

NYSE ARCA, INC.

FINRA DEPARTMENT OF MARKET
REGULATION,

Complainant,

v.

ELECTRONIC TRANSACTION
CLEARING, INC.,

Respondent.

Proceeding No. 20100254756-03¹

February 18, 2016

Respondent violated NYSE Arca Equities Rules and 6.18, 6.1(b), 6.2(b), and 2010 by failing to establish, maintain and enforce adequate supervisory systems and procedures, including written supervisory procedures, reasonably designed to supervise its market access business and achieve compliance with applicable securities laws, rules, and regulations.

Respondent violated Exchange Act Section 15(c)(3), Exchange Act Rule 15c3-5, and NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010 by failing to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of providing market access.

Respondent also violated NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010 by failing to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its market access business.

Consent to a censure, a \$218,750 fine, and an undertaking.

¹ This Decision also includes matter numbers 20100242001, 20100242634, 20110284587, 20120325248, 20120349915, 20130354688, 20130358277, 20130364653, 20130368332, 20140410488, 20140426517, and 20150471654.

Appearances

FINRA Market Regulation:

Jason A. Harman, Esq.
Gary E. Jackson, Esq.
Kenneth R. Bozza, Esq.
James J. Nixon, Esq.
David E. Rosenstein, Esq.
Robert A. Marchman, Esq.

Electronic Transaction Clearing, Inc.:

Monique Saugstad
Chief Compliance Officer

Ivan P. Harris, Esq.
Morgan, Lewis & Bockius LLP

A Hearing Officer at the Financial Industry Regulatory Authority ("FINRA") considered an Offer of Settlement and Consent² entered into between FINRA's Department of Market Regulation (Market Regulation) on behalf of NYSE Regulation, Inc.³ and Electronic Transaction Clearing, Inc. (ETC or Firm).

ETC submitted the Offer of Settlement and Consent 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 Equities Rules.⁴

FINDINGS OF FACTS AND VIOLATIONS

Background and Jurisdiction

1. ETC is a Delaware corporation headquartered in Los Angeles, California. It has been registered with the Securities and Exchange Commission (SEC) since June 27, 2008, with NYSE Arca Equities, Inc. (NYSE Arca or Exchange) since August 21, 2008, and with FINRA since July 15, 2009. At all relevant times, ETC also was an NYSE Arca Equities Trading Permit (ETP) Holder. ETC is registered with multiple equities exchanges. ETC does not have a relevant disciplinary history.

² Submission of the Offer of Settlement and Consent is conditioned upon acceptance of equivalent settlement agreements in related matters between the Firm and FINRA, BATS Exchange, Inc., and NASDAQ Stock Market LLC.

³ 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.

⁴ The facts, allegations, and conclusions contained in this Decision are taken from the executed Offer of Settlement and Consent submitted on January 25, 2016.

2. This disciplinary proceeding originated from examinations, investigations, and reviews that several surveillance and examination groups within FINRA's Department of Market Regulation conducted on behalf of NYSE Regulation, FINRA, and various securities exchanges. Market Regulation based its examinations, investigations, and reviews upon, among other things, various automated market surveillance programs (including cross-market surveillance) that detect potentially manipulative and suspicious activity and other potential violations of NYSE Arca Equities rules, FINRA rules, the rules of various securities exchanges, and the federal securities laws, as well as responses to referrals received from various securities exchanges.
3. In letters dated September 21, 2012, October 1, 2012, April 10, 2013, September 18, 2013, February 28, 2014, April 15, 2014, and December 10, 2014, which the Firm received directly or through counsel, Market Regulation, on behalf of NYSE Regulation, notified the Firm that it was investigating suspicious and potentially manipulative trading activity by ETC's Market Access Customers on the NYSE Arca Marketplace and other exchanges, and Respondent's supervision thereof, during all times relevant to this matter.

Summary

4. This disciplinary proceeding involves supervisory violations committed by executing and clearing broker-dealer ETC from November 1, 2009, through March 31, 2015 (Relevant Period), in connection with the Firm's business of providing direct market access and sponsored market access to registered and unregistered market participants (Market Access Customers) to multiple market centers, including NYSE Arca, BATS Exchange, Inc. ("BATS"), BATS Y-Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., The Nasdaq Stock Market, LLC ("Nasdaq"), NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, LLC, New York Stock Exchange, LLC and NYSE MKT LLC (NYSE Amex LLC prior to May 14, 2012) (collectively, Exchanges or SROs).
5. During the Relevant Period, ETC was a significant market access provider, acting as the gateway to U.S. securities markets for dozens of Market Access Customers, including foreign, domestic, registered, and unregistered day-trading firms, as well as thousands of affiliated individual traders and trader groups, many of which were located in foreign jurisdictions. Using trading systems they owned directly or which they leased from a third-party provider (*i.e.* service bureau), ETC's Market Access Customers executed billions of shares each month by electronically routing orders directly to the Exchanges and other trading venues through the use of ETC-registered mnemonics and market participant identifiers (MPIDs).
6. As a market access provider, the Firm was responsible for establishing, implementing, and maintaining adequate supervisory procedures and a system of follow-up and review, including written supervisory procedures (WSPs), reasonably designed to investigate red flags and monitor the trading activity of its Market Access Customers, to detect and prevent potentially manipulative trades, and to ensure that all trades entered under the Firm's mnemonics or MPIDs complied with applicable federal securities laws and regulations, NYSE Arca rules, FINRA rules, and the Exchanges rules. Implicit in this

responsibility was the requirement that ETC invest sufficient resources in its supervisory technology, compliance infrastructure, and compliance staff.

7. Beginning on July 14, 2011, and continuing through the end of the Relevant Period, pursuant to Rule 15c3-5 of the Securities Exchange Act of 1934 (Exchange Act or the Market Access Rule),⁵ ETC was also required to establish, document, and maintain an adequate system of risk management controls and supervisory procedures reasonably designed to manage financial, regulatory, and other risks in connection with the Firm's provision of market access, including the implementation of certain pre-trade and post-trade risk controls, to ensure compliance with all applicable federal securities laws and regulations, NYSE Arca rules, FINRA rules, and the Exchanges' rules, restricting access to ETC's trading systems and technology to approved persons, and ensuring direct and exclusive control over its financial and regulatory risk management controls.
8. During the Relevant Period, ETC's supervisory systems and procedures and risk management controls were not reasonably designed to supervise and manage the risks of its market access business involving thousands of foreign-based traders, and therefore, could not reasonably monitor, detect, and prevent potentially manipulative activity.
9. Despite numerous red flags, heightened risks, and repeated notice by regulators of potentially manipulative activity being effected by certain Market Access Customers, ETC's approach to its regulatory responsibilities was inadequate. The Firm also failed to dedicate sufficient compliance resources and staff to meet its regulatory responsibilities as its business grew, and, in some instances, to conduct adequate follow-up and review of potentially manipulative activity, such as wash trades, pre-arranged trades, layering, spoofing and other momentum ignition strategies, violative odd-lot trades, and trades that impermissibly marked the opening and closing of trading. Moreover, certain systems and controls ETC did design and implement were flawed and inadequately tailored to its business.
10. By failing to establish, maintain, and enforce an adequate supervisory system, including WSPs, reasonably designed to monitor and investigate red flags, detect and prevent potentially manipulative trades of its Market Access Customers, and ensure compliance with the federal securities laws and regulations, including the Market Access Rule, and NYSE Arca rules, FINRA rules, and SRO Rules, ETC violated NYSE Arca Equities Rules 6.18 (concerning, among other things, ETP Holders' supervisory responsibilities), 6.1(b) (concerning, among other things, adherence to principles of good business practice), and 6.2(b) and 2010 (as of June 30, 2011) (both concerning, among other things, conduct inconsistent with just and equitable principles of trade).

⁵ The SEC adopted the Market Access Rule in November 2010 to require that, as gatekeepers to the financial markets, broker-dealers that provide market access "appropriately control the risks associated with market access so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system." 17 C.F.R. § 240.15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (Final Rule Release). The Market Access Rule became effective July 14, 2011.

11. By failing to establish, document, and maintain an adequate system of risk management controls and supervisory procedures reasonably designed to manage the financial and regulatory risks and ensure compliance with all regulatory requirements in connection with ETC's provision of market access, ETC violated Exchange Act Section 15(c)(3) (concerning, among other things, broker-dealers' compliance with SEC rules regarding safeguards, financial responsibility, and related practices of broker-dealers) and Rule 15c3-5 thereunder (requiring, among other things, that broker-dealers appropriately control risks associated with market access), and also violated NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010 (as of June 30, 2011).
12. By failing to dedicate sufficient resources to ensure appropriate regulatory risk management controls and supervisory systems and procedures, and failing to prevent its Market Access Customers and their traders from executing thousands of potentially manipulative trades on the Exchanges, ETC failed to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business, in violation of NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010 (as of June 30, 2011).

Regulatory Framework

13. During the Relevant Period, NYSE Arca Equities Rule 6.18(a) required, among other things, that every ETP Holder supervise its associated persons to ensure compliance with federal securities laws and the Constitution or the Rules of NYSE Arca. NYSE Arca Equities Rule 6.18(b) required each ETP Holder to "establish and maintain a system to supervise the activities of its associated persons and the operation of its business[.]" and that such system "must be reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca Equities Rules." NYSE Arca Equities Rule 6.18(c) also required each ETP Holder 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 achieve compliance with applicable federal securities laws and regulations, and with the NYSE Arca Equities Rules."
14. NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007), made clear that ETP Holders who accept electronic orders from clients to whom they provide access to the NYSE Arca Marketplace must have a supervisory system in place, including written supervisory procedures, designed to review all trading activity for potentially manipulative or otherwise improper trading patterns or practices. NYSE Arca Regulatory Information Bulletin 08-05, *Preventing Clearly Erroneous Executions* (Nov. 11, 2008) provided that, when establishing and maintaining supervisory systems and procedures, an ETP Holder's trading systems should include controls that limit their use to authorized persons and prevent orders that exceed preset credit and size parameters from being submitted to the Exchange. NYSE Arca Regulatory Information Bulletin RBE-02-02, *Supervision Obligations of ETP Holders* (April 25, 2002), identified specific types of manipulative trading practices ETP Holders are required to monitor for, including marking-the-close, prearranged trading, phantom orders (orders entered with the sole intention of artificially

influencing the market that are usually cancelled prior to execution), influencing the open and wash sales.

15. During the Relevant Period, NYSE Arca Equities Rule 6.1(b) required ETP Holders to adhere to good business practices in the conduct of their business affairs. In addition, NYSE Arca Equities Rule 6.2(b) also stated: "it being declared among other things, that the willful violation of any provision of the federal securities laws, the regulations of the Securities and Exchange Commission . . . , and the Bylaws and Rules and procedures of [NYSE Arca] shall be considered conduct or proceedings inconsistent with just and equitable principles of trade." Similarly, on and after June 30, 2011, pursuant to NYSE Arca Equities Rule 2010, an ETP Holder was required to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business.
16. Effective July 14, 2011, Exchange Act Rule 15c3-5 required broker-dealers to act as gatekeepers to the financial markets and to appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.
17. The various subsections of Exchange Act Rule 15c3-5 set forth the risk management controls and supervisory procedures that a broker or dealer that provides a customer, or any other person, with access to an exchange through the use of its MPID, or otherwise, is required to establish, document, and maintain to manage the financial, regulatory, and other risks of its market access business.
18. During the Relevant Period, Exchange Act Rule 15c3-5(e) required a broker-dealer with market access to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures.
19. NYSE Arca Regulatory Information Bulletin RB-11-63, *New SEC Rule 15c3-5 Governing Supervision of Market Access* (May 13, 2011), reminded ETP Holders that a failure to establish and enforce the risk management controls and supervisory procedures required by Exchange Act Rule 15c3-5 may also violate NYSE Arca Equities rules, including the supervisory requirements of NYSE Arca Equities Rule 6.18.

Violations

20. During the Relevant Period, ETC was a significant market access provider to dozens of Market Access Customers, including foreign, domestic, registered and unregistered day-trading firms, as well as thousands of their individual traders and trader groups.
21. During the Relevant Period, ETC's Market Access Customers executed an average of almost five billion shares per month under ETC-registered mnemonics and/or MPIDs across multiple market centers including, but not limited to, the Exchanges.

22. Between 2009 and 2013, ETC earned millions of dollars from executing and clearing securities trades on behalf of its Market Access Customers.

ETC's Market Access Customers Raised Numerous Red Flags

23. From the time ETC first started executing trades for Market Access Customers in March 2009, it was aware, or should have been aware, that its market access business posed regulatory and compliance risks.
24. Multiple industry-wide notices published by FINRA both before and throughout the Relevant Period put ETC on notice that its market access business posed particular regulatory and compliance risks, and reminded market access providers like ETC that, among other things, they are ultimately responsible for all orders entered into their systems, including third-party services used to facilitate trading, and must ensure that all trading activity complies with all applicable securities laws and regulations. *See, e.g.,* FINRA's 2010 Annual Regulatory and Examination Priorities Letter ("Priorities Letter") (Mar. 1, 2010) (stating that market access providers: (i) must have written control and supervisory procedures to monitor trading activity and are responsible for taking steps to ensure that orders represent bona fide trading interest; (ii) must have appropriate processes for conducting due diligence with respect to the approval of market access customers; and (iii) should establish controls to limit financial exposure arising from the trading activity of sponsored participants and limiting the use of trading systems to authorized persons).⁶
25. Moreover, during the Relevant Period, NYSE Arca Equities rules prohibited manipulative and abusive trading practices, such as fictitious transactions, wash trades, and pre-arranged trades. (*See, e.g.,* NYSE Arca Equities Rules 6.5, 6.15, and 2020 (as of June 30, 2011) (prohibiting, among other things, efforts to effect or induce securities transactions for the purpose of creating or inducing a false, misleading, or artificial appearance of trading activity and directly or indirectly participating in, or having an interest in, the profits of a manipulative trading operation)).

⁶ *See also* FINRA's 2009 Priorities Letter (Mar. 9, 2009) (referencing NASD Notice to Members 04-66 (Sep. 2004), which specifically noted the need to ensure that orders entered by a firm or its customers via the firm's trading systems are representative of bona fide trading and quote activity); FINRA's 2011 Priorities Letter (Feb. 8, 2011) (noting: (i) FINRA's focus on compliance with the newly adopted Exchange Act Rule 15c3-5; (ii) FINRA's expectation that firms have written policies and procedures to ensure that trading complies with applicable FINRA rules and federal securities laws and regulations; and (iii) risks associated with master/sub-account relationships and the requirement for firms to have systems to monitor, detect and report suspicious activity); FINRA's 2012 Priorities Letter (Jan. 31, 2012) (noting: (i) FINRA's emphasis on post-trade surveillance procedures reasonably designed to identify various potential trading violations of SEC and FINRA rules; (ii) FINRA's focus on surveillance of abusive trading, including "momentum ignition strategies" such as layering, spoofing, and aggressive trading activity near the open or close, where market participants attempt to induce others to trade at artificially high or low prices through the entry of non-bona fide orders; and (iii) FINRA's focus on problematic activity by sponsored participants); FINRA's 2013 Priorities Letter (Jan. 11, 2013) (reiterating FINRA's trading concerns from 2012).

26. ETC also was aware, or should have been aware, of red flags raised by the business model of certain of its Market Access Customers and the relationship between those customers and their authorized traders, which was open to heightened risk and abuse:
- a. Some of ETC's Market Access Customers were affiliated with hundreds or even thousands of authorized traders located in various different countries.
 - b. ETC's "Consolidated Trader List" contained several examples of trader subgroups and unregistered business entities approved as authorized traders on behalf of ETC Market Access Customers.
 - c. ETC was aware that these Market Access Customers may have earned transaction-based compensation from their traders.
 - d. Whether or not some of those traders were acting as independent day-traders.
29. Notwithstanding being on notice of the particular risks associated with being a market access provider and the red flags arising out of the business model of certain of ETC's Market Access Customers, the Firm did not adequately investigate or understand the nature of the relationship between or among its customers and their authorized traders, subgroups, or other entities and the impact on ETC's ability to supervise their trading.

ETC Inadequately Monitored for Potentially Manipulative Activity

30. ETC's WSPs prohibited the specific trading practices that included most, if not all, of the types of conduct at issue here, including violative wash trades, prearranged trades, marking the close/influencing the open, painting the tape, and odd-lot abuse. ETC's WSPs further prescribed that "phantom orders" and other trading "activities to induce others to trade," including "unusual patterns of cancelled or unexecuted orders," were prohibited.
31. ETC registered with the SEC in June 2008 and started executing trades for Market Access Customers in or around March 2009, yet the Firm effectively had no trade surveillance program and conducted no automated reviews of its Market Access Customers' trading to detect and prevent the types of conduct that were expressly prohibited by both NYSE Arca rules (and those of other SROs) and ETC's own WSPs until on or around February 1, 2010, when the Firm implemented its first automated exception report. The only "exception report" ETC used before that time was a web-based short sale locate tool it had implemented in September 2009.
32. Prior to February 2010, two of ETC's employees under the oversight of ETC's President/Chief Operating Officer ("COO") may have conducted real-time monitoring of its Market Access Customers' trading but, if they did so, no document evidences the criteria they used to monitor for suspicious trading. In November and December 2009, ETC executed an average of more than 1.4 billion shares per month, and the Firm's

reliance on two or three employees to conduct real-time monitoring of that quantity of trading generated by a rapidly growing customer base⁷ was inadequate.

33. Although ETC ultimately developed and implemented a series of surveillances between February 2010 and October 2012:
- a. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potentially violative wash trades until on or around February 1, 2010.
 - b. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential pre-arranged trading until February 2010.
 - c. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential odd-lot manipulation until April 2010.
 - d. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential layering until March 2011.
 - e. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential spoofing until October 2012.
 - f. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential marking-the-open or marking-the-close activity until at least October 2011.

ETC's Market Access Customers Effected Significant Quantities of Potentially Manipulative Trades

34. ETC's supervisory failures were also evident in the quantity of potentially manipulative trading activity attributable to its Market Access Customers and entered on the SROs under ETC's MPIDs during the Relevant Period, including wash trades, pre-arranged trades, layering, spoofing and other momentum ignition strategies, violative odd-lot trades, and trades that impermissibly marked the opening and closing of trading.
35. During the Relevant Period, ETC's Market Access Customers employed aggressive, potentially manipulative trading strategies, often in illiquid securities. For example, FINRA and NYSE Arca staff identified hundreds of potential pre-arranged trades, thousands of potentially violative wash sales, and thousands of instances of potential layering across the Exchanges involving the Firm's Market Access Customers. Also, ETC's surveillance reports identified significant amounts of potentially manipulative activity executed by and through ETC for its Market Access Customers. Despite these red flags and this potentially manipulative activity, ETC failed to adequately review and investigate this activity and prevent potential violations of the relevant federal securities

⁷ Between November and December 2009 and the first quarter of 2010, ETC's customer base expanded from 8 to 15 firms, and executed share volume jumped from an average of 1.4 billion shares per month to 2.3 billion shares per month.

laws and regulations, including the Market Access Rule, and FINRA, NYSE Arca, and SRO rules.⁸

Wash Trades

36. Wash trades are trades with no change in beneficial ownership. Such trades can be violative when they are used to inject false information into the market to manipulate the prices of securities. Intentionally taking both sides of a trade can minimize financial risk for the trading firm, while potentially creating a false impression of higher volume in the market. Even wash trades not undertaken with fraudulent or manipulative intent can create a misimpression of the level of legitimate trading interest and activity in a security. NYSE Arca members have an obligation to have policies and procedures in place to review for and prevent potentially violative wash trades.⁹
37. Throughout the Relevant Period, ETC's Market Access Customers effected significant quantities of potentially violative wash trades. For example, from May 5, 2011, through September 30, 2012, 28 different MPIDs used by ETC's Market Access Customers appeared on ETC's Multivenue Wash report, reflecting significant quantities of potentially violative conduct across the SROs:
- 11 customers had 10 or more unique trader IDs show up on the report;
 - 16 customers effected potential wash trades on 10 or more different trade dates;
 - 17 customers effected 100 or more potential wash trades;
 - 11 customers effected potential wash trades totaling 100,000 or more shares;
 - 13 customers effected potential wash trades totaling \$1 million or more in value.

Below is a chart listing the Firm Market Access Customers that accounted for the most potentially violative activity cited in the Multivenue Wash report during this period:

MPID	Active Period	Traders	Dates	Shares	Value	Trades	Avg
ETCX	5/11-9/12 (17 mos.)	288	353	806,802	\$24,044,991.60	6,335	18/day
ETCT	5/11-10/11 (6 mos.)	593	104	1,575,291	\$47,598,566.55	11,699	112/day
ETAM	5/11-1/12 (9 mos.)	258	207	1,648,046	\$49,363,941.19	14,073	68/day
ETBB	6/12-9/12 (3 mos.)	79	62	998,810	\$33,221,260.36	9,474	153/day
ETCN	5/11-9/11 (5 mos.)	12	76	2,381,859	\$19,255,035.79	17,438	229/day
ETCO ¹⁰	5/11 (1 mo.)	69	1	73,159	\$1,642,671.32	687	687/day

The number of times that certain traders and Market Access Customers appeared on the Multivenue Wash report was suspicious and presented a red flag that required adequate

⁸ See NYSE Arca Regulatory Information Bulletin RBE-02-02 (Apr. 25, 2002).

⁹ See *id.*

¹⁰ This firm stopped the majority of its trading through ETC in or around early May 2011.

review and investigation in order to prevent potentially violative conduct, which ETC failed to do. Although ETC conducted some reviews of this activity, they were inadequate and did not appear to prevent potentially violative conduct from continuing to occur.

Layering

38. Layering is a manipulative trading tactic designed to induce other market participants into executing trades at artificial prices. Layering generally involves, but is not limited to, a pattern in which multiple, non-bona fide (*i.e.* not intended to be executed) limit orders are entered on one side of the market in a stock at various price levels, which creates the appearance of a change in the supply and demand of the security, thereby moving the price. At or around the same time, the trader enters one or more orders for execution on the opposite side of the market; upon execution of some or all of those orders (in full or in part), any open non-bona fide orders are immediately cancelled. The activity is often then repeated on the opposite side of the market.
39. Throughout the Relevant Period, the Firm's Market Access Customers repeatedly and consistently effected instances of potential layering. During the period from March 2011 through September 2012, 12 different MPIDs used by ETC Market Access Customers appeared on the Firm's Layering report, reflecting significant quantities of potentially violative conduct across the SROs:
- 5 customers had 100 or more unique trader ids show up on the report;
 - 6 customers effected potential layering on 50 or more different trade dates.

Below is a chart listing the Market Access Customers that accounted for the most potentially violative activity cited in ETC's Layering report:

MPID	Active Period	Traders	Dates on Report	Total Trade Dates During Period
ETCX	3/11-9/12 (19 mos.)	201	351	418
ETCT	3/11-10/11 (8 mos.)	451	112	176
ETAM	3/11-1/12 (11 mos.)	238	224	242
ETBB	6/12-9/12 (3 mos.)	116	60	66
ETCO	3/11-5/11 (2 mo.)	187	32	44

The number of times that certain traders and Market Access Customers appeared on the Layering report was suspicious and presented a red flag that required adequate review and investigation in order to prevent potentially violative conduct, which ETC failed to do.¹¹ Although the Firm conducted some reviews of this activity, the reviews it did

¹¹ See NYSE Arca Regulatory Information Bulletin RBE-02-02 (Apr. 25, 2002) (noting that ETP Holders must ensure compliance with federal securities laws and Arca rules preventing manipulative trading, including "phantom orders" entered to artificially influence the market, which are usually cancelled prior to execution.)

perform were inadequate and did not appear to prevent potentially violative conduct from continuing to occur.

Pre-arranged Trading/Mid-Point Passive Liquidity Trades

40. During the Relevant Period, ETC's Market Access Customers effected hundreds of potential pre-arranged trades in numerous different securities across multiple market centers.¹²
41. Beginning in February 2010, ETC was aware that some of its Market Access Customers intentionally engaged in trading on both sides of the market to try and capture liquidity rebates, which could lead to large numbers of pre-arranged and/or wash trades, yet ETC did not take adequate steps to review, investigate and prevent this potentially violative activity. In particular, from March 2010 through April 2010, ETC Market Access Customers A,¹³ B, and C and, at the time, non-ETC customers D, E, and F, engaged in an apparent pre-arranged trading scheme on NYSE Arca using the Mid-point Passive Liquidity ("MPL") order type (*i.e.* undisplayed limit orders priced at the mid-point of the protected best bid/offer).¹⁴ The suspicious trades involved hundreds of securities and millions of shares, and comprised a high percentage (well in excess of 10%) of the total daily consolidated volumes of the securities involved; in 26 instances, ETC's customer and the non-ETC customer made up over 50% of the daily consolidated volume in a symbol.
42. For example, on April 19, 2010, ETC Market Access Customer C executed approximately 42,500 trades in 323 symbols, totaling approximately 170 million shares, almost exclusively with F, earning the participants over \$335,000 in rebates. Although ETC's surveillances detected some of this activity, they did not do so in a manner that enabled ETC to uncover the potential pre-arranged trading.

Spoofing

43. Spoofing generally involves, but is not limited to, a trading pattern in which multiple, non-bona fide limit orders are entered thereby triggering some type of market movement and/or response from another market participant, combined with the entry of one or more orders for execution on the opposite side of the market. Upon execution of some or all of those orders, any open non-bona fide orders are canceled.¹⁵

¹² See *id.*

¹³ In this Offer of Settlement, generic identifiers have been used in place of the names of certain individuals and entities.

¹⁴ At the time, NYSE Arca paid a rebate of \$.20 per 100 shares to firms that provided liquidity using MPL orders and did not charge a fee for taking liquidity.

¹⁵ See NYSE Arca Regulatory Information Bulletin RBE-02-02 (Apr. 25, 2002) (noting that ETP Holders must ensure compliance with federal securities laws and Arca rules preventing manipulative trading, including "phantom orders" entered to artificially influence the market, which are usually cancelled prior to execution.).

44. During the Relevant Period, ETC's Market Access Customers effected hundreds of instances of apparent spoofing in numerous different securities across multiple market centers. For example, between January 19, 2010, and July 20, 2010, traders for ETC Market Access Customer A effected approximately 390 instances of potential spoofing, totaling hundreds of thousands of shares, by engaging in a trading scheme on NYSE Arca. A's traders entered non-bona fide Post No Preference (PNP) Orders¹⁶ on NYSE Arca to move or anchor the National Best Bid and Offer (NBBO) by sending false or misleading signals to other market participants to induce them to purchase or sell. The traders then subsequently entered bona fide "PO+" Orders¹⁷ for execution at the more favorable price. Immediately upon execution of the bona fide order, the traders canceled any open non-bona fide orders and then repeated the process on the other side of the market.

Gaming

45. During the Relevant Period, ETC's Market Access Customers engaged in other momentum ignition strategies, including gaming activity in dark pools and auto execution manipulation. ETC was aware of this type of conduct, yet failed to conduct adequate review and investigation in order to prevent potentially violative conduct from occurring.¹⁸
46. For example, in January 2011, in five different thinly-traded (average daily trade volume less than 90,000 shares) NYSE-listed securities, traders from ETC Market Access Customer A entered non-bona fide orders on NYSE Arca and other market centers, causing the NBBO to move and triggering the NYSE Designated Market Maker's algorithm to execute against bona fide orders entered on the NYSE book by A's traders as dark interest, guaranteeing a profit for A on each transaction. Any open non-bona fide orders were then canceled by A's traders and the activity was repeated on the opposite side of the market. A's traders entered and canceled hundreds of orders in each security:

Date	Symbol	No. Canceled Orders	Time	Total Buys	Total Short Sales	% Daily Volume
1/6/11	ABC	384	11:07 - 11:41	14,957	14,957	32
1/25/11	DEF	200	11:16 - 11:49	7,200	7,200	15
1/26/11	GHI	326	12:12 - 12:44	12,600	12,600	23.5
1/31/11	JKL	427	12:46 - 14:48	15,358	15,358	17
1/31/11	MNO	133	11:44 - 12:14	10,200	10,200	27

¹⁶ PNP Orders are limit orders to buy or sell that are executed in whole or in part on NYSE Arca without routing any portion of the order to another market center.

¹⁷ PO+ Orders are immediately routed to the primary listing market for execution.

¹⁸ See NYSE Arca Regulatory Information Bulletin RBE-02-02 (Apr. 25, 2002).

ETC Market Access Customer A earned thousands of dollars in profits and hundreds of dollars in rebates from the NYSE based on these trades alone.

Odd-Lot Manipulation

47. Odd-lots are orders of less than 100 shares. During the Relevant Period and before June 2011, the NYSE Arca matching engine automatically executed odd-lot orders at the NBBO against the odd-lot dealer (*i.e.* market maker) in a given security.
48. During the Relevant Period, ETC was aware that some of its Market Access Customers engaged in potential odd-lot manipulation, yet it failed to conduct adequate review and investigation in order to prevent potentially violative conduct from occurring.¹⁹ For example, beginning in March 2010, traders from ETC Market Access Customers A and C and their counterparties trading through other broker-dealers, including, at the time, non-ETC customers B, D, F, and G, entered round-lot trades on one side of the market on BZX to manipulate the price of the NBBO to get favorable odd-lot executions on NYSE Arca, which auto-executed, and then repeated the process on the other side of the market. Using this scheme ETC Market Access Customer A traded over 170,000 shares and generated an estimated \$25,000 in profits, and ETC Market Access Customer C generated over \$11,000 in profits in just five symbols.
49. As set forth in paragraphs 36 through 48, even though certain Market Access Customers and their traders appeared frequently, even daily, on ETC's exception reports, and even though the Firm disabled and/or restricted many individual traders, ETC did not aggregate and review trading conduct at the customer/MPID level across all authorized traders and never terminated ETC's relationship with any of its Market Access Customers due to potentially manipulative trading activity.²⁰

ETC Did Not Allocate Sufficient Resources to Supervision

50. Although ETC added resources over time during the Relevant Period, it failed to allocate sufficient resources to meet its supervisory responsibilities.
51. During the period between December 2009 and March 2011, ETC's Chief Compliance Officer (CCO) was the only person in the Firm's compliance department; he was solely responsible for reviewing the Firm's exception reports for potentially manipulative activities, as well as investigating and responding to regulatory inquiries and all other compliance functions at the Firm.

¹⁹ See NYSE Arca Regulatory Information Bulletin RBE-07-01 (Jan. 29, 2007) (citing an NYSE Arca disciplinary action involving a firm's failure to diligently supervise its market access customer insofar as it failed to have in place an "automated surveillance system" to periodically review customer accounts for abuse of NYSE Arca restrictions on odd-lot trading).

²⁰ See NYSE Arca Regulatory Information Bulletin RBE-07-01 (Jan. 29, 2007) (providing that ETP Holders that discover a pattern of improper client activity cannot continue to provide access to that client and should report the activity to NYSE Arca regulatory staff).

52. In the March 2010 Gap Analysis Report that the Firm's CCO prepared and submitted to ETC's former Chief Executive Officer ("CEO"), the CCO noted that the Firm should consider whether additional compliance resources were necessary. However, a second compliance employee, AB, was not hired until March 2011, one year later.
53. Between December 2009, when ETC's CCO started at the Firm, and March 2011, when AB was hired, ETC's execution volume increased significantly from an average of 1.4 billion shares per month (approximately 69 million shares/day) to an average of 5.14 billion shares per month (approximately 248 million shares/day).
54. Even after hiring AB in March 2011, ETC needed another compliance person to assist with the volume of compliance work. In the March 2011 Gap Analysis Report that the Firm's CCO prepared and submitted to ETC's former CEO, the CCO noted that the Firm should consider whether additional compliance resources were necessary. However, ETC did not hire a third compliance employee until December 2012.
55. Faced with the significant quantity of trading by ETC's Market Access Customers in 2010, 2011, and 2012 (averaging almost 4.5 billion shares per month over that entire period), the thousands of authorized traders associated with those customers, the risks associated with that trading, the Firm's own WSPs, as well as notice from FINRA and the relevant SRO rules, ETC did not allocate sufficient and adequate resources to compliance.

Notice by Regulators of Potentially Manipulative Trading

56. During the Relevant Period, ETC was on notice that some of its Market Access Customers were engaging in potentially manipulative activity.
57. Beginning in 2010, and continuing throughout the Relevant Period, numerous regulators sent inquiries to the Firm regarding potentially manipulative trading conduct by its Market Access Customers. From January 2010 to October 2012, the time when ETC was developing and implementing its trade surveillance program, staff from FINRA and the SROs issued dozens of inquiries to the Firm that identified numerous instances of potentially manipulative conduct by its Market Access Customers, many of which were repeatedly cited by name and/or MPID. Despite this, ETC failed to take adequate steps, such as placing these customers under heightened supervision, to address these risks.
58. ETC also was on notice that, prior to accepting them as Market Access Customers, some of its customers were higher-risk due to prior regulatory inquiry and/or discipline. Yet the Firm failed to take sufficient precautions or place certain of these customers under heightened scrutiny, and in fact some of these customers later engaged in potentially manipulative trading activity:
 - a. For example, ETC Market Access Customer F, which ETC was aware was involved in a prior regulatory matter resolved with FINRA in October 2012 and was also the

subject of regulatory inquiries sent to the Firm during the Relevant Period, started trading through ETC in October 2012.

- b. Similarly, ETC Market Access Customer D, which the Firm was aware was the subject of regulatory inquiries sent to the Firm during the Relevant Period, started trading through ETC in November 2012.
- c. Notwithstanding this knowledge, ETC did not place Market Access Customers D or F under heightened scrutiny or restrict their trading prior to commencing executing and clearing transactions for these firms.

59. In its May 2011 examination report, an SEC examination team specifically referenced firm H, which was an entity listed as an authorized trader subgroup for ETC Market Access Customers I and J, as an example of some of the regulatory risks posed by certain of ETC's customers. In January 2012, ETC subsequently learned that a Latvian trader affiliated with H was charged and later sanctioned by the SEC for engaging in account intrusions. ETC also knew, or should have known, around this time that H was affiliated with at least one other ETC Market Access Customer, and yet there is no evidence that ETC ever took action to prevent H from trading through the Firm.

ETC's Automated Exception Reports Were Flawed and Inadequate

60. Some automated exception reports ETC implemented were critically flawed, either because the reports were improperly designed or because they relied on deficient parameters that were not adequately tailored to the trading of ETC's Market Access Customers.
61. A primary flaw of certain of ETC's automated exception reports is that they were designed to look at the trading activities of individual authorized traders, rather than look at the total quantity of exceptions on a customer/MPID basis. This had the effect of fragmenting customer activity and obscuring and underreporting the total amount of potentially violative trading at the customer/MPID level.
62. Some of ETC's exception reports and trade controls had deficient parameters and/or were not reasonably designed, especially given the manner of trading conducted by ETC's Market Access Customers. For example:
- a. In addition to the flaws noted above, prior to February 28, 2011, ETC's wash trade report only looked at transactions with the same execution quantity rather than all executions between the same MPID or related MPIDs.
 - b. None of the self-trade prevention (STP) tools relied on by ETC appear to have been set to prevent trading between different MPIDs held by the same customer, even though a number of related ETC Market Access Customers appear to have shared MPIDs and/or held multiple MPIDs at the same time during the Relevant Period.
 - c. The original Trade Participation Report (TPR), implemented by ETC to surveil for pre-arranged trades and which was run and reviewed every two weeks, only alerted when 10% or more of the total shares traded by one authorized trader was with a

single contra authorized trader, which was inadequate because each trade between two authorized traders working for the same Market Access Customer or under the same MPID constituted a potential wash trade.

- d. The original TPR was shut down in or around May 2010 and a redesigned version of the TPR was implemented in September 2010. However, the parameters still were not set appropriately to detect and prevent wash trades until at least January 2011, when ETC set the report to specifically identify all trades between the same MPID. Between March 2009 and January 2011, ETC failed to adequately surveil a large segment of its Market Access Customers' trading activities for potentially violative wash trades.
- e. At the time it was first implemented in March 2011, the ETC layering report captured activity with, among other factors, at least 10 or more canceled transactions and an execution of at least 1,000 shares. However, these parameters were too wide to adequately surveil for layering activity. On July 5, 2011, the surveillance was changed to capture execution volumes of more than 300 shares, down from 1,000 shares, though this was still too wide. In March 2013, ETC changed the surveillance to capture execution volumes of 100 shares or more. Because the parameters were too wide for most of the Relevant Period, a significant quantity of potentially manipulative activity was not captured by ETC's Layering report.
- f. During the Relevant Period, ETC implemented a restriction through at least one of its service bureaus to prevent traders from entering odd-lot orders except to offset odd-lots resulting from partial round lot executions. However, ETC later learned that there was a "bug" in this restriction that, in the instance a trader received a partial fill, the trader could then enter multiple odd-lot orders to cover the remaining amount of shares until one executed, closing out the original position. The trader could then switch positions to continue entering odd-lot traders to cover the other portion of the partial fill. Moreover, the Firm did not consistently implement restrictions on odd-lot orders across all service bureaus.
- g. In October 2012, ETC implemented two different reports to surveil for spoofing – one for pre-open and one for market hours. Both reports required an execution coupled with cancellations of at least 10,000 shares or \$200,000 value within a time interval of 5 minutes, and the average canceled order had to equal 2,500 shares. However, these parameters were too wide and excluded potentially manipulative conduct.
- h. Marking-the-open/close involves the practice of executing transactions in a stock at or near the open of trading, or the end of the trading day, in order to affect the stock's opening/closing price. Such activity sends false signals to the market about the value of the security. Starting in October 2011, ETC used a Mini-Manipulation Report to surveil for marking the open or marking the close activity, although that report was not adequately designed to detect such activity.²¹

²¹ See NYSE Arca Regulatory Information Bulletin RBE-02-02 (Apr. 25, 2002) (identifying manipulative trading practices ETP Holders must monitor for, including marking-the-close and influencing the open).

ETC Did Not Conduct Adequate Follow-up and Review

63. ETC's system of follow-up and review was inconsistent, insufficient and not reasonably designed to prevent potentially manipulative activity from recurring, particularly for those Market Access Customers that relied on hundreds or thousands of foreign-based traders.
64. ETC's compliance and operations staff sometimes detected potentially manipulative conduct based on their review of the Firm's exception reports and real-time monitoring, but its follow-up and review was often deficient. In certain instances, ETC followed up with customers about the trader(s) involved in the conduct and the strategy(ies) employed and did on a number of occasions warn, restrict and even disable traders. However, many times, ETC appeared to accept the customer's and/or trader's explanations at face value even when they did not make economic sense.
65. Moreover, ETC did not have any set criteria for when to restrict or disable a trader:
 - a. Certain Market Access Customers and traders were captured on ETC's Layering report repeatedly over days, weeks, and months during the Relevant Period without being disabled.
 - b. Similarly, certain Market Access Customers and traders alerted on ETC's Multi-Venue Wash Trade report thousands of times during the Relevant Period, yet many were not disabled.
 - c. ETC staff sometimes saw evidence that various traders and trader groups within and among ETC's Market Access Customers were colluding with each other with regard to their trading, yet ETC either did not take action, or took action that was deficient.
66. Also, some of ETC's exception reports do not have any evidence of review; in other instances, the reports were reviewed significantly after T+1, the date they were supposed to be reviewed. In addition, ETC was unable to produce a significant number of surveillance reports for trade dates during the Relevant Period, including reports for wash trades and layering.

ETC's Controls Around Authorized Trader Logins Were Deficient

67. In most of the trading platforms used by ETC's Market Access Customers, authorized traders were identified by a unique login, or sometimes multiple logins. Significantly, ETC failed to establish and implement adequate controls around the assignment, sharing and deactivation of trader logins, which hampered the Firm's ability to detect and prevent potentially manipulative trading and conduct reasonable follow-up and review.²² ETC's inadequate controls led to a number of problems, including: (i) enabling traders to use

²² See NYSE Arca Regulatory Information Bulletin RBE-07-01 (Jan. 29, 2007) (ETP Holders who accept electronic orders from clients must have real-time system checks to ensure that each order is submitted by an authorized person); RBE-08-05 (Nov. 11, 2008) (trading systems should include controls that limit their use to authorized persons). See also FINRA's 2010 Priorities Letter (Mar. 1, 2010), *supra*.

multiple logins to circumvent surveillance monitoring conducted at the trader login level; (ii) enabling traders to potentially have access to higher trading limits through the use of multiple logins; and (iii) enabling dozens of traders that were restricted and/or disabled being able to continue to trade through the Firm's systems.

68. The use of individual trader logins served an integral role in ETC's trade surveillance and risk management policies and procedures. However, ETC did not have any formal procedures for tracking trader logins until in or around April 2011, when the Firm started maintaining the Consolidated Trader List and conducting reviews of new traders at the request of the Chicago Board Options Exchange (CBOE). As ETC knew or should have known, the Consolidated Trader List contained hundreds of traders with multiple logins at the same Market Access Customer and/or different Market Access Customers, which was a red flag that the Firm did not respond to appropriately.
69. ETC also knew or should have known that some logins were used by more than one customer, sometimes by different traders, that were the source of potentially violative activities. For example, the Consolidated Trader List contained numerous logins listed with more than one customer.
70. ETC only started tracking traders it had restricted or disabled on a "Disabled Trader List" in or around May 2010. However, even though ETC was aware that previously disabled traders were sometimes re-entering its systems, the Firm did not start to cross-reference the Disabled Trader List against the Consolidated Trader List until at least July 2011.
71. ETC also knew or should have known that there were discrepancies between the Disabled Trader List and Consolidated Trader List. There were dozens of traders on the Disabled Trader List that were disabled under logins that did not appear on the Consolidated Trader List, or were disabled under a login that was associated with another individual on the Consolidated Trader List. Moreover, some of the individuals listed on the Disabled Trader List were not located on the Consolidated Trader List at all.
72. In addition, dozens of traders that appear to have been disabled and/or restricted from trading by ETC were not included on the Disabled Trader List. Moreover, the Disabled Trader List contained dozens of repeat offenders who were disabled and/or restricted from trading on more than one occasion, some under multiple logins. These deficiencies impeded ETC's ability to prevent potentially manipulative activity from recurring.
73. Even in the face of this evidence, as of the end of the Relevant Period, ETC still did not inquire about, track and/or restrict: (i) the start/end dates for each trader login; (ii) the number of logins held by each trader; (iii) whether traders held logins with other ETC Market Access Customers and/or other firms; and (iv) whether the same login was used by more than one trader and/or associated with more than one Market Access Customer/MPID. Also, the Firm did not implement mechanisms to prevent associated trader logins from trading with each other.

Exchange Act Rule 15c3-5 - ETC's Risk Management Controls Were Inadequate and Flawed

74. ETC failed to ensure that it established, documented, and maintained a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of its market access business activities in compliance with the Market Access Rule.
75. In particular, as described in detail above, ETC's risk management controls and supervisory procedures were not reasonably designed to prevent the entry of orders unless there was compliance with all regulatory requirements, including, specifically, monitoring for potentially manipulative trading activities in accordance with NYSE Arca Equities Rule 6.18,²³ as required by Exchange Act Rule 15c3-5(c). ETC did not timely develop and implement automated exception reports, and some of the reports they did use were flawed and deficient. In certain instances, ETC also did not conduct adequate follow-up and review of the trading activity identified by those reports.
76. ETC's risk management controls and supervisory procedures also were not reasonably designed to restrict access to its trading systems and technology to approved and authorized persons, as specifically required by Exchange Act Rule 15c3-5(c), and ETC failed to ensure that its regulatory risk management controls and supervisory procedures were under its direct and exclusive control as specifically required by Exchange Act Rule 15c3-5(d):²⁴
- a. During the Relevant Period, both prior to and after implementation of the Market Access Rule in July 2011, ETC gave representatives of its Market Access Customers certain managerial and/or administrative permissions to its third-party service bureaus, permitting those representatives to, *inter alia*, directly change the settings for individual traders and enable and disable traders without the Firm's knowledge or consent. Although ETC's WSPs specified that the Firm would ensure that only authorized personnel had access to its trading systems, and would document and preserve in its books and records the system access documentation, prior to September 2013, ETC did not specifically track which individuals were given administrative and/or managerial access to its third-party service bureaus on behalf of its Market Access Customers. ETC also did not maintain records of the risk settings used on the trading platforms and thus could not review whether any of those settings were ever changed without their consent.
 - b. ETC was aware that during the Relevant Period some of its Market Access Customers were misusing the administrative and/or managerial rights to the third-party trading system used by approximately 90% of ETC's Market Access Customers, including:
 - (i) adding and removing authorized traders by going directly to the service bureau

²³ See also RBE-02-02, RBE-07-01 and RBE-08-05 (describing certain requirements imposed by Rule 6.18).

²⁴ The requirement for ETP Holders acting as market access providers to restrict access to their trading systems was in place prior to the implementation of the Market Access Rule in July 2011. See fn. 20, *supra*.

without the Firm's knowledge or consent; (ii) re-enabling or unrestricting traders that were previously restricted or disabled by ETC; (iii) adding securities to ETC's Easy-to-Borrow list without authorization; and (iv) intentionally misusing functionality in the system to circumvent Reg. SHO order-marking requirements. Yet the Firm did not take sufficient steps to prevent the recurrence of this misconduct.

77. In addition, ETC's risk management controls and supervisory procedures were not reasonably designed to prevent the entry of erroneous orders that exceeded appropriate price or size parameters, as required by Exchange Act Rule 15c3-5(c). While ETC's WSPs provided that its Clearly Erroneous (CE) trade controls would reject or block a limit order that is more than 10% away from the last sale, ETC's risk manager stated that its controls could be set to reject or block a limit order that is more than 10% away from *either* the last sale *or* the current bid/offer in the market (*i.e.* last price). The failure to define the pre-trade control for a set threshold, either from the last sale or the last price, but not both, makes the control inadequate. In fact, between January and December 2012, ETC Market Access Customers effected five pre-open executions at prices at least 10% away from the last sale at the time of order entry that were neither rejected nor blocked by ETC's systems and subsequently resulted in CE filings by the Firm.
78. In addition, because they did not employ hard blocks, ETC's risk management controls and supervisory procedures were not reasonably designed to prevent the entry of orders that exceed pre-set credit limits for each Market Access Customer, as required by Exchange Act Rule 15c3-5(c). In fact, ETC's own WSPs specifically state that while its systems could automatically prevent an order from being accepted that would exceed pre-set credit limits, the Firm chose not to implement such a restriction.
79. Finally, ETC did not establish appropriate credit limits and/or controls for its Market Access Customers. ETC permitted some of its Market Access Customers to substantially over-allocate Day Trade Buying Power ("DTBP") to their individual traders. This practice, coupled with the lack of hard blocks and the fact that ETC's DTBP report did not accurately track the amount of equity on deposit by ETC's Market Access Customers, created a risk of a customer exceeding its credit limits.

ETC's Transaction's WSPs Were Inadequate

80. During the Relevant Period, ETC's WSPs were not reasonably designed for its market access business:
 - a. Prior to April 2010, the Firm's WSPs failed to set forth detailed procedures on the types of automated exception reports that would be run, the frequency of review of those reports, what action was required when potentially violative conduct was identified, and how to document such reviews. Prior to September 2011, the Firm's WSPs did not include adequate controls around authorized trader logins.
 - b. In addition, ETC's WSPs were not reasonably designed to ensure that (i) it employed adequate pre-trade controls to prevent the entry of orders that would exceed credit limits; (ii) it employed adequate pre-trade controls to prevent the entry of erroneous

orders that exceeded appropriate price or size parameters; (iii) access to its trading systems and technology was restricted to approved and authorized persons; and (iv) the Firm's regulatory risk management systems and financial controls were under ETC's direct and exclusive control at all times.

81. In summary, ETC's failure to meet its supervisory obligations and to reasonably manage the risks of providing market access to its Market Access Customers allowed significant quantities of potentially manipulative trading activity to enter and impact the integrity of the securities markets.

DECISION

Supervisory Deficiencies NYSE Arca Equities Rules 6.18, 6.1(b), 6.2(b), and 2010

82. ETC's supervisory systems and procedures were inadequate and were not reasonably designed for its market access business, as required by NYSE Arca Equities Rule 6.18. Specifically, ETC failed to: (i) adequately monitor red flags and the trading of its Market Access Customers, particularly those that posed heightened risk; (ii) adequately detect and prevent potentially manipulative trades, including prompt and decisive follow-up and review and investigation; (iii) invest appropriate and sufficient resources in its supervisory technology, compliance infrastructure, and compliance staff; and (iv) ensure that all trading activities entered under the Firm's mnemonics or MPIDs complied with applicable federal securities laws and regulations and the rules of NYSE Arca, FINRA and the Exchanges. ETC also failed to supervise to ensure compliance with Exchange Act Section 15(c)(3) and Exchange Act Rule 15c3-5.
83. Also, as required by NYSE Arca Equities Rule 6.18, ETC failed to establish, maintain and enforce WSPs reasonably designed for the Firm's market access business and to supervise the activities of its Market Access Customers to ensure compliance with applicable securities laws, regulations and NYSE Arca Rules, including Exchange Act Rule 15c3-5. Specifically, ETC's WSPs failed to: (i) set forth detailed procedures on the types of automated exception reports ETC would run, the frequency of review of those reports, what action was required when potentially violative conduct was identified, and how to document such reviews and oversight; (ii) include adequate controls around authorized trader logins; (iii) ensure that the Firm employed adequate pre-trade controls to prevent the entry of orders that would exceed credit limits; and (iv) ensure that the Firm's regulatory risk management systems and financial controls were under ETC's direct and exclusive control at all times.
84. By failing to establish, implement and enforce adequate supervisory systems and procedures, including WSPs, reasonably designed to supervise its market access business and achieve compliance with the securities laws, regulations and NYSE Arca rules, ETC violated NYSE Arca Equities Rules 6.18, 6.1(b), 6.2(b) and 2010 (for conduct on and after June 30, 2011).

Market Access Deficiencies
Exchange Act Section 15(c)(3), Exchange Act Rule 15c3-5, and
NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010

85. In its capacity as a provider of “market access,” as the term is defined in Exchange Act Rule 15c3-5, ETC failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of providing market access, as required by Exchange Act Rule 15c3-5(b).
86. ETC also failed to ensure, as required by Exchange Act Rule 15c3-5(c), that it had in place financial and regulatory risk management controls and supervisory procedures reasonably designed to: (i) prevent the entry of orders that exceed appropriate pre-set credit limits or capital thresholds in the aggregate for each Market Access Customer; (ii) prevent the entry of erroneous orders by rejecting orders that exceed appropriate price or size parameters on an order-by-order basis or over a short period of time; (iii) prevent the entry of orders unless there was compliance with all regulatory requirements, including, specifically, monitoring for potentially manipulative trading activity in accordance with NYSE Arca Equities Rules 6.18, 6.1(b), 6.2(b), and 2010; and (iv) restrict access to its trading systems and technology to approved and authorized persons.
87. ETC also failed to ensure that its regulatory risk management controls and supervisory procedures were under its direct and exclusive control, as required by Exchange Act Rule 15c3-5(d).
88. By failing to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of providing market access, ETC violated Exchange Act Rule Section 15(c)(3) and Exchange Act Rule 15c3-5 (for misconduct beginning July 14, 2011), and also violated NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010 (for conduct on and after June 30, 2011).

Just and Equitable Principles of Trade
NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010

89. As described in detail above, the systemic deficiencies in ETC’s supervisory systems and procedures and risk management controls enabled certain of its Market Access Customers to effect potentially manipulative trades, and the tremendous volume of trading generated by these customers substantially contributed to ETC’s status as a significant market access provider. ETC profited significantly, earning millions of dollars from executing securities trades on behalf of its Market Access Customers.
90. As a result of the foregoing, ETC failed to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business, in violation of

NYSE Arca Equities Rules 6.1(b), 6.2(b), and 2010 (for conduct on and after June 30, 2011).

SANCTIONS

1. Electronic Transaction Clearing, Inc. is censured and fined \$218,750.²⁵
2. ETC shall conduct a comprehensive review (Review) of the adequacy of the Firm's policies, systems and procedures (written and otherwise), and training (collectively, the Controls) to ensure the following:
 - a. That the Firm is in compliance with any and all Sponsored Access and/or Direct Market Access Rules of FINRA and all Exchanges to which the Firm grants customers market access;
 - b. That the Firm is in compliance with Rule 15c3-5 of the Securities Exchange Act of 1934; and
 - c. That the Firm adequately supervises the trading of its market access customers and associated persons, including, but not limited to, in the following areas:
 - i. The sufficiency of the staff and resources dedicated to compliance and trading supervision;
 - ii. Procedures for the review of business relationships between customers and their authorized traders;
 - iii. Trading surveillances and/or exception reports;
 - iv. Controls around the assignment and deactivation of authorized trader logins and/or identifiers; and
 - v. Procedures and systems of follow-up and review of potentially violative trading activity.
 - d. ETC shall provide to FINRA Staff three written reports, certified by the Chief Executive Officer of the Firm, concerning the Review, on dates that are 3 months, 6 months and 12 months after the date of this Decision. The written reports shall address, at a minimum:

²⁵ Under the Offer of Settlement and Consent, ETC agreed to pay a total fine of \$875,000, of which \$218,750 shall be paid to NYSE Arca and the remaining amount shall be paid equally to (i) BATS Exchange, Inc. (ii) the NASDAQ Stock Market LLC; and (iii) FINRA in accordance with the terms of parallel settlement agreements in related matters between ETC and each of these self-regulatory organizations. Concurrently, ETC entered into an AWC to resolve FINRA Matter No. 20120352981 under which ETC agreed to pay FINRA a separate fine of \$125,000 for related AML violations, for a total fine of \$1 million for FINRA matters Nos. 20100254756 and 20120352981.

- i. A description of the review performed by the Firm and the factual conclusions reached;
 - ii. A list of all recommendations for modifications and/or additions to the Firm's Controls and the dates of actual and/or planned implementation of such recommendations;
 - iii. A review and analysis of the trading activity by any specific customers identified herein, or identified by FINRA Staff, as raising significant regulatory concerns; and
 - iv. The steps taken by supervisory personnel to ensure the Firm's compliance in the above-mentioned areas.
3. Upon written request showing good cause, FINRA Staff may extend any of the procedural dates set forth herein.

The sanctions shall take effect immediately.



Andrew H. Perkins
Chief Hearing Officer