BEFORE THE BOARDS OF DIRECTORS OF CBOE EXCHANGE, INC.
DECISION NO. 19 BD 01

In the Matter of:	)	CBOE File No. 15-0065
	)	Star No. 20150456213
Equitec Proprietary Markets, LLC	)	
	)	
Respondent.	)	

I. PROCEDURAL HISTORY

This is a decision of the Board of Directors of Cboe Exchange, Inc. (f/k/a Chicago Board Options Exchange, Incorporated) ("Cboe" or "Exchange") relating to Cboe Disciplinary Case 15-0065. The following is a brief summary of the background and procedural history in this matter.[1]

On June 2, 2015, pursuant to the authorization of the Exchange Business Conduct Committee ("BCC"), the Exchange Office of Enforcement issued to Equitec Proprietary Markets, LLC ("Equitec") a Statement of Charges in Cboe Disciplinary Case 15-0065.[2] The charges were issued for six alleged violations of two rules: (1) Rule 15c3-5 - *Risk Management Controls for Brokers or Dealers with Market Access* ("Market Access Rule" or "Rule 15c3-5") under the Securities Exchange Act of 1934, as amended ("Exchange Act"); and (2) Exchange Rule 4.2 – *Adherence to Law*.[3] Equitec filed a timely Answer on July 10, 2015 denying all charges.[4]

Pursuant to Exchange Rule 17.6, a panel of three public members of the BCC conducted a two-day hearing on the charges on January 23-24, 2017. During the hearing, Regulation[5] and Equitec were provided a full opportunity to present evidence regarding the charges. The BCC panel heard testimony from 4 witnesses and admitted 31 exhibits into evidence. In accordance with Exchange Rule 17.9, the BCC panel presented its findings and conclusions to a majority of the BCC, which issued a decision in this matter on June 14, 2017 ("BCC Decision"). The BCC held that Regulation met its burden to establish by a preponderance of the evidence that Equitec had violated the Market Access Rule and Exchange Rule 4.2 as to each of the six charges.[6] The BCC then determined that a reasonable and appropriate sanction for Equitec's violations was a censure and a fine in the amount of $50,000.[7]

On July 14, 2017, Equitec timely submitted a petition ("Petition" or "Pet.") requesting that the Board conduct a review of the BCC Decision pursuant to Rule 17.10. Regulation timely submitted a response to the Petition ("Response" or "Resp.") and also filed a Motion to Strike on August 4, 2017.

[1] Cboe Regulatory Division ("Regulation") exhibit references are listed as "Reg. Ex. [number]," and Equitec exhibit references are listed as "Resp. Ex. [number]."
[2] Reg. Ex. 1.
[3] *Id.*
[4] Reg. Ex. 2.
[5] The Financial Industry Regulatory Authority ("FINRA") assisted Regulation in the handling of this matter in FINRA's capacity as regulatory services provider to Cboe.
[6] BCC Decision at 30-31.
[7] *Id.* at 30-31.

Equitec timely submitted a reply to Regulation's Response and Motion to Strike on August 18, 2017. The Petition, Response, and Reply were each submitted by the respective due date for the applicable submission that was set pursuant to Cboe Rule 17.13 by the Secretary in response to extension requests by the parties.

On July 28, 2017, the Board appointed a three-member panel to review Equitec's appeal. The directors appointed to the panel were Frank English (Chairperson), William Farrow III, and Michael Richter. The Board also delegated to the panel the authority to rule on any procedural matters related to the appeal.

One of the legal issues raised in Equitec's appeal was the proper standard of review that applied to the Board's review of the BCC Decision. At the time of Equitec's petition for review, that issue was under review before the Securities and Exchange Commission ("SEC") in connection with a separate matter.[8] In its response to Equitec's Petition in this matter, Regulation asked that the Board to defer resolution of the matter until the SEC ruled on the applicable standard of review.[9] In its Reply, Equitec joined in Regulation's request.[10] On September 20, 2017, the panel of the Board appointed to review Equitec's appeal notified the parties that consideration and resolution of the appeal would be deferred until the earlier of (i) the SEC's ruling regarding the standard of review in the separate matter; or (ii) the SEC setting a schedule for merits briefing in the separate matter without ruling on the standard of review.

On August 15, 2018, the SEC issued a decision in the separate matter holding that the Board should apply a *de novo* standard of review to findings of the BCC in disciplinary matters.[11] On August 21, 2018, Equitec and Regulation were notified of the decision, told that the composition of the Board had changed since September 20, 2017, and told that the Board would confer regarding the next procedural steps. On September 18, 2018, the Equitec and Regulation were advised of the Board's determination that the Board itself would conduct the review of Equitec's appeal, and that the members of the Board who would participate in the review were Kevin Murphy, David Roscoe, Jill Sommers, and Scott Wagner.[12] The parties were further directed by the Board to submit a brief on or before October 31, 2018 regarding whether the Board should affirm, reverse, or modify the BCC's Decision under a *de novo* standard of review.

On October 31, 2018, pursuant to the Board's direction, Regulation and Equitec submitted supplemental briefs regarding how the matter should be resolved under a *de novo* standard of review. ("Regulation Supp." and "Equitec Supp.").

II. BACKGROUND

During all relevant periods, Equitec was an Exchange Trading Permit Holder ("TPH").[13] On June 2, 2015, after an examination relating to Equitec's compliance with the Market Access Rule, Equitec was charged with six violations of Exchange Rule 4.2 and the Market Access Rule.[14] Exchange Rule 4.2 provides, in relevant part:

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[8] *See In re ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 80983, Admin. Proc. File No. 3-17906 (June 20, 2017).
[9] Resp. at 4-5.
[10] Reply at 1.
[11] *See In re ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 83849, Admin. Proc. File No. 3-17906 (Aug. 15, 2018).
[12] The other two members of the Board, Bruce Andrews and Edward Tilly, recused themselves from consideration of the matter.
[13] Reg. Ex. 2, ¶ 1.
[14] Reg. Ex. 1.

> No Trading Permit Holder shall engage in conduct in violation of the Securities Exchange Act of 1934, as amended, rules or regulations thereunder, the Bylaws or the Rules of the Exchange, . . . or any written interpretation thereof. Every Trading Permit Holder shall so supervise persons associated with the Trading Permit Holder as to assure compliance therewith.

The Market Access Rule provides, in relevant part:

> (b) 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 through use of its market participant identifier or otherwise, 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. Such broker or dealer shall preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with §240.17a-4(e)(7) . . . .
>
> (c) The risk management controls and supervisory procedures required by paragraph (b) of this section shall include the following elements:
>
>> (1) Financial risk management controls and supervisory procedures. 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, including being reasonably designed to: (i) <u>Prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer</u> and, where appropriate, more finely-tuned by sector, security, or otherwise by rejecting orders if such orders would exceed the applicable credit or capital thresholds . . . .[15]

The Statement of Charges charged Equitec with the following six violations of Exchange Rule 4.2 and the Market Access Rule:

1. Equitec failed to establish a reasonable credit or capital threshold that limits the overall financial exposure of both the Firm and its customers by taking into account both executions and pending orders.

2. Equitec's Written Supervisory Procedures ("WSPs") as they relate to Rule 15c3-5 failed to specify the process through which the Firm's systems prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate.

3. Equitec's WSPs as they relate to Rule 15c3-5 failed to specify the process through which the Firm's on-floor market makers are made aware of the Firm's capital thresholds and risk appetites so those on-floor market makers do not manually and/or verbally disseminate quotes or orders in open outcry that exceed those thresholds.

4. Equitec's WSPs as they relate to Rule 15c3-5 failed to specify the process through which the Firm prevents the entry of orders unless there has been compliance with

[15] 17 C.F.R. § 240.15c3-5 (emphasis added).

all regulatory requirements that must be satisfied on a pre-order entry basis, including, but not limited to, reporting duties, trading in options restricted to closing only, quoting in nonappointed classes, and order protection.

5. Equitec's WSPs as they relate to Rule l5c3-5 failed to specify the process through which the Firm's on-floor market makers are restricted from disseminating quotes or orders in securities in the event the on-floor market maker is restricted from trading those securities.

6. Equitec's WSPs as they relate to Rule 15c3-5 failed to specify the process through which the Firm restricts access to the Exchange's trading floor to those persons pre-approved and authorized by the Firm.[16]

Count I in the Statement of Charges thus alleged that Equitec failed to implement a risk management control, and Counts II through VI alleged that Equitec failed to have in place several necessary WSPs. The relevant time period of the first charge was November 30, 2011 through April 8, 2015 and the relevant time period of the other charges was October 18, 2012 through April 8, 2015.[17]

As stated above, the BCC held that Regulation met its burden to establish by a preponderance of the evidence that Equitec had violated the Market Access Rule and Exchange Rule 4.2 as to each of the six charges.[18]

III. BOARD REVIEW OF EQUITEC'S APPEAL

In accordance with Rule 17.10(b), the Board has reached its decision regarding the appeal based upon the Board's review of the record in this matter and the written exceptions filed by the parties. Pursuant to Rule 17.10(a), which provides that any objections to a BCC decision not specified by written exception shall be considered to have been abandoned, the Board has limited the scope of its review in this matter to the issues raised by the parties in their briefing. In conducting its review, the Board has carefully considered all of the contentions and arguments presented to the Board by the parties, even if each is not specifically discussed in this decision, and those contentions and arguments have been rejected or sustained to the extent that they are inconsistent or in accord with this decision. This decision, and the findings and conclusions in this decision, are expressly limited to the facts and circumstances of this matter.

IV. MOTION TO STRIKE

As a preliminary matter, the Board considers Regulation's Motion to Strike certain materials from Equitec's petition. Regulation has argued that the following should be stricken from Equitec's petition: (1) documents relating to an examination of Compass Professional Services, LLC ("Compass") performed by FINRA on behalf of a different exchange, NASDAQ OMX PHLX ("PHLX") and references to the same in Equitec's briefing; and (2) an addendum prepared by Equitec's consultant, Stephen O'Malley (the "O'Malley Addendum") and references to the same in Equitec's briefing.[19] The Board addresses each of these items separately below.

A. Compass Examination Documents

[16] Reg. Ex. 1.
[17] *Id.*
[18] BCC Decision at 30-31.
[19] Regulation Motion to Strike.

At the BCC hearing, Equitec sought to introduce documents relating to an examination of Compass that was performed by FINRA on behalf of PHLX.[20] Compass was a broker-dealer that used SMILE, the same proprietary system used by Equitec, to meet its Market Access Rule obligations.[21] These documents show that FINRA conducted an examination of Compass and found that Compass violated the Market Access Rule for the same reason that Regulation alleged Equitec had violated the Market Access Rule: Compass failed to establish reasonable credit and capital thresholds that accounted for both open and executed orders.[22] The documents further showed that, on the recommendation of FINRA staff, PHLX addressed the violation with a Cautionary Action Letter.[23] The BCC ruled that these documents were irrelevant and excluded them from the hearing.[24] Equitec attached these documents to its petition for review to the Board.

Regulation argues that the documents and "those portions of Equitec's petition discussing the same" should be "stricken in their entirety."[25] Regulation notes that the Board's review of BCC decisions is governed by Exchange Rule 17.10, which provides that, "unless the Board shall decide to open the record for the introduction of evidence or to hear argument, such review shall be based solely upon the record and the written exceptions filed by the parties." Regulation argues that the documents relating to the Compass examination were not part of the record before the BCC and that the Board should thus strike the documents, and discussion of the documents, from Equitec's briefing.[26] Equitec responds by arguing that the Board should take judicial notice of the documents relating to the Compass examination.[27]

The Board denies Regulation's Motion to Strike these materials. Exchange Rule 17.10 provides that the Board's review is based "solely upon the record *and the written exceptions filed by the parties*." Here, Equitec's written exception includes an argument that the BCC improperly excluded documents relating to the Compass examination.[28] Striking the Compass documents and Equitec's argument as to the documents would deprive Equitec of the opportunity to challenge the BCC excluding this evidence, and the Board therefore denies Regulation's Motion to Strike these materials.

B. The O'Malley Addendum

At the BCC hearing, Equitec sought to be represented by Stephen O'Malley, an independent contractor functioning as "chief advisor" to Equitec.[29] As discussed in greater detail below, the BCC excluded O'Malley from the hearing.[30] In its petition for review, Equitec attached the O'Malley Addendum, in which O'Malley states his belief that the Board should reverse the BCC's decision that Regulation met its burden to prove Equitec's violations and that the BCC erred in excluding him from the hearing.[31] The O'Malley addendum was not submitted to the BCC for consideration.

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[20] *See* 1/23/17 Hrg. Tr. at 265-71; 1/24/17 Hrg. Tr. at 116-17; Resp. Ex. 5.
[21] 1/24/17 Hrg. Tr. (Kuehner) at 116.
[22] Resp. Ex. 5 at 5.
[23] *Id.* at 15-16.
[24] *See* 1/23/17 Hrg. Tr. at 265-71; 1/24/17 Hrg. Tr. at 116-17.
[25] Regulation Motion to Strike at 4.
[26] *Id.* at 3-4.
[27] Reply Br. at 2.
[28] Pet. at 4.
[29] 1/23/17 Hrg. Tr. at 5.
[30] 1/23/17 Hrg. Tr. at 8-14.
[31] Addendum to Appeal to the Chicago Board Options Exchange Board of Directors by Equitec Proprietary Markets, LLC.

Regulation argues that the addendum should be stricken under Cboe Rule 17.10, which generally limits the Board's review to "the record and the written exceptions filed by the parties." Regulation argues that the addendum was not submitted to the BCC for consideration and thus is not properly before the Board.[32] Equitec responds that the Board should consider the addendum because it shows the guidance and advice that O'Malley would have provided had he not been improperly excluded.[33]

The Board finds that the O'Malley Addendum was not presented to the BCC and thus is not properly before the Board. Accordingly, the Board grants Regulation's Motion to Strike the O'Malley Addendum and references thereto from Equitec's briefs. The Board notes, however, that even if it did not strike the information contained in the O'Malley Addendum, the Board would reach the same decision as to the merits of Equitec's appeal, both as to its findings of violations and sanctions.

V. WHETHER EQUITEC VIOLATED THE MARKET ACCESS RULE AND EXCHANGE RULE 4.2.

A. Standard of Review

The Board applies a *de novo* standard of review to disciplinary decisions by the BCC.[34] Under the *de novo* standard of review, the Board "should exercise its own judgment as to the resolution of issues properly before it and do so non-deferentially, without presuming the correctness of or giving special weight to the BCC's prior rulings."[35]

B. Equitec's Failure to Implement Certain WSPs (Counts II – VI)

As discussed above, the BCC found on Counts II through VI that Regulation met its burden of proving that Equitec failed to have in place proper WSPs.[36] Equitec does not provide any arguments in its petition regarding how the BCC's findings of violations as to Counts II through VI were incorrect. In its supplemental brief, Equitec argues that reversal of the BCC's decision as to Count I would "essentially moot[] the remainder of the Exchange's case," but provides no support for this assertion.[37] Regulation argues that Equitec's petition has waived any objection to the BCC findings as to Counts II through VI.[38]

Under Cboe Rule 17.10(a), "[a]ny objections to a decision not specified by written exception shall be considered abandoned." Equitec has failed to challenge the BCC's findings on Counts II through VI and thus, under Cboe rules, has waived any such challenge.[39] The Board thus affirms the BCC's decision as to Counts II through VI.

C. Equitec's Failure to Account for Executed Orders in its Capital and Credit Thresholds (Count I)

The BCC found that Equitec violated the Market Access Rule in failing to establish a reasonable credit or capital threshold that limited the overall financial exposure of Equitec and its customers by taking

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32 Regulation Motion to Strike at 2.
33 Reply at 2.
34 *In re ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 83849, at 2.
35 *Id.* at 21 (footnote omitted).
36 BCC Decision at 20-29.
37 Equitec Supp. at 10.
38 Resp. at 6.
39 Even if Equitec's unsupported assertion that reversal on Count I would "moot" the remainder of Regulation's case were adequate to preserve a challenge, it is rejected, because the Board affirms the BCC's decision as to Count I.

into account both pending and executed orders.[40] Equitec raises four arguments why the BCC's decision should be overturned. First, Equitec argues that the BCC's exclusion of the documents relating to the Compass examination warrants reversal.[41] Second, Equitec argues that the BCC's exclusion of O'Malley as the firm's representative at the hearing warrants reversal.[42] Third, Equitec argues that the Market Access Rule does not require broker-dealers to decrement, or decrease, a capital or credit threshold based on orders that have been executed.[43] Fourth, Equitec argues that it did not have fair notice of the conduct that was prohibited by the Market Access Rule and that it was deprived of a fair procedure.[44] The Board addresses each of these arguments separately below.

1. Exclusion of the Documents Relating to the Compass Examination

As discussed above, at the BCC hearing, Equitec sought to introduce documents relating to an examination of Compass performed by FINRA on behalf of PHLX.[45] Compass, like Equitec, used SMILE to meet its Market Access Rule obligations.[46] The documents that Equitec sought to introduce show that FINRA, on behalf of PHLX, found that Compass violated the Market Access Rule for the same reason Regulation alleged that Equitec violated the Market Access Rule, and that PHLX addressed this violation with a Cautionary Action Letter.[47] The BCC ruled that these documents were irrelevant and excluded them from the hearing.[48]

Equitec argues that, because Compass used the same control system as Equitec, and was found to have the same deficiency, the Cautionary Action Letter should have been admitted into evidence to show that a Cautionary Action Letter was the proper remedy for Equitec's deficiency.[49] Equitec claims that the letter went to "the very heart of the[] charges" against it and that its exclusion denied Equitec a fair hearing.[50]

Regulation responds that, under Cboe Rule 17.6(c) the BCC hearing panel is granted discretion to determine questions of admissibility of evidence.[51] Regulation argues that the documents were properly excluded because "an examination performed on a different broker-dealer on behalf of a different exchange is not relevant to whether or not Equitec violated the Market Access Rule."[52] Regulation notes that exchange disciplinary dispositions are not binding on other exchanges' enforcement actions and that each case presents unique facts and circumstances, including possible mitigating factors, that may impact the disposition. Finally, Regulation argues that, even if the documents had been admitted, the BCC's findings of violations would not have been impacted because FINRA, on behalf of PHLX, interpreted the Market Access Rule the same way as the BCC—that is, the Market Access Rule required the broker-dealer to maintain a reasonably designed capital threshold control that accounted for both pending and executed orders.[53]

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[40] BCC Decision at 30.
[41] Pet. at 4.
[42] *Id.* at 4-5.
[43] *Id.* at 5-8.
[44] *Id.* at 5, 8-9.
[45] *See* 1/23/17 Hrg. Tr. at 265-71; 1/24/17 Hrg. Tr. at 116-17; Resp. Ex. 5.
[46] Resp. Ex. 5 at 5.
[47] *Id.* at 5, 15-16.
[48] 1/23/17 Hrg. Tr. at 265-71; 1/24/17 Hrg. Tr. at 116-17.
[49] Pet. at 4.
[50] *Id.* at 4.
[51] Resp. at 14-15.
[52] *Id.* at 14-15.
[53] *Id.* at 14-15.

Under Cboe Rule 17.6(c), the BCC hearing panel was given the discretion to "determine all questions concerning the admissibility of evidence" at the hearing. The Board finds that Equitec has not shown that the exclusion of the documents relating to the Compass examination was an error. The documents related to a different exchange disciplining a different broker-dealer differently for a similar violation of the Market Access Rule. Many factors that were not known to the BCC and are not known to the Board could have influenced PHLX's decision to issue a Cautionary Action Letter rather than issue charges, including distinguishable facts, different enforcement priorities, different remediation efforts, or prior violations. Indeed, the Cautionary Action Letter itself states that the letter "pertains only to the specific reviews conducted by Market Regulation during this examination, and does not address, limit, or in any way impact any other matter(s) being reviewed by Market Regulation, other FINRA departments, or other regulatory agencies or any findings made in connection with any such matter(s)."[54] The Cautionary Action Letter further states that "a determination by FINRA not to take action against a NASDAQ OMX PHLX, LLC member or person associated with a member has no evidentiary weight in any mediation, arbitration or judicial proceeding" and that "it is inconsistent with just and equitable principles of trade for a NASDAQ OMX PHLX, LLC member or person associated with a member to attempt to introduce such a determination into evidence in any of these forums."[55]

Moreover, the Board finds that, even if the Compass documents were admitted, they would not support Equitec's argument that it did not violate the Market Access Rule, because in the Compass matter FINRA also interpreted the Market Access Rule to require capital and credit thresholds that account for both open and executed orders.[56]

2. Exclusion of O'Malley as Equitec's Representative

At the BCC hearing, Equitec sought to be represented by Stephen O'Malley. O'Malley had served for several years as an outside consultant to Equitec on regulatory matters, but he was not an employee, officer, or director of Equitec, and Equitec did not offer him as a witness or counsel.[57] Regulation sought to exclude O'Malley from the hearing under Cboe Rule 17.6(a), which provides that "[w]here a TPH organization is a party, it shall be represented by one of its Trading Permit Holders (including nominees) at the hearing." The BCC found that, because O'Malley was not an employee, officer, or nominee of Equitec, he did not meet the definition of a TPH or nominee under Cboe Rule 17.6(a), and the BCC dismissed him from the hearing.[58]

Equitec argues that the BCC committed reversible error in excluding Mr. O'Malley because he would have provided insight and assistance in the firm's defense at the hearing. Equitec argues that Regulation conceded that firms are allowed to have officers and employees present at the hearing, and that an independent contractor is no different.[59]

Regulation responds that the BCC correctly excluded O'Malley under Cboe Rule 17.6(a), which requires a TPH to be represented by someone from the TPH or their nominee. Regulation also points to Cboe Rule 3.8(a), which states in relevant part that a "TPH organization must designate an individual nominee to represent the organization with respect to that Trading Permit in all matters relating to the Exchange," and that "each nominee of a TPH organization designated . . . is required to have an authorized

[54] Resp. Ex. 5 at 14.
[55] *Id.* at 15.
[56] *Id.* at 5.
[57] 1/23/17 Hrg. Tr. at 8-11.
[58] 1/23/17 Hrg. Tr. at 8-14.
[59] Pet. at 4-5.

trading function." Regulation argues that the BCC properly excluded O'Malley because he did not satisfy the requirements of Rule 17.6(a), as he was neither a Trading Permit Holder nor Equitec's nominee, as he did not have "an authorized trading function."[60]

The Board finds that the BCC did not err in excluding O'Malley from the hearing given that he was not an employee, officer, or nominee of the firm, and was not offered as a witness or counsel. The Board further finds that, even if O'Malley were improperly excluded, Equitec has not shown that Mr. O'Malley's presence could have altered the resolution of the proceedings.[61] Accordingly, the Board finds that O'Malley's exclusion is not a basis for reversal of the BCC's decision.

3. Whether the Market Access Rule Requires Broker-Dealers to Account for Executed Orders When Establishing Capital or Credit Thresholds

Equitec next argues that the BCC erred in concluding that the Market Access Rule requires broker-dealers to maintain a system of controls reasonably designed to prevent entry of orders exceeding credit and capital thresholds accounting for both open and executed orders.

The Market Access Rule requires a broker-dealer to, among other things, maintain risk management controls that are "reasonably designed to systematically limit the financial exposure of the broker-dealer that could arise as a result of market access, including being reasonably designed to . . . prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and broker or dealer . . . by rejecting orders if such orders would exceed the applicable credit or capital thresholds."[62] A credit threshold is a threshold that a broker-dealer must set for each customer to whom it provides market access.[63] A capital threshold is a threshold that a broker-dealer must set as to proprietary trading by the broker-dealer itself.[64]

Equitec had in place controls that prevented the entry of orders that would exceed credit or capital thresholds that were determined based on "the maximum value of <u>open</u> orders that may exist for each client at any time."[65] Equitec's credit and capital thresholds, however, did not take into account <u>executed</u> orders.[66] By way of example, if Equitec had in place a threshold of $100 million, and then placed a pending order of $10 million, Equitec's threshold would be decremented, or reduced, to $90 million. If the order were canceled, Equitec's threshold would be increased back to $100 million, which both Equitec and Regulation agreed was appropriate.[67] However, if a pending order were executed, Equitec's controls during the relevant time period allowed the amount of that order to be added back to the credit or capital threshold in the same manner as if the order were canceled, increasing the threshold back to $100 million in the example above.[68] This formed the basis of Count I of the charges against Equitec.

The BCC found that, to comply with the Market Access Rule, a firm must establish a system of

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[60] Resp. at 12-14.
[61] As noted above, even if consideration of the O'Malley Addendum were appropriate, it would not change the Board's resolution of this issue, The O'Malley Addendum primarily reiterates arguments that Equitec made to the BCC panel even without O'Malley present, and the BCC panel rejected those arguments.
[62] 17 C.F.R. § 240.15c3-5(c)(1).
[63] Reg. Ex. 15 at 69802.
[64] *Id.*
[65] Reg. Ex. 8A at 35 (emphasis added); 1/23/17 Hrg. Tr. (Wright) at 90; 1/24/17 Hrg. Tr. (Shimanek) at 35, 50-52.
[66] 1/24/17 Hrg. Tr. (Shimanek) at 50-52.
[67] 1/23/17 Hrg. Tr. (Wright) at 63-64; 1/23/17 Hrg. Tr. (Markovic) at 251.
[68] Reg. Ex. 8A at 35 (emphasis added); 1/23/17 Hrg. Tr. (Wright) at 90; 1/23/17 Hrg. Tr. (Markovic) at 187-88; 1/24/17 Hrg. Tr. (Shimanek) at 35, 50-52.

controls reasonably designed to prevent the entry of orders that exceed pre-set credit or capital thresholds, taking into account both pending and executed orders.[69] The BCC considered a variety of authorities in reaching this conclusion, including the SEC's Proposing Release on the Market Access Rule ("Proposing Release"), Adopting Release on the Market Access Rule ("Adopting Release"), answers to Market Access FAQs, and its decision in *In re Knight Capital Americas LLC*.[70]

Equitec argues that the BCC erred in concluding that the Market Access Rule requires credit or capital thresholds to take into account both pending and executed orders. Equitec argues that the Market Access Rule says nothing about executions, and instead speaks only of orders.[71] Equitec argues that the purpose of the Market Access Rule is to protect the market and firms, and that executed orders are thus outside of the Market Access Rule's scope because they "do not have the capacity to harm the market."[72] Equitec points to language in the Proposing Release that "controls should measure compliance with appropriate credit or capital thresholds on the basis of orders entered rather than executions obtained."[73] Equitec notes that the Market Access Rule was not designed to be one-size-fits-all, but was instead intended to allow firms flexibility in designing controls to manage risk.[74] Equitec argues that the BCC's interpretation of the Market Access Rule was based on a misunderstanding of how decrementation works, and did not take into account whether an execution opens or closes a position or any corresponding hedges the firm had in place.[75]

Regulation responds that, to be reasonably designed to systematically limit the financial exposure of a broker or dealer, a capital threshold must take into account both orders that are pending and orders that have been executed.[76] Regulation argues that adding an executed order back to the threshold essentially "defeats the purpose of subtracting the order in the first place" and fails to mitigate against risks that broker-dealers and their clients would face from rapid execution of trades.[77] Regulation argues that the language in the Adopting Release relied on by Equitec—that "controls should measure compliance with appropriate credit or capital thresholds on the basis of orders entered rather than executions obtained"—simply is stating that <u>all</u> orders, not limited to executed orders only, must be accounted for in the threshold.[78]

Regulation argues that, contrary to Equitec's assertions, the Proposing Release and Adopting Release support Regulation's position. Regulation notes that the Proposing Release states that a "broker-dealer must assess compliance with the applicable threshold on the basis of exposure from orders entered on an exchange or ATS, rather than waiting for executions to make that determination."[79] Regulation also notes that the Adopting Release states that a broker-dealer must consider exposure from orders entered "rather than relying on a post-execution, after-the-fact determination."[80] Regulation argues that the Releases are not advising firms to <u>ignore</u> executed orders; instead, this language provides guidance making clear that a capital threshold must be decremented by the value of an order when it is entered rather than waiting until after it is executed.[81]

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[69] BCC Decision at 12-20.
[70] *Id.* at 12-18.
[71] Pet. at 6.
[72] *Id.* at 6.
[73] *Id.* at 6 (citing Proposing Release).
[74] *Id.* at 5-7.
[75] Reply at 6-8.
[76] Resp. at 5-10.
[77] *Id.* at 6-7.
[78] *Id.* at 8.
[79] *Id.* at 8 (quoting Reg. Ex. 14 (Proposing Release) at 4013).
[80] *Id.* at 9 (quoting Reg. Ex. 15 (Adopting Release) at 69802).
[81] *Id.* at 8-9.

The Board finds that the Market Access Rule requires a broker-dealer to implement a control that accounts for all orders, including executed orders, in determining an appropriate credit or capital threshold. The language of the Market Access Rule is broad and requires implementation of controls reasonably designed to "systematically limit the financial exposure of the broker or dealer that *could* arise as a result of market access."[82] Even after an order has been executed, a firm still has risk exposure from that position.[83] Allowing a broker-dealer to add back the value of executed orders to the credit or capital threshold thus would not yield a "true risk measurement," as it would not account for the risk relating to a firm's executed orders.[84] The language of the Market Access Rule does not draw any distinction between orders that are entered and orders that are executed, or suggest that the latter need not be accounted for in a broker-dealer's system of risk management controls. Under the Market Access Rule, Equitec was required to implement a control that was reasonably designed to systematically limit this risk.

The Proposing Release and Adopting Release further support the conclusion that broker-dealers must consider both entered and executed orders in setting appropriate credit or capital thresholds. As stated in the Proposing Release, the Market Access Rule is designed to ensure that broker-dealers "appropriately control 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."[85] The evidence shows that executed orders pose such a risk, and that Equitec's controls failed to account for this risk.[86]

The Proposing Release and Adopting Release also include language suggesting that the SEC intended for the Market Access Rule to require that credit and capital thresholds account for both entered and executed orders. For example, the Proposing Release states the following:

> [B]ecause rejection must occur if such orders would exceed the applicable credit or capital thresholds, the broker-dealer must assess compliance with the applicable threshold on the basis of exposure from orders entered on an exchange or ATS, <u>rather than waiting for executions to make that determination</u>. The Commission believes that, because financial exposure through rapid order entry can be incurred very quickly in today's fast electronic markets, controls should measure compliance with appropriate credit or capital thresholds on the basis of orders entered rather than executions obtained.[87]

This language indicates that a broker-dealer cannot limit its assessment of compliance with the applicable threshold until after an order is executed—the broker-dealer must do so as soon as the order is entered. The SEC's pronouncement therefore implicitly acknowledges that executed orders are included and is noting that entered orders must be decremented *in addition* to executed orders, not *instead* of them.

The Adopting Release contains similar language suggesting that both entered and executed orders must be accounted for:

> [B]ecause the risk management controls and supervisory procedures should be designed such that rejection must occur if such orders would exceed the applicable credit or capital

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[82] 17 C.F.R. § 240.15c3-5(c)(1).
[83] 1/23/17 Hrg. Tr. (Markovic) at 197-98.
[84] 1/23/17 Hrg. Tr. (Markovic) at 197-98.
[85] Reg. Ex. 14 (Proposing Release) at 4007.
[86] 1/23/17 Hrg. Tr. (Markovic) at 197-98.
[87] Reg. Ex. 14 (Proposing Release) at 4013.

> thresholds, the broker dealer must assess compliance with the applicable threshold on the basis of exposure from orders entered on an exchange or ATS, rather than relying on a post-execution, after-the-fact determination. Because financial exposure through rapid order entry can be incurred very quickly in today's fast electronic markets, controls should measure compliance with appropriate credit or capital thresholds on the basis of orders entered rather than executions obtained.[88]

Like the language of the Proposing Release, this language reinforces that the SEC was concerned about entered orders *in addition to* executed orders. This interpretation also is supported by the SEC's statement in the Adopting Release that "broker-dealers should monitor compliance with applicable credit or capital thresholds based on orders entered, including the potential financial exposure resulting from open orders not yet executed."[89] The SEC's statement that the risks for which a broker-dealer must control "include[e]" the risks attendant to open orders indicates that it is not only these risks about which the SEC was concerned.

This conclusion is supported by the SEC's rejection of an alternative proposal that advocated for decrementing from a credit or capital threshold only upon execution of an order.[90] Under this proposal, a control would have blocked the routing of additional orders only after executed orders exceeded the applicable credit or capital threshold.[91] The SEC rejected this proposal because it would not adequately safeguard against the financial exposure from rapid order entry in the fast electronic markets.[92] Nothing about the SEC's rejection of this proposal suggests that executed orders could be added back to credit or capital thresholds.

An SEC decision cited by the parties further supports this understanding of the Market Access Rule. In *Knight Capital Americas LLC*, the SEC found that Knight Capital Americas, LLC ("Knight Capital") violated the Market Access Rule by failing to implement financial controls to prevent entry of orders exceeding capital thresholds based on coding errors in the firm's routing system.[93] In particular, the SEC found that Knight Capital failed to link its "post-execution monitoring system" to "its entry of orders so that the entry of orders in the market would automatically stop when Knight exceeded pre-set capital thresholds or its gross position limits."[94] If Equitec were correct that executed orders can be added back to a broker-dealer's capital threshold, a broker-dealer would not need to link a post-execution monitoring system to its order entry, as its capital threshold could have been returned to its full amount upon execution of the orders. The SEC's decision in *Knight Capital* thus further supports the conclusion that the Market Access Rule requires a broker-dealer to implement thresholds that account for both open and executed orders.

Equitec's remaining arguments to the contrary are unavailing. Equitec argues that the Market Access Rule says nothing about executions, and refers only the entry of orders.[95] But, even a former Equitec employee conceded that an executed order necessarily had been entered,[96] and nothing in the Market Access Rule states that it is appropriate to add back the value of an order to the threshold once it has been executed.

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[88] Reg. Ex. 15 (Adopting Release) at 69802.
[89] *Id.* at 69801 (emphasis added); *see also* 1/23/17 Hrg. Tr. (Markovic) at 248.
[90] Reg. Ex. 15 (Adopting Release) at 69801.
[91] *Id.*; 1/23/17 Hrg. Tr. (Markovic) at 189.
[92] Reg. Ex. 15 (Adopting Release) at 69801; 1/23/17 Hrg. Tr. (Markovic) at 189.
[93] *In re Knight Capital Americas LLC*, Exchange Act Release No. 70694, at 7 (Oct. 16, 2013).
[94] *Id.*
[95] Pet. at 6.
[96] 1/24/17 Hrg. Tr. (Shimanek) at 66.

Next, Equitec argues that executed orders "do not have the capacity to harm the market."[97] But this was refuted by the evidence. There was testimony that, even after an order has been executed, a firm still has risk exposure from that position.[98] Equitec also argues that the BCC's ruling was incorrect because the Market Access Rule was not designed to be one-size-fits-all, and was instead intended to allow firm's flexibility to design controls to manage risk.[99] However, the Market Access Rule does impose requirements on broker-dealers, and permitting flexibility in designing controls that meet those requirements does not allow a broker-dealer to ignore the requirements altogether.

Finally, Equitec argues that Regulation and the BCC's interpretation of the Market Access Rule was based on a flawed understanding of how decrementation works, as it did not take account of whether an execution opens or closes a position or potential hedges.[100] But neither Regulation nor the BCC took the position that whether an order opened or closed a position or whether there were potential hedges was irrelevant to whether a control was adequate.[101] Regulation's position, with which the BCC agreed, was instead that Equitec was obligated to account for executed orders in establishing appropriate credit or capital thresholds. Equitec did not present evidence that, for example, it had a documented control that accounted for hedging and whether orders opened or closed positions when determining whether to add an executed order back to the threshold. Accordingly, Equitec's argument fails.

In sum, the BCC correctly found that the Market Access Rule required Equitec to establish and maintain a system of controls that limits financial exposure by taking into account both pending and executed orders.

4. Whether Equitec Was Provided Fair Notice and a Fair Procedure.

The BCC found that Equitec had information that provided Equitec with fair notice that, under the Market Access Rule, Equitec had to decrement executed trades against its threshold. The BCC noted the following information that provided Equitec with notice of its obligation: (1) the Proposing Release; (2) the Adopting Release; (3) a November 5, 2010 article by the law firm Davis Polk; (4) the SEC's decision in *Knight Capital*; (5) SEC answers to frequently asked questions regarding the Market Access Rule, dated April 15, 2014; and (6) the testimony of Milan Markovic, a Director in FINRA's Trading and Financial Compliance, that, based on numerous market access examinations he had conducted, the common industry understanding was that executed orders had to be decremented against the threshold.[102]

Equitec raises three related arguments for reversing the BCC's decision. First, Equitec argues that the BCC's interpretation of the Market Access Rule was not published or revealed prior to Regulation's examination of Equitec and violated Equitec's due process rights because Equitec was not given fair notice of the conduct that was prohibited.[103] Equitec argues that the Proposing Release, Adopting Release, Davis Polk memorandum, SEC decision in *Knight Capital*, and the SEC FAQ's on the Market Access Rule are all silent on whether executed orders need to be decremented against a credit or capital threshold, and Mr. Markovic's testimony came long after Equitec's violation and was thus irrelevant to whether Equitec had

[97] Pet. at 6.
[98] 1/23/17 Hrg. Tr. (Markovic) at 197-98.
[99] Pet. at 5-7.
[100] *Id.* at 7-8.
[101] *See, e.g.*, 1/23/17 Hrg. Tr. (Markovic) at 150, 152, 274-75. To the extent Equitec is criticizing the BCC's use of a simple example to explain the concept of decrementation (BCC Decision at 8-9), the BCC's example was merely illustrative, and it did not suggest that this was how the process of decrementation must work in all instances.
[102] BCC Decision at 17-19.
[103] Pet. at 5.

fair notice.[104] Second, Equitec argues that the BCC's interpretation of the Market Access Rule violated the Exchange's obligation under 15 U.S.C. § 78f(b)(7) of the Exchange Act to provide "a fair procedure."[105] Third, Equitec argues that the BCC's interpretation was improper because it was not "reasonably and fairly implied" by the Market Access Rule in violation of 17 C.F.R. § 240.19b-4.[106]

Regulation responds that the Exchange was "under no obligation to provide Equitec with notice regarding how to design and implement its capital threshold control."[107] Regulation argues that the Market Access Rule was promulgated by the SEC via its statutory rulemaking procedures, including notice and comment procedures, which provided Equitec with more than ample notice of the rule. Regulation argues that the BCC's reliance on the cited sources, including the *Knight Capital* decision and Mr. Markovic's testimony, was proper and that Equitec had adequate notice that its conduct was improper.[108] And, Regulation argues that Equitec's argument is unsupported by case law, which has consistently found that fair procedure and due process considerations are satisfied upon completion of a contested hearing before a neutral panel and review by the Board of Directors.[109]

The Board finds that Equitec did have fair notice that its conduct would be prohibited. As a preliminary matter, the SEC has repeatedly found that "ignorance of the securities laws is not a defense to liability thereunder."[110] While Equitec is correct that regulatory authorities must provide fair warning of prohibited conduct,[111] the SEC and courts have explained that it is sufficient that a rule "mark out the rough area of prohibited conduct, allowing law-abiding individuals to confirm their conduct by steering clear of the prohibition."[112] Here, the Board finds that the Market Access Rule—particularly when viewed in light of the Proposing Release, the Adopting Release, and the SEC's decision in *Knight Capital*—provides adequate notice that executed orders, like open orders, must be decremented against credit or capital thresholds. Moreover, the Market Access Rule was passed pursuant to the SEC's rulemaking procedures, which provided all broker-dealers, including Equitec, with an opportunity for notice and comment. And Equitec does not cite any authority supporting its argument that the BCC's interpretation of the Market Access Rule deprived Equitec of due process because it had no notice of this interpretation.

The Board also finds that Equitec has not shown that the BCC's decision deprived it of due process or violated the Exchange's obligation under 15 U.S.C. § 78f(b)(7) of the Exchange Act to provide "a fair procedure." As Equitec concedes, the Securities Act's "fair procedure" provision gives rise to "due-process-like requirements," but the full panoply of constitutional due process protections does not apply to SROs.[113] SROs must instead provide "only those procedures basic to 'fundamental standards of due process.'"[114] Equitec has cited no authority showing that the BCC's interpretation of the Market Access Rule deprived Equitec of a fair procedure. Equitec received the procedures provided by the Exchange rules, including a contested hearing where it offered witnesses and exhibits and an appeal to the Board. The SEC

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[104] *Id.* at 8-9.
[105] *See* 15 U.S.C. § 78f(b)(7).
[106] *Id.* at 5.
[107] Resp. at 10.
[108] *Id.* 11-12.
[109] *Id.* at 10.
[110] *In re Robert L. Burns*, Exchange Act Release No. 29746, at 20 n.60 (Aug. 5, 2011).
[111] *In re American Funds Distributors, Inc.*, Exchange Act Release No. 64747, at 8 (June 24, 2011) (quoting *Rooms v. S.E.C.*, 444 F.3d 1208, 1214 (10th Cir. 2006)).
[112] *In re James M. Schneider*, Exchange Act. Release No. 69922, at 9 (July 2, 2013) (quoting *DiCola v. Food & Drug Admin.*, 77 F.3d 504, 509 (D.C. Cir. 1996)).
[113] *In re David Kristian Evansen*, Exchange Act Release No. 75531, 2015 WL 4518588, at *6 n.35 (July 27, 2015).
[114] *In re Walter T. Newman*, Exchange Act Release No. 18932, 1982 WL 524718, at *2 n.5 (Aug. 4, 1982) (citation omitted).

has found that these procedures constitute fair procedure.[115]

The Board also rejects Equitec's argument that the BCC's interpretation is not "reasonably and fairly implied" by the Market Access Rule.[116] Under 17 C.F.R. § 240.19b-4(d), an SRO's interpretation of an existing SRO rule is deemed a proposed rule change if it is not "reasonably and fairly implied" by that rule. This requirement, however, applies to an SRO's interpretation of *its own rules*, not SEC rules like the Market Access Rule. Moreover, for the reasons discussed above, the BCC's interpretation of the Market Access Rule is reasonably and fairly implied by the language of the rule. Equitec's argument therefore fails.

Accordingly, the Board affirms the BCC's decision that Regulation proved by a preponderance of the evidence that Equitec violated the Market Access Rule and Exchange Rule 4.2 by failing to establish and maintain risk management controls reasonably designed to prevent the entry of orders that exceed credit or capital thresholds, taking into account both open and executed orders.

VI. THE PROPER SANCTIONS FOR EQUITEC'S VIOLATIONS

The Board has affirmed the BCC findings of violations on Count I through Count VI. Accordingly, the Board now must conduct a *de novo* review of the BCC's sanctions determination.[117]

A. The BCC's Sanctions Decision

The BCC imposed against Equitec sanctions of a censure and a $50,000 fine against Equitec for its violations of the Market Access Rule and Exchange Rule 4.2. In reaching this conclusion, the BCC considered the factors set out in Exchange Rule 17.11 – Judgment and Sanction.[118] The BCC also considered several factors set out in relevant cases, including "[t]he seriousness of the offense, the corresponding harm to the trading public, the potential gain to the broker for disobeying the rules, the potential for repetition in light of the current regulatory and enforcement regime."[119] The BCC also considered the following matters, which were identified by Regulation as matters involving comparable violations:

- *In re Consolidated Trading, LLC*, Cboe File No. 14-0145 – Consolidated agreed to a $50,000 fine and censure for violations of the Market Access Rule and Exchange Rule 4.2 based on its failure to maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of the firm's business activity.[120]

- *In the Matter of Citadel Securities LLC*, Cboe File No. 15-0064 – Citadel agreed to a $100,000 fine and censure for violations of the Market Access Rule and Exchange Rule 4.2 based on its failure to have in place a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders, including the failure to establish appropriate pre-set credit thresholds.[121]

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[115] *See In re David C. Ho*, Exchange Act Release No. 54481, at 8 (Sept. 22, 2006).
[116] Pet. at 5.
[117] *In re ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 83849, at 4.
[118] BCC Decision at 29.
[119] BCC Decision at 29 (quoting *McCarthy v. SEC*, 406 F.3d 179, 190 (2d Cir. 2005)).
[120] Reg. Ex. 22.
[121] Reg. Ex. 21.

- *In re Essex Radez*, Cboe File No. 15-0041 – Essex Radez was fined $90,000 and received a censure after a contested hearing, based in part on its failure to have in place adequate supervisory systems and WSPs.[122]

Counsel for Equitec did not identify to the BCC any precedential matters relating to the appropriate amount of sanctions.[123]

Finally, the BCC considered that Equitec had past violations based on inadequate WSPs and controls. The BCC considered (1) a September 8, 2005 Equitec settlement of claims by Pacific Stock Exchange based on failure to have in place adequate WSPs for $2,000; and (2) an April 18, 2007 Equitec settlement of claims by American Stock Exchange for failing to have in place adequate supervisory systems and WSPs for a censure, an undertaking to revise its WSPs, and $90,000 fine.[124]

Based on the above considerations, the BCC imposed sanctions of a $50,000 fine and a censure against Equitec.[125]

B. The Board's Determination of the Proper Amount of Sanctions

Equitec argues that the Board should overturn the BCC's decision and sanction Equitec with a Cautionary Action Letter or a fine "in the $10,000 range."[126] Regulation responds that the BCC's sanctions determination was correct. As stated above, the Board reviews the BCC's sanctions determination *de novo*.[127]

Cboe Rule 17.11, "Judgment and Sanction," sets out the "Principal Considerations in Determining Sanctions" that guide the Board's sanctions determination. This list includes the following factors:

- Sanctions are "remedial in nature" and should be designed "to prevent and deter future misconduct by wrongdoers, to discourage others from engaging in similar misconduct, and to improve overall business standards."

- Sanctions should "consider a party's relevant disciplinary history."

- "[P]rior similar disciplinary decisions" should be considered, including from other self-regulatory organizations."

- Sanctions should be "tailored to the misconduct at issue."

In addition to these factors, as recognized by the BCC, other factors relevant to the imposition of a penalty include "[t]he seriousness of the offense, the corresponding harm to the trading public, the potential gain to the broker for disobeying the rules, the potential for repetition in light of the current regulatory and enforcement regime."[128] The Board turns to the parties' arguments with these factors in mind.

Equitec raises several arguments why the sanctions imposed by the BCC should be overturned.

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122 Reg. Ex. 23.
123 BCC Decision at 29.
124 *Id.* at 30.
125 *Id.* at 31.
126 Pet. at 10.
127 *In re ABN AMRO Clearing Chicago LLC*, Exchange Act Release No. 83849, at 4.
128 BCC Decision at 29 (quoting *McCarthy*, 406 F.3d at 190).

First, Equitec argues that the sanctions imposed are out of line with relevant precedent. Equitec provides a table listing 15 matters in which settlements with the BCC were reached for violations of the Market Access Rule and the fines imposed were between $7,500 and $30,000.[129] Equitec argues that, in these cases, controls were found "lacking," and "in many cases completely absent," and Equitec's table suggests that 12 of the 15 settlements listed involved a charge of "no controls."[130] Equitec also points to the Cautionary Action Letter to Compass as evidence of what a proper sanction would be in this case. Equitec argues that the *Citadel* and *Radez* matters relied on by the BCC are not comparable because those cases involved actual harm to the market, and that the *Consolidated Trading* matter relied on by the BCC is not comparable because there, the company had "no 15c3-5 filter at all for three years."[131]

Second, Equitec argues that, with the exception of its violation under Count I, there were no other "substantive issue[s] with the market access controls of Equitec," only "defects in the written procedures describing the market access controls."[132] Equitec argues that the Exchange reviewed its WSPs nine months before the exam and none of the items listed was mentioned as deficient.[133]

Third, Equitec argues that consideration of the 2007 Equitec settlement is inappropriate because that matter "dealt with an issue specific to trading on the AMEX, was prior to the existence of the market access rule and involved an operation and personnel that have not been a part of Equitec in over a decade."[134]

Fourth, Equitec argues that a larger fine is not consistent with Cboe Rule 17.11's remedial purposes because Equitec purportedly had no way of knowing that the BCC would interpret the Market Access Rule as it did.[135] Thus, according to Equitec, it would be impossible for it to be "more mindful of reading the Exchange's mind for new interpretations."[136]

Regulation responds that the sanctions imposed by the BCC are in line with the relevant precedent. Regulation argues that the cases considered by the BCC all involved Market Access Rule procedural and/or control-related issues that were similar to the issues in the Equitec matter and all yielded fines from $50,000 to $100,000. Regulation argues that two of these matters—*Consolidated Trading* and *Citadel Securities*—involved settlements, which suggests that an even a higher penalty is appropriate here, where there was a finding of a rule violation after a contested hearing. Regulation notes that the SEC has consistently found that it is appropriate to impose higher sanctions after a contested hearing, as parties weigh litigation risk and expense when they evaluate settlement, and those considerations no longer exist after a case has been litigated.[137] Regulation argues that the sanctions in the matters cited by Equitec are distinguishable because they involved different Market Access Rule issues and because any lesser fines were the product of settlements, not contested hearings.[138] Regulation argues that the BCC properly weighed the relevant factors under Cboe Rule 17.11 and that the BCC's determination of sanctions was appropriate.[139]

The Board addresses each of Equitec's arguments in turn. First, the Board finds that a fine of $50,000 is consistent with the fines imposed in relevant precedential matters. Equitec cites several

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[129] *See* Pet. at "Table of Relevant BCC Decisions Involving Rule 15c-3-5."
[130] Pet. at 10.
[131] *Id.*
[132] *Id.*
[133] *Id.*
[134] *Id.* at 11.
[135] Reply at 7.
[136] *Id.*
[137] Resp. at 17.
[138] *Id.*
[139] *Id.* at 18.

settlements that it claims warrant a lower penalty. As a preliminary matter, contrary to Equitec's claim, the settlements upon which it relies are not matters in which controls were found "completely absent," but instead are cases where the basis for the finding of a violation of the Market Access Rule was not specified. Moreover, the matters cited by Equitec are settlements, and the SEC has repeatedly found that penalties in settled matters often are lower than penalties after a contested hearing, because settlement avoids the time, cost, and expense of litigating a matter in a contested hearing and because Regulation's risk of losing a contested hearing—which is factored into any settlement—no longer exists once Regulation has prevailed.[140]

The Board further finds that, even assuming that the Compass documents are properly before the Board for consideration in connection with sanctions, they do not warrant a lower fine here. The fact that a different exchange, PHLX, took a different action as to a different broker-dealer for what was, at least in part, similar misconduct is "irrelevant to the determination of an appropriate sanction."[141] Many unknown factors—including distinguishable facts, different enforcement priorities, different remediation, or prior violations—could have led PHLX to issue a Cautionary Action Letter to Compass for its violation of the Market Access Rule rather than pursuing charges. The Board finds that the Compass documents thus do not warrant a lower penalty in this case.

The Board has considered the precedent cited by Regulation in favor of a $50,000 penalty—*Consolidated Trading*, *Citadel Securities*, and *Essex Radez*. The Board notes that two of these matters—*Consolidated Trading* and *Citadel Securities*—also involved settlements of charges based on deficient risk management controls under the Market Access Rule. The fines imposed in these matters were $50,000 and $100,000, respectively, which again may be less than the fines that would have been imposed in those matters after a contested hearing. Notably, in *Citadel Securities*, the fine was imposed based in part on the firm's failure to establish appropriate credit thresholds under the same provision of the Market Access Rule at issue here. Finally, in *Essex Radez*, the only cited matter in which a penalty was imposed after a contested hearing before the BCC, the BCC imposed a fine of $90,000 based in part on multiple deficiencies in the firm's WSPs—similar to the deficiencies in Equitec's WSPs here. The Board finds that these matters support the imposition of a $50,000 fine in this case.

The Board next finds that, although Equitec repeatedly describes its other violations as "procedural," that does not ameliorate the significance of these violations. The Market Access Rule requires broker-dealers to "maintain a system of risk management controls *and* supervisory procedures,"[142] and Equitec's WSPs were deficient in a number of ways, which Equitec does not dispute in its Petition. As *Essex Radez* makes clear, fines are an appropriate sanction for failure to maintain adequate WSPs under the Market Access Rule. Moreover, the fact that Equitec's deficient WSPs were not identified at an earlier date does not mitigate Equitec's failure to have WSPs that complied with the Market Access Rule.[143]

Third, the Board finds, consistent with Cboe Rule 17.11, that Equitec's prior rule violations are relevant to the appropriate amount of sanctions in this matter.

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[140] *In re David C. Ho.*, Exchange Act Release No. 54481, at 11 n.25 (Sept. 22, 2006).

[141] *In re Richard J. Puccio*, SEC Release No. 68, Admin. Proc. File No. 3-8438, at *10 (July 10, 1995) (finding that it was "irrelevant to the determination of an appropriate sanction" that the SEC's Division of Enforcement did not charge other registered representatives who worked with the respondent).

[142] 17 C.F.R. § 240.15c3-5(c)(1) (emphasis added).

[143] *See In re G.K. Scott & Co.*, SEC Release No. 33485, 1994 WL 17114, at *3 n.21 (Jan. 14, 1994) (rejecting argument that failure of prior examinations to note misconduct excused the misconduct and stating that a "regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation").

Fourth, the Board rejects Equitec's assertion that a large fine would effectively be requiring Equitec to be "more mindful of reading the Exchange's mind for new interpretations" in the future.[144] As discussed above, Equitec had adequate notice that its control system needed to decrement all orders—both open and executed—under the Market Access Rule and relevant SEC guidance and decisions.

In light of the above considerations, the factors set out in Cboe Rule 17.11, and relevant case law, the Board affirms the BCC's finding that Equitec be sanctioned with a fine of $50,000 and a censure.

VII. CONCLUSION

Based on the foregoing, the Board finds that Regulation has proven by a preponderance of the evidence that, from November 30, 2011 through April 8, 2015 Equitec violated the Market Access Rule and Exchange Rule 4.2 by failing to establish a reasonable credit or capital threshold that limits the overall financial exposure of both Equitec and its customers by taking into account both pending and executed orders.

The Board further finds that Regulation has proven by a preponderance of the evidence that, from October 18, 2012 through April 8, 2015, Equitec violated the Market Access Rule and Exchange Rule 4.2 by failing to have in place WSPs that specify the processes through which:

- Equitec's systems prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate.

- Equitec's on-floor market makers are made aware of the firm's capital thresholds and risk appetites so those on-floor market makers do not manually and/or verbally disseminate quotes or orders in open outcry that exceed those thresholds.

- Equitec prevents the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis, including, but not limited to, reporting duties, trading in options restricted to closing only, quoting in nonappointed classes, and order protection.

- Equitec's on-floor market makers are restricted from disseminating quotes or orders in securities in the event the on-floor market maker is restricted from trading those securities.

- Equitec restricts access to the Exchange's trading floor to those persons pre-approved and authorized by the Firm.[145]

The Board finds that, as sanctions for Equitec's violations of the Market Access Rule and Exchange Rule 4.2 discussed above, Equitec shall receive a fine of $50,000 and a censure.

SO ORDERED FOR THE BOARD OF DIRECTORS OF
CBOE EXCHANGE, INC.

By Directors Kevin Murphy, David Roscoe, Jill Sommers, and Scott Wagner

Dated: April 23, 2019

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[144] Reply at 7.
[145] Reg. Ex. 1.