FINRA MARKET REGULATION –
LEGAL SECTION,

                Complainant,

v.

CITADEL SECURITIES LLC,

                Respondent.

Proceeding No. 20100223345

June 25, 2014

Respondent violated NYSE Arca Equities Rules 6.1 and 6.18, and Exchange Act Rule 15c3-5, by failing to establish, maintain, and enforce a supervisory system, including supervisory procedures and risk management controls, reasonably designed to: (1) check for order accuracy; (2) reject orders that exceeded appropriate price and/or size parameters; (3) reject duplicative orders; and (4) monitor appropriate message level activity, including message activity at the desk, firm, and market level. Consent to a censure, an $160,000 fine, and an undertaking.

Appearances

For FINRA Market Regulation:

Laurie A. Doherty, Esq.
Justin Chretien, Esq.
David E. Rosenstein, Esq.
Robert A. Marchman, Esq.

For Citadel Securities LLC:

Paul R. Eckert, Esq.

A Hearing Officer at the Financial Industry Regulatory Authority ("FINRA") considered an Offer of Settlement and Consent entered into between the Market Regulation Department at FINRA ("Market Regulation") on behalf of NYSE Regulation, Inc.[1] and Respondent Citadel Securities LLC ("CDRG"), an NYSE Arca Equities Trading Permit Holder ("ETP Holder").

The Offer of Settlement and Consent 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 findings referred to therein.

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[1] FINRA is handling this matter on behalf of NYSE Regulation, Inc. pursuant to a Regulatory Services Agreement among NYSE Group, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., NYSE Amex LLC (now NYSE MKT LLC), NYSE Regulation, Inc., and FINRA, which became effective June 14, 2010.

The Hearing Officer accepts the Offer of Settlement and Consent and issues this Decision in accordance with NYSE Arca Equities Rules.[2]

BACKGROUND AND JURISDICTION

1. CDRG became registered as an ETP Holder with NYSE Arca, Inc. ("NYSE Arca Equities") on March 23, 2004. As a retail equity market maker in the United States, CDRG provides execution services to millions of retail investors through its broker-dealer clients. CDRG also engages in proprietary trading for its own account.

2. On behalf of NYSE Arca Equities, FINRA's Market Regulation Department conducted a review of CDRG's compliance with NYSE Arca Rules 6.1 and 6.18, and Rule 15c3-5 of the Securities Exchange Act of 1934 ("Exchange Act Rule 15c3-5") concerning the detection and prevention of erroneous orders and executions from March 18, 2010, through January 8, 2013 ("Review Period").

3. In a letter dated April 11, 2013, which CDRG received, Market Regulation, on behalf of NYSE Arca Equities, notified CDRG that it was investigating its compliance with applicable FINRA and NYSE Arca Equities Rules, and federal securities laws and regulations, concerning the entry of erroneous orders into securities exchanges and market centers during the Review Period.

Overview

4. This matter involves CDRG's failure to reasonably prevent the transmission of erroneous orders to NYSE Arca Equities, Nasdaq Stock Market LLC ("Nasdaq"), BATS Exchange, Inc. (BZX"), and BATS Y-Exchange, Inc. ("BYX") (collectively the "Exchanges") during the Review Period.

    - On 24 occasions during the Review Period, CDRG used the Exchanges' clearly erroneous petition processes to obtain cancellations of erroneous customer orders that its supervisory procedures and risk controls failed to reasonably detect and prevent.

    - Separately, in April 2010, while implementing a software upgrade, CDRG released a test version of a previously abandoned software update, causing a quoting system to send aggressively priced marketable sell limit orders to the exchanges. This release caused CDRG to erroneously sell short 2.75 million shares of PC Group, Inc. during an eleven minute period.

    - In August 2011, CDRG released an updated version of its order sizing software for one of its proprietary trading strategies. The

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[2] The facts, allegations, and conclusions contained in this Decision are taken from the executed Offer of Settlement and Consent. Consistent with the Offer of Settlement and Consent, this Decision refers to the governing rules of NYSE Arca, Inc. as "NYSE Arca Equities Rules."

release caused the trading strategy to enter into an order sending and cancellation loop.

- On December 13, 2012, CDRG applied inaccurate market data to its order book when a CDRG data server dedicated to handling NYSE Arca market data failed to start up properly. This failure caused CDRG's proprietary trading desk to send erroneous hyper-marketable limit orders in 16 different stock symbols to the Exchanges during a two minute period.

5. By failing to establish, maintain, and enforce a supervisory system, including supervisory procedures and risk management controls, reasonably designed to: (1) check for order accuracy; (2) reject orders that exceeded appropriate price and/or size parameters; (3) reject duplicative orders; and (4) monitor appropriate message level activity, including message activity at the desk, firm and market level, CDRG violated NYSE Arca Equities Rules 6.1 and 6.18 (for conduct occurring during the Review Period), and Exchange Act Rule 15c3-5 (for conduct occurring on or after July 14, 2011).

Violative Conduct

6. CDRG conducts its business through fully-automated electronic trading desks, three of which are the subject of this review.

7. CDRG's equity market making desk experienced two different types of erroneous order events during the Review Period: (1) erroneous orders submitted by CDRG's broker dealer clients on behalf of retail customers; and (2) erroneous orders generated by CDRG's proprietary trading activity.

Customer Error Events involving CDRG's Equity Market Making Desk

8. In 24 instances during the Review Period, CDRG's equity market making desk failed to prevent the transmission of erroneous customer orders to the Exchanges. Transactions resulting from the 24 erroneous customer orders affected the price of each security, in some cases, dramatically. As one example, on September 23, 2010, CDRG failed to block an erroneously entered customer market order for 45,000 shares. CDRG's transmission of this erroneous order to the Exchanges was followed by an immediate increase in the price of the security of 132 percent.

9. In each instance cited above in paragraph eight, CDRG petitioned the Exchanges to cancel the resulting executions on the ground that the orders were clearly erroneous. Seventeen of the 24 petitions that CDRG submitted stated that the customer mistakenly entered a market order or stop order instead of a limit order or stop limit order. In most instances, the Exchanges granted CDRG's petitions, in whole or in part, and cancelled the transactions resulting from the erroneous orders. CDRG relied primarily on post-trade notifications from the Exchanges, or in a few instances, from its customers, to identify the erroneous customer orders and the executions resulting therefrom.

10. In April 2010 through June 2010, CDRG had no specific pre-trade risk control on the equity market making desk for preventing erroneous customer orders other than a general requirement that the order size not exceed 999,999 shares. None of the subject customer orders triggered this order size control because none exceeded 999,999 shares.

11. In June 2010, prior to the effective date of Exchange Act Rule 15c3-5, CDRG added a pre-trade risk control to the equity market making desk that compared the size of the customer order to the average daily trading volume in the security. Between June 2010 and January 2013, CDRG modified this size/volume control on multiple occasions, narrowing its parameters and adding new parameters to detect a broader range of potentially erroneous orders. Notwithstanding these changes, erroneous customer orders continued to pass through this control because (1) the orders did not exceed the size and volume parameters, or (2) the security or order type was excluded from this pre-trade control's review. For example, in February 2012, CDRG failed to prevent an erroneous customer order of 105,257 shares because the size/volume control did not apply to not-held orders.

12. In addition to the deficiencies described above, in November 2010 through the end of the Review Period, CDRG's risk control parameters on the equity market making desk were inadequate because they excluded from review whole categories of securities symbols, including Nasdaq 100, S&P 100, and high-volume ETF symbols.

PC Group, Inc. ("PCGR")

13. On April 7, 2010, the equity market-making desk erroneously sold short, on a proprietary basis, 2.75 million shares of PCGR, causing the share price of PCGR to fall by 77 percent during an eleven minute period. The 2.75 million shares sold short equaled 567 percent of the average daily volume of 485,686 for the month of April 2010.

14. CDRG's profit and loss server, a monitor that provides a real time view of CDRG's positions and profit and losses, reflected the large short position accumulating in PCGR, which alerted the CDRG desk and IT Support personnel. Upon discovery of this activity, CDRG disabled the desk's ability to send quotes in PCGR.

15. The erroneous executions in PCGR were triggered by an update to part of CDRG's trading system. While implementing a software upgrade, CDRG released an unrelated test version of a previously abandoned software update. This software update caused CDRG to transmit to the Exchanges aggressive, marketable sell limit orders for 100 shares at an average of 25 orders per second. Because the size of each order was less than 999,999 shares, CDRG's order size control, which was the primary pre-trade risk control for preventing erroneous orders in place on the equity market making desk at that time, did not block the orders.

16. At the time of the PCGR event, CDRG had neither (1) formal written policies, procedures, or controls in place to address modifications to its trading systems, quoting systems, or algorithms, nor (2) an assigned employee to continuously monitor the system

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involved in this event.

Excessive Messaging Activity

17.   On August 23, 2011, CDRG's options market making desk released an updated version of its order sizing software for one of its proprietary trading strategies. The strategy was first released to an electronic trading desk quoter ("quoter") with a small number of symbols. The quoter, however, did not have a properly configured wait timer. That fact, combined with the new order sizing logic, resulted in an unintended "loop" in the strategy's order send and cancel logic.

18.   As a result, between August 23, 2011, and August 31, 2011, CDRG sent multiple, periodic bursts of order messages, at 10,000 orders per second, to the Exchanges. This excessive messaging activity, which involved hundreds of thousands of orders for more than 19 million shares, occurred two to three times per day. For example, on August 25, 2011, in one second, CDRG sent 13,917 order messages to the Exchanges in one security totaling 2,410,700 shares. Each order was displayed and cancelled before execution.

19.   Because of the brief duration and small size of each order, none of the risk controls in force on the options market-making desk were triggered by the message burst events.

20.   After receiving an inquiry about its order activity from FINRA on August 31, 2011, CDRG modified its trading software on the options market making desk to prevent the recurrence of this activity.

December 13, 2012 Data Server Failure on CDRG's Proprietary Trading Desk

21.   On December 13, 2012, a CDRG data server dedicated to handling NYSE Arca market data used by CDRG's proprietary trading desk failed to start up properly. This failure caused a CDRG data server dedicated to handling NYSE Stock Exchange LLC market data to connect and disseminate NYSE Stock Exchange LLC market data in its place. The software used by CDRG at the time did not separately record or denote the specific exchange from which it uploaded market data, so a trading strategy intended for NYSE Arca downloaded an image of the NYSE Stock Exchange LLC market data. The transposition of the market data caused CDRG's proprietary trading desk to send erroneous hyper-marketable limit orders in 16 different stock symbols to the Exchanges during a two minute period. CDRG incurred a loss of approximately $1.4 million on the resulting erroneous executions. The Exchanges granted, in part, CDRG's petition to cancel the executions, reducing CDRG's loss to $400,000.

DECISION

CDRG violated NYSE Arca Equities Rules 6.1 and 6.18 (for conduct during the Review Period), and Exchange Act Rule 15c3-5 (for conduct occurring on or after July 14, 2011), by failing to establish, maintain, and enforce a supervisory system, including supervisory procedures and risk management controls reasonably designed to: (1) check for order accuracy; (2) reject orders that exceeded appropriate price and/or size parameters; (3) reject duplicative orders; and (4) monitor

appropriate message level activity, including message activity at the desk, firm, and market level.

SANCTIONS

CDRG is:

    1.   censured;

    2.   fined $160,000;[3]

    3.   ordered to revise its written supervisory procedures and risk management controls to address the deficiencies described in this Decision.

Within 60 business days after this Decision, a CDRG registered principal shall submit either a signed, dated letter to
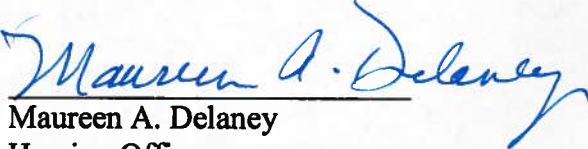
<div align="center">

Compliance Assistant
Legal Section, Market Regulation Department
9509 Key West Avenue, Rockville, MD 20850

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or an e-mail from a work-related email address, to

<div align="center">

MarketRegulationComp@finra.org

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that provides the following information: (i) a reference to this matter; (ii) a representation that CDRG has revised its written supervisory procedures and risk management controls to address the deficiencies described in this Decision; and (iii) the date CDRG implemented the revised procedures and risk management controls.

The sanctions shall take effect immediately.

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Maureen A. Delaney
Hearing Officer

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[3] This $160,000 fine is part of a global settlement whereby CDRG agreed to a total fine of $800,000 payable to five self-regulatory organizations ($420,000 to Nasdaq, $160,000 to NYSE Arca, $100,000 to BZX, $70,000 to BYX, and $50,000 to FINRA).