

**BEFORE THE BOARDS OF DIRECTORS OF  
CBOE EXCHANGE, INC. AND CBOE C2 EXCHANGE, INC.  
DECISION NO. 16 BD 01.3**

In the Matter of:	)	CBOE File No. 14-0177
	)	Star No. 20140438963
ABN AMRO Clearing Chicago LLC,	)	
	)	
Respondent.	)	C2 File No. 14-0003
	)	Star No. 20140439040

**I. PROCEDURAL HISTORY**

This is a consolidated decision of the Board of Directors of Cboe Exchange, Inc. (f/k/a Chicago Board Options Exchange, Incorporated) (“Cboe Options” or “Cboe”) and Cboe C2 Exchange, Inc. (f/k/a C2 Options Exchange, Incorporated) (“C2”).<sup>1</sup> This decision concerns two related disciplinary matters involving ABN AMRO Clearing Chicago LLC (“AACC”). The Cboe Board of Directors is issuing this decision as it relates to Cboe Disciplinary Case 14-0177, and the C2 Board of Directors is issuing this decision as it relates to C2 Disciplinary Case 14-0003. The following is a brief summary of the procedural history in this matter.<sup>2</sup>

On December 4, 2014, pursuant to the authorization of the Exchange Business Conduct Committee (“BCC”), the Exchange Office of Enforcement issued to AACC a Statement of Charges in Cboe Disciplinary Case 14-0177 (“Cboe Charges”), and an Amended and Restated Statement of Charges in C2 Disciplinary Case 14-0003 (“C2 Charges”).<sup>3</sup>

The Cboe Charges were issued for certain alleged violations of three rules: Exchange Rule 4.2 - *Adherence to Law*, Cboe Rule 6.53C - *Complex Orders on the Hybrid System*, and 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”). The C2 Charges were issued for certain alleged violations of Exchange Rule 4.2, C2 Rule 6.13 - *Complex Orders on the Hybrid System*,<sup>4</sup> and the Market Access Rule. AACC filed Answers to the Charges on January 9, 2015, and denied all allegations in the Charges to the extent they suggested that AACC violated Exchange Rules or the Exchange Act.<sup>5</sup>

On June 4, 2015, pursuant to Exchange Rule 17.8, the BCC issued an Amended and Restated Decision Accepting Offer of Settlement under which the alleged violations of Cboe Rule 6.53C and one of

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<sup>1</sup> Cboe and C2 are together referred to as the “Exchange,” and the Boards of Cboe and C2 are together referred to as the “Board.” As set out in a September 18, 2018 letter to the parties, the members of the Board who participated in the review are Kevin Murphy, David Roscoe, Jill Sommers, and Scott Wagner. Bruce Andrews and Edward Tilly, the other two members of the Board, recused themselves from consideration of this matter.

<sup>2</sup> Exchange exhibit references are listed as “Exch. Ex. [number],” and AACC exhibit references are listed as “Resp. Ex. [number].”

<sup>3</sup> See Exch. Ex. 22 and 23. The Cboe Charges and C2 Charges are together referred to as the “Charges.”

<sup>4</sup> Cboe Rule 6.53C and C2 Rule 6.13 are together referred to as the “Complex Order Rules.”

<sup>5</sup> See Exch. Ex. 24 and 25.

the alleged violations of Exchange Rule 4.2 were settled.<sup>6</sup> Under this decision, the BCC found that AACC violated (i) Cboe Rule 6.53C, by and through Cboe Rule 6.20A, because Simplex, AACC's Sponsored User,<sup>7</sup> improperly responded to Complex Order Auctions ("COAs") on Cboe and (ii) Exchange Rule 4.2 because AACC failed to adequately supervise Simplex in order to assure compliance with Cboe Rule 6.53C. The BCC imposed sanctions of a \$20,000 fine and a censure for these violations.

Also on June 4, 2015, pursuant to Exchange Rule 17.8, the BCC issued an Amended and Restated Decision Accepting Offer of Settlement under which the alleged violations of C2 Rule 6.13 and one of the alleged violations of Exchange Rule 4.2 were settled.<sup>8</sup> Under this decision, the BCC found that AACC violated (i) C2 Rule 6.13, by and through C2 Rule 3.15, because AACC's Sponsored User Simplex improperly responded to COAs on C2 and (ii) Exchange Rule 4.2, because AACC failed to adequately supervise Simplex in order to assure compliance with C2 Rule 6.13. The BCC imposed sanctions of a \$25,000 fine and a censure for these violations.

Accordingly, AACC was fined a total of \$45,000 and received two censures for the above conduct. The only alleged Charges that were not resolved by settlement were charges relating to alleged violations of Rule 15c3-5 and additional violations of Rule 4.2 on both Cboe and C2 ("Remaining Charges").

From November 2 to 4, 2015, a panel of three public members of the BCC conducted a hearing on the Remaining Charges. During the hearing, the Exchange Regulatory Division ("Regulation")<sup>9</sup> and AACC were provided a full opportunity to present evidence regarding the Remaining Charges. The BCC panel heard testimony from 10 witnesses and admitted 76 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 December 14, 2015 ("BCC Decision").

The BCC held that Regulation failed to meet its burden to establish by a preponderance of the evidence that AACC violated Rule 15c3-5.<sup>10</sup> Accordingly, the BCC also held that Regulation failed to meet its burden in establishing by a preponderance of the evidence that AACC violated Exchange Rule 4.2. As a result, the BCC dismissed the Remaining Charges.<sup>11</sup>

On January 15, 2016, Regulation timely submitted a petition ("Petition" or "Pet.") requesting that the Board conduct a review of the BCC Decision pursuant to Rule 17.10.<sup>12</sup> In accordance with Rule 17.10(a)(2), AACC timely submitted a response to the Petition on February 12, 2016 ("Response" or "Resp."), and Regulation timely submitted a reply to AACC's Response on March 11, 2016 ("Reply"). 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 February 17, 2016, pursuant to Rule 17.10(b), the Board appointed a three-member panel of the Board to review Regulation's appeal. The directors appointed to the panel by the Board were Eugene

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<sup>6</sup> See Exch. Ex. 26.

<sup>7</sup> A Sponsored User is a firm or individual that is not a Trading Permit Holder and that receives electronic access to the Exchange through a sponsorship arrangement with a Sponsoring Trading Permit Holder. See Cboe Rule 6.20A (Exch. Ex. 15) and C2 Rule 3.15 (Exch. Ex. 16).

<sup>8</sup> See Exch. Ex. 27.

<sup>9</sup> The Financial Industry Regulatory Authority ("FINRA") assisted Regulation in the handling of this matter in FINRA's capacity as regulatory services provider to Cboe and C2.

<sup>10</sup> BCC Decision at 25.

<sup>11</sup> *Id.*

<sup>12</sup> This Rule and others in Chapter XVII of the Cboe Rules also apply to C2. Chapter 17 of the C2 Rules states that "[t]he rules contained in Cboe Options Chapter XVII, as such rules may be in effect from time to time, apply to C2 and are incorporated into this chapter."

Sunshine (Chairperson), Frank English, and Jill Goodman. The Board also delegated to the panel the authority to rule on any procedural matters related to the Board's review of the appeal.

One of the issues in the appeal was the proper standard of review that applied to the Board's review of BCC disciplinary decisions. Regulation argued that the Board should apply a *de novo* standard of review, and AACC argued that the Board should apply a "clearly erroneous" standard of review.<sup>13</sup>

On March 16, 2016, AACC submitted a Motion to Strike part of Regulation's Reply, and on March 23, 2016, Regulation submitted a response to AACC's Motion to Strike.

On July 28, 2016, the Board issued its initial decision in this matter ("Board Decision"), which adopted in full the decision of the panel of the Board appointed to resolve the appeal. The Board held that the "clearly erroneous" standard of review applied to findings and conclusions of the BCC.<sup>14</sup> Applying this standard of review, the Board found that the BCC's findings and conclusions were clearly erroneous and that Regulation had proven by a preponderance of the evidence that AACC violated the Market Access Rule and Exchange Rule 4.2 in both the Cboe and C2 cases.<sup>15</sup>

The Board remanded the matter to the BCC for a determination of what sanctions, if any, should be imposed, consistent with the Board's direction that the BCC consider AACC's "prior sanctions in determining whether additional monetary sanctions [were] necessary and appropriate."<sup>16</sup> On October 27, 2016, the BCC issued a decision ("BCC Sanctions Decision") finding that AACC should be sanctioned with a censure and a \$25,000 fine as to the Cboe matter and a censure and a \$30,000 fine as to the C2 matter.<sup>17</sup>

AACC appealed the BCC's sanction decision to the Board ("AACC Sanctions Br.") and Regulation filed a response ("Regulation Sanctions Resp."), and on February 16, 2017, the Board issued a decision as to sanctions ("Board Sanctions Decision"), which again adopted in full the decision of the panel of the Board appointed to resolve the appeal. The Board stated that, under the standard of review it had applied in prior matters, a BCC sanctions determination could not be reversed unless the appellant showed that the decision was "arbitrary, capricious, or a clear abuse of discretion."<sup>18</sup> The Board found that AACC failed to show that the sanctions imposed by the BCC were arbitrary, capricious, or a clear abuse of discretion and affirmed the BCC's sanctions decision.<sup>19</sup>

AACC appealed the Board's decisions to the Securities and Exchange Commission ("SEC"). On June 20, 2017, the SEC entered an order directing the parties to submit briefs limited to the issue of the appropriate standard of review the Board should apply to BCC decisions, and deferring briefing on the other issues.<sup>20</sup> After AACC and the Exchange submitted briefing on this issue, on August 15, 2018, the

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<sup>13</sup> Pet. at 5-7; Resp. at 4-8.

<sup>14</sup> Board Decision at 7-8.

<sup>15</sup> Board Decision at 16-17.

<sup>16</sup> Board Decision at 17. Specifically, the Board stated that: "In its determination of any sanctions, the BCC should take into account that the same trading activity underlying the violation of Rule 15c3-5 found in this decision also constituted the basis for the violations of CBOE Rule 6.53C and Exchange Rule 4.2 found in the Initial CBOE Decision and the violations of C2 Rule 6.13 and Exchange Rule 4.2 found in the Initial C2 Decision. The Board notes that AACC therefore already has been fined and censured in connection with the underlying trading activity, and suggests that the BCC consider those prior sanctions in determining whether additional monetary sanctions are necessary and appropriate." *Id.*

<sup>17</sup> BCC Sanctions Decision at 9.

<sup>18</sup> Board Sanctions Decision at 2.

<sup>19</sup> Board Sanctions Decision at 4.

<sup>20</sup> *In re ABN AMRO Clearing Chicago LLC*, SEC Release No. 80893, Admin. Proc. File No. 3-17906 (June 20, 2017).

SEC issued a decision (“SEC Decision”) holding that the Board should have applied a *de novo* standard of review to the BCC’s findings.<sup>21</sup> The SEC set aside the disciplinary action and remanded the matter to the Exchange for the Board to conduct a *de novo* review of the BCC’s decisions.

On October 31, 2018, pursuant to the Board’s direction, Regulation and AACC submitted supplemental briefs regarding how the matter should be resolved under a *de novo* standard of review. (“Regulation Supp.” and “AACC Supp.”).<sup>22</sup>

## II. BACKGROUND

During the relevant periods, AACC was an Exchange Trading Permit Holder (“TPH”) registered with the Exchange to conduct business as a Clearing TPH and was a registered broker-dealer.<sup>23</sup> On May 29, 2012, AACC entered into a Sponsored User Agreement (“Agreement”) with Simplex Investments, LLC (“Simplex”), a proprietary trading firm that was not an Exchange TPH or a broker-dealer. The Agreement provided that AACC, as the Sponsoring TPH for Simplex, would provide Simplex with access to the Exchange.<sup>24</sup> In the Agreement and as required by Cboe Rule 6.20A and C2 Rule 3.15, AACC acknowledged and agreed that:

(A) all orders entered by Sponsored User, any person acting on behalf of Sponsored User . . . or any person acting in the name of Sponsored User . . . and any executions occurring as a result of such orders are binding in all respects on the Sponsoring Trading Permit Holder; (B) Sponsoring Trading Permit Holder is responsible for any and all actions taken by such Sponsored User and any person acting on behalf of or in the name of Sponsored User. . .<sup>25</sup>

AACC initially proposed that Simplex submit orders for its sponsored trading through AACC’s proprietary risk management system called AMG.<sup>26</sup> However, Simplex told AACC it wished to engage in complex order trading, which includes orders involving the execution of two or more different options series in the same underlying security at or near the same time.<sup>27</sup> AMG did not support complex order trading.<sup>28</sup> Therefore, AACC contracted with Fundamental Interactions, Inc., a third party software provider, in order to provide Simplex access to the Exchange via Fundamental Interactions’ proprietary order delivery

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<sup>21</sup> *In re ABN AMRO Clearing Chicago LLC*, SEC Release No. 83849, Admin. Proc. File No. 3-17906 (Aug. 15, 2018).

<sup>22</sup> On October 3, 2018, counsel for AACC objected to the involvement of the outside counsel who assisted internal counsel in advising the panel of the Board during the prior stage of this appeal, Jenner & Block LLP, and requested that the Board retain new outside counsel. On October 19, 2018, the Board denied this request and stated that it would set forth its rationale in the final decision. The SEC has held that the Board is “free to utilize the services of subordinates and to rely on others’ analyses and summaries in the course of reaching a sufficiently informed judgment about the matters in dispute.” *Id.* at 22 (citation and internal quotation marks omitted). The Board—not its counsel—is the decision-maker with regard to this matter. AACC has not alleged any bias on the part of the Board. Additionally, AACC has cited no evidence or authority for its claim that existing outside counsel cannot impartially advise the Board or that the Board could not reach an independent decision given outside counsel’s prior involvement in the matter. *See, e.g., In re Stratton Oakmost, Inc.*, SEC Release No. 34-38390 (Mar. 12, 1997) (rejecting as “meritless” a challenge to appointment of attorney-advisor with prosecutorial experience to hearing panel where there was no evidence that panel’s decision “did not reflect the independent views of that body”).

<sup>23</sup> Exch. Ex. 1; Exch. Ex. 2; Exch. Ex. 24, ¶ 1.

<sup>24</sup> Exch. Ex. 4; Exch. Ex. 5.

<sup>25</sup> Exch. Ex. 4 at 1 ¶¶ (A) and (B); Exch. Ex. 5 at 1 ¶¶ (A) and (B).

<sup>26</sup> 11/3/15 Hrg. Tr. (Breault) at 149.

<sup>27</sup> 11/3/15 Hrg. Tr. (Tyrichtrova) at 33, 108, 113.

<sup>28</sup> 11/3/15 Hrg. Tr. (Tyrichtrova) at 33, 108, 113.

system (“FIN”), which is widely used in the industry and supports complex order trading.<sup>29</sup> AACC had tested and certified FIN prior to contracting to use FIN for Simplex. The prior testing, however, did not include testing FIN for complex order trading, and AACC did not test FIN again prior to implementing the system for Simplex’s trading.<sup>30</sup>

The Exchange provides a variety of mechanisms for complex order trading, including COAs. COAs are automated auctions that send out requests for responses to trade with certain complex orders. During the relevant time period, Cboe Rule 6.53C(d)(iii) and C2 Rule 6.13(c)(3) permitted Cboe and C2 to designate which of the following two groups of participants could respond to COAs: (i) each Market-Maker registered in the relevant options class and each TPH acting as agent for orders resting at the top of the Complex Order Book in the relevant option series or (ii) all TPHs.<sup>31</sup>

Prior to November 12, 2012, the Exchanges only permitted eligible Market-Makers and TPHs acting as agent for orders resting at the top of the Complex Order Book in the relevant option series to respond to COAs on Cboe and C2. On November 12, 2012, Cboe Regulatory Circular RG12-152 became effective and provided that all TPHs were eligible to respond to COAs in classes other than certain proprietary index products, and were allowed to redistribute COA messages, including by accepting and forwarding responses from their clients. RG12-152 further provided that for certain proprietary index products—BACD, BSZ, BVZ, CITD, DJX, GSSD, GVZ, JPMD, MSTD, OEX, OVX, SPX, SPXW, SRO, VIX, VSTRP, VXEEM, VXEWZ, XEO, and XSP (“Proprietary Classes”)—only Cboe Market-Makers with appointments in the Proprietary Classes and TPHs acting as agent for orders resting at the top of the Complex Order Book were permitted to respond to COAs.<sup>32</sup>

Between November 12, 2012 and March 1, 2013, the rules on C2 continued to provide that only eligible Market-Makers and TPHs acting as agent for orders resting at the top of the Complex Order Book in the relevant option series were permitted to respond to COAs. On March 1, 2013, C2 Regulatory Circular RG13-008 became effective and provided that all TPHs were eligible to respond to all COAs on C2.<sup>33</sup>

Simplex was not a Market-Maker or an agent for orders in any option classes at any relevant time and therefore, pursuant to Exchange rules, could not respond to COAs in the Relevant Classes. Nonetheless, from February 1, 2013 through March 31, 2013, Simplex responded to 514 COAs on Cboe in the Relevant Classes.<sup>34</sup> Additionally, from January 1, 2013 through February 28, 2013, Simplex responded to 18,412 COAs on C2 in the Relevant Classes.<sup>35</sup>

The FIN system used by Simplex to submit these responses to COAs did not have in place a control that blocked Simplex’s improper COA responses from being sent to the Exchange.<sup>36</sup> AACC’s AMG risk management system did not support complex order trading and, therefore, had it been used instead of the FIN system, Simplex would not have been able to respond to COAs.<sup>37</sup>

During the relevant time period, Rule 15c3-5 provided, in relevant part that:

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<sup>29</sup> See Resp. Ex. 8.

<sup>30</sup> 11/3/15 Hrg. Tr. (Tyrichtrova) at 40, 114, 117.

<sup>31</sup> Exch. Ex. 18; Exch. Ex. 19.

<sup>32</sup> See Cboe Regulatory Circular RG12-152 (Exch. Ex. 20).

<sup>33</sup> See C2 Regulatory Circular RG13-008 (Exch. Ex. 21). “Relevant Options Classes” and “Relevant Classes” will be used to refer to the Proprietary Classes on Cboe, and any classes on C2, during the relevant time period.

<sup>34</sup> See Exch. Ex. 22 at 2 ¶ 7.

<sup>35</sup> See Exch. Ex. 23 at 2 ¶ 7.

<sup>36</sup> See Exch. Ex. 8 at ¶¶ 1-2.

<sup>37</sup> See Exch. Ex. 8 at ¶¶ 1-2, 6.

(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 . . .

(c) The risk management controls and supervisory procedures required by paragraph (b) of this section shall include the following elements: . . .

(2) Regulatory risk management controls and supervisory procedures. The risk management controls and supervisory procedures shall be reasonably designed to ensure compliance with all regulatory requirements, including being reasonably designed to:

(i) Prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis . . .<sup>38</sup>

During the relevant time period, Exchange Rule 4.2 provided, in relevant part that:

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.<sup>39</sup>

### **III. BOARD REVIEW OF 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, which involve application of the Market Access Rule to a TPH with a Sponsored User that responds to COAs in violation of Exchange rules.

### **IV. MOTION TO STRIKE**

As a preliminary matter, the Board considered AACC's Motion to Strike certain language from Regulation's Reply.

AACC requested that counsel to the Board rule on the Motion to Strike on an *in camera* basis

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<sup>38</sup> 17 C.F.R. § 240.15c3-5.

<sup>39</sup> Exch. Ex. 17.

without disclosing to the Board the language which AACC requested be stricken. Rule 17.10(b) provides that the review of a petition for review of a BCC disciplinary hearing decision “shall be conducted by the Board or a committee of the Board composed of at least three Directors whose decision must be ratified by the Board.” Exchange rules do not vest counsel to the Board with the authority to rule on a matter related to the Board’s review of a petition for review of a BCC disciplinary hearing decision. This authority is vested solely with the Board. Accordingly, the Board determines that it is the appropriate body to consider the Motion to Strike.

In the Motion to Strike, AACC seeks to strike the following language from Regulation’s Reply because it allegedly violates Rule 17.10(b):

Given Exchange Regulatory staff’s regular dealings with the SEC staff, Exchange staff is confident that the SEC would regard the BCC’s interpretations to be legally wrong. It is critical that the Board correct these errors, so they do not become the official position of the Exchange regarding the meaning and proper enforcement of the Market Access Rule. Pursuant to Section 19(g) of the Exchange Act, the Exchange has a statutory obligation to enforce all SEC rules, including the Market Access Rule, and the Exchange is subject to SEC discipline if it fails to do so, absent reasonable justification or excuse. An erroneous BCC decision can subject the Exchange to that risk.

AACC contends that the first sentence of this language improperly references previously undisclosed conversations with SEC staff regarding the Market Access Rule that were not subject to cross-examination or rebuttal evidence. AACC also argues that the remaining language is an improper attempt to intimidate the Board with the threat of SEC sanctions if the Board does not rule in Regulation’s favor.<sup>40</sup>

In its response to AACC’s Motion to Strike, Regulation argues that the language in question is appropriate legal argument and not an attempt to introduce evidence of particular conversations with SEC staff or to intimidate the Board. According to Regulation, the sentence stating that “[g]iven Exchange Regulatory staff’s regular dealings with the SEC staff, Exchange staff is confident that the SEC would regard the BCC’s interpretations to be legally wrong” merely emphasizes that Regulation is confident that its interpretation is correct based on Regulation staff’s experience with the SEC. Accordingly, Regulation claims this language is proper legal argument.<sup>41</sup> Regulation also contends that the rest of the challenged language is not a threat. Rather, Regulation states that this language reminds the Board of its legal obligations and is proper argument emphasizing the nature and critical importance of the Board’s duties.<sup>42</sup>

Rule 17.10(b) states that “[u]nless the Board shall decide to open the record for the introduction of evidence or to hear argument,” the Board’s review of a BCC disciplinary hearing decision “shall be based solely upon the record and the written exceptions filed by the parties.” The Board believes that the precise nature of the content and intent of the language that AACC seeks to strike is unclear. The sentence stating, “[g]iven Exchange Regulatory staff’s regular dealings with the SEC staff, Exchange staff is confident that the SEC would regard the BCC’s interpretations to be legally wrong,” could be read to reference specific conversations with SEC staff relating to SEC staff’s views regarding the Market Access Rule. To the extent the language references specific communications between Regulation staff and SEC staff about SEC staff’s interpretation of the Market Access Rule, any such reference should be stricken as there is no evidence in the record reflecting those conversations. To the extent the language is, as Regulation suggests, not related to specific SEC conversations but rather is rhetoric intended to convey confidence in its legal arguments, the language is unnecessary, and remains open to misinterpretation as a reference to specific conversations

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<sup>40</sup> AACC Motion to Strike at 2–3.

<sup>41</sup> Exchange Response to Motion to Strike at 2–3.

<sup>42</sup> *Id.* at 3–4.

outside the record.

Accordingly, the Board grants the Motion to Strike in part and strikes the sentence stating “[g]iven Exchange Regulatory staff’s regular dealings with the SEC staff, Exchange staff is confident that the SEC would regard the BCC’s interpretations to be legally wrong” from the Reply. The Board has not considered that language in reaching its decision in this appeal. The Board denies the Motion with respect to the remaining language that AACC seeks to strike, as a party is not precluded from referencing an Exchange Act provision that is generally applicable to the Exchange and providing argument as to how that provision may apply in the context of a BCC decision. However, the Board notes that it also has not considered the remaining language in reaching its decision because Regulation’s argument is not necessary to determining the specific issues on appeal.

## **V. WHETHER AACC VIOLATED THE MARKET ACCESS RULE AND EXCHANGE RULE 4.2**

### **A. Standard of Review**

In its decision remanding this matter to the Board, the SEC directed that the Board apply a *de novo* standard of review to disciplinary decisions by the BCC.<sup>43</sup> The SEC also described what is and is not required by this review. 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.”<sup>44</sup>

### **B. Applicability of Market Access Rule**

The BCC found that the Market Access Rule does not apply to Exchange rules governing participation in COAs for two reasons. First, the BCC found that the purpose of the Market Access Rule, based on the BCC’s interpretation of the Proposing and Adopting Releases, limits application of the Market Access Rule to the prevention of events that can cause severe market disruption. The BCC found that Simplex’s impermissible COA responses did not pose a significant risk of severe market disruption and thus were not within the scope of the Market Access Rule.<sup>45</sup> The BCC therefore held that sustaining the charge brought against AACC would be inconsistent with what the BCC believed to be the public policy that was the basis for the adoption of the Market Access Rule.<sup>46</sup>

Second, the BCC found that, under the Adopting Release, the Market Access Rule was not intended to expand upon, or create, any regulatory requirements.<sup>47</sup> Accordingly, the BCC held, the Market Access Rule requires controls to prevent prohibited orders from being sent to the Exchange only when there is an existing regulatory obligation specifically requiring a control blocking the prohibited orders. Therefore, the BCC held that the Market Access Rule cannot be read to require a block on improper COA responses without impermissibly expanding upon or creating a new regulatory requirement because there was no requirement in Exchange rules specifying that AACC must put in place a block preventing COA responses that violate Exchange rules.<sup>48</sup>

The Board addresses each of these findings separately below.

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<sup>43</sup> SEC Release No. 83849, at 2.

<sup>44</sup> *Id.* at 21 (footnote omitted).

<sup>45</sup> BCC Decision at 22–23.

<sup>46</sup> *Id.* at 22–23.

<sup>47</sup> *Id.* at 23–24.

<sup>48</sup> *Id.* at 24–25.

### i. Purpose of Market Access Rule

Regulation argues that the BCC's decision limiting the reach of the Market Access Rule to regulatory requirements meant to address severe market disruptions is contrary to the plain language of the Market Access Rule.<sup>49</sup> Regulation contends that the plain language of the Market Access Rule applies to all regulatory requirements: "risk management controls and supervisory procedures shall be reasonably designed to ensure compliance *with all regulatory requirements*, including being reasonably designed to prevent the entry of orders unless there has been compliance with *all regulatory requirements* that must be satisfied on a pre-order entry basis."<sup>50</sup> Further, Regulation notes that "regulatory requirements" is defined to include, "all federal securities laws, rules and regulations and rules of *self-regulatory organizations*."<sup>51</sup> Therefore, according to Regulation, since Exchange rules governing participation in COAs are regulatory requirements, AACC was required under the Market Access Rule to implement controls reasonably designed to ensure compliance with those rules.<sup>52</sup>

AACC, on the other hand, argues that the BCC decision should be affirmed because Simplex's use of the COA process never posed the type of severe risk of market disruption to which AACC contends application of the Market Access Rule is limited.<sup>53</sup>

The Board finds that the language of the Market Access Rule is clear in applying to all regulatory requirements, and that the BCC's interpretation of the Market Access Rule is inconsistent with the language of the Market Access Rule.

The BCC specifically relied on language in the Adopting Release stating that the SEC is "concerned about preventing other, potentially severe, widespread incidents" and the Market Access Rule is designed to protect "the integrity of trading on the securities markets, and the stability of the financial system."<sup>54</sup> However, the Adopting Release does not state that the application of the Market Access Rule is limited to conduct that poses a risk of severe market disruption. Rather, the Adopting Release repeatedly states that the Market Access Rule is meant to address a broad range of risks including "financial, regulatory, and other risks, such as legal and operational risks, associated with market access."<sup>55</sup> The Adopting Release further states that "[t]hese risks—whether they involve the potential breach of a credit or capital limit, the submission of erroneous orders as a result of a computer malfunction or human error, the *failure to comply with SEC or exchange trading rules*, the failure to detect illegal conduct, or otherwise—are present whenever a broker-dealer trades as a member of an exchange or subscriber to an ATS, whether for its own proprietary account or as agent for its customers, including traditional agency brokerage and *through direct market access or sponsored access arrangements*."<sup>56</sup> The Adopting Release, therefore, makes clear that the risks the Market Access Rule seeks to mitigate are not only those which may cause severe market disruption, but also include more common risks that are present whenever a broker-dealer provides market access to an exchange. These risks include the risk that a market access recipient like Simplex will fail to

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<sup>49</sup> Pet. at 8.

<sup>50</sup> *Id.* at 9 (quoting Exch. Ex. 28).

<sup>51</sup> *Id.*

<sup>52</sup> AACC argues that Regulation has waived any argument that the Market Access Rule should apply in situations where there was no market risk. Resp. at 31–33. The Board finds that Regulation has not waived this argument, because Regulation has consistently argued that the Market Access Rule applies to *all* regulatory requirements regardless of the type of risk posed by the regulated activity. See BCC Decision at 8–10, 19–20; 11/2/15 Hrg. Tr. (Kelly) at 197–198; 11/2/15 Hrg. Tr. (Marrin) at 282–283.

<sup>53</sup> Resp. at 28–31.

<sup>54</sup> BCC Decision at 22–23.

<sup>55</sup> Resp. Ex. 2 at 7; see also *id.* at 3–4, 12, 14, and 21.

<sup>56</sup> Resp. Ex. 2 at 7–8 (emphasis added).

follow “exchange trading rules.”

Additionally, the plain language of the Market Access Rule itself is unambiguous. The Market Access Rule states that “risk management controls and supervisory procedures shall be reasonably designed to ensure compliance with *all regulatory requirements*, including being reasonably designed to prevent the entry of orders unless there has been compliance with *all regulatory requirements* that must be satisfied on a pre-order entry basis.”<sup>57</sup> The Market Access Rule defines “regulatory requirements” to include the “rules of self-regulatory organizations.”<sup>58</sup> Because the Exchange is a self-regulatory organization, the Exchange’s rules are “regulatory requirements.” Therefore, the plain language of the Market Access Rule required AACC to implement controls reasonably designed to ensure compliance with *all* Exchange rules, including those governing participation in COAs.

The BCC’s interpretation of the Market Access Rule as limited to regulatory requirements aimed at preventing severe market disruptions contradicts the plain language of the Market Access Rule and finds no support in the Adopting Release or any other materials cited by AACC. Accordingly, the Board rejects this limitation and finds that AACC was required to implement controls reasonably designed to ensure compliance with *all* Exchange rules.

## ii. Existing Regulatory Requirements

The BCC held that language in the Adopting Release of the Market Access Rule stating that the SEC “intends these controls and procedures to encompass existing regulatory requirements . . . and does not intend to substantively expand upon them,” makes clear the Market Access Rule requires controls to prevent prohibited orders from being sent to the Exchange only when there is an existing regulatory obligation specifically requiring a control blocking the prohibited orders.<sup>59</sup> While the Complex Order Rules prohibited Simplex from responding to COAs in the Relevant Classes, the BCC held that, since there was no Exchange rule specifically requiring a control blocking the prohibited orders, the Market Access Rule did not require such a control be implemented.<sup>60</sup>

AACC agrees with the BCC’s conclusions and findings, and asks the Board to affirm the BCC’s holding on this issue.

Regulation, on the other hand, argues that the plain language of the Market Access Rule requires AACC to have had controls that are reasonably designed to prevent Simplex’s entry of orders unless there has first been compliance with *all* regulatory requirements that must be satisfied on a pre-order entry basis, including Exchange rules of this nature. Regulation argues that Exchange rules during the relevant period required that prior to responding to a COA on either Cboe or C2, a market participant must have been appointed as a Market-Maker in the Relevant Options Classes.<sup>61</sup> According to Regulation, the Market Access Rule does not expand this requirement, but simply requires that market access providers (such as AACC) implement controls that will ensure compliance with these Exchange rules on a pre-order entry basis.<sup>62</sup> Regulation also argues that the BCC’s construction of the Market Access Rule—to require a control that blocks participation in COAs only if an Exchange rule specifically requires a control blocking these

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<sup>57</sup> 17 C.F.R. § 240.15c3-5(c)(2) (emphasis added).

<sup>58</sup> *Id.* § 240.15c3-5(a)(2).

<sup>59</sup> Resp. Ex. 2 at 42; BCC Decision at 24–25.

<sup>60</sup> BCC Decision at 24–25.

<sup>61</sup> Pet. at 15–16. Exchange rules also allowed TPHs acting as agent for orders resting at the top of the Complex Order Book to respond to COAs. Simplex was not a TPH acting as agent for orders so Simplex could not have responded to COAs in this capacity.

<sup>62</sup> *Id.* at 16.

orders—would render the Market Access Rule entirely superfluous to Exchange rules.<sup>63</sup>

The Board agrees with Regulation that the BCC’s interpretation of the language of the Adopting Release contradicts the language of the Market Access Rule and Adopting Release. The Market Access Rule states that market access providers must implement risk management controls and supervisory procedures “reasonably designed to ensure compliance with *all* regulatory requirements, including being reasonably designed to prevent the entry of orders unless there has been compliance with *all* regulatory requirements that must be satisfied on a pre-order entry basis.”<sup>64</sup> The SEC states in the Adopting Release that regulatory requirements that *must* be satisfied on a pre-trade basis are those requirements that can effectively be complied with only before an order is routed to an exchange.<sup>65</sup> Exchange rules required that prior to responding to a COA in a specific option class, the responder must have been appointed as a Market-Maker in that class or be an agent for orders resting at the top of the Complex Order Book in that class. In order to act in either of those capacities, a firm must first register as a broker-dealer with the SEC and become an Exchange TPH. Additionally, to be an Exchange Market-Maker in an option class, a TPH must register with the Exchange to become a Market-Maker and obtain a Market-Maker appointment in that option class. These are requirements that only can be satisfied before responding to a COA. If a firm does not have the proper appointments in place prior to responding to a COA, the firm would be in violation of Exchange rules from the moment it routes a response to a COA. Since Simplex did not satisfy any of these requirements, AACC was required under the language of both the Market Access Rule and the Adopting Release to implement controls that would ensure Simplex complied with Exchange rules governing participation in COAs.

The Board also finds that the BCC’s interpretation and AACC’s argument—that the Adopting Release’s statement that the term “regulatory requirements” in the Market Access Rule refers to “existing regulatory requirements . . . and is not intended to substantively expand upon them”—cannot reasonably be read to mean that market access providers must only implement controls under the Market Access Rule when an exchange rule already requires the control.<sup>66</sup> To adopt this interpretation would render the Market Access Rule superfluous, as market access providers would need to implement only controls that they were already required to implement under regulatory requirements such as Exchange rules. The Board instead finds that the reference to “existing regulatory requirements” means regulatory requirements, such as Exchange rules governing participation in COAs, that “exist” outside of the Market Access Rule. In other words, the language in the Adopting Release was not intended to limit the scope of the plain language of the Market Access Rule, but rather explains how the Market Access Rule will interact with “existing regulatory requirements,” including Exchange rules governing participation in COAs.

Accordingly, the Board finds that the BCC’s interpretation of the Market Access Rule to require a control to prevent prohibited COA responses from being sent to the Exchange only if there also was an existing regulatory obligation specifically requiring the block is incorrect. The Board finds that, under the Market Access Rule, AACC was required to implement controls reasonably designed to ensure compliance with *all* Exchange rules, including Exchange rules governing participation in COAs.

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<sup>63</sup> Reply at 12–13.

<sup>64</sup> 17 C.F.R. § 240.15c3-5(c)(2) (emphasis added).

<sup>65</sup> Resp. Ex. 2 at 46.

<sup>66</sup> Resp. Ex. 2 at 14-15 n.22; BCC Decision at 24–25. AACC also argues that the term “regulatory requirements” only refers to rules that existed at the time of the promulgation of the Market Access Rule in 2011. The BCC’s decision did not rely on this interpretation, and the Board finds that this interpretation is incorrect. The SEC specifically stated in the Adopting Release that the “specific content of the ‘regulatory requirements’ would, of course, adjust over time as laws, rules, and regulations are modified.” Resp. Ex. 2 at n.22.

### C. “Reasonably Designed” Risk Management Controls

The BCC held that the Adopting Release’s provision that risk management controls must be “reasonably designed” is a flexible standard that adapts to the specific circumstances at hand.<sup>67</sup> Further, according to the BCC, “reasonably designed” does not require AACC to institute risk management controls on activity that the BCC believed AACC had no reason to anticipate Simplex would engage in, especially when it was “impossible for [AACC] to know of or observe the impermissible trading activity (on a pre- or post-trade basis) or block the impermissible trading activity without blocking permissible trading activity.”<sup>68</sup> The BCC noted that the record reflects that during AACC’s onboarding process for Simplex, AACC asked Simplex about desired order types, and Simplex did not state that it intended to respond to COAs for any products, including those in the Relevant Classes.<sup>69</sup> The BCC also found that AACC had reason to believe from the Exchange’s specifications for its Financial Information eXchange (“FIX”) protocol, which is the technological interface through which the Exchange and Simplex communicated, that, even if a Sponsored User tried to send improper COA responses, those responses would be blocked by the Exchange.<sup>70</sup> In other words, according to the BCC, “reasonably designed” does not require that AACC have a risk management control in place for every possible circumstance.<sup>71</sup> The BCC believed that to find otherwise would apply no limiting principle to a “reasonableness” standard.<sup>72</sup>

AACC agrees with these BCC conclusions and findings, and asks the Board to affirm the BCC’s holding on this issue.<sup>73</sup>

Regulation, on the other hand, argues that the “reasonably designed” language of the Adopting Release allows flexibility in how controls are designed but does not allow a firm to choose not to implement a required control.<sup>74</sup> Therefore, Regulation argues that AACC’s failure to even attempt to implement a control ensuring compliance with Exchange COA rules means that AACC’s controls cannot be considered reasonably designed.<sup>75</sup> Moreover, according to Regulation, the possibility and/or difficulty involved in implementing the control is irrelevant to the threshold question of whether AACC even sought to implement a control that AACC was required to have under the Market Access Rule, because the record reflects that AACC did not try to block Simplex’s access to COAs.<sup>76</sup> In any event, according to Regulation, it was not impossible for AACC to comply with the Market Access Rule. AACC’s proprietary risk management system, AMG, which AACC used for other direct market access clients, did not support COAs and therefore

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<sup>67</sup> BCC Decision at 10.

<sup>68</sup> *Id.* at 21.

<sup>69</sup> *Id.* at 19.

<sup>70</sup> *Id.* at 21. The Exchange’s FIX specifications are guides published by the Exchange explaining the proper methods for electronic communication of trade-related messages between the Exchange and its market participants. Put another way, the FIX specifications describe how market participants can communicate their trade-related messages to the Exchange.

<sup>71</sup> *Id.* at 20–21.

<sup>72</sup> *Id.* at 21.

<sup>73</sup> AACC also argues that, based on recent Exchange disciplinary actions finding violations of COA and other auction rules that did not include Market Access Rule violations, the Exchange has engaged in a pattern of selective enforcement and that the Exchange has not considered violations of its auction rules to be “regulatory requirements.” Resp. at 73–76 (citing *In the Matter of Allston Trading LLC*, Cboe File No. 13-0042 (Oct. 16, 2013); *In the Matter of Citadel Securities LLC*, C2 File No. 13-0001 (Apr. 29, 2014); *In the Matter of Spot Trading LLC*, Cboe File No. 14-0117 (Oct. 6, 2014); *In the Matter of IMC-Chicago LLC*, Cboe File No. 14-0013 (Apr. 3, 2014)). The Board finds that those disciplinary actions do not support AACC’s argument because they involved different facts and circumstances than this matter including, among other things, that none of those matters involved a respondent providing access to a Sponsored User.

<sup>74</sup> Pet. at 16–17.

<sup>75</sup> *Id.* at 17.

<sup>76</sup> *Id.* at 18.

would not have allowed Simplex’s auction responses, effectively preventing improper responses to COAs.<sup>77</sup> AACC, however, chose not to use the AMG risk management system for Simplex. Further, Regulation argues, AACC did not rely on the FIX specifications because the record shows that in the relevant time period AACC was not aware of whether or not the FIX specifications might have indicated that improper COA responses would be rejected.<sup>78</sup>

According to Regulation, AACC had three options available to it to comply with the Market Access Rule, none of which it even tried to pursue. First, AACC could have prohibited all Simplex auction activity, thereby preventing improper COA responses. Second, AACC could have reached out to the Exchange to determine a way to prevent Simplex from responding to COAs, but not other auctions. Finally, AACC could have discontinued the Sponsored User business it chose to enter into with Simplex.<sup>79</sup>

Additionally, Regulation argues that the BCC’s decision could create a dangerous exception to the Market Access Rule, whereby market access providers would be allowed to tailor their controls only to the “known trading strategies and intentions” of their clients.<sup>80</sup>

The Board finds that the language of the Market Access Rule provides that market access providers must implement controls “reasonably designed to ensure compliance with *all* regulatory requirements.”<sup>81</sup> Therefore, under the language of the Market Access Rule, AACC was required to implement controls to ensure compliance with *all* Exchange rules, including those governing participation in COAs. The Board finds that AACC did not have in place a control to ensure compliance with the Exchange COA rules, and thus its system of controls were not “reasonably designed” to prevent such violations. In other words, “reasonably designed” provides a market access provider with some discretion in how to design controls to ensure compliance with regulatory requirements. It does not, however, allow market access providers to fail to implement any control whatsoever to ensure compliance with an Exchange rule. Here, the record reflects that AACC failed to attempt to implement any control to ensure Simplex’s compliance with COA limitations.<sup>82</sup>

Moreover, contrary to AACC’s arguments and the BCC’s findings, the Board finds that it was not impossible for AACC to implement a control to ensure compliance with Exchange COA rules. As Regulation notes, AACC had a number of options available to it. First, AACC could have provided Simplex with market access using a risk management system that did not support auction activity, thereby preventing improper COA responses. Indeed, AACC’s proprietary risk management system, AMG, which AACC used for its other direct market access clients, does not support any auction activity and would thus “effectively block” responses to COAs.<sup>83</sup> AACC also could have reached out to the Exchange to determine a way to prevent Simplex from responding to COAs.<sup>84</sup> Finally, AACC could have discontinued the

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<sup>77</sup> Reply at 21–22; Exch. Ex. 8 at ¶ 1.

<sup>78</sup> Resp. Br. 49 n.29.

<sup>79</sup> Pet. at 19–21.

<sup>80</sup> BCC Decision at 18–19; Reply at 16–17.

<sup>81</sup> 17 C.F.R. § 240.15c3-5(c)(2) (emphasis added).

<sup>82</sup> *E.g.*, Exch. Ex. 8; 11/2/15 Hrg. Tr. (McNamee) at 41–45.

<sup>83</sup> *See* Exch. Ex. 8 at ¶¶ 1, 2, 6; 11/3/15 Hrg. Tr. (Tyrichtrova) at 84. AACC argues in its supplemental brief that there was no evidence AMG was viable for use for Simplex. AACC Supp. 15. But the evidence showed that AACC offered its AMG system to Simplex. 11/3/15 Hrg. Tr. (Tyrichtrova) at 113; 11/3/15 Hrg. Tr. (Breault) at 149. AACC further argues that the BCC barred testimony regarding why AACC decided not to use the AMG system for Simplex. AACC Supp. 15. But the record reflects that BCC barred the testimony of Exchange witness Jessica Kelly because she admitted she did not know the reason that AMG was not used, and her testimony thus would have been speculative, which does not support AACC’s argument that it was barred from presenting testimony regarding why AMG was not used for Simplex. 11/2/15 Hrg. Tr. (Kelly) at 171–75.

<sup>84</sup> *See, e.g.*, 11/2/15 Hrg. Tr. (Marrin) at 300–301.

Sponsored User business it chose to enter into with Simplex if it could not implement a control to prevent improper COA responses from Simplex.<sup>85</sup> Indeed, AACC ultimately did terminate its sponsored access business for Simplex in June 2013, and at the time of the BCC hearing AACC did not have any Sponsored Users.<sup>86</sup>

Further, the BCC's finding that a "reasonably designed" system did not require AACC to attempt to block Simplex from improperly responding to COAs because the BCC believed that "the Exchange's FIX specifications indicated that the sending of such COA responses would cause a rejection" fails for legal and factual reasons.<sup>87</sup> As a legal matter, an SEC staff release regarding the Market Access Rule states that a broker-dealer may not rely on a third-party's system, including an exchange's system, to meet its Market Access Rule responsibilities unless the broker-dealer "has direct and exclusive control over the tools or technology" and the broker-dealer performs "appropriate due diligence to assure that the exchange . . . provided controls are reasonably designed to be effective, and otherwise consistent with the Rule."<sup>88</sup> Neither of these conditions was satisfied by AACC. Therefore, AACC cannot rely on the Exchange's FIX specifications as a defense to failing to adopt required controls under the Market Access Rule. As a factual matter, AACC concedes that it did not examine the FIX specifications regarding COAs during the relevant time period and therefore did not in fact rely on the specifications when attempting to meet its Market Access Rule responsibilities.<sup>89</sup>

The BCC acknowledged that AACC never reviewed the FIX specifications concerning COAs, but determined that the importance of this fact was mitigated because, according to the BCC, AACC never had any reason to believe that Simplex might respond to COAs in the Relevant Classes.<sup>90</sup> The Board finds that AACC did have reason to believe that Simplex might respond to COAs in the relevant option classes. In particular, during AACC's onboarding of Simplex, Simplex identified complex order trading as one of its planned activities.<sup>91</sup> Indeed, AACC used FIN for Simplex's sponsored access precisely because AMG did not support complex order trading, which Simplex had made clear it desired to conduct.<sup>92</sup>

AACC raises several additional arguments in defense of the BCC's decision. AACC argues that the Statement of Charges alleged only that AACC failed to implement a specific control to prevent Simplex from improperly responding to COAs and that, on appeal, Regulation has impermissibly shifted its theory of liability to be that AACC should have required Simplex to trade through its AMG system or never

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<sup>85</sup> See, e.g., 11/2/15 Hrg. Tr. (Kelly) at 182-83.

<sup>86</sup> See Exch. Ex. 8 at ¶¶ 6-7; 11/3/15 Hrg. Tr. (Tyrichtrova) at 80.

<sup>87</sup> BCC Decision at 21.

<sup>88</sup> Securities and Exchange Commission, Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access ("FAQ Responses"), Question 5 (Apr. 15, 2014).

<sup>89</sup> AACC Resp. 49 n.29; BCC Decision at 20. AACC also claims that if the Board finds a control was required, the Exchange is in violation of its obligations under Section 19(g)(1) of the Exchange Act because the FIX protocol rendered such a control, and consequently compliance with the Market Access Rule, impossible. Resp. at 61-62. Section 19(g)(1) of the Exchange Act generally requires that a self-regulatory organization comply with the Exchange Act, Exchange Act regulations, and the self-regulatory organization's own rules and to enforce compliance by its TPHs with these provisions absent reasonable justification or excuse. See 15 U.S.C. § 78s(g)(1). The Board rejects AACC's argument. First, as stated above, the Exchange's FIX protocol did not render compliance with the Market Access Rule impossible. Second, Section 19(g)(1) does not impose a duty on the Exchange to modify its technology to allow for any specific control to be implemented by AACC, because the Market Access Rule does not apply to the Exchange. Rather, Section 19(g)(1) requires only that the Exchange enforce compliance by AACC with AACC's own obligations under the Exchange Act and Exchange rules, including the Market Access Rule.

<sup>90</sup> BCC Decision at 20-21.

<sup>91</sup> 11/3/15 Hrg. Tr. (Tyrichtrova) at 33, 113.

<sup>92</sup> 11/3/15 Hrg. Tr. (Tyrichtrova) at 33, 108, 113.

engaged in sponsored access in the first place.<sup>93</sup> AACC argues that this improper shift violated the Exchange’s obligations under 15 U.S.C. § 78f(d) to bring “specific charges,” violated the Exchange’s obligation under Exchange Rule 17.4(b) to “specify the facts” upon which charges are based, and violated AACC’s due process rights by failing to provide fair warning of what conduct is prohibited.<sup>94</sup> The Board finds that Regulation has not impermissibly shifted its theory of liability, which has always been that AACC failed to establish, document, and maintain a system of risk management controls that were reasonably designed to ensure compliance with all regulatory requirements that must be met on a pre-order entry basis, including Exchange rules prohibiting responding to COAs without the proper appointment.<sup>95</sup> This charge was sufficiently specific to satisfy the Exchange’s obligations under 15 U.S.C. § 78f(d) and Rule 17.4(b) and provide AACC with adequate notice of the charges against it.

AACC next argues that Regulation’s interpretation of the Market Access Rule to “prohibit all complex orders or completely discontinue sponsored access” is a “radical change in the standard of conduct” required of sponsoring firms and thus must have been submitted to the SEC as a proposed rule under SEC Rule 19b-4.<sup>96</sup> AACC misstates Regulation’s position, as Regulation has not argued (and the Board does not find) that the Market Access Rule prohibits all complex orders or requires the discontinuation of sponsored access. AACC provides no explanation why Regulation’s actual position—that AACC was required to establish risk management controls reasonably designed to ensure compliance with Exchange rules prohibiting improper COA responses—required a rule filing, and the Board finds that it did not.

AACC next claims that the Exchange specifically enabled Simplex to respond to COAs in the Relevant Classes.<sup>97</sup> AACC points to two e-mail exchanges between Simplex employees and Exchange staff in support of this assertion.<sup>98</sup> However, contrary to AACC’s claim, the e-mail exchanges do not show that the Exchange encouraged Simplex to respond to COAs in the Relevant Classes. Rather, the first e-mail exchange shows Exchange staff providing Simplex with a log-in ID that is necessary for every firm before it can engage in any trading on the Exchange. Further, the e-mail exchange refers to permissible trading activity, not to COAs.<sup>99</sup> The second e-mail exchange also refers to permissible trading activity involving a product not in the Relevant Classes.<sup>100</sup> AACC also points to testimony from AACC’s Chief Compliance Officer that Simplex told her Simplex was approached by Cboe and told her that “now the COA responses will not be limited to the market makers.”<sup>101</sup> However, it is not clear from this second-hand reporting of a communication—with neither participant identified—whether or not the Exchange encouraged Simplex to respond to COAs in the Relevant Classes. Moreover, as discussed above, none of the evidence that AACC cites can rebut the application of the SEC’s rule requiring that AACC must have had “direct and exclusive control over the tools or technology” used by the Exchange to be entitled to rely on the Exchange’s risk management controls to ensure compliance with the Market Access Rule.<sup>102</sup> It is undisputed that AACC did not have that control. Accordingly, the Board finds that the Exchange’s emails and the testimony of AACC’s Chief Compliance Officer do not support AACC’s argument that it is not liable for its failure to establish a control to ensure compliance with the Exchange’s rules regarding COA responses.

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<sup>93</sup> AACC Supp. 3-4, 13-16, 20-21.

<sup>94</sup> *Id.*

<sup>95</sup> *E.g.*, Exch. Ex. 23, ¶¶ 9, 13.

<sup>96</sup> AACC Supp. 21-22; *see* 17 C.F.R. § 240.19b-4.

<sup>97</sup> Resp. at 63–66.

<sup>98</sup> Resp. Ex. 38 and 39.

<sup>99</sup> Resp. Ex. 38.

<sup>100</sup> Resp. Ex. 39.

<sup>101</sup> 11/3/15 Hrg. Tr. (Tyrichtova) at 139.

<sup>102</sup> FAQ Responses, Question 5.

Finally, the Board does not agree with the BCC's belief that AACC had no way of knowing, nor reason to suspect, that Simplex was participating in COAs, and therefore was not required to implement a control to ensure compliance with the Exchange's rules governing COAs. As previously noted, the record shows that during AACC's onboarding of Simplex, Simplex identified complex order trading as one of its planned activities.<sup>103</sup> Yet, there is no evidence in the record that AACC inquired as to whether Simplex's desired complex order trading would include COAs. Further, the plain language of the Market Access Rule is broad, requiring compliance with *all* regulatory requirements. There is no exception to the Market Access Rule that allows market access providers to tailor their controls only to the known trading strategies of their clients.

Accordingly, the Board finds that Regulation showed by a preponderance of the evidence that AACC did not maintain a system of risk management controls reasonably designed to ensure compliance with all regulatory requirements. The Board thus finds that AACC violated the Market Access Rule and Exchange Rule 4.2 in both the Cboe and C2 matters.

## **VI. THE PROPER SANCTION FOR AACC'S VIOLATIONS**

As discussed above, after the July 28, 2016 Board Decision finding that AACC violated the Market Access Rule and Exchange Rule 4.2, the matter was remanded to the BCC for a determination of what sanctions, if any, should be imposed.<sup>104</sup> On October 27, 2016, the BCC determined that AACC should be sanctioned with a censure and a \$25,000 fine as to the Cboe matter and a censure and a \$30,000 fine as to the C2 matter.<sup>105</sup> The BCC Sanctions Decision was appealed to the Board, which found that the sanctions determinations of the BCC were not arbitrary, capricious, or a clear abuse of discretion and affirmed the BCC's decision.<sup>106</sup> The Board noted that while it "might have decided the determination of sanctions differently if presented with the issue in the first instance, it could not say that the BCC Sanctions Decision was arbitrary, capricious, or a clear abuse of discretion."<sup>107</sup> In light of the SEC's August 15, 2018 decision, the Board now applies a *de novo* review to the BCC's determination of sanctions.<sup>108</sup>

### **A. The BCC's Sanctions Decision**

AACC argued to the BCC that it should impose no additional sanctions against AACC because AACC already settled charges in this matter based on the same facts for fines totaling \$45,000.<sup>109</sup> The BCC rejected this argument, finding that AACC's two settlement agreements did not include the Market Access Rule charges and that additional sanctions for these separate violations were warranted.<sup>110</sup>

As to the proper amount of the sanction, Regulation argued that the BCC should impose sanctions of a censure and a \$25,000 fine as to the Cboe matter and a censure and a \$30,000 fine as to the C2 matter.<sup>111</sup> Regulation relied on the following cases involving a broker-dealer's failure to implement a risk management control that was required under the Market Access Rule:

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<sup>103</sup> BCC Decision at 7; 11/3/15 Hrg. Tr. (Tyrichtrova) at 33, 113.

<sup>104</sup> Board Decision at 17.

<sup>105</sup> BCC Sanctions Decision at 9.

<sup>106</sup> Board Sanctions Decision at 4.

<sup>107</sup> *Id.*

<sup>108</sup> SEC Decision at 4.

<sup>109</sup> BCC Sanctions Decision at 4.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 5.

- *In the Matter of Consolidated Trading, LLC* – Consolidated agreed to a \$50,000 fine and censure for violations of the Market Access Rule and Exchange Rule 4.2 based on Consolidated’s 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.<sup>112</sup>
- *In the Matter of Ronin Capital, LLC* – In a matter handled by FINRA for another SRO, Ronin agreed to a \$55,000 fine and censure for violations of the Market Access Rule and International Securities Exchange Rule 401 based on failure to have in place risk management controls and supervisory procedures designed to prevent the entry of erroneous orders and failure to prevent the entry of orders unless there had been compliance with all regulatory requirements.<sup>113</sup>
- *In the Matter of Citadel Securities LLC* – Citadel agreed to a \$100,000 fine and censure for violations of the Market Access Rule and Exchange Rule 4.2 based on Citadel’s failure to have in place a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders and failure to have in place risk management controls and supervisory procedures that assured appropriate surveillance personnel received immediate post-trade execution reports.<sup>114</sup>
- *In the Matter of Nomura Securities International, Inc.* – Nomura agreed to a \$120,000 fine and censure for violation of the Market Access Rule based on, among other things, failure to establish and maintain procedures that were reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit limits.<sup>115</sup>
- *In the Matter of Credit Suisse Securities LLC* – Credit Suisse agreed to a \$250,000 fine and censure for violation of the Market Access Rule based on, among other things, failure to have in place an adequate system of risk management controls and supervisory procedures, including pre-order controls and a system of follow-up and review, which were reasonably designed to prevent the transmission of excessive orders or quotations.<sup>116</sup>

Regulation also argued that the sanctions imposed in those matters were imposed via settlement and were therefore lower than what would have been imposed after a contested hearing.<sup>117</sup>

AACC argued that several factors weighed against a larger penalty: (1) it was “impossible for AACC to observe, monitor, identify, specifically block or surveil for COA messaging due at least in part to” Exchange system limitations; (2) “the Exchange’s published FIX protocol specifications were false and misleading regarding the ability of trading firms to process COA messages”; (3) “[t]he Exchange could only block COA messaging by blocking all market data”; and (4) “[t]he Exchange’s own personnel

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<sup>112</sup> *In the Matter of Consolidated Trading, LLC*, File No. 14-0145 (Dec. 29, 2014 Decision Accepting Offer of Settlement).

<sup>113</sup> *In the Matter of Ronin Capital, LLC*, STAR No. 20120344702 (Letter of Acceptance, Waiver and Consent, Decision issued June 23, 2014).

<sup>114</sup> *In the Matter of Citadel Securities LLC*, File No. 15-0064, STAR No. 20150456215 (Oct. 20, 2015 Decision Accepting Offer of Settlement).

<sup>115</sup> *In the Matter of Nomura Securities International, Inc.*, STAR No. 20130367785 (Letters of Acceptance, Waiver and Consent, Decisions issued June and July 2016); see Letter of Acceptance, Waiver and Consent between BATS BZX Exchange, Inc. and Nomura (July 5, 2016).

<sup>116</sup> *In the Matter of Credit Suisse Securities (USA) LLC*; STAR No. 20110292793 (Offers of Settlement and Consent, and Letters of Acceptance, Waiver and Consent, Decisions issued September and Oct. 2015); see Letter of Acceptance, Waiver and Consent between NASDAQ Options Market and Credit Suisse (October 14, 2015).

<sup>117</sup> BCC Sanctions Decision at 5.

marketed COAs” to Simplex.<sup>118</sup> The BCC noted, however, that certain of these argument were counterbalanced by the actual findings of the Board in its decision on AACC’s liability.<sup>119</sup> For instance, the Board had found that it was *not* impossible for AACC to comply with the Market Access Rule, and the Board had found that AACC could not and did not rely on the Exchange’s FIX specifications.<sup>120</sup>

Taking into consideration these facts and the relevant precedent cited by the parties, the BCC imposed sanctions of a censure and a \$25,000 fine as to the Cboe matter and a censure and a \$30,000 fine as to the C2 matter.<sup>121</sup>

## **B. The Board’s Determination of The Proper Amount of Sanctions**

AACC argues that the Board should overturn the BCC’s decision and impose no additional sanctions against AACC beyond the \$45,000 penalty already assessed pursuant to the prior settlements.<sup>122</sup> Regulation responds that the BCC’s sanctions determination was correct. As discussed above, the Board reviews the BCC’s sanctions determination *de novo*.<sup>123</sup>

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.”

The Board turns to the parties’ arguments with these factors in mind.

AACC makes several arguments in favor of overturning the BCC’s sanctions decision. First, AACC argues that the BCC’s sanction is improper because it exceeds what Regulation had been prepared to accept if AACC had been willing to settle the Market Access Rule charges ahead of the hearing in this matter.<sup>124</sup> Second, AACC argues that the BCC failed to consider the Board’s prior direction to consider the prior sanctions imposed against AACC in determining whether additional sanctions were warranted.<sup>125</sup> Third, AACC argues that the BCC failed to take proper account of certain factors it claims mitigate against a sanction,<sup>126</sup> including: (1) that it was impossible to observe, monitor, identify, block or surveil for impermissible COA responses; (2) that the Exchange’s published FIX protocol specifications were false and misleading regarding the ability of trading firms to process COA messages; (3) that it is impossible to

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<sup>118</sup> *Id.* at 7.

<sup>119</sup> *Id.* at 8.

<sup>120</sup> *Id.* at 7-8.

<sup>121</sup> *Id.* at 8-9.

<sup>122</sup> AACC Sanctions Br. at 8-9.

<sup>123</sup> SEC Decision at 4.

<sup>124</sup> AACC Sanctions Br. at 2.

<sup>125</sup> *Id.* at 4-6.

<sup>126</sup> *Id.* at 6-8.

monitor a firm's Market-Maker appointments; and (4) that the restriction on COA messaging was merely designed as an exclusive franchise for Exchange Market-Makers and that Simplex's improper COA responses posed no risk to, and actually benefited, the market.<sup>127</sup> And fourth, AACC argues that BCC should not have relied on the precedential cases cited by Regulation because they were all settled matters.<sup>128</sup>

Regulation addresses each of AACC's arguments in its response. First, Regulation argues its prior settlement position is irrelevant, as courts and the SEC recognize that a party's settlement position is inadmissible to prove the validity or amount of a claim.<sup>129</sup> Regulation argues that parties weigh litigation risk and expense when they evaluate settlement, and that those considerations no longer exist after a case has been litigated.<sup>130</sup> Regulation points to several SEC decisions recognizing that it is appropriate to impose higher sanctions following a contested proceeding.<sup>131</sup> Second, Regulation argues that the BCC did consider the Board's direction to consider prior sanctions against AACC and the BCC found that additional sanctions beyond that were warranted.<sup>132</sup> Third, Regulation argues that the BCC did take into account the mitigating factors identified by AACC, and properly considered them in light of the countervailing findings by the Board.<sup>133</sup> And fourth, Regulation argues that the BCC's sanctions determination is supported by the relevant cases involving Market Access Rule that the BCC considered, and that these cases would support an even higher award here, where sanctions were imposed after a contested hearing.<sup>134</sup>

The Board addresses each of AACC's arguments in turn. First, the Board finds that Regulation's prior settlement position—a position taken before time and effort were expended on a contested hearing and the appeals that have followed—is not relevant to the Board's determination of proper sanctions. As the SEC has noted, sanctions imposed in settled cases “may understate the sanctions that would be imposed in litigated cases because settled sanctions reflect pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary litigation.”<sup>135</sup>

Second, the Board finds that the BCC did consider the prior sanctions against AACC in reaching its sanctions determination. The BCC explicitly stated that the violations at issue “are separate from and additional to those violations that were included in the Settlement Agreements.”<sup>136</sup> While the Board agrees with the BCC that the violations of the Market Access Rule at issue in this appeal are distinct from the violations previously settled by AACC, the Board finds that certain of the violations settled by AACC are similar in nature to AACC's violation of the Market Access Rule. In particular, AACC settled claims that it violated Exchange Rule 4.2, which addresses the supervision of persons associated with TPHs. On the facts here, the supervisory requirements imposed by Exchange Rule 4.2 are similar to the Market Access Rule's requirement that a broker-dealer have in place supervisory procedures and controls reasonably designed to ensure compliance with all regulatory requirements. The Board finds that this similarity militates in favor of a lesser sanction.

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<sup>127</sup> *Id.* at 6.

<sup>128</sup> *Id.* at 8.

<sup>129</sup> Regulation Sanctions Resp. at 4-5.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at 5 (citing *In re David C. Ho.*, Securities Exchange Act Rel. No. 54481, at 11 n.25 (Sept. 22, 2006); *In re Arthur James Niebauer*, Securities Exchange Act Rel. No. 54384, at 13-14 n.46 (Aug. 30, 2006); *In re Monetta Fin. Servs., Inc.*, Investment Advisors Act of 1940 Rel. No. 2438, at 6 n.17 (Oct. 4, 2005)).

<sup>132</sup> *Id.* at 3-4.

<sup>133</sup> *Id.* at 6-7.

<sup>134</sup> *Id.* at 7-8.

<sup>135</sup> *In re David C. Ho.*, Securities Exchange Act Rel. No. 54481, at 11 n.25 (Sept. 22, 2006).

<sup>136</sup> BCC Sanctions Decision at 5.

Third, the Board finds that the BCC did consider the factors that AACC argued were mitigating factors.<sup>137</sup> Under a *de novo* review, however, the Board does not defer to the BCC's consideration of these factors and considers independently the factors identified by AACC. AACC claims that it is a mitigating factor that it was impossible to observe, monitor, identify, block or surveil for impermissible COA responses. But, as stated above, the Board finds that it was not impossible for AACC to comply with the Market Access Rule, and that AACC had options available to it that could have avoided violating the rule.<sup>138</sup>

AACC next claims that the Exchange's published FIX protocol specifications were false and misleading regarding the ability of trading firms to process COA messages and this should mitigate against a sanction.<sup>139</sup> However, even if AACC were correct, as a matter of law, AACC *could not* rely on the Exchange's FIX specifications to comply with the Market Access Rule,<sup>140</sup> and as a factual matter *did not* rely on the FIX specifications when designing its controls.<sup>141</sup>

AACC next argues that it was impossible to monitor a firm's Market-Maker appointments. AACC's argument is misplaced. Simplex was a Sponsored User.<sup>142</sup> By definition, a Sponsored User is not a TPH. The fundamental purpose of becoming a Sponsored User is to receive direct access to the Exchange by contracting with a TPH.<sup>143</sup> And a Market-Maker, by definition, must be a TPH.<sup>144</sup> Simplex thus could not have been a Market-Maker, and there were no Market-Maker appointments that AACC would have to "monitor."

AACC then argues in mitigation that the Exchange's restriction on COA messaging was merely designed to be an exclusive franchise for Exchange Market-Makers and that Simplex's improper COA responses posed no risk, and actually benefited, the market by providing additional liquidity. As an initial matter, AACC's argument is factually incorrect because TPHs acting as agent for orders resting at the top of the Complex Order Book also were permitted to respond to COAs in the Relevant Classes.<sup>145</sup> Moreover, AACC ignores the testimony that the SEC was particularly concerned with the risks posed by Sponsored User agreements such as AACC's agreement with Simplex.<sup>146</sup> AACC also ignores that these COA rules were part of the Exchange's program for providing critical liquidity in its markets, one component of which is to provide Market-Makers with incentives to provide liquidity and to assume the obligations and requirements that are applicable to Market-Makers.<sup>147</sup> Contrary to AACC's assertion, Simplex's impermissible participation in large numbers of COAs could have diminished these incentives and thus been detrimental to the overall market.

Fourth, the Board finds that the settlements considered by the BCC, which involved violations of the Market Access Rule for failure to implement a risk management control, are relevant to the determination of the proper sanctions in this matter, even though they were settled matters. As discussed above, the Board further acknowledges that penalties in settled matters often are lower than penalties after

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<sup>137</sup> *Id.* at 7-8.

<sup>138</sup> *See supra* at 13-14.

<sup>139</sup> AACC Sanctions Br. at 7.

<sup>140</sup> The prior panel of the Board which reviewed this matter noted that, although as a matter of law the language of the FIX protocol specifications was not relevant to the issues of the appeal, it is important for the Exchange to publish accurate FIX specifications. The prior Board panel referred the FIX specifications to the Exchange's Chief Compliance Officer for review. *See* Board Decision at 15 n.100.

<sup>141</sup> *See supra* at 14.

<sup>142</sup> Exch. Ex. 4.

<sup>143</sup> *See* Cboe Rule 6.20A (Exch. Ex. 15); C2 Rule 3.15 (Exch. Ex. 16).

<sup>144</sup> *See* Cboe Rule 8.1.

<sup>145</sup> *See* Cboe Regulatory Circular RG12-152 (Exch. Ex. 20); C2 Regulatory Circular RG13-008 (Exch. Ex. 21).

<sup>146</sup> *See* 11/2/2015 Hrg. Tr. (McNamee) at 119; 11/2/2015 Hrg. Tr. (Marrin) at 278, 293.

<sup>147</sup> *See, e.g.*, 11/2/15 Hrg. Tr. (McNamee) at 48.

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.

The Board finds that an additional penalty for the additional violations is proper. The amount of sanctions in a given case depends on the individual facts and circumstances of that case. Here, after analyzing each of the factors and arguments of the parties as described above and in light of the facts discussed above—in particular, the fact that AACC has already received fines of \$45,000 based in part on violations similar in nature to the violations at issue here—the Board finds that, as sanctions for AACC's violations of the Market Access Rule and Exchange Rule 4.2, AACC shall receive a fine of \$5,000 and a censure in the Cboe case and a fine of \$5,000 and a censure in the C2 case.

## VII. CONCLUSION

Based on the foregoing, the Board finds that Regulation has proven by a preponderance of the evidence that AACC violated Rule 15c3-5, in both Cboe Disciplinary Case 14-0177 and C2 Disciplinary Case 14-0003, by failing to maintain risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements. Accordingly, the Board also finds that Regulation has proven by a preponderance of the evidence that AACC violated Exchange Rule 4.2 in both Cboe Disciplinary Case 14-0177 and C2 Disciplinary Case 14-0003.

As detailed above, Regulation has proven the following by a preponderance of the evidence. AACC entered into a Sponsored User Agreement with Simplex, which provided that AACC was responsible for actions taken by Simplex. From February 1, 2013 through March 31, 2013, Simplex improperly responded to COAs in the Relevant Classes on Cboe in violation of Cboe Rule 6.53C. Also, from January 1, 2013 through February 28, 2013, Simplex improperly responded to COAs in the Relevant Classes on C2 in violation of C2 Rule 6.13. AACC did not implement any control to ensure Simplex's compliance with Cboe Rule 6.53C and C2 Rule 6.13.<sup>148</sup> Accordingly, Regulation has met its burden to prove that AACC violated Rule 15c3-5 by failing to maintain risk management controls and supervisory procedures reasonably designed to ensure compliance with Cboe Rule 6.53C and C2 Rule 6.13.

The Board further finds that, as sanctions for AACC's violations of the Market Access Rule and Exchange Rule 4.2 discussed above, AACC shall receive a fine of \$5,000 and a censure in Cboe Disciplinary Case 14-0177, and a fine of \$5,000 and a censure in C2 Disciplinary Case 14-0003.

SO ORDERED FOR THE BOARDS OF DIRECTORS OF  
CBOE EXCHANGE, INC. AND CBOE C2 EXCHANGE, INC.

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

Dated: April 4, 2019

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<sup>148</sup> BCC Decision at 8; Exch. Ex. 8.