

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

Department of Market Regulation, Complainant, v. Electronic Transaction Clearing, Inc. (CRD No. 146122), Respondent.	Disciplinary Proceeding No. 20100254756-01 ¹ Hearing Officer – MAD Date: February 19, 2016
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ORDER ACCEPTING OFFER OF SETTLEMENT

INTRODUCTION

A Complaint was filed in Disciplinary Proceeding No. 20100254756-01 on March 30, 2015, by the Financial Industry Regulatory Authority's ("FINRA") Department of Market Regulation ("Complainant"). On January 20, 2016, Respondent Electronic Transaction Clearing, Inc. ("ETC" or "the Firm") submitted an Offer of Settlement ("Offer") to Complainant. Pursuant to FINRA Rule 9270(e), the Complainant and the National Adjudicatory Council ("NAC"), a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA") have accepted the uncontested Offer. Accordingly, this Order now is issued pursuant to FINRA Rule 9270(e)(3). The findings, conclusions and sanctions set forth in this Order are those stated in the Offer as accepted by the Complainant and approved by the NAC.

Under the terms of the Offer, Respondent ETC has consented, without admitting or denying the allegations of the Complaint, as amended by the Offer, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA

¹ Includes merged STAR Nos. 20100242001, 20100242634, 20110284587, 20120325248, 20120349915, 20130354688, 20130358277, 20130364653, 20130368332, 20140410488, 20140426517, and 20150471654.

is a party, to the entry of findings and violations consistent with the allegations of the Complaint, as amended by the Offer, and to the imposition of the sanctions set forth below, and fully understand that this Order will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA.

BACKGROUND

Executing and clearing broker-dealer ETC is a Delaware corporation headquartered in Los Angeles, California, and has been registered with the SEC since June 27, 2008 and with FINRA since July 15, 2009. In addition to being registered with FINRA, ETC is also registered with multiple equities exchanges, including BATS Exchange, Inc. ("BZX"), BATS Y-Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., NASDAQ Stock Market LLC ("Nasdaq"), NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, LLC, New York Stock Exchange, LLC ("NYSE"), NYSE Arca Equities, Inc. ("NYSE Arca") and NYSE MKT LLC (NYSE Amex LLC prior to May 14, 2012) (collectively, the "Exchanges" or "SROs"). Under Article IV of the FINRA By-Laws, FINRA has jurisdiction over ETC because: (a) the Firm currently is a FINRA member; and (b) the Complaint charges the Firm with securities-related misconduct committed while it was a FINRA member.

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:

SUMMARY

1. This matter involves supervisory violations committed by executing and clearing broker-dealer ETC, during the period from November 1, 2009 through March 31, 2015 (the "Relevant Period"), in connection with the Firm's business of providing direct market access

and/or sponsored market access to both registered and unregistered market participants (“Market Access Customers”) to multiple market centers, including the Exchanges.

2. During the Relevant Period, ETC was a significant market access provider, acting as the gateway to U.S. securities markets for dozens of Market Access Customers, including foreign, domestic, registered, and unregistered day-trading firms, as well as thousands of affiliated individual traders and trader groups, many located in foreign jurisdictions. Using trading systems they owned directly or leased from a third-party provider (*i.e.* service bureau), ETC’s Market Access Customers executed billions of shares each month by electronically routing orders directly to the Exchanges and other trading venues through the use of ETC-registered mnemonics and/or market participant identifiers (“MPIDs”).

3. As a provider of market access, ETC was responsible for establishing, implementing and maintaining adequate supervisory procedures and a system of follow-up and review, including written supervisory procedures (“WSPs”), reasonably designed to investigate red flags and monitor the trading activity of its Market Access Customers, to detect and prevent potentially manipulative trades, and to ensure that all trades entered under the Firm’s mnemonics or MPIDs complied with applicable federal securities laws and regulations and the rules of FINRA and the Exchanges. Implicit in this responsibility was the requirement that ETC invest sufficient resources in its supervisory technology, compliance infrastructure, and compliance staff.

4. Beginning on July 14, 2011 through the end of the Relevant Period, pursuant to Rule 15c3-5 of the Securities Exchange Act of 1934 (“SEA”) (the “Market Access Rule”),² ETC

² The SEC adopted the Market Access Rule in November 2010 to require that, as gatekeepers to the financial markets, broker-dealers that provide market access “appropriately control the risks associated with market access so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.” 17 C.F.R. § 240.15c3-5, *Risk Management Controls for*

was also required to establish, document and maintain an adequate system of risk management controls and supervisory procedures reasonably designed to manage financial, regulatory and other risks in connection with the Firm's provision of market access, including implementing certain pre-trade and post-trade risk controls, ensuring compliance with all applicable federal securities laws and regulations and the rules of FINRA and the Exchanges, restricting access to its trading systems and technology to approved persons, and ensuring direct and exclusive control over its financial and regulatory risk management controls.

5. During the Relevant Period, ETC's supervisory systems and procedures and risk management controls were not reasonably designed to supervise and manage the risks of its Market Access business involving thousands of foreign-based traders, and therefore, could not reasonably monitor, detect and prevent potentially manipulative activity.

6. Despite numerous red flags, heightened risks and repeated notice by regulators of potentially manipulative activity being effected by certain Market Access Customers, ETC's approach to its regulatory responsibilities was inadequate. ETC also failed to dedicate sufficient compliance resources and staff to meet its regulatory responsibilities as its business grew, and, in some instances, to conduct adequate follow-up and review of potentially manipulative activity, such as wash trades, pre-arranged trades, layering, spoofing and other momentum ignition strategies, violative odd-lot trades, and trades that impermissibly marked the opening and closing of trading. Moreover, certain of the systems and controls ETC did design and implement were flawed and not adequately tailored to its business.

7. By failing to establish, maintain and enforce an adequate supervisory system, including WSPs, reasonably designed to monitor and investigate red flags, detect and prevent

Brokers or Dealers with Market Access, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (Final Rule Release). The Market Access Rule became effective July 14, 2011.

potentially manipulative trades of its Market Access Customers, and ensure compliance with the federal securities laws and regulations, including the Market Access Rule, and FINRA and SRO Rules, ETC violated NASD Rule 3010 (for conduct prior to December 1, 2014), and FINRA Rules 2010 and 3110 (for conduct on or after December 1, 2014).

8. By failing to establish, document and maintain an adequate system of risk management controls and supervisory procedures reasonably designed to manage the financial and regulatory risks and ensure compliance with all regulatory requirements in connection with the Firm's provision of market access, ETC violated SEA Section 15(c)(3), Rule 15c3-5 thereunder, and FINRA Rule 2010.

9. By failing to dedicate sufficient resources to ensure appropriate regulatory risk management controls and supervisory systems and procedures, and failing to prevent its Market Access Customers and their traders from executing thousands of potentially manipulative trades on the Exchanges, ETC also failed to observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business, in violation of FINRA Rule 2010.

Respondent and Jurisdiction

10. ETC is a Delaware corporation headquartered in Los Angeles, California, and has been registered with the SEC since June 27, 2008 and with FINRA since July 15, 2009. As of March 2015 the firm had 18 registered employees. In addition to being registered with FINRA, ETC is also registered with multiple equities exchanges, including the SROs. FINRA has jurisdiction over ETC because it is currently a FINRA member firm.

Statement of Facts

11. During the Relevant Period, ETC was a significant market access provider to dozens of Market Access Customers, including foreign, domestic, registered and unregistered, day-trading firms, as well as thousands of their individual traders and trader groups.

12. During the Relevant Period, ETC's Market Access Customers executed an average of almost five billion shares per month under ETC-registered mnemonics and/or MPIDs across multiple market centers including, but not limited to, the Exchanges.

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

ETC's Market Access Customers Raised Numerous Red Flags

14. From the time ETC first started executing trades on behalf of Market Access Customers in March 2009, it was aware, or should have been aware, that its market access business posed regulatory and compliance risks.

15. Multiple industry-wide notices published by FINRA both before and throughout the Relevant Period put ETC on notice that its market access business posed particular regulatory and compliance risks, and reminded market access providers like ETC that, among other things, they are ultimately responsible for all orders entered into the firm's systems, including third-party services used to facilitate trading, and must ensure that all trading activity complies with all applicable securities laws and regulations. *See, e.g.*, FINRA's 2010 Annual Regulatory and Examination Priorities Letter ("Priorities Letter") (Mar. 1, 2010) (market access providers: (i) must have written control and supervisory procedures to monitor trading activity and are responsible for taking steps to ensure that orders represent bona fide trading interest; (ii) must have appropriate processes for conducting due diligence with respect to the approval of market

access customers; and (iii) should establish controls to limit financial exposure arising from the trading activity of sponsored participants and limiting the use of trading systems to authorized persons).³

16. Moreover, during the Relevant Period, FINRA Rules specifically prohibited manipulative and abusive trading practices, such as wash trades, pre-arranged trades, and the use of deceptive and misleading transactions to induce other market participants to trade (*see, e.g.*, FINRA Rules 2020 and 6140).

17. ETC also was aware, or should have been aware, of red flags raised by the business model of certain of its Market Access Customers and the relationship between those customers and their authorized traders, which was open to heightened risk and abuse:

a. Some of ETC's Market Access Customers were affiliated with hundreds or even thousands of authorized traders located in various different countries.

b. ETC's "Consolidated Trader List" contained several examples of trader subgroups and unregistered business entities approved as authorized traders on behalf of ETC Market Access Customers.

c. ETC was aware that some of its Market Access Customers may have earned transaction-based compensation from their traders.

³ *See also* FINRA's 2009 Priorities Letter (Mar. 9, 2009) (referencing NASD Notice to Members 04-66 (Sep. 2004), which specifically noted the need to ensure that orders entered by a firm or its customers via the firm's trading systems are representative of bona fide trading and quote activity); FINRA's 2011 Priorities Letter (Feb. 8, 2011) (noting: (i) FINRA's focus on compliance with the newly adopted SEA Rule 15c3-5; (ii) FINRA's expectation that firms have written policies and procedures to ensure that trading complies with applicable FINRA rules and federal securities laws and regulations; and (iii) risks associated with master/sub-account relationships and the requirement for firms to have systems to monitor, detect and report suspicious activity); FINRA's 2012 Priorities Letter (Jan. 31, 2012) (noting: (i) FINRA's emphasis on post-trade surveillance procedures reasonably designed to identify various potential trading violations of SEC and FINRA rules; (ii) FINRA's focus on surveillance of abusive trading, including "momentum ignition strategies" such as layering, spoofing, and aggressive trading activity near the open or close, where market participants attempt to induce others to trade at artificially high or low prices through the entry of non-bona fide orders; and (iii) FINRA's focus on problematic activity by sponsored participants); FINRA's 2013 Priorities Letter (Jan. 11, 2013) (reiterating FINRA's trading concerns from 2012).

d. Whether or not some of those traders were acting as independent day-traders.

18. Notwithstanding being on notice of the particular risks associated with being a market access provider and the red flags arising out of the business model of certain of ETC's Market Access Customers, ETC did not adequately investigate or understand the nature of the relationship between or among its customers and their authorized traders, subgroups or other entities and the impact on ETC's ability to supervise their trading.

ETC Inadequately Monitored for Potentially Manipulative Activity

19. ETC's WSPs prohibited the specific trading practices that included most, if not all, of the types of conduct at issue here, including violative wash trades, prearranged trades, marking the close/influencing the open, painting the tape, and odd-lot abuse. ETC's WSPs further prescribed that "phantom orders" and other trading "activities to induce others to trade," including "unusual patterns of cancelled or unexecuted orders," were also prohibited.

20. ETC registered with the SEC in June 2008 and started executing trades for Market Access Customers in or around March 2009, yet ETC effectively had no trade surveillance program and conducted no automated reviews of its Market Access Customers' trading to detect and prevent the types of conduct that were expressly prohibited by both FINRA rules (and those of other regulators) and ETC's own WSPs until on or around February 1, 2010, when the Firm implemented its first automated exception report. The only "exception report" used by ETC prior to that time was a web-based short sale locate tool it implemented in September 2009.

21. Prior to February 2010, two of ETC's employees under the oversight of ETC's President/Chief Operating Officer ("COO") may have conducted real-time monitoring of its

Market Access Customers' trading, but if they did so, no document evidences the criteria used by those ETC employees to monitor for suspicious trading. In November and December 2009, ETC executed an average of more than 1.4 billion shares per month, and the Firm's reliance on two or three employees to conduct real-time monitoring of that quantity of trading generated by a rapidly growing customer base⁴ was inadequate.

22. Although ETC ultimately developed and implemented a series of surveillances between February 2010 and October 2012:

a. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potentially violative wash trades until on or around February 1, 2010.

b. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential pre-arranged trading until February 2010.

c. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential odd-lot manipulation until April 2010.

d. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential layering until March 2011.

e. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential spoofing until October 2012.

f. ETC did not reasonably monitor for, and had no automated exception reports designed to detect, instances of potential marking-the-open or marking-the-close activity until at least October 2011.

⁴ Between November and December 2009 and the first quarter of 2010, ETC's customer base expanded from eight to 15 firms, and executed share volume jumped from an average of 1.4 billion shares per month to 2.3 billion shares per month.

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

23. ETC's supervisory failures were also evident in the quantity of potentially manipulative trading activity attributable to its Market Access Customers and entered on the SROs under ETC's MPIDs during the Relevant Period, including wash trades, pre-arranged trades, layering, spoofing and other momentum ignition strategies, violative odd-lot trades, and trades that impermissibly marked the opening and closing of trading.

24. During the Relevant Period, ETC's Market Access Customers employed aggressive, potentially manipulative trading strategies, often in illiquid securities. For example, FINRA and SRO staff identified hundreds of potential pre-arranged trades, thousands of potentially violative wash sales, and thousands of instances of potential layering across the Exchanges involving ETC's Market Access Customers. In addition, ETC's own surveillance reports identified significant amounts of potentially manipulative activity executed by and through ETC for its Market Access Customers. Despite these red flags and this potentially manipulative activity, ETC failed to adequately review and investigate this activity and prevent potential violations of the relevant federal securities laws and regulations, including the Market Access Rule, and FINRA and SRO rules.

Wash Trades

25. Wash trades are trades with no change in beneficial ownership. Such trades can be violative when used to inject false information into the market to manipulate the prices of securities. Intentionally taking both sides of a trade can minimize financial risk for the trading firm while potentially creating a false impression of higher volume in the market. Even wash trades not undertaken with fraudulent or manipulative intent can create a misimpression of the level of legitimate trading interest and activity in a security. FINRA members have an obligation

to have policies and procedures in place to review for and prevent potentially violative wash trades.

26. Throughout the Relevant Period, ETC’s Market Access Customers effected significant quantities of potentially violative wash trades. For example, during the period of May 5, 2011 through September 30, 2012, 28 different MPIDs used by ETC Market Access Customers appeared on ETC’s Multivenue Wash report, reflecting significant quantities of potentially violative conduct across the SROs:

- 11 customers had 10 or more unique trader IDs show up on the report;
- 16 customers effected potential wash trades on 10 or more different trade dates;
- 17 customers effected 100 or more potential wash trades;
- 11 customers effected potential wash trades totaling 100,000 or more shares;
- 13 customers effected potential wash trades totaling \$1 million or more in value.

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

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

The number of times that certain traders and Market Access Customers appeared on the Multivenue Wash report was suspicious and presented a red flag that required adequate review and investigation in order to prevent potentially violative conduct, which ETC failed to do.

Although ETC conducted some reviews of this activity, the reviews it did perform were inadequate and did not appear to prevent potentially violative conduct from continuing to occur.

⁵ This firm stopped the majority of its trading through ETC in or around early May 2011.

Layering

27. Layering is a manipulative trading tactic designed to induce other market participants into executing trades at artificial prices. Layering generally involves, but is not limited to, a pattern in which multiple, non-bona fide (*i.e.* not intended to be executed) limit orders are entered on one side of the market in a stock at various price levels, which creates the appearance of a change in the supply and demand of the security, thereby moving the price. At or around the same time, the trader enters one or more orders for execution on the opposite side of the market; upon execution of some or all of those orders (in full or in part), any open non-bona fide orders are immediately cancelled. The activity is often then repeated on the opposite side of the market.

28. Throughout the Relevant Period, ETC's Market Access Customers repeatedly and consistently effected instances of potential layering. During the period from March 2011 through September 2012, 12 different MPIDs used by ETC Market Access Customers appeared on ETC's Layering report, reflecting significant quantities of potentially violative conduct across the SROs:

- Five customers had 100 or more unique trader ids show up on the report;
- Six customers effected potential layering on 50 or more different trade dates.

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

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

The number of times that certain traders and Market Access Customers appeared on the Layering report was suspicious and presented a red flag that required adequate review and investigation in order to prevent potentially violative conduct, which Respondent failed to do. Although ETC conducted some reviews of this activity, the reviews it did perform were inadequate and did not appear to prevent potentially violative conduct from continuing to occur.

Pre-arranged Trading/Mid-Point Passive Liquidity Trades

29. During the Relevant Period, ETC's Market Access Customers effected hundreds of instances of potential pre-arranged trades in numerous different securities across multiple market centers.

30. Beginning in February 2010, ETC was aware that some of its Market Access Customers intentionally engaged in trading on both sides of the market to try and capture liquidity rebates, which could lead to large numbers of pre-arranged and/or wash trades, yet it did not take adequate steps to review, investigate and prevent this potentially violative activity. In particular, during the period March 2010 through April 2010, ETC Market Access Customers A⁶, B and C and, at the time, non-ETC customers D, E and F, engaged in an apparent pre-arranged trading scheme on NYSE Arca using the Mid-point Passive Liquidity ("MPL") order type (*i.e.* undisplayed limit orders priced at the mid-point of the protected best bid/offer).⁷ The suspicious trades involved hundreds of securities and millions of shares, and comprised a high percentage (well in excess of 10%) of the total daily consolidated volumes of the securities involved; in 26 instances, ETC's customer and the non-ETC customer made up over 50% of the daily consolidated volume in a symbol.

⁶ In this Order, generic identifiers have been used in place of the names of certain individuals and entities.

⁷ At the time, NYSE Arca paid a rebate of \$.20 per 100 shares to firms that provided liquidity using MPL orders and did not charge a fee for taking liquidity.

31. For example, on April 19, 2010, ETC Market Access Customer C executed approximately 42,500 trades in 323 symbols, totaling approximately 170 million shares, almost exclusively with F, earning the participants over \$335,000 in rebates. Although ETC's surveillances detected some of this activity, they did not do so in a manner that enabled ETC to uncover the potential pre-arranged trading.

Spoofing

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

33. During the Relevant Period, ETC's Market Access Customers effected hundreds of instances of apparent spoofing in numerous different securities across multiple market centers. For example, between January 19, 2010 and July 20, 2010, traders for ETC Market Access Customer A effected approximately 390 instances of potential spoofing, totaling hundreds of thousands of shares, by engaging in a trading scheme on NYSE Arca. A's traders entered non-bona fide Post No Preference ("PNP") Orders⁸ on NYSE Arca to move or anchor the NBBO by sending false or misleading signals to other market participants to induce them to purchase or sell. The traders then subsequently entered bona fide "PO+" Orders⁹ for execution at the more favorable price. Immediately upon execution of the bona fide order, the traders canceled any open non-bona fide orders and then repeated the process on the other side of the market.

⁸ PNP Orders are limit orders to buy or sell that are executed in whole or in part on NYSE Arca without routing any portion of the order to another market center.

⁹ PO+ Orders are immediately routed to the primary listing market for execution.

Gaming

34. During the Relevant Period, ETC's Market Access Customers engaged in other momentum ignition strategies, including gaming activity in dark pools and auto execution manipulation. ETC was aware of this type of conduct, yet failed to conduct adequate review and investigation in order to prevent potentially violative conduct from occurring.

35. For example, in January 2011, in five different thinly-traded (average daily trade volume less than 90,000 shares) NYSE-listed securities, traders from ETC Market Access Customer A entered non-bona fide orders on NYSE Arca and other market centers, causing the NBBO to move and triggering the NYSE Designated Market Maker's algorithm to execute against bona fide orders entered on the NYSE book by A's traders as dark interest, guaranteeing a profit for A on each transaction. Any open non-bona fide orders were then canceled by A's traders and the activity was repeated on the opposite side of the market. A's traders entered and canceled hundreds of orders in each security:

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

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

Odd-Lot Manipulation

36. Odd-lots are orders for a quantity between 1 and 99 shares. During the Relevant Period prior to June 2011, the NYSE Arca matching engine automatically executed odd-lot orders at the NBBO against the odd-lot dealer (*i.e.* market maker) in a given security.

37. During the Relevant Period, ETC was aware that some of its Market Access Customers engaged in potential odd-lot manipulation, yet the Firm failed to conduct adequate review and investigation in order to prevent potentially violative conduct from occurring. For example, beginning in March 2010, traders from ETC Market Access Customers A and C and their counterparties trading through other broker-dealers, including, at the time, non-ETC customers B, D, F and G, entered round-lot trades on one side of the market on BZX to manipulate the price of the NBBO to get favorable odd-lot executions on NYSE Arca, which auto-executed, and then repeated the process on the other side of the market. Using this scheme ETC Market Access Customer A traded over 170,000 shares and generated an estimated \$25,000 in profits, and ETC Market Access Customer C generated over \$11,000 in profits in just five symbols.

38. As set forth in paragraphs 25 through 37, even though certain Market Access Customers and their traders appeared frequently, even daily, on ETC's exception reports, and even though ETC disabled and/or restricted many individual traders, ETC did not aggregate and review trading conduct at the customer/MPID level across all authorized traders and never terminated ETC's relationship with any of its Market Access Customers due to potentially manipulative trading activity.

ETC Did Not Allocate Sufficient Resources to Supervision

39. Though they added resources over time during the Relevant Period, ETC failed to allocate sufficient resources to meet its supervisory responsibilities.

40. During the period between December 2009 and March 2011, ETC's Chief Compliance Officer ("CCO") was the only person in the Firm's compliance department and was solely responsible for reviewing its exception reports for potentially manipulative activities, as

well as investigating and responding to regulatory inquiries and all other compliance functions at the Firm.

41. In the March 2010 Gap Analysis Report that the Firm's CCO prepared and submitted to ETC's former Chief Executive Officer ("CEO"), the CCO noted that the Firm should consider whether additional compliance resources were necessary. However, a second compliance employee, AB, was not hired until March 2011, one year later.

42. Between December 2009, when ETC's CCO started at the Firm, and March 2011, when AB was hired, ETC's execution volume increased significantly from an average of 1.4 billion shares per month (approximately 69 million shares/day) to an average of 5.14 billion shares per month (approximately 248 million shares/day).

43. Even after hiring AB in March 2011, ETC needed another compliance staffer to assist with the volume of compliance work. In the March 2011 Gap Analysis Report that the Firm's CCO prepared and submitted to ETC's former CEO, the CCO noted that the Firm should consider whether additional compliance resources were necessary. However, ETC did not hire a third compliance employee until December 2012.

44. Faced with the significant quantity of trading by ETC's Market Access Customers in 2010, 2011 and 2012 (averaging almost 4.5 billion shares per month over that entire period), the thousands of authorized traders associated with those customers, the risks associated with that trading, the Firm's own WSPs, as well as notice from FINRA and the relevant SRO rules, ETC did not allocate sufficient and adequate resources to compliance.

Notice by Regulators of Potentially Manipulative Trading

45. During the Relevant Period, ETC was on notice that some of its Market Access Customers were engaging in potentially manipulative activity.

46. Beginning in 2010 and continuing throughout the Relevant Period, numerous regulators sent inquiries to the Firm regarding potentially manipulative trading conduct by its Market Access Customers. From January 2010 to October 2012, the time when ETC was developing and implementing its trade surveillance program, staff from FINRA and the SROs issued dozens of inquiries to ETC that identified numerous instances of potentially manipulative conduct by its Market Access Customers, many of which were repeatedly cited by name and/or MPID. Despite this, ETC failed to take adequate steps, such as placing these customers under heightened supervision, to address these risks.

47. ETC was also on notice that, prior to accepting them as Market Access Customers, some of its customers were higher-risk due to prior regulatory inquiry and/or discipline. Yet ETC failed to take sufficient precautions or place certain of these customers under heightened scrutiny, and in fact some of these customers later engaged in potentially manipulative trading activity:

a. For example, ETC Market Access Customer F, which ETC was aware was involved in a prior regulatory matter resolved with FINRA in October 2012 and was also the subject of regulatory inquiries sent to the Firm during the Relevant Period, started trading through ETC in October 2012.

b. Similarly, ETC Market Access Customer D, which ETC was aware was the subject of regulatory inquiries sent to the Firm during the Relevant Period, started trading through ETC in November 2012.

c. Notwithstanding this knowledge, ETC did not place Market Access Customers D or F under heightened scrutiny or restrict their trading prior to commencing executing and clearing transactions for these firms.

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

ETC's Automated Exception Reports Were Flawed and Inadequate

49. Some of the automated exception reports ETC implemented were critically flawed, either because the reports were improperly designed or because they relied on deficient parameters that were not adequately tailored to the trading of ETC's Market Access Customers.

50. A primary flaw of certain of ETC's automated exception reports is that they were designed to look at the trading activities of individual authorized traders, rather than look at the total quantity of exceptions on a customer/MPID basis. This had the effect of fragmenting customer activity and obscuring and underreporting the total amount of potentially violative trading at the customer/MPID level.

51. Some of ETC's exception reports and trade controls had deficient parameters and/or were not reasonably designed, especially given the manner of trading conducted by ETC's Market Access Customers. For example:

a. In addition to the flaws noted above, prior to February 28, 2011, ETC's wash trade report only looked at transactions with the same execution quantity rather than all executions between the same MPID or related MPIDs.

b. None of the self-trade prevention (“STP”) tools relied on by ETC appear to have been set to prevent trading between different MPIDs held by the same customer, even though a number of related ETC Market Access Customers appear to have shared MPIDs and/or held multiple MPIDs at the same time during the Relevant Period.

c. The original Trade Participation Report (“TPR”), implemented by ETC to surveil for pre-arranged trades and which was run and reviewed every two weeks, only alerted when 10% or more of the total shares traded by one authorized trader was with a single contra authorized trader, which was inadequate because each trade between two authorized traders working for the same Market Access Customer or under the same MPID constituted a potential wash trade.

d. The original TPR was shut down in or around May 2010 and a redesigned version of the TPR was implemented in September 2010. However, the parameters still were not set appropriately to detect and prevent wash trades until at least January 2011, when ETC set the report to specifically identify all trades between the same MPID. In sum, between March 2009 and January 2011, ETC failed to adequately surveil a large segment of its Market Access Customers’ trading activities for potentially violative wash trades.

e. At the time it was first implemented in March 2011, the ETC layering report captured activity with, among other factors, at least 10 or more canceled transactions and an execution of at least 1,000 shares. However, these parameters were too wide to adequately surveil for layering activity.

i. For example, on March 28, 2011, one of ETC’s Market Access Customers, K, engaged in approximately 1,000 instances of potential layering and manipulative trading in PQR and STU. However, none of this trading activity was captured on ETC’s layering

report, due largely to the fact that many of the executions were for 100 shares rather than 1,000 shares.

f. On July 5, 2011, the surveillance was changed to capture execution volumes of more than 300 shares, down from 1,000 shares, though this was still too wide. In March 2013, ETC changed the surveillance to capture execution volumes of 100 shares or more. Because the parameters were too wide for most of the Relevant Period, a significant quantity of potentially manipulative activity was not captured by ETC's Layering report.

g. During the Relevant Period, ETC implemented a restriction through at least one of its service bureaus to prevent traders from entering odd-lot orders except to offset odd-lots resulting from partial round lot executions. However, ETC later learned that there was a "bug" in this restriction that, in the instance a trader received a partial fill, the trader could then enter multiple odd-lot orders to cover the remaining amount of shares until one executed, closing out the original position. The trader could then switch positions to continue entering odd-lot traders to cover the other portion of the partial fill. Moreover, ETC did not consistently implement restrictions on odd-lot orders across all service bureaus.

h. In October 2012, ETC implemented two different reports to surveil for spoofing – one for pre-open and one for market hours. Both reports required an execution coupled with cancellations of at least 10,000 shares or \$200,000 value within a time interval of 5 minutes, and the average canceled order had to equal 2,500 shares. However, these parameters were too wide and excluded potentially manipulative conduct.

i. Marking-the-open/close involves the practice of executing transactions in a stock at or near the open of trading, or the end of the trading day, in order to affect the stock's opening/closing price. Such activity sends false signals to the market about the value of the

security. Starting in October 2011, ETC used a Mini-Manipulation Report to surveil for marking the open or marking the close activity, although that report was not adequately designed to detect such activity.

i. For example, on trade date March 10, 2011, one of ETC's Market Access Customers, L, engaged in instances of apparent marking the open in VWX that went undetected by ETC. Beginning at 9:29:29 and continuing to the time of the NYSE Amex Opening Auction, L entered short sale orders in VWX on the BZX market totalling 13,281 shares, leading to a decrease in VWX's price on the NYSE Amex from \$15.25 to as low as \$15.00 per share. At 9:36:12, L's market-on-open buy orders totalling 13,821 shares executed at a price of \$15.00 per share, generating a profit of \$1,996.05. This questionable activity was not identified or investigated by ETC.

ii. In another instance, on November 26, 2012, during the last five minutes of trading, ETC Market Access Customer M sold 13,900 shares of YZ, over 51% of the total number of shares executed in the symbol during that time period, leading to a decrease in the price on NYSE Arca Equities from \$8.26/share to \$8.12/share. This questionable activity was not identified or investigated by ETC.

ETC Did Not Conduct Adequate Follow-up and Review

52. ETC's system of follow-up and review was inconsistent, insufficient and not reasonably designed to prevent potentially manipulative activity from recurring, particularly for those Market Access Customers that relied on hundreds or thousands of foreign-based traders.

53. ETC's compliance and operations staff sometimes detected potentially manipulative conduct based on their review of ETC's exception reports and real-time monitoring, but the Firm's follow-up and review was often deficient. In certain instances, ETC

followed-up with customers about the trader(s) involved in the conduct and the strategy(ies) employed and did on a number of occasions warn, restrict and even disable traders. However, many times, ETC appeared to accept the customer's and/or trader's explanations at face value even when they did not make economic sense.

54. Moreover, ETC did not have any set criteria for when to restrict or disable a trader:

a. Certain Market Access Customers and traders were captured on ETC's Layering report repeatedly over days, weeks and months during the Relevant Period without being disabled.

b. Similarly, certain Market Access Customers and traders alerted on ETC's Multi-Venue Wash Trade report thousands of times during the Relevant Period, and yet many were not disabled.

c. ETC staff sometimes saw evidence that various traders and trader groups within and among ETC's Market Access Customers were colluding with each other with regard to their trading, and yet ETC either did not take action, or took action that was deficient.

55. Further, some of ETC's exception reports do not have any evidence of review; in other instances, the reports were reviewed significantly after T+1, the date they were supposed to be reviewed. In addition, ETC was unable to produce a significant number of surveillance reports for trade dates during the Relevant Period, including reports for wash trades and layering.

ETC's Controls Around Authorized Trader Logins Were Deficient

56. In most of the trading platforms used by ETC's Market Access Customers, authorized traders were identified by a unique login, or sometimes multiple logins. Significantly, ETC failed to establish and implement adequate controls around the assignment, sharing and

deactivation of trader logins, which hampered the Firm's ability to detect and prevent potentially manipulative trading and conduct reasonable follow-up and review. ETC's inadequate controls led to a number of problems, including: (i) enabling traders to use multiple logins to circumvent surveillance monitoring conducted at the trader login level; (ii) enabling traders to potentially have access to higher trading limits through the use of multiple logins; and (iii) enabling dozens of traders that were restricted and/or disabled being able to continue to trade through the Firm's systems.

57. The use of individual trader logins served an integral role in ETC's trade surveillance and risk management policies and procedures. However, ETC did not have any formal procedures for tracking trader logins until in or around April 2011, when the Firm started maintaining the Consolidated Trader List and conducting reviews of new traders at the request of the Chicago Board Options Exchange ("CBOE"). As ETC knew or should have known, the Consolidated Trader List contained hundreds of traders with multiple logins at the same Market Access Customer and/or different Market Access Customers, which was a red flag that the Firm did not respond to appropriately.

58. ETC also knew or should have known that some logins were used by more than one customer, sometimes by different traders, that were the source of potentially violative activities. For example, the Consolidated Trader List contained numerous logins listed with more than one customer.

59. ETC only started tracking traders it had restricted or disabled on a "Disabled Trader List" in or around May 2010. However, even though ETC was aware that previously disabled traders were sometimes re-entering its systems, the Firm did not start to cross-reference the Disabled Trader List against the Consolidated Trader List until at least July 2011.

60. ETC also knew or should have known that there were discrepancies between the Disabled Trader List and Consolidated Trader List. There were dozens of traders on the Disabled Trader List that were disabled under logins that did not appear on the Consolidated Trader List, or were disabled under a login that was associated with another individual on the Consolidated Trader List. Moreover, some of the individuals listed on the Disabled Trader List were not located on the Consolidated Trader List at all.

61. In addition, dozens of traders that appear to have been disabled and/or restricted from trading by ETC were not included on the Disabled Trader List. Moreover, the Disabled Trader List contained dozens of repeat offenders who were disabled and/or restricted from trading on more than one occasion, some under multiple logins. These deficiencies impeded ETC's ability to prevent potentially manipulative activity from recurring.

62. Even in the face of this evidence, as of the end of the Relevant Period, ETC still did not inquire about, track and/or restrict: (i) the start/end dates for each trader login; (ii) the number of logins held by each trader; (iii) whether traders held logins with other ETC Market Access Customers and/or other firms; and (iv) whether the same login was used by more than one trader and/or associated with more than one Market Access Customer/MPID. Also, ETC did not implement mechanisms to prevent associated trader logins from trading with each other.

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

63. ETC failed to ensure that it established, documented and maintained a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of its market access business activities in compliance with the Market Access Rule.

64. In particular, as described in detail above, ETC's risk management controls and supervisory procedures were not reasonably designed to prevent the entry of orders unless there was compliance with all regulatory requirements, including, specifically, monitoring for potentially manipulative trading activities in accordance with NASD Rule 3010 and FINRA Rules 2010 and 3110, and as required by SEA Rule 15c3-5(c). ETC did not timely develop and implement automated exception reports, and some of the reports they did use were flawed and deficient. In certain instances, ETC also did not conduct adequate follow-up and review of the trading activity identified by those reports.

65. ETC's risk management controls and supervisory procedures were also not reasonably designed to restrict access to its trading systems and technology to approved and authorized persons, as specifically required by SEA Rule 15c3-5(c), and ETC failed to ensure that its regulatory risk management controls and supervisory procedures were under its direct and exclusive control as specifically required by SEA Rule 15c3-5(d):

a. During the Relevant Period, both prior to and after implementation of the Market Access Rule in July 2011, ETC gave representatives of its Market Access Customers certain managerial and/or administrative permissions to its third-party service bureaus, permitting those representatives to, *inter alia*, directly change the settings for individual traders and enable and disable traders without ETC's knowledge or consent. Although ETC's WSPs specified that the Firm would ensure that only authorized personnel had access to its trading systems, and would document and preserve in its books and records the system access documentation, prior to September 2013, ETC did not specifically track which individuals were given administrative and/or managerial access to its third-party service bureaus on behalf of its Market Access Customers. ETC also did not maintain records of the risk settings used on the

trading platforms and thus could not review whether any of those settings were ever changed without their consent.

b. ETC was aware that during the Relevant Period some of ETC's Market Access Customers were misusing the administrative and/or managerial rights to the third-party trading system used by approximately 90% of ETC's Market Access Customers, including: (i) adding and removing authorized traders by going directly to the service bureau without ETC's knowledge or consent; (ii) re-enabling or unrestricting traders that were previously restricted or disabled by ETC; (iii) adding securities to ETC's Easy-to-Borrow list without authorization; and (iv) intentionally misusing functionality in the system to circumvent Reg. SHO order-marking requirements. Yet ETC did not take sufficient steps to prevent the recurrence of this misconduct.

66. In addition, ETC's risk management controls and supervisory procedures were not reasonably designed to prevent the entry of erroneous orders that exceeded appropriate price or size parameters, as required by Rule 15c3-5(c). While ETC's WSPs provided that its Clearly Erroneous ("CE") trade controls would reject or block a limit order that is more than 10% away from the last sale, ETC's risk manager stated that ETC's controls could be set to reject or block a limit order that is more than 10% away from *either* the last sale *or* the current bid/offer in the market (*i.e.* last price). The failure to define the pre-trade control for a set threshold, either from the last sale or the last price, but not both, makes the control inadequate. In fact, between January and December 2012, ETC Market Access Customers effected five pre-open executions at prices at least 10% away from the last sale at the time of order entry that were neither rejected nor blocked by ETC's systems and subsequently resulted in CE filings by the Firm.

a. For example, in one instance, ETC's systems permitted the entry of a sell order with a limit price of \$.01 on a stock that was trading at over \$9 per share.

67. In addition, because they did not employ hard blocks, ETC's risk management controls and supervisory procedures were not reasonably designed to prevent the entry of orders that exceed pre-set credit limits for each Market Access Customer, as required by Rule 15c3-5(c). In fact, ETC's own WSPs specifically state that while ETC's systems could automatically prevent an order from being accepted that would exceed pre-set credit limits, the Firm chose not to implement such a restriction.

68. Finally, ETC did not establish appropriate credit limits and/or controls for its Market Access Customers. ETC permitted some of its Market Access Customers to substantially over-allocate Day Trade Buying Power ("DTBP") to their individual traders. This practice, coupled with the lack of hard blocks and the fact that ETC's DTBP report did not accurately track the amount of equity on deposit by ETC's Market Access Customers, created a risk of a customer exceeding its credit limits.

ETC's WSPs Were Inadequate

69. During the Relevant Period, ETC's WSPs were not reasonably designed for its market access business:

a. Prior to April 2010, the Firm's WSPs failed to set forth detailed procedures on the types of automated exception reports that would be run, the frequency of review of those reports, what action was required when potentially violative conduct was identified, and how to document such reviews. Prior to September 2011, the Firm's WSPs did not include adequate controls around authorized trader logins.

b. In addition, ETC's WSPs were not reasonably designed to ensure that (i) it employed adequate pre-trade controls to prevent the entry of orders that would exceed credit limits; (ii) it employed adequate pre-trade controls to prevent the entry of erroneous orders that exceeded appropriate price or size parameters; (iii) access to its trading systems and technology was restricted to approved and authorized persons; and (iv) the Firm's regulatory risk management systems and financial controls were under ETC's direct and exclusive control at all times.

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

**Supervisory Deficiencies
NASD Rule 3010 and FINRA Rules 2010 and 3110**

71. ETC's supervisory systems and procedures were inadequate and were not reasonably designed for its market access business, as required by NASD Rule 3010 and FINRA Rule 3110. Specifically, ETC failed to (i) adequately monitor red flags and the trading of its Market Access Customers, particularly those that posed heightened risk; (ii) adequately detect and prevent potentially manipulative trades, including prompt and decisive follow-up and review and investigation; (iii) invest appropriate and sufficient resources in its supervisory technology, compliance infrastructure, and compliance staff; and (iv) ensure that all trading activities entered under the Firm's mnemonics or MPIDs complied with applicable federal securities laws and regulations and the rules of FINRA and the Exchanges. ETC also failed to supervise to ensure compliance with SEA Section 15(c)(3) and SEA Rule 15c3-5.

72. In addition, as required by NASD Rule 3010 and FINRA Rule 3110, ETC failed to establish, maintain and enforce WSPs reasonably designed for the Firm's market access business and to supervise the activities of its Market Access Customers to ensure compliance with applicable securities laws, regulations and FINRA Rules, including SEA Rule 15c3-5. Specifically, ETC's WSPs failed to: (i) set forth detailed procedures on the types of automated exception reports ETC would run, the frequency of review of those reports, what action was required when potentially violative conduct was identified, and how to document such reviews and oversight; (ii) include adequate controls around authorized trader logins; (iii) ensure that ETC employed adequate pre-trade controls to prevent the entry of orders that would exceed credit limits; and (iv) ensure that the Firm's regulatory risk management systems and financial controls were under ETC's direct and exclusive control at all times.

73. By failing to establish, implement and enforce adequate supervisory systems and procedures, including WSPs, reasonably designed to supervise its market access business and achieve compliance with the securities laws, regulations and FINRA rules, ETC violated NASD Rule 3010 (for conduct prior to December 1, 2014) and FINRA Rules 2010 and 3110 (for conduct on or after December 1, 2014).

Market Access Deficiencies
SEA Section 15(c)(3), SEA Rule 15c3-5 and FINRA Rule 2010

74. In its capacity as a provider of "market access," as the term is defined in SEA Rule 15c3-5, ETC failed to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of providing market access, as required by SEA Rule 15c3-5(b).

75. ETC also failed to ensure, as required by SEA Rule 15c3-5(c), that it had in place financial and regulatory risk management controls and supervisory procedures reasonably

designed to: (i) prevent the entry of orders that exceed appropriate pre-set credit limits or capital thresholds in the aggregate for each Market Access Customer; (ii) prevent the entry of erroneous orders by rejecting orders that exceed appropriate price or size parameters on an order-by-order basis or over a short period of time; (iii) prevent the entry of orders unless there was compliance with all regulatory requirements, including, specifically, monitoring for potentially manipulative trading activity in accordance with NASD Rule 3010 and FINRA Rules 2010 and 3110; and (iv) restrict access to its trading systems and technology to approved and authorized persons.

76. ETC also failed to ensure that its regulatory risk management controls and supervisory procedures were under its direct and exclusive control, as required by SEA Rule 15c3-5(d).

77. By failing to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory and other risks of providing market access, ETC violated SEA Section 15(c)(3) and SEA Rule 15c3-5 (for misconduct beginning July 14, 2011), and violated FINRA Rule 2010.

Just and Equitable Principles of Trade
FINRA Rule 2010

78. As described in detail above, the systemic deficiencies in ETC's supervisory systems and procedures and risk management controls enabled certain of ETC's Market Access Customers to effect potentially manipulative trades, and the tremendous volume of trading generated by these customers substantially contributed to ETC's status as a significant market access provider. ETC profited significantly, earning millions of dollars from executing securities trades on behalf of its Market Access Customers.

79. As a result of the foregoing, in the conduct of its business, ETC failed to observe high standards of commercial honor and just and equitable principles of trade, in violation of FINRA Rule 2010.

SANCTIONS

It is ordered that:

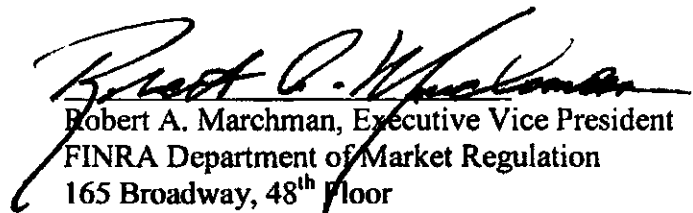
Respondent ETC be censured, fined in the total amount of **\$875,000** (to be paid collectively to FINRA, BZX, Nasdaq, and NYSE Arca, of which **\$218,750** shall be paid to FINRA). Concurrent with this Order, by entering into an AWC and agreeing to pay FINRA a separate fine of \$125,000, Respondent is also resolving related AML violations in FINRA Matter No. 20120352981, for a total fine of **\$1,000,000** for FINRA Matter Nos. 20100254756 and 20120352981. ETC shall also comply with the undertaking in accordance with the terms of the Offer.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

SO ORDERED.

FINRA Department of Market Regulation

Signed on behalf of the Director of ODA, by
delegated authority



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