FOCUS Report. The Firm further violated NYSE Arca Options Rule 11.18 by failing to provide for appropriate procedures of supervision and control and to establish a system of follow-up and review, including ensuring the execution and maintenance of agreements with its clearing firm, to prevent the foregoing net capital violations.

Review of All Associated Persons’ Outside Brokerage Accounts

11. NYSE Arca Options Rule 11.3(a) states that “[e]very OTP Holder or OTP Firm must establish, maintain and enforce written policies and procedures reasonably designed...to prevent the misuse of material, non-public information by such OTP Holder or OTP Firm or persons associated with such OTP Holder or OTP Firm.” Commentary .03 (C) to NYSE Arca Options Rule 11.3 states: “ Each OTP Holder or OTP Firm must receive and retain copies of trade confirmations and monthly account statements for each account in which an Associated Person: has a direct or indirect financial interest or makes investment decisions. The activity in such brokerage accounts should be reviewed at least quarterly by the OTP Holder or OTP Firm for the express purpose of detecting the possible misuse of material, non-public information ...” Pursuant to NYSE Arca Options Rule 11.3(b), firms must file timely, complete and accurate compliance acknowledgment forms disclosing all such accounts.

12. In 2005, the Firm failed to maintain appropriate documentation evidencing its review of outside brokerage accounts. In the 2005 FINOP Report, the Firm was reminded of its obligations to create and maintain appropriate documentation evidencing its outside brokerage account review. Despite such reminder, through the time of the 2007 FINOP examination, the Firm failed to obtain all outside brokerage account statements for at least two of its associated persons, failed to document on at least a quarterly basis the reviews that it did perform, and had inadequate supervisory procedures to review, monitor and ensure required disclosure of its associated persons' outside accounts. In addition, the Firm failed to include all associated persons' outside brokerage accounts in its 2007 Annual Compliance Acknowledgment Form, which was also untimely filed.
13. Thus, the Firm violated NYSE Arca Options Rules 11.3(a) and (b) and 11.18.

Background Checks of Associated Persons

14. Exchange Act Rule 17a-3(12)(i) sets forth the required documents and information that each firm must obtain in connection with applications for employment for associated persons, including name, address, Social Security number, date of birth, past 10 years business connections and employment history and prior disciplinary actions. NYSE Arca Regulatory Information Bulletin RBO-02-06, dated February 12, 2002, titled "Supervision Obligations of Members and Member Organizations," states that member firms must verify the accuracy and completeness of all information contained in each associated person's Form U-4, and must verify prior employment of new employees prior to hire.
15. In 2005, the Firm failed to document required background checks of all associated persons prior to hiring. The Firm was reminded of its obligations to document required background checks in the 2005 FINOP Report. Despite such reminder, through the time of the 2007 FINOP examination, the Firm had inadequate supervisory procedures to ensure that all required background checks were conducted, and failed to document required background checks, prior to hiring certain associated persons.
16. Thus, the Firm violated Exchange Act Rule 17a-3(12)(i) and NYSE Arca Options Rule 11.18.

Electronic Communications

17. Section 17(a)(1) of the Exchange Act and Rule 17a-4(b)(4) thereunder require member firms to preserve originals of all communications received and copies of all communications sent by members relating to its business, for a period of not less than three years, the first two years in an easily accessible place. Exchange Act Rule 17a-4(f) requires that if records are stored electronically, they must be kept in a non-rewritable, non-erasable format.

18. NYSE Arca Options Rule 11.16(a), which pertains to the duty to make and maintain books and records, states in part: “[e]ach OTP Holder and OTP Firm must make, keep current and preserve such books and records as the Exchange may prescribe and as may be prescribed by the Exchange Act and the rules and regulations thereunder (including any interpretation relating thereto) as though such OTP Holder or OTP Firm were a broker or dealer registered with the SEC pursuant to Section 15 of the Exchange Act.”
19. NYSE Arca Regulatory Bulletin RB-05-02, dated January 5, 2005, titled “Clarification Regarding Supervisory Obligations and Recordkeeping Requirements for E-Mail and Instant Messages,” states that a firm’s supervision of instant messages is the same as that for e-mails. It states that if a firm “is unable to establish an adequate supervisory program, the ...[firm] must prohibit the use of instant messaging. OTP or ETP Holders must also ensure that their use of instant messaging complies with applicable SEC recordkeeping requirements.” NYSE Arca Regulatory Bulletin RBO-04-04, dated January 7, 2004, titled “Clarification for Members Regarding Supervisory Obligations and Recordkeeping Requirements for E-Mail and Instant Messages,” sets forth similar requirements for retaining e-mails and instant messages.
20. Through the time of the 2007 FINOP examination, the Firm failed to capture, retain and review all required emails and instant messages. The Firm did not capture or preserve in the required format electronic communications with all email domains used by its associated persons for business communications. Also, the Firm failed to adequately supervise and document its supervision of the use of its emails and instant messages by its associated persons.
21. Thus, the Firm violated Section 17(a)(1) of the Exchange Act, and Rules 17a-4(b)(4) and 17a-4(f) thereunder, and NYSE Arca Options Rules 11.16(a) and 11.18.

Disclosure of Financial Arrangements

22. Pursuant to NYSE Arca Options Rule 11.11(a), an OTP Firm that enters into a financial arrangement ² with any other person or entity must disclose to the Exchange the identity of such person or entity and the terms of the arrangement. Pursuant to NYSE Arca Options Rule 11.11(b), OTP Firms have a continuing obligation to notify the Exchange of the initiation, modification or termination of their financial arrangements within ten business days of such arrangements by way of a Financial Arrangements Disclosure Form.
23. The Firm failed to adequately disclose to NYSE Arca the terms of its financial arrangements with certain affiliates, pursuant to which, among other things, one

² For purposes of this Rule, a financial arrangement is defined as either the direct financing of an OTP Holder’s or OTP Firm’s dealings with the Exchange, any direct equity investment or profit sharing agreement or any consideration over \$5,000, including gifts, loans, annual salaries or bonuses.

affiliate paid certain expenses on behalf of the Firm in exchange for a monthly management fee. Also, the Firm failed to submit to NYSE Arca the required Financial Arrangements Disclosure Form with respect to its expense sharing arrangements.

24. Thus, the Firm violated NYSE Arca Options Rule 11.11(a) and (b).

Additional Factors Considered

25. In arriving at the agreed upon penalty in this matter, Enforcement took into consideration the following: (i) the Firm corrected the violations during the course of the 2007 FINOP examination or shortly thereafter, and (ii) the Firm has taken steps to improve its supervision, including hiring additional compliance and administrative staff and a compliance consultant and enhancing and updating its policies and procedures to prevent future violations.

VIOLATIONS

26. Respondent violated Sections 15(c)(3) and 17(a) of the Exchange Act, and Rules 15c3-1, 17a-3 and 17a-5 thereunder, and NYSE Arca Options Rules 4.1 and 11.16(a), by improperly calculating required net capital and creating and maintaining inaccurate records with respect to net capital computations.
27. Respondent violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder, and NYSE Arca Options Rules 4.5 and 4.11(a) by filing an inaccurate FOCUS Report.
28. Respondent violated NYSE Arca Options Rule 11.3(a) and (b) by failing to obtain and review all outside brokerage account statements of certain associated persons, including review for the possible misuse of material, non-public information, failing to document such review at least quarterly, and failing to report all such accounts on its 2007 Annual Compliance Form.
29. Respondent violated Exchange Act Rule 17a-3(12)(i) by failing to document required background checks prior to hiring certain associated persons.
30. Respondent violated Section 17(a)(1) of the Exchange Act and Rules 17a-4(b)(4) and 17a-4(f) thereunder, and NYSE Arca Options Rule 11.16(a) by failing to retain and preserve in the required format certain electronic communications relating to the business of the Firm.
31. Respondent violated NYSE Arca Options Rule 11.11(a) and (b) by failing to disclose to the Exchange in writing certain required details and terms of an expense sharing agreement and by failing to submit to the Exchange a Financial Arrangement Disclosure Form.

32. Respondent violated NYSE Arca Options Rule 11.18 by failing to establish, maintain and/or enforce appropriate written policies and procedures for supervision and control, including a separate system of follow-up and review, in the following areas:
- a. the execution and maintenance of agreements with its clearing firm, to prevent net capital violations;
 - b. the obtaining and reviewing of all associated persons' outside brokerage account statements and reporting all such accounts on the Annual Compliance Form;
 - c. the performance of background checks prior to hiring each associated person; and
 - d. the retention and review of all business electronic communications.

DECISION

The Hearing Officer accepted the Offer of Settlement as set forth above, and Respondent is found to have committed the violations contained therein.

PENALTY

In accordance with the Offer of Settlement, Respondent is hereby censured and fined \$25,000.

For the Hearing Board

Peggy Kuo - Chief Hearing Officer