

NYSE ARCA, INC.

FINRA DEPARTMENT OF MARKET
REGULATION,

Complainant,

v.

VIRTU FINANCIAL BD LLC

Respondent.

Proceeding No. 20120334122-03

October 8, 2015

Virtu Financial BD LLC violated (i) Rule 15c3-5(c)(1)(ii) of the Securities and Exchange Act of 1934 by failing to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders; and (ii) NYSE Arca Options Rule 11.18 (Supervision) by failing to establish, implement and maintain adequate supervisory procedures and a system of follow-up and review, including written supervisory procedures, reasonably designed to ensure compliance with Exchange Act Rule 15c3-5. Consent to a censure, a \$20,000 fine, and an undertaking.

Appearances

FINRA Market Regulation:

Jason A. Harman, Esq.
Kenneth R. Bozza, Esq.
David E. Rosenstein, Esq.
Robert A. Marchman, Esq.

Virtu Financial BD LLC:

Julian Rainero, Esq.
Bracewell & Giuliani LLP

A Hearing Officer at the Financial Industry Regulatory Authority (“FINRA”) considered an Offer of Settlement and Consent entered into between FINRA’s Department of Market Regulation on behalf of NYSE Regulation, Inc.¹ and Virtu Financial BD LLC.

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

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.

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

FINDINGS OF FACTS AND VIOLATIONS

Background and Jurisdiction

1. Virtu Financial is a Delaware limited liability corporation with its principal place of business located in New York, New York. At all relevant times, the firm was an NYSE Arca Options Trading Permit (“OTP”) holder, having registered on June 14, 2012. The firm does not have any relevant prior disciplinary history.
2. After receiving a referral concerning Obvious Error filings submitted by Virtu Financial to bust or adjust certain trades effected by the firm in ABCD Inc.³ options (symbol: ABCD) on July 25, 2012, between 9:30 and 9:45 a.m., the Options Regulation staff of Market Regulation conducted a review of Virtu Financial’s pre-trade risk management controls and supervisory procedures related to preventing the entry of erroneous orders.
3. A jurisdiction letter was sent to the Virtu Financial on May 2, 2014.

Overview

4. Based on a review of the firm’s trading in ABCD options on July 25, 2012, Virtu Financial violated: (i) Rule 15c3-5(c)(1)(ii) of the Securities and Exchange Act of 1934 (“Exchange Act”) by failing to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders; and (ii) NYSE Arca Options Rule 11.18 (Supervision) by failing to establish, implement and maintain adequate supervisory procedures and a system of follow-up and review, including written supervisory procedures, reasonably designed to ensure compliance with Exchange Act Rule 15c3-5.

Violations

5. On or around March 19, 2012, ABCD declared a \$2.65 per share dividend that would be payable sometime during the fourth quarter. At that time, the Options Clearing Corporation issued a memo indicating that, in accordance with its By-Laws, it would not adjust ABCD options strike prices to accommodate what it deemed to be an ordinary

² The facts, allegations, and conclusions contained in this Decision are taken from the executed Offer of Settlement and Consent submitted on September 11, 2015.

³ A generic identifier has been used in place of this company.

dividend. Subsequently, during an earnings call after the close of trading on July 24, 2012, ABCD reported its third quarter results and declared that the \$2.65 dividend would be payable August 16, 2012. This announcement by ABCD of the dividend payment was not included in Virtu Financial's nightly dividend download from Bloomberg on July 24, 2012.

6. Because the dividend was not properly accounted for by Virtu Financial in its trading and pricing systems, when the firm's trading models commenced trading on the morning of July 25, 2012, they mispriced any ABCD options with an expiration date on or after August 16, 2012.⁴
7. Between the open of trading at 9:30:00 a.m. and 9:41:38 a.m., when the firm halted trading, Virtu Financial sent approximately 1.45 million orders in ABCD options with an August 2012 expiration date to multiple exchanges, resulting in almost 16,400 executions for ABCD options. A total of 6,614 contracts were executed on NYSE Arca.
8. While each order placed and executed was subjected to the firm's pre-trade risk controls, due to the failure to adjust for the expected dividend, almost all of the ABCD options contracts with August 2012 expiration dates were executed at unfavorable prices, resulting in a loss to the firm of almost \$3.7 million.
9. Virtu Financial requested obvious error rulings for any mispriced ABCD executions across all exchanges. However, while Virtu Financial's executions were at prices away from the National Best Bid and Offer, the vast majority of executions did not meet the obvious error requirements and only a very small number of trades were broken, adjusted or otherwise unwound by the exchanges.
10. Virtu Financial's Registered Options Principal, AB,⁵ was also the trading supervisor responsible for the strategies placing the specific ABCD orders at issue. Between 9:30 a.m. and 9:40 a.m., when AB noticed that certain trading strategies⁶ were "locking down" (*i.e.*, prevented from placing additional orders until unlocked by an authorized risk manager) due to the firm's pre-trade risk controls, he believed that those lockdowns were related to market-data issues and thus began manually resetting the strategies, thereby permitting the relevant strategy to continue placing orders subject to the firm's Maximum Distance from the NBBO pre-trade risk control, which was set to \$1.00 at the time.⁷

⁴ When a dividend is declared on a stock, the market typically discounts the market price of the stock by the amount of the dividend, resulting in a lower stock price after the dividend payment date. Correspondingly, options in the stock with expiration dates after the dividend payment date typically have lower call premiums and higher put premiums.

⁵ A generic identifier has been used in place of the name of this individual.

⁶ Virtu Financial refers to "strategies" as trades in both the calls and puts of an option at the same strike price.

⁷ This control was subsequently made more restrictive.

11. Because AB manually reset a total of 72 lockdowns (without disabling the Maximum Distance from the NBBO pre-trade risk control), the firm's strategies continued to submit orders in ABCD that, while still subject to the firm's pre-trade risk controls, were mispriced and were also disadvantageous to the firm.
12. On the date at issue in this matter, AB was the principal with primary responsibility for monitoring and supervising Virtu Financial's automated options market making. At certain thresholds, AB had the ability, without additional review and/or approval, to manually reset trading strategies (without disabling any firm-wide pre-trade risk controls) after a pre-trade risk control was triggered.
13. In addition, because the firm's pre-trade risk controls were applied to each options series individually rather than the firm's aggregate position in the underlying security, many of the firm's other pre-trade risk controls were not triggered, thereby contributing to the firm's failure to detect and prevent the entry of erroneous orders.
14. As a result of the conduct described in paragraphs five through thirteen above, the firm's risk management and supervisory controls were not reasonably designed to prevent the entry of erroneous orders, in violation of Exchange Act Rule 15c3-5(c)(1)(ii) and NYSE Arca Options Rule 11.18.

DECISION

Virtu Financial BD LLC violated (i) Rule 15c3-5(c)(1)(ii) of the Securities and Exchange Act of 1934 by failing to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders; and (ii) NYSE Arca Options Rule 11.18 (Supervision) by failing to establish, implement and maintain adequate supervisory procedures and a system of follow-up and review, including written supervisory procedures, reasonably designed to ensure compliance with Exchange Act Rule 15c3-5.

SANCTIONS

Virtu Financial BD LLC is censured and fined \$20,000.⁸

Virtu Financial is also ordered to revise its policies and procedures, including its written supervisory procedures, to establish and maintain adequate supervisory procedures: (i) related to the use of pre-trade controls with more restrictive parameters than the firm-wide pre-trade risk controls, including the manual resetting of trading strategies restricted by such controls; and (ii)

⁸ Under the Offer of Settlement and Consent, Virtu Financial BD LLC agreed to pay a total fine of \$60,000, of which \$20,000 shall be paid to NYSE Arca and the remaining amount shall be paid to (i) NYSE MKT LLC; and (ii) NASDAQ Options Market LLC in accordance with the terms of parallel settlement agreements in related matters between Virtu Financial and each of these self-regulatory organizations.

to ensure sufficient oversight and review of the reset of trading strategies that are restricted by one or more firm-wide pre-trade risk controls.

Within 90 days of the date of this Decision, a registered principal of Virtu Financial shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a signed, dated letter, or an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org that provides the following information: (i) a reference to this matter; (ii) a representation that the firm has revised its policies and procedures, including its written supervisory procedures, to address the deficiencies described above; and (iii) the date the revised procedures were implemented.

The sanctions shall take effect immediately.



Andrew H. Perkins
Chief Hearing Officer