FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

Department of Market Regulation, Complainant, v. Lightspeed Trading, LLC (CRD No. 35519), Respondent.	Disciplinary Proceeding No. 20130354682-01

COMPLAINT

The Department of Market Regulation alleges that:

Summary

1. From July 2011 through the present (the "relevant period"), Lightspeed Trading, LLC ("Lightspeed" or the "Firm") failed to establish, document and maintain an adequate system of risk management controls and supervisory procedures, including certain pre-trade and post-trade risk controls, to ensure compliance with applicable federal securities laws and regulations and rules of FINRA. For example, from July 2011 through November 2012, Lightspeed failed to properly monitor and supervise the activities of its customers, as well as one of its registered representatives.

2. As an introducing broker, Lightspeed was responsible for monitoring and reviewing its customers' order flow to detect and report suspicious and potentially manipulative trades, and to ensure that order flow entered by the Firm's customers complied with applicable federal securities laws and regulations and the rules of FINRA.

3. Through multiple industry-wide notices published during the relevant period, Lightspeed was on notice of its obligations and responsibilities to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access business.

4. For example, in FINRA's 2011 Priorities Letter dated February 8, 2011, FINRA noted that just as firms have a primary responsibility to supervise their associated persons and ensure that they are not involved in fraudulent schemes, firms must also be vigilant regarding their customers. The letter also noted that customer-initiated schemes can expose firms to regulatory, operational and reputational risk, and that FINRA expects firms to maintain robust supervisory systems that reasonably are designed to detect and report suspicious transactions.

5. In FINRA's 2012 Priorities Letter dated January 31, 2012, FINRA emphasized that market access providers must have post-trade surveillance procedures reasonably designed to identify various potential trading violations such as wash sales, marking, spoofing, layering, quote stuffing and manipulation related to the open and close of trading.

6. In addition, FINRA's 2013 Priorities Letter dated January 11, 2013 noted FINRA's focus on trading abuses intended to bait other market participants into trading at artificially higher or lower prices.

7. Despite the applicable rules and notices, Lightspeed failed to adequately surveil for, and prevent, potentially manipulative trading activity by its customers. In addition, Lightspeed failed to adequately supervise the activities of one of its registered representatives who had entered transactions in customer accounts, used a non-firm instant message account to conduct Lightspeed business, provided log-in information for customer accounts to persons who

had not received Firm authorization, and conducted an outside business activity without notifying the Firm.

8. The Firm also failed to enforce its supervisory procedures concerning the reporting of an outside business activity of a registered representative, and failed to review the electronic communications of that registered representative.

9. By failing to establish adequate controls and procedures, and properly monitor and supervise the foregoing activities, the Firm violated NASD Rule 3010 (for the period prior to December 1, 2014), and FINRA Rules 3110 (for conduct on and after December 1, 2014), and 2010.

10. By failing to maintain electronic communications of the previously referenced registered representative, Lightspeed thereby willfully violated Section 17(a) of the Exchange Act of 1934 and Rule 17a-4(b)(4) thereunder, and violated NASD Rules 3010(d)(3) and 3110 (for the period prior to December 5, 2011), and FINRA Rules 4511 (for conduct on and after December 5, 2011) and 2010.

11. Moreover, although the Firm had learned that a registered representative was affiliated with a previously unreported outside business activity, the Firm willfully failed to amend that person's Uniform Application for Securities Industry Registration or Transfer ("Form U4") to report the activity, thereby willfully violating FINRA By-Laws Article V, Section 2 and violating NASD Rule 3010 and FINRA Rule 2010.

Respondent and Jurisdiction

12. Lightspeed has been registered with FINRA since June 23, 1994, and its registration remains in effect. Its principal place of business is in New York, New York; the Firm also has a branch office in Chicago, Illinois.

13. At all times relevant to this Complaint, Lightspeed offered access to trading platforms, including Sterling, RealTick, Lightspeed Trader, Lightspeed Gateway, and others, to clients to trade their accounts on an unsolicited basis. Lightspeed's clients were primarily retail clients. The Firm had more than 8,000 accounts during the relevant period.

STATEMENT OF FACTS

A. The Brothers and RK

14. As alleged herein, the Firm's primary supervisory deficiencies relate to its failure to reasonably supervise trading by two customers: FTG, owned by BA, and MC, owned by BA's brother, SA (jointly referred to as the "Brothers"), who engaged in potentially manipulative activity through accounts that were serviced by RK, a registered representative formerly employed by Lightspeed.[1]

15. In October 2010, RK became a registered representative at the Firm, as a result of the Firm's acquisition of another FINRA member firm, TNF.

16. RK brought with him to Lightspeed certain customer accounts he had serviced while at TNF, including the accounts of the Brothers.

[1] RK was the subject of a Hearing Panel Decision in which he was found liable for violating FINRA Rules 8210 and 2010 for failing to respond completely to FINRA requests for information issued in connection with the investigation that led to this proceeding.

17. While he was employed by Lightspeed, RK operated from a desk he leased on one of the floors of the Chicago Stock Exchange, Inc. ("CSX"). RK's customers BA, SA, and a third customer, BG, also worked on this desk.

18. During 2011 and 2012, RK's customer accounts generated approximately $4,387,000 in commissions, and the Firm paid him approximately $1,490,000. Approximately $1,197,000 of the $1,490,000 was directly attributable to the FTG and MC accounts.

B. The "Professional" Order Type for Options

19. The FTG and MC accounts engaged in a potentially manipulative trading scheme which included the use of option orders in one account that was identified as a "customer," and option orders in the other account that was marked as "professional." By using these designations, the Brothers entered orders in a manner to artificially move the price of securities for the benefit of the Brothers' accounts.

20. Certain U.S. options exchanges, including NASDAQ PHLX LLC ("PHLX"), require option orders from the accounts of public customers (not broker-dealers) to be marked as "professional" if certain criteria are met.

21. The orders involved in this matter were routed to PHLX. Because Lightspeed was not a PHLX member, the orders were routed by the Firm, as an introducing broker, to another firm, which thereafter routed the orders to PHLX.

22. An order designated by a firm as a "professional order" is an order for the account of a person or entity that: 1) is not a broker or dealer in securities; and 2) places more than 390 orders in listed options per day — whether executed or not — on any listed options exchange on average during any calendar month of the quarter for its own beneficial accounts.

23. PHLX Rule 1000(b)(14) defines "professional orders." A professional will be treated in the same manner as an off-floor broker-dealer, except for all-or-none orders, which will generally be treated as customer orders. PHLX added the professional order designation effective April 1, 2010 to allow retail investors to have priority of orders.

24. A "customer" order entered on PHLX, with few exceptions, does not incur any transaction fees and receives higher rebates (or pays lower fees) for adding (or removing) liquidity.

25. The Brothers utilized the "professional" designation to their advantage, for it in part enabled them to perpetrate their apparent spoofing activity, as alleged herein.

C. Potentially Manipulative Spoofing Activity in the Brothers' Accounts

26. "Spoofing" is a form of market manipulation that generally involves, but is not limited to, the manipulator entering certain non-bona fide orders, with the intention of cancelling those orders once they trigger some type of market movement and/or response from other market participants, from which the market manipulator might benefit by trading certain other orders.

27. Between July 2011 and November 2012, in more than a thousand instances, the Brothers appear to have engaged in such "spoofing," using the FTG and MC accounts that accessed the PHLX through Lightspeed. This conduct also enabled the Brothers to generate rebates from PHLX options symbols eligible for such rebates, as PHLX was a "maker-taker" exchange at the time.[2]

28. More specifically, the Brothers implemented their spoofing pattern by taking advantage of Lightspeed's designation of one account as "customer," and the other account as

[2] A "maker-taker" fee model is a pricing structure in which an exchange generally pays its members a per share rebate to provide (i.e., "make") liquidity in securities, and assesses a fee on them to remove (i.e., "take") liquidity.

"professional." The designation of each account was based on the number of option orders entered in each of their accounts during the prior calendar quarter. Firm personnel were aware of the significance of the professional designation, in that they had informed FTG, MC and RK of the trading thresholds utilized for an account to be designated as "professional."

29. To effect the scheme, in many instances, the account that was designated as "customer" first placed All-Or-None ("AON") orders — undisplayed orders that must be executed in their entirety or not at all — in an option series on the PHLX market. The account that was designated as "professional" then placed orders for one options contract (a "one-lot") in the same option series, and at the same price, as the larger AON orders that had just been sent to PHLX, but on the opposite side of the market. In other instances, both the AON order and the one-lot order were placed by just one account.

30. These one-lot orders, which *were* displayed, were not bona fide orders, in that the Brothers apparently never intended for these orders to be executed. Instead, they appear to have been placed only to alter the option's series best bid or offer ("BBO") in order to induce, or "spoof," other market participants into submitting their own orders at the new BBO. Once there was sufficient volume, the orders would execute against the undisplayed AON orders. Upon execution of the AON orders, any open displayed one-lot orders placed by the Brothers were usually cancelled.

31. Because the AON orders were sent to PHLX prior to the entry of the other market participants' orders, they were deemed to have added liquidity and, therefore, generated rebates for the accounts that had placed these orders — FTG or MC (depending on the calendar quarter).

32. In each calendar quarter during the time of the Brothers' trading, the FTG and MC accounts at the Firm alternated their order activity, which ensured that the Firm would be required to designate one account as "customer," and the other account as "professional."

33. Because the account that was designated as "customer" in a given calendar quarter would have more than 390 orders in listed options per day on average during a calendar month, that account would be marked "professional" for the next calendar quarter.

34. Conversely, because the account that was designated as "professional" in a given calendar quarter would have fewer than 390 orders in listed options per day on average during a calendar month, that account would be marked "customer" for the next calendar quarter.

35. An example of the Brothers' manipulative trading strategy took place on October 15, 2012 in Ford Motor Company ("F") Nov 11 call options. At that time, during the fourth quarter of 2012, the MC account was designated as professional, and the FTG account was designated as customer.

36. Between 9:52:50[3] and 9:52:54, FTG entered 12 AON orders at a price of $0.08, each to sell 10 contracts. At the time, the national best bid and offer ("NBBO") was .07 x .09. Because these were AON orders, they were not displayed to other market participants, and therefore did not change the national best offer ("NBO").

37. These 12 AON sell orders entered by the FTG account had been entered by RK himself, using his own trading identification provided to him by the Firm for the Sterling platform.

38. Next, at 9:52:56, RK, using the same trading identification, entered a one-lot buy order in the MC account for $0.08. This order *was* displayed, and raised the National Best Bid

[3] All times referenced in this Complaint are in military time.

("NBB") from \$0.07 to \$0.08, narrowing the NBBO spread from two cents (\$.0.07 x \$0.09) to one cent (\$0.08 x \$0.09). At that one-cent spread, the bid size consisted of only one contract, reflecting the MC one-lot order.

39. Because the one-lot order was designated as "professional," it was assigned priority after customers and market makers, and therefore, largely protected against order execution, even though it had the effect of narrowing the quote.

40. Because the size of the AON orders (each for ten contracts) exceeded the size of the one-lot order, the AON orders were not executed.

41. At 9:52:59, RK, using the same trading identification, cancelled the one-lot buy order in the MC account, which lowered the NBB back to \$0.07.

42. Then at 9:56:01, RK, again using the trading identification provided to him by the Firm, entered another one-lot buy order for \$0.08 in the MC account, increasing the NBB to \$0.08. This order *was* displayed, and raised the NBB from \$0.07 to \$0.08, narrowing the NBBO spread from two cents (\$.0.07 x \$0.09) to one cent (\$0.08 x \$0.09). At that one-cent spread, the bid size consisted of only one contract, reflecting the MC one-lot order.

43. Next, between 9:56:03 and 9:56:04, six more AON sell orders at \$0.08 were entered by RK, using his own trading identification, in the FTG account, increasing the AON sell orders to 180 contracts in total.

44. At 9:56:42, other market participants joined the \$0.08 bid, and the volume added by those market participants led to the execution of FTG's 18 AON orders (totaling 180 contracts) at a price of \$0.08.

45. Because of the lower priority afforded to "professional" orders, however, the one-lot order was not executed and, at 9:56:45, the one-lot order was cancelled by RK.

46. The execution price of FTG's 180 contracts, $0.08, was $0.01 better than if the MC account had not sent in the one-lot spoofing order, for a total benefit of $180.

47. Moreover, the trading resulted in $46.80 in liquidity rebates for the FTG account ($0.26 per contract).

48. The above-described pattern of trading by FTG and MC ceased at around the time that PHLX changed its rebate program in January 2013.

D. Failure To Supervise Potentially Manipulative Activity

49. FINRA rules require that member firms maintain a system of supervision and written supervisory procedures ("WSPs") that are reasonably designed to achieve compliance with applicable securities laws and regulations.

50. As the introducing broker of the transactions placed by the Brothers and RK, Lightspeed was responsible for monitoring and reviewing its customers' order flow to detect and report suspicious and potentially manipulative trades, and to ensure that order flow entered by the Firm complied with applicable federal securities laws and regulations and the rules of FINRA.

51. Lightspeed, however, failed to establish and implement adequate supervisory systems and WSPs to monitor for potentially manipulative spoofing or suspicious trading activity.

"Red Flags" Of Potentially Improper Activity

52. Lightspeed failed to detect the potential spoofing activity effected in the Brothers' accounts, notwithstanding "red flags" that should have alerted the Firm to this activity. For example, the Firm failed to detect that one of the Brothers' accounts would enter option orders at

about the same time that the other Brothers' account entered a one-lot order on the opposite side of the market.

53. Another "red flag" was that RK used, but should not have had, a Firm log-in identification to enter orders in the Brothers' accounts even though his job function at the Firm was limited and did not include entering orders for customers. The fact that RK had entered trades in customer accounts using his own trading identification should have led the Firm to conduct closer supervision of RK.

54. Another "red flag" that should have alerted the Firm to conduct closer supervision of the Brothers' accounts was that during each calendar quarter during the time of the Brothers' trading, the FTG and MC accounts, which were among RK's largest accounts, alternated which account the Firm designated a "customer" account and a "professional" account.

55. In addition, as alleged below, individuals who did not have valid signed trading authorizations were given access to enter orders in the FTG and MC accounts.

Lightspeed Failed to Establish Adequate Supervisory Systems

56. During the time of the Brothers' trading, although the Firm had a surveillance that was designed to detect potential spoofing activity, its surveillance was limited to only one of the trading platforms used by the Firm (RealTick). Lightspeed had not implemented any system, policy or procedures to surveil for instances of potential spoofing on other trading platforms used by Lightspeed, including Sterling, the Firm platform that was used by the Brothers.

57. It was not until May 2014 that the Firm implemented a surveillance for potential instances of spoofing on the Sterling platform.

58. At least through July 1, 2014, the spoofing report that had been implemented by the Firm never detected any instances of potentially manipulative spoofing.

59. During the time of the Brothers' trading, to detect potentially manipulative spoofing, in addition to its spoofing surveillance on the RealTick platform, the Firm relied upon its Low Volume Reports, one of which identified accounts that traded 15 percent or more of a symbol's daily volume,[4] and another that reported transactions in symbols where the daily volume is under 100,000 shares and a Firm customer accounted for at least 25 percent of the volume. However, the Low Volume Reports did not surveil for activity that occurred through the Sterling trading platform until March 2013, after the time of the Brothers' trading.

60. Furthermore, the Low Volume Reports that were in place on the Firm's other trading platforms during the relevant period were not reasonably designed to detect potential instances of spoofing. Specifically, unless the trading occurred in a stock with a total daily volume of fewer than 100,000 shares, or the customer was responsible for at least 15 percent (or later, 25 percent) of a stock's or option's series daily volume, the activity did not appear on either of these reports.

61. Moreover, the Firm currently does not maintain an adequate electronic surveillance to detect when potentially manipulative spoofing activity may have been coordinated between different accounts.

<u>Lightspeed Failed to Establish Adequate WSPs</u>

62. FINRA members are required to establish, maintain, and enforce WSPs reasonably designed to achieve compliance with applicable securities laws, regulations, and exchange rules.

63. At a minimum, adequate WSPs should include: (i) the identification of the individual(s) responsible for supervision; (ii) the supervisory steps and reviews to be taken by the

[4] In November 2012, this was raised to 25 percent.

appropriate supervisory personnel; (iii) the frequency of such reviews; and (iv) how such reviews are documented.

64. During the time of the Brothers' trading, the Firm's WSPs contained a section titled "Market Manipulation" that prohibited employees from effecting "alone, or with one or more other persons, a series of transactions in any security creating actual or apparent active trading in such security or raising or depressing the price of such security for the purpose of inducing the purchase or sale of such security by others . . ." or from creating "an atmosphere or impression of false supply and demand." But, during this time the WSPs did not set forth any of the minimum requirements of supervision set forth above.

65. It was not until January 4, 2013 that the Firm's WSPs, in a document titled "Compliance Reviews," made any reference to a review to detect potential spoofing activity in a customer's account.

66. Thus, the Firm's WSPs during the relevant period failed to adequately address reviews for manipulative trading activity conducted by customers. Although the Firm accepted orders from customers, including the Brothers, the Firm's WSPs did not provide for sufficient reviews of trading activity by its customers, and did not include monitoring for potentially manipulative spoofing activity by customers. Moreover, the Firm's WSPs currently do not provide for any review for potentially manipulative spoofing activity that may be coordinated between different accounts.

<u>Lightspeed Failed to Supervise RK</u>

67. In addition to not having adequate systems to detect potentially manipulative spoofing activity, the Firm failed to adequately supervise RK.

68. Although a Firm organizational chart reflects that in 2012, RK reported to JM, a "Relationship Manager" at Lightspeed, JM's supervisory duties over RK were limited to matters such as reviewing RK's e-mail messages.

69. Another Firm organizational chart reflects that during 2013, RK reported to AW, a "VP, Institutional Sales and Trading." However, AW did not have any supervisory responsibility over RK during the relevant period.

70. Although RK, using his own trading identification, entered orders into customer accounts for whom he was the registered representative, and even though RK should not have had the ability to enter orders into customer accounts, no individual at the Firm had the responsibility of supervising orders that RK had entered into his customer's accounts.

<u>Lightspeed Failed to Supervise Transfers of Funds</u>

71. The Firm also failed to adequately supervise the transfer of funds from the FTG account.

72. During the relevant period, the Firm's WSPs for its anti-money laundering program required the monitoring for suspicious activity, through the monitoring of activity including incoming and outgoing cash activity. The procedures further stated that its manual monitoring of customer accounts includes a review of a "sufficient amount of account activity to ensure the detection of suspicious activity" by identifying patterns that are inconsistent with the customer's financial status, or fail to make economic sense.

73. Additionally, a Firm document titled "Compliance Reviews," dated January 4, 2013, required that questionable money movements result in the Firm's Relationship Manager Desk contacting the customer for an explanation of the activity.

74. To detect suspicious money transfer activity, the Firm used a report titled "30 Day Activity 5000 or More" (the "30 Day Reports") that identified transfers of at least $5,000 over the past 30 days.

75. During the period between December 11, 2012 and January 15, 2013, there were 16 withdrawals from the FTG account with "ACH" as the method of withdrawal;[5] 14 of those withdrawals were for $50,000.[6]

76. The repeated withdrawals of the same amount of funds within a short period of time was a red flag that the withdrawals may have been effected for an improper purpose, and should have required further follow-up and review.

77. However, even though these transactions were reflected on the 30 Day Reports, and that the 30 Day Reports reflect that the transfers had been reviewed, no one at the Firm ever contacted BA, who owned FTG, to inquire about the reason for these large withdrawals in a short time period.

78. Despite the frequency and amounts of the FTG withdrawals, Firm compliance personnel did not detect any issue for follow-up and review.

79. Even when an employee in the Firm's Account Services area asked RK, on December 18, 2012, why FTG had been requesting more transfers than usual during the month, and RK responded that it was because the Firm had a $50,000 limit on ACH transfers, the Firm did not seek additional information from the ultimate account holder.

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[5] ACH transfers involve the use of a clearing house, rather than a wire transfer in which funds are sent directly between financial institutions.

[6] The other two were for $47,197.61 and $43,434.07.

80. After the inquiry, through January 15, 2013, there were ten additional ACH withdrawals, nine of which were for $50,000.

81. RK's response should have enhanced the significance of the red flags attached to these withdrawals, many of which exactly matched the Firm's ACH transfer limit, and should have been brought to the attention of the Firm's anti-money laundering officer, but they were not.

Lightspeed Failed to Supervise for the Entry of Orders by Unauthorized Persons

82. In addition to the Firm's failure to adequately supervise the FTG and MC accounts to detect and prevent potentially manipulative spoofing activity, the Firm also failed to detect and prevent unauthorized individuals from being given access to trade in those accounts.

83. The Firm's WSPs dated October 3, 2011, and in effect during the relevant period, stated that the Firm "will only permit the use of limited third party discretion, when an effective Limited Trading Authorization Form is on file with the Firm . . . . Orders will not be accepted for an account from a person other than the customer without first obtaining the prior written authorization of the customer."

84. However, despite this explicit requirement, individuals who did not have signed trading authorizations, or whose trading authorizations were no longer valid, were given access to enter orders in the FTG and MC accounts.

85. In separate e-mails sent on January 3, 2012, each with the subject "New Sterling User," using the Firm's e-mail system, RK sent to four unauthorized individuals (SJ, GM, DW, and BG) user IDs and passwords for the MC account. Any written trading authorizations for the MC account that had previously been given to SJ, GM and BG had previously been cancelled, and written trading authorization for the MC account had never been given to DW.

86. Additionally, in separate e-mails sent on April 2, 2012, each with the subject "New Sterling User," using the Firm's e-mail system, RK sent to SJ, RB, BG, and GM user IDs and passwords for the FTG account. Written trading authorizations for the FTG account had never been given to BG or GM.

87. Although SJ and RB had been given written trading authorization in the FTG account on October 22, 2010, these trading authorizations were rescinded when other trading authorization forms for the same sub-accounts, dated September 28, 2011, gave trading authorization to BA.

88. Although RB, SJ, GM, and BG did not have any current trading authority, on October 2, 2012, BA sent them an e-mail message in which BA gave instructions limiting the amount of trading in the FTG account that could be effected.

89. Moreover, Firm records during the period between at least November 2011 and June 2012 show trades were entered by host names "R…-PC-1," "R…-PC-2," and "S…-PC-1," reflecting that RB and SJ may have entered orders in the MC account without having authorization from the Firm.

90. The Firm's trading records reflecting that RB and SJ may have entered orders in the MC account, where they did not have a current trading authorization, together with BA's October 2, 2012 e-mail, which shows that RB, SJ, GM and BG were given directions regarding the FTG account, and RK's e-mail messages providing user IDs and passwords for the FTG and MC accounts, were all "red flags" to the Firm that unauthorized individuals were effecting transactions in those accounts.

91. Despite these red flags, the Firm failed to properly supervise the trading in the FTG and MC accounts so as to detect and prevent unauthorized persons from trading in those accounts.

Lightspeed Failed to Supervise Wash Transactions

92. The Firm's systems also were not adequate to detect and prevent wash transactions. Although the Firm's systems blocked wash trades that were effected within a sub-account, it did not block two different sub-accounts within the same master account from trading with each other.

93. Additionally, when wash trades were detected, the Firm's actions were inadequate, as further alleged below.

Wash Trades in the RK Account

94. In an e-mail message to RK sent on March 11, 2013, CH, an employee in the Firm's compliance department, asked about three sets of wash trades that had occurred in RK's account at the Firm on March 8, 2013. In a responsive e-mail message on March 12, 2013, RK stated that the orders had been entered at an incorrect price.

95. The very next day after CH sent the e-mail message to RK about wash trades, in an e-mail message to RK sent on March 12, 2013, CH asked about two other sets of wash trades that had occurred in RK's account on March 11, 2013. In a responsive e-mail message on March 12, 2013, RK again stated that the orders had been entered at an incorrect price.

96. In an e-mail message to RK sent on April 5, 2013, CH asked about another set of wash trades that had occurred in RK's account at the Firm on April 4, 2013. The e-mail message stated that a failure by RK to take steps to prevent future wash transactions could result in a revocation of trading privileges and a closing of his account. In a responsive e-mail message on

April 8, 2013, RK stated that the "client" had entered an order at an incorrect price, and that the "client" is taking precautions to avoid it in the future.[7]

97. Despite this warning, another wash trade in the RK account again was detected by the Firm for trading on August 16, 2013. On or about August 20, 2013, RK was informed by the Firm that future incidents would result in trading limitations.

Wash Trades in the MC Account

98. In e-mail messages to RK sent on March 8, 2013, and to both RK and SA on March 11, 2013, CH asked about one set of wash trades that had occurred on March 7, 2013 between two sub-accounts of the MC account. In an e-mail message on March 12, 2013, RK responded that the client had "entered [the] order in one subaccount vs another subaccount in error."

99. In an e-mail message to SA and RK sent on April 8, 2013, CH asked about four sets of wash trades that had occurred on April 5, 2013 in the MC account. In a responsive e-mail message on April 9, 2013, SA stated that "[o]ne of the 2 separate strategies running in one of the two sub accounts sent an order at an incorrect price . . . ."

100. Then, in an e-mail message to SA and RK sent on April 19, 2013, CH asked about one set of wash trades that had occurred on April 18, 2013 between the same two sub-accounts of the MC account. In an e-mail message on April 24, 2013, SA responded that "one of the 2 separate strategies running in one of the two sub accounts sent an order at an incorrect price."

101. On June 27, 2013, in response to a letter from FINRA staff ("Staff") inquiring what corrective action was taken by the Firm in response to the identification of wash sales between MC sub-accounts on March 7, 2013, April 5, 2013, and April 18, 2013, the Firm stated

[7] In a later e-mail message on that date, RK confirmed that this was his own personal account.

that "[n]o specific corrective action was taken other than to educate the client of the issue and to obtain an explanation for the activity."

102. Thereafter, the Firm again a detected wash trade that had occurred in the MC account on July 22, 2013. At about that time, CH informed RK that further incidents would likely result in either the closure of the account, or closing all of the sub-accounts and allowing only a single account to trade.

103. Subsequently, the Firm detected another wash trade that had occurred in the MC account on August 13, 2013. Instead of following up with the client about the wash trades, the Firm only noted that it would "continue to monitor. Has not been on reports (seldom)."[8]

104. The Firm's follow-up after detecting repeated wash trades was not adequate. In the MC account (which had previously engaged in potentially manipulative trading activity), where there were wash trades on five dates during the period between March 7, 2013 and August 13, 2013, and in RK's account, where there were wash trades on four dates during the period between March 8, 2013 and August 16, 2013, the Firm did not take any action, other than ask for explanations and warn against further wash trades.

E. <u>Willful Failure To File An Amended Form U4</u>

105. Article V, Section 2(c) of FINRA's By-Laws requires that every application for registration be kept current by supplementary amendments. Specifically, Amended Forms U4 must be filed within 30 days of learning the facts or circumstances giving rise to the amendment.

106. The Firm's WSPs dated October 3, 2011 stated that the Firm's Chief Compliance Officer ("CCO"), or his designee, is responsible for the supervision of "Associate Outside

[8] In addition to these transactions, the Firm detected a wash transaction in the FTG account on June 3, 2013.

Business Activities." The WSPs further stated that the CCO will notify the Firm's Registration department if any outside business activity is required to be disclosed on the Form U4.

107. In a June 7, 2012 e-mail message from KP, the Firm's CCO, RK was asked about his involvement in an entity named GBF, which, according to KP's e-mail to RK, had not been disclosed to Firm in accordance with FINRA Rule 3270.

108. In a responsive message, RK stated that he was a member of GBF, a company that had been recently formed, and that it "provides import/export financial solutions for its clients."

109. Although the Firm had become aware that RK was associated with GBF, it willfully failed to amend RK's Form U4 to report this material fact within 30 days of being notified. In fact, at no time did the Firm amend RK's Form U4 to report his association with GBF.

110. Lightspeed should have reasonably known that it was required to make the disclosure reporting RK's association with GBF.

111. By failing to disclose RK's association with GBF, the Firm failed to enforce its own WSPs, which required that the CCO notify the Firm's Registration department if any outside business activity is required to be disclosed on the Form U4.

F. <u>Failure To Retain And Supervise Electronic Communications</u>

112. In a letter dated May 29, 2013, Staff requested that the Firm produce all of RK's "retained communications" between RK and BA for the period since February 1, 2010, and between RK and SA from December 27, 2010; the request specifically included instant messages ("IMs"). Although the Firm produced responsive e-mail messages, it did not produce any IMs.

113. Thereafter, in a letter dated February 19, 2014, Staff requested that the Firm produce copies of all "retained communications" for RK, including telephone calls and IMs, for the years 2012 and 2013. Although the Firm produced e-mail messages, it again did not produce any IMs.

114. Thereafter, in a letter dated July 10, 2014, Staff requested that the Firm produce all IMs between AW, an employee in the Firm's Institutional Sales and Trading area, and RK. In response, the Firm produced more than 1,000 IMs; the files show that they were archived by the Firm as AW's communications, with the person on the other side as "rk4."

115. "Rk4" was RK's personal IM identification. The Firm had never provided RK with an IM user name.

116. Based on the volume of IMs between AW and RK, many of which were business-related, and all of which had been captured by the Firm through AW's Firm-issued IM user name, the Firm should have been aware that RK was using IMs for business purposes, and retained those communications.

117. The Firm failed to adequately capture and retain the electronic communications of RK, and failed to review those communications in accordance with applicable regulatory rules and Firm procedures.

FIRST CAUSE OF ACTION
Supervisory Failures
(Violations of NASD Rule 3010(a), 3010(b)(1) and FINRA Rules 3110(a), 3110(b)(1) and 2010)

118. The Department of Market Regulation realleges and incorporates by reference all preceding paragraphs.

119. Prior to December 1, 2014, NASD Rules 3010(a) and 3010(b)(1) required each member firm to establish, maintain, and enforce written procedures to supervise the types of

business in which it was engaged and to supervise the activities of registered representatives, registered principals, and other associated persons that were reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of FINRA. Firms were also required to establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations.

120. As of December 1, 2014, FINRA Rules 3110(a) and 3110(b)(1) imposed the same requirements.

121. FINRA Rule 2010 requires that member firms, in the conduct of their business, observe high standards of commercial honor and just and equitable principles of trade.

122. As alleged above, Lightspeed failed to establish a system of reasonable supervision, including adequate WSPs, in that it failed to have sufficient procedures for the review of orders entered by Firm customers, and failed to maintain systems to surveil for potentially manipulative trading activity.

123. Additionally, as set forth above, Lightspeed failed to enforce the Firm's supervisory procedures, including its procedures pertaining to outside business activities and adherence to the Firm's electronic communications policy.

124. Lightspeed also failed to establish and maintain the required systems to supervise the activities of its registered representatives, registered principals, and other associated persons, including but not limited to RK, notwithstanding red flags suggesting closer supervision was warranted. These red flags include that RK was entering orders into customer accounts, suspicious trading activity in those accounts, that RK had sent account user identification and passwords to persons that did not have Limited Trading Authorization Forms on file at the Firm,

that RK's own account and that of one of his customers had repeatedly engaged in wash trades, and that an account of RK had engaged in repeated withdrawals of the same amount of money within a short period of time.

125. Moreover, although the Firm's WSPs required that its CCO notify the Firm's Registration department if any outside business activity is required to be disclosed on the Form U4, by failing to disclose a person's outside business activity, the Firm failed to follow its supervisory procedures to notify its Registration department that a Form U4 was required to be filed.

126. The Firm's WSPs dated October 3, 2011 state that the CCO or designee is responsible for the supervision of the electronic communication review process. The WSPs further require that the Firm retain records of business communications in accordance with the rule requirements of regulators.

127. The WSPs further state that the use of IMs subjects those communications to review by the Firm, and requires the Firm to retain such messages. They also state that employees are not permitted to use IMs to conduct the Firm's business, except for departments or personnel specifically authorized. Electronic communications with customers and/or the public are permitted only through company-sponsored or alternative approved facilities.

128. By failing to review its registered representative's electronic communications, Lightspeed failed to adequately supervise its registered representative's electronic communications.

129. As a result of these supervisory deficiencies, the orders entered by customers of Lightspeed had the potential to adversely impact the integrity of the market and cause potential harm to other market participants.

130. As a result of the foregoing, Lightspeed violated NASD Rules 3010(a) and 3010(b)(1) (for the period prior to December 1, 2014), and FINRA Rules 3110(a) and 3110(b)(1) (for conduct on and after December 1, 2014), and 2010.

SECOND CAUSE OF ACTION
Failure to Make and Preserve Books and Records
(Willful Violations of Section 17(a) of the Exchange Act and Rule 17a-4 thereunder, and Violations of NASD Rules 3010(d)(3) and 3110, and FINRA Rules 4511 and 2010)

131. The Department of Market Regulation realleges and incorporates by reference all preceding paragraphs.

132. For conduct prior to December 5, 2011, NASD Rule 3010(d)(3) required members to retain correspondence of registered representatives relating to its securities business in accordance with NASD Rule 3110, which in turn required the retention of records in accordance with SEC Rule 17a-4.

133. For conduct on or after December 5, 2011, FINRA Rule 4511(a) requires that members "make and preserve books and records as required under the FINRA rules, the Exchange Act and the applicable Exchange Act rules." FINRA Rule 4511(c) requires that "books and records required to be made pursuant to the FINRA rules shall be preserved in a format and media that complies with [Exchange Act] Rule 17a-4."

134. Specifically, SEC Rule 17a-4(b)(4) requires that copies of communications received and sent by the member, broker or dealer (including inter-office memoranda and communications) relating to its business be preserved for a period of not less than three years.

135. A Lightspeed registered representative was using a non-firm IM account to conduct Lightspeed business. The Firm was or should have been aware of such use. The Firm did not preserve records of these communications.

136. By so doing, Lightspeed failed to adequately make and preserve electronic business records, and thereby willfully violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder, and also violated NASD Rules 3010(d)(3) and 3110 (for the period prior to December 5, 2011), and FINRA Rules 4511 (for conduct on and after December 5, 2011) and 2010.

THIRD CAUSE OF ACTION
Willful Failure to File Amended Form U4
(Willful violation of FINRA By-Laws Article V, Section 2
and violation of FINRA Rule 2010)

137. The Department of Market Regulation realleges and incorporates by reference all preceding paragraphs.

138. FINRA By-Laws Article V, Section 2(c) requires that every application for registration be kept current by supplementary amendments. Amended Forms U4 must be filed within 30 days of learning the facts or circumstances giving rise to the amendment, including disclosures of any outside business activity.

139. FINRA Rule 3270 states that no registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member.

140. Although the Firm learned that a registered representative was affiliated with a previously unreported outside business activity, the Firm willfully failed to amend that person's Form U4 to report the activity.

141. As a result, Lightspeed willfully violated FINRA By-Laws Article V, Section 2(c) and violated FINRA Rule 2010.

RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

A. make findings of facts and conclusions of law that Respondent committed the violations charged and alleged;

B. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed;

C. make specific findings that Lightspeed willfully violated Section 17(a) of the Exchange Act and Rule 17a-4 thereunder;

D. make specific findings that Lightspeed's conduct, as alleged in the Third Cause of Action, was willful; the omitted information was material; and the omission to state material facts was on a Form U4 application;

E. order that the Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330; and

F. grant all further relief, legal or equitable, that is warranted under the circumstances.

FINRA DEPARTMENT OF MARKET REGULATION

Date: 2/28/2017

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