

NYSE ARCA, INC.

NYSE REGULATION,

Complainant,

Proceeding No. 2017-10-00061

v.

COBRA TRADING, INC.,

November 1, 2018

Respondent.

Cobra Trading, Inc. violated: (i) Rule 15c3-5(c)(1)(i), by failing to have controls and supervisory procedures reasonably designed to prevent the entry of orders that exceeded appropriate pre-set credit thresholds; (ii) Rule 15c3-5(c)(1)(ii), by failing to have controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders by rejecting orders that exceed appropriate price parameters, on an order-by-order basis or over a short period of time; and (iii) NYSE Arca Equities Rules 6.18(b) and (c), by failing to establish and maintain adequate supervisory systems and written supervisory procedures reasonably designed to ensure compliance with Rule 15c3-5. Consent to censure, fine of \$20,000, and undertaking.

Appearances

For the Complainant: Aaron H. Krieger, Esq., and Adam J. Wasserman, Esq., NYSE Regulation.

For the Respondent: Chadd Hessing, Cobra Trading, Inc.

DECISION

Cobra Trading, Inc. (“Cobra Trading” or “Firm”) and NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) entered into an 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 in the offer of settlement.¹ The Hearing Officer

¹ FINRA’s Office of Hearing Officers reviewed the Offer of Settlement and Consent under the terms of a Regulatory Services Agreement (as amended) among NYSE Group, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., NYSE MKT LLC, and FINRA.

accepts the Offer of Settlement and Consent and issues this Decision in accordance with NYSE Arca Equities Rules.²

FINDINGS OF FACTS AND VIOLATIONS

Overview

1. This matter involves violations of Rule 15c3-5 under the Securities Exchange Act of 1934³ (“Rule 15c3-5” or “Market Access Rule”) and NYSE Arca Equities Rule 6.18.
2. The violations of Rule 15c3-5 arose out of Cobra Trading’s failure to exercise reasonable control over its risk management controls; rather, the Firm relied on third parties for the implementation of those controls, including order management system (“OMS”) providers and its clearing firm.
3. As set forth below, Cobra Trading violated:
 - a. Rule 15c3-5(c)(1)(i), by failing to establish, document, and maintain risk management controls and supervisory procedures reasonably designed to prevent the entry of orders that exceeded appropriate pre-set credit thresholds;
 - b. Rule 15c3-5(c)(1)(ii), by failing to establish, document, and maintain risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price parameters, on an order-by-order basis or over a short period of time; and
 - c. NYSE Arca Equities Rules 6.18(b) and (c), by failing to establish and maintain adequate supervisory systems and written procedures reasonably designed to ensure compliance with Rule 15c3-5.

Background and Jurisdiction

4. Cobra Trading has been registered as an Equities Trading Permit (“ETP”) Holder with NYSE Arca, Inc. since January 2005. The Firm is a registered broker-dealer with its principal place of business in Plano, Texas.
5. This matter arises from an investigation by NYSE Regulation into the circumstances surrounding orders Cobra Trading (or Firm clients) entered between March 2017 and June 2017 (“Review Period”). As part of its review, NYSE Regulation investigated the Firm’s compliance with Rule 15c3-5 and NYSE Arca Equities Rule 6.18.

² The facts, allegations, and conclusions contained in this Decision were taken from the executed Offer of Settlement and Consent. Prior to August 17, 2017, the rules involved in this matter were called NYSE Arca Equities Rules.

³ 17 C.F.R. § 240.15c3-5.

Violations

6. Rule 15c3-5 states that “a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or alternative trading system . . . shall establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.”
7. Specifically, the rule requires that the risk management controls and supervisory procedures “shall be reasonably designed to systematically limit the financial exposure of the broker or dealer that could arise as a result of market access.”
8. Rule 15c3-5(c)(1)(i) requires controls and procedures reasonably designed to “prevent the entry of orders that exceed appropriate pre-set credit thresholds . . . for each customer.”
9. Rule 15c3-5(c)(1)(ii) requires controls and procedures reasonably designed to “[p]revent 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, or that indicate duplicative orders.”
10. Per Rule 15c3-5(d), the risk management controls Rule 15c3-5 requires must generally be in the direct and exclusive control of the broker-dealer providing market access (but for limited circumstances by which a broker-dealer may take specific steps to reasonably allocate certain regulatory risk management controls not at issue here).
11. During the Review Period, NYSE Arca Equities Rule 6.18(b) required each member firm to “establish and maintain a system to supervise the activities of its associated persons and the operations of its business. Such system must be reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca Equities Rules.”
12. And, NYSE Arca Equities Rule 6.18(c) required each member firm to “establish, maintain, and enforce written procedures to supervise the business in which it engages and to supervise the activities of its associated persons that are reasonably designed to achieve compliance with applicable federal securities laws and regulations, and with the NYSE Arca Equities Rules.”
13. Cobra Trading is a broker dealer whose clientele includes retail customers who send order flow to the Exchange and other markets through third-party OMSs approved, but not provided, by the Firm. Although the vast majority of the Firm’s client order flow was funneled to the Exchange through other broker-dealers via Cobra Trading and the OMSs, in some instances the Firm provided direct access to the Exchange for its client order flow. Accordingly, Rule 15c3-5 applied to the order flow for which Cobra Trading provided direct market access to the Exchange.

14. Although certain risk management controls (including credit limit or buying power controls and erroneous order controls) were maintained and enforced in the third-party OMSs, the manner in which Cobra Trading maintained and enforced these controls did not comply with the requirements of Rule 15c3-5.
15. Cobra Trading did not determine the client credit limits and did not exercise direct or exclusive control over maintaining and enforcing the credit limits. Rather, as a matter of practice, the credit limits enforced at the OMS level were entered on a daily basis by Cobra Trading's clearing firm. Cobra Trading understood that the buying power limits were based on a margin account agreement between the client and clearing firm, as permitted by Federal Reserve Board Regulation T.⁴ Cobra Trading was able to oversee and review the daily buying power its clearing firm entered.
16. With respect to erroneous order controls, certain of these controls were not under Cobra Trading's direct and exclusive control. Each OMS had controls that could be set by the broker (here, Cobra Trading) or the customer (here, Cobra Trading's clients). These controls included, but were not limited to, single order limits, maximum position thresholds, and messaging rate limits.
17. During the Review Period, the single order limits in each of the OMSs Cobra Trading's clients utilized included an away from market price control.⁵ However, one of the OMSs maintained the price control at the customer level, not the broker level, and so the control was only activated subject to the discretion of Firm clients. The Firm did not enforce the control nor did Cobra Trading require its clients to have the control active. During the Review Period, clients could send order flow through the relevant OMS without being subject to any away from market price control.
18. The absence of the aforementioned control contributed to the entry of potentially erroneous orders by Cobra Trading's clients during the Review Period, resulting in the Firm filing four requests for review for erroneous orders to the Exchange.
19. Cobra Trading's supervisory system and the controls Rule 15c3-5(c)(1)(i) requires were inadequate during the Review Period. Although Firm clients were subject to credit limits, the Firm did not establish or implement those credit limits. Cobra Trading relied on its clearing firm to establish those credit limits, and its limited role with entering the credit limits into the relevant OMSs was not reasonable under Rule 15c3-5, which requires broker-dealers to have "direct and exclusive control" over the risk management controls. Further, although the Firm established other controls to limit certain financial risks, those controls were not a reasonable substitute for establishing appropriate credit limits.

⁴ 12 CFR § 220.12.

⁵ An away from market price control halts or rejects orders entered at prices outside of some predetermined threshold from the, for example, prevailing National Best Bid and Offer or last sale.

20. Cobra Trading's supervisory system and the controls Rule 15c3-5(c)(1)(ii) requires were also inadequate during the Review Period. The Firm enabled clients to trade through an OMS without a mandatory price control for orders. Accordingly, the Firm's controls were not reasonably designed to 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.
21. Cobra Trading's written supervisory procedures ("WSPs") did not adequately describe the Firm's supervisory system, including with respect to the Firm's Market Access controls. The WSPs did not specifically describe the Firm's processes for establishing pre-set credit limits, pre-trade controls, or conducting reviews of client trading and any relevant escalation procedures related thereto.
22. As a result, Cobra Trading violated NYSE Arca Equities Rules 6.18(b) and (c) during the Review Period.

Relevant Disciplinary History

23. Cobra Trading has no relevant formal disciplinary history.

Other Factors Considered

24. In determining to resolve this matter on the basis set forth herein, Enforcement took into consideration the nature of the Firm's retail business model and clientele, the presence of other mitigating controls that served as additional limits on the risk the Firm and its clients posed to the markets, the fact that Cobra Trading only served as the direct market access provider to its clients in limited circumstances during the Review Period, and remedial efforts Cobra Trading took during the course of the investigation (including implementing a price control on the relevant OMS described herein that previously lacked such a control). As set forth below, the Firm has undertaken to address any remaining deficiencies.

ORDER

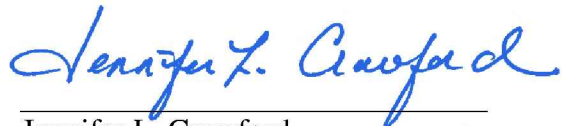
Cobra Trading violated: (i) Rule 15c3-5(c)(1)(i), by failing to have controls and supervisory procedures reasonably designed to prevent the entry of orders that exceeded appropriate pre-set credit thresholds; (ii) Rule 15c3-5(c)(1)(ii), by failing to have controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders by rejecting orders that exceed appropriate price parameters, on an order-by-order basis, or over a short period of time; and (iii) NYSE Arca Equities Rules 6.18(b) and (c), by failing to establish and maintain adequate supervisory systems and written supervisory procedures reasonably designed to ensure compliance with Rule 15c3-5.

SANCTIONS

Cobra Trading, Inc. is censured and fined \$20,000.

Cobra Trading shall undertake to address any remaining Market Access Rule deficiencies described in this Decision to ensure that it has implemented controls and procedures reasonably designed to achieve compliance with the rules and regulations cited herein pertaining to market access requirements. Within 90 days of the date of this Decision, a registered principal of the Respondent shall submit to Aaron Krieger, Enforcement Counsel, NYSE Regulation, New York Stock Exchange, 11 Wall Street, New York, NY 10005, a signed, dated letter, or an email from a work-related account of the registered principal, to aaron.krieger@theice.com, providing the following information: (i) a reference to this matter; (ii) a representation that the Firm has addressed any remaining Market Access Rule deficiencies described in this Decision to ensure that it has implemented controls and procedures that are reasonably designed to achieve compliance with the rules and regulations cited herein pertaining to market access requirements; and (iii) the date(s) the deficiencies were addressed.

These sanctions are effective immediately.



Jennifer L. Crawford
Hearing Officer