

CBOE BZX EXCHANGE, INC.
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013036836006

TO: Cboe BZX Exchange, Inc.
c/o Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Instinet, LLC, Respondent
Broker-Dealer
CRD No. 7897

Pursuant to Rule 8.3 of the Rules of Cboe BZX Exchange, Inc. ("BZX" or the "Exchange"), Instinet, LLC ("INCA" or the "Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, BZX will not bring any future actions against the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of BZX, or to which BZX is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by BZX:

BACKGROUND

1. The Firm has been a broker-dealer registered with the Securities and Exchange Commission (the "Commission") since April 25, 1979, and registered with BZX since August 18, 2008. Its registrations remain in effect. The Firm, among other things, provides market access and execution services to institutional market participants ("Market Access Clients") for a wide variety of products. In or about February 2007, INCA was acquired by Nomura Holdings, Inc., which shifted the majority of its global equities execution business to INCA in December 2012.
2. The Firm does not have a relevant disciplinary history.

SUMMARY

3. In Matter 20130376217, the Trading Analysis Section ("Trading Analysis") of FINRA's Department of Market Regulation ("Market Regulation") reviewed potential layering, spoofing, and wash trades by the Firm's Market Access Clients

STAR No. 20130368360 (incl. merged STAR Nos. 20130376217, 20130382620, 20130384257, 20130386900, 20130395417, 20140399233, 20140402026, 20140416803, 20140422166, 20140430948, 20140435161, 20140436283, 20150451541, 20150463006, 20150463452, 20150481875, 20150482156, 20160502382, 20160504175, 20160509709, 20160514500, 20160521544, 20160525489, 20160526107, 20170543142, 20170545607, 20170551643, 20170554299, 20170555223, 20170561010, 20160485810, and 20160512438) (MWB)

from July 17, 2013 through May 29, 2015, and the Firm's compliance with Rule 15c3-5 of the Securities Exchange Act of 1934 ("SEA") (the "Market Access Rule").¹

4. In Matter No. 20150463452, the Market Manipulation Investigations Group of Market Regulation reviewed the Firm's layering and spoofing surveillances and exception reports in effect from April 2015 through April 2016, and the Firm's compliance with the Market Access Rule.
5. In Matter No. 20140399233, the Exchange-Traded Product Surveillance and Investigations Group ("ETP") of the Quality of Markets Section ("Quality of Markets") of Market Regulation reviewed pre-arranged trading by the Firm in August 2013 and the Firm's compliance with the Market Access Rule.
6. In Matter No. 20140436283, the Market Analysis Section ("Market Analysis") of Quality of Markets reviewed the Firm's duplicative order controls from July 1, 2013 through September 30, 2013, and the Firm's compliance with the Market Access Rule.
7. In Matter 20140422166, Market Analysis reviewed the Firm's compliance with Rule 611 of Regulation National Market System ("Reg NMS") from July 25, 2011 through May 31, 2012, and the Firm's compliance with the Market Access Rule.
8. In Matter No. 20130386900, the Options Regulation Section ("Options Regulation") of Market Regulation reviewed potential options layering and spoofing activity entered by the Firm on BZX in June 2012, and the Firm's compliance with the Market Access Rule.
9. In Matter No. 20150463006, Market Analysis reviewed a Clearly Erroneous Execution ("CEE") petition filed on February 1, 2016; the Firm's pre-set credit and capital thresholds; the Firm's duplicative order controls; and the Firm's compliance with the Market Access Rule.
10. In Matter No. 20160525489, ETP reviewed numerous potentially erroneous orders entered by the Firm on February 23, 2016, and the Firm's compliance with the Market Access Rule.
11. In Matter No. 20160509709, Options Regulation reviewed messaging activity by the Firm on March 30 and 31, 2016, and the Firm's compliance with the Market Access Rule.

¹ The SEC adopted Rule 15c3-5 effective January 14, 2011. See 17 C.F.R. § 240.15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792 (Nov. 15, 2010) (Final Rule Release).

12. In Matter No. 20150482156, Trading Analysis reviewed the Firm's procedures, systems, and controls related to potential layering, pre-opening spoofing, intraday spoofing, and wash trades in place from January 1, 2015 through May 31, 2017, and the Firm's compliance with the Market Access Rule.
13. The above matters were part of investigations conducted by Market Regulation on behalf of the Exchange and other self-regulatory organizations, including The NASDAQ Stock Market LLC; NASDAQ BX, Inc.; The NASDAQ Options Market LLC; Nasdaq PHLX LLC; Cboe BYX Exchange, Inc. ("BYX"); Cboe EDGA Exchange, Inc. ("EDGA"); Cboe EDGX Exchange, Inc. ("EDGX"); Investors Exchange LLC; NYSE Arca Options, Inc.; NYSE Arca Equities, Inc.; the New York Stock Exchange LLC; NYSE American Equities LLC; NYSE American Options LLC; BOX Options Exchange LLC; and FINRA (collectively, the "SROs"), to review the Firm's compliance with the Market Access Rule and the supervisory rules of the SROs, including BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2, during the period of August 2012 through at least November 2017 (the "Review Period").
14. As a result of Market Regulation's investigations, it was determined that, during the Review Period, INCA failed to establish, document, and maintain a system of risk management controls and supervisory procedures, including written supervisory procedures ("WSPs") and an adequate system of follow-up and review, reasonably designed to manage the financial, regulatory, and other risks of its market access business.
15. Specifically, during the Review Period, the Firm:
 - a. failed to have adequate risk management controls and supervisory procedures reasonably designed to systematically limit its financial exposure and prevent the entry of orders that exceeded appropriate pre-set credit or capital thresholds in violation of SEA Rules 15c3-5(b) and (c)(1)(i), and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3;
 - b. failed to have adequate risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous or duplicative orders and messaging resulting from malfunctioning software programs or trading systems in violation of SEA Rules 15c3-5(b) and (c)(1)(ii), and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3;
 - c. failed to establish, maintain, and preserve an adequate written description of its risk management controls and supervisory procedures in violation of SEA Rule 15c3-5(b) and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3;
 - d. failed to have adequate risk management controls and supervisory procedures reasonably designed to detect and prevent potentially violative layering,

spoofing, wash trading, and pre-arranged trading in violation of SEA Rules 15c3-5(b), (c)(2), and (c)(2)(iii), and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3;

- e. failed to have adequate pre-trade risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements of Rule 611(c) of Reg NMS in violation of SEA Rules 15c3-5(b), (c)(2), and (c)(2)(i), and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3;
- f. failed to ensure that its financial and regulatory risk management controls and supervisory procedures were under its direct and exclusive control in violation of SEA Rule 15c3-5(d) and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3; and
- g. failed to establish, document, and maintain a reasonably designed system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required by paragraphs (b) and (c) of SEA Rule 15c3-5, to assure the overall effectiveness of the Firm's risk management controls and supervisory procedures, in violation of SEA Rules 15c3-5(b) and (e)(1), and BZX Rules 3.1, 3.2, 5.1, 5.2, and 5.3.

FACTS AND VIOLATIVE CONDUCT

Applicable Rules

- 16. During the Review Period, SEA Rule 15c3-5(b) required broker-dealers that provide market access 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 their market access business.²
- 17. During the Review Period, SEA Rule 15c3-5(c)(1)(i) specifically required market access broker-dealers to have financial risk management controls and supervisory procedures reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each client and the broker-dealer.
- 18. During the Review Period, SEA Rule 15c3-5(c)(1)(ii) specifically required market access broker-dealers to have financial risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.

² Rule 15c3-5 requires that, as gatekeepers to the financial markets, broker-dealers providing market access must "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." 75 Fed. Reg. at 69792.

19. During the Review Period, SEA Rule 15c3-5(c)(2) required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements to, among other things, prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis and restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the market access broker-dealer.
20. During the Review Period, SEA Rule 15c3-5(c)(2)(i) specifically required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis.
21. During the Review Period, SEA Rule 15c3-5(c)(2)(iii) specifically required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker or dealer.
22. During the Review Period, SEA Rule 15c3-5(d) required that the financial and regulatory risk management controls and supervisory procedures as set forth in the Market Access Rule to be under the direct and exclusive control of the market access broker-dealer.
23. During the Review Period, SEA Rule 15c3-5(e) required market access broker-dealers “to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls . . . and for promptly addressing any issues.”³ This provision is intended to ensure that a broker-dealer “implements supervisory review mechanisms to support the effectiveness of its risk management controls and supervisory procedures on an ongoing basis.”⁴ Moreover, market access broker-dealers are required to adjust their controls and procedures “to help assure their continued effectiveness in light of any changes in the broker-dealer’s business or weaknesses that have been revealed.”⁵
24. SEA Rule 15c3-5 requires, among other things, that a broker-dealer with market access document its system of risk management controls and supervisory procedures that are designed to manage the financial, regulatory, and other risks of market access. The broker-dealer must preserve a copy of its supervisory procedures and “a written description of its risk management controls” as part of

³ 17 C.F.R. § 240.15c3-5(e).

⁴ 75 Fed. Reg. at 69811.

⁵ *Id.*

its books and records for the time period required by SEC Rule 17a-4(e)(7).⁶ The required written description is intended, among other things, to assist Commission and SRO staff to assess the broker-dealer's compliance with the rule.⁷

25. During the Review Period, BZX Rules 5.1, 5.2, and 5.3 required, among other things, that each member firm establish, maintain, and enforce written procedures to enable it to properly supervise the activities of associated persons to assure compliance with applicable securities laws and regulations, and BZX Rules.
26. During the Review Period, BZX Rule 3.1 provided that member firms, in the conduct of their business, shall observe high standards of commercial honor and just and equitable principles of trade.
27. During the Review Period, BZX Rule 3.2 provided that no member firm shall engage in conduct in violation of the SEA, or the rules or regulations thereunder and that every member firm shall supervise persons associated with the Member as to assure compliance with those requirements.

Inadequate Supervision of Customer Trading

Access to Trading Systems

28. Pursuant to INCA's written "Know Your Customer" procedures, when opening a new account, the New Account Sales Supervisor is required to obtain certain account information, complete a New Account form and confirm, in writing, the names of persons authorized to trade the account. However, from January 2013 through December 2013, INCA failed to enforce this procedure.
29. Specifically, for the account of two of its Market Access Clients, INCA only pre-approved and authorized the principals of the client. INCA failed to pre-approve the individual traders utilizing INCA's MPID to access the market through the clients and, therefore, did not know the identity of the underlying trader.
30. In addition, because INCA did not know the identity of the underlying traders, it had no means of verifying its Market Access Client's representation that a particular trader had been truly terminated or whether a disabled trader had been given a new trader ID for the client to access U.S. markets via INCA's systems after the trader had been terminated.
31. Accordingly, the Firm failed to have risk management controls and supervisory procedures to restrict access to trading systems and technology that provide

⁶ See 17 C.F.R. § 240.15c3-5(b) (emphasis added). Rule 17a-4(e)(7) requires a broker-dealer to maintain and preserve such description "until three years after the termination of the use of" the document. See 17 C.F.R. § 240.17a-4(e)(7).

⁷ 75 Fed. Reg. at 69812.

market access to persons and accounts pre-approved and authorized by the broker-dealer.

32. The acts, practices, and conduct described above in paragraphs 28 through 31 constituted violations of SEA Rules 15c3-5(b) and (c)(2)(iii), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Wash Trading

33. During the Review Period, INCA had two systemic controls to detect potential wash trading by its customers: (i) a system operated by its parent company, Nomura Securities International; and (ii) its own proprietary alert system.
34. However, INCA was unable to determine if the noted exceptions were valid for the Market Access Clients noted above. Specifically, for those Market Access Clients, INCA did not know the identity of the underlying trader utilizing its MPID and, therefore, was unable to determine if the same trader was on both sides of a transaction or if one trader was using multiple trader IDs to engage in wash trading.
35. As a result, INCA relied on its Market Access Clients to determine if beneficial ownership had changed during the relevant trade and report the occurrence of wash trading. However, INCA took wholly inadequate steps to follow-up with the Market Access Clients to verify that beneficial ownership had changed when a wash trade exception was detected.
36. The acts, practices, and conduct described above in paragraphs 33 through 35 constituted violations of SEA Rules 15c3-5(b) and (c), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Equities Layering⁸ and Spoofing⁹

37. During the Review Period, INCA employed a proprietary alert system to detect potential layering and spoofing by its Market Access Clients. For certain Market Access Clients that previously had accounts with Nomura, INCA also relied upon a third-party surveillance operated by Nomura.
38. However, INCA's proprietary alert system improperly excluded potential instances of layering or spoofing where a market participant enters and cancels a series of orders that improve the National Best Bid ("NBB") or National Best Offer ("NBO"), ignoring a significant number of non-bona fide orders entered as part of a potential layering or spoofing strategy.
39. For exceptions detected by INCA's proprietary alert system, INCA's Compliance Department reviewed a sample and, where it was determined to be necessary, forwarded the exception to the relevant business side supervisor for follow-up with the client.
40. However, there were several deficiencies with INCA's follow-up and review of exceptions flagged by its proprietary surveillance systems. INCA's WSPs failed to describe the steps to be taken in addressing an exception. Specifically, INCA's WSPs: (i) did not describe the business side supervisor's role in the review of layering exceptions; (ii) failed to document the steps requiring the suspicious alerts to be sent to the business supervisor or describe the business supervisor's responsibility when receiving the client's response; (iii) failed to provide guidance in conducting sampling; (iv) failed to outline that the business side supervisor will investigate the alerts beyond any initial determinations by Compliance; and (v) failed to state where documentation of any such review will be maintained.
41. There were no WSPs to address exceptions detected by Nomura's third-party surveillance system. In the absence of any written guidance, INCA personnel engaged in an undocumented process whereby Nomura's Compliance Department would forward layering exception reports to the Firm's Compliance Department

⁸ "Layering" is a form of market manipulation that typically includes placement of multiple limit orders on one side of the market at various price levels that are intended to create the appearance of a change in the levels of supply and demand. In some instances, layering involves placing multiple limit orders at the same or varying prices across multiple exchanges or other trading venues. An order is then executed on the opposite side of the market and most, if not all, of the multiple limit orders are immediately cancelled. The purpose of the multiple limit orders that are subsequently cancelled is to induce, or trick, other market participants to enter orders due to the appearance of interest created by the orders such that the trader is able to receive a more favorable execution on the opposite side of the market.

⁹ "Spoofing" is a manipulative trading tactic designed to induce other market participants into executing trades. Spoofing is a form of market manipulation that generally involves, but is not limited to, the market manipulator placing an order or orders with the intention of cancelling the order or orders once they have triggered some type of market movement and/or response from other market participants, from which the market manipulator might benefit by trading on the opposite side of the market.

and the relevant business-side desk supervisor to follow-up with the relevant Market Access Client. The business-side desk supervisor would review any explanation or information provided by the relevant Market Access Client with Compliance and take any further necessary action. The business-side desk supervisor and the Firm's Compliance Department failed to take adequate action to review the explanations provided by the relevant Market Access Client.

42. As a result, six Market Access Clients were allowed to engage in potential layering and spoofing unabated despite regularly appearing on INCA's and Nomura's exception reports.
43. For example, from April 2013 through December 2013,¹⁰ a Market Access Client of INCA generated approximately 694 layering and spoofing exceptions on Nomura's third-party surveillance.
44. Likewise, from January 2013 to on or about October 22, 2013,¹¹ another Market Access Client generated approximately 6,288 layering and spoofing alerts on INCA's proprietary surveillance system. During this time period, all INCA clients, in total, generated approximately 10,107 layering and spoofing alerts. Thus, the Market Access Client was responsible for approximately 60% of all INCA's layering and spoofing alerts.
45. The acts, practices, and conduct described above in paragraphs 37 through 44 constituted violations of SEA Rules 15c3-5(b) and (c)(2), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Spoofing the Open by INCA's Market Access Clients

46. During the Review Period, INCA had procedures and controls to detect potential instances of spoofing prior to the open. Beginning in January 2014, INCA had an exception report that identified any instance in which a customer placed an order and cancelled the order prior to 9:30 a.m., where the cancellation quantity exceeded 5% of the security's 30-day average daily volume ("ADV").
47. However, in certain instances when an exception was triggered, INCA failed to conduct an adequate follow up and review.
48. For example, from April 7, 2015 through June 29, 2016, a Market Access Client of INCA generated approximately 279 pre-opening spoofing exceptions. Despite the number of exceptions, INCA failed to take adequate steps to address this Market Access Client's pre-opening activity.

¹⁰ INCA terminated the account on December 31, 2013.

¹¹ INCA terminated the account on October 22, 2013.

49. The acts, practices, and conduct described above in paragraphs 46 through 48 constituted violations of SEA Rules 15c3-5(b) and (c)(2), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Options Layering and Spoofing

50. INCA did not have WSPs or a system or control to address layering and spoofing on an options exchange until April 2014. In April 2014, INCA implemented a third-party system to surveil for potential manipulative options activity including layering and spoofing.
51. The third-party system was programmed to identify instances in which a Market Access Client creates a layer of multiple orders on the bid or ask side, and then shortly after, trades significant volume on the opposite side of the market, and then shortly after removes all, or most of the layered orders.
52. However, the parameters employed by the Firm were unreasonable. Specifically, the number of non-bona fide layering orders needed to trigger an alert was unduly high. In addition, the parameters improperly excluded instances where a market participant enters and cancels a series of orders that improve the NBB or NBO, ignoring a significant number of non-bona fide orders entered as part of a potential layering or spoofing strategy.
53. The acts, practices, and conduct described above in paragraphs 50 through 52 constituted violations of SEA Rules 15c3-5(b) and (c), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Unusual Price/Volume Activity

54. Staff reviewed potential prearranged trading during July – August, 2013 by a Market Access Client, who entered orders in illiquid securities at unusual high or low prices.
55. During the Review Period, INCA did not have any surveillance reports or reviews, such as an ADTV filter, specifically designed to detect unusual price and/or volume activity in thinly traded securities that could be indicative of manipulative trading, such as prearranged trading.
56. The acts, practices, and conduct described above in paragraphs 54 and 55 constituted violations of SEA Rules 15c3-5(b) and (c), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Inadequate Credit Thresholds

57. During the Review Period, INCA established the following credit limit thresholds tier system for its clients.¹²

<u>Tier</u>	<u>Credit Limit</u>
A	\$25,000,000,000
B	\$5,000,000,000
C	\$1,250,000,000
D	\$500,000,000
E	\$250,000,000
F	\$75,000,000

58. In assigning appropriate credit thresholds, broker-dealers providing market access must conduct appropriate due diligence as to the Market Access Client's business, financial condition, trading patterns, and other matters, and document that decision.
59. In assigning existing clients to a credit tier, INCA's procedures required it to analyze each client's historical trading data beginning from the time when the client was on-boarded by INCA or an affiliate. The data used encompassed: (1) the number of years the client has been a Firm client; (2) the amount of capital or assets under management; (3) whether the client has traded at the upper-end of credit limits; (4) the average notional value traded by the client; (5) the type of trading/trading strategy used by the client; (6) products traded by the client; and (7) the settlement profile of the client.
60. The tiers established by the Firm, however, are unreasonable in that they are too large and have significant gaps between certain tiers.
61. Moreover, INCA failed to document and retain all of the information it relied upon when making credit limit determinations for its Market Access Clients. As a result, it was unable to evidence that the due diligence required by its procedures was conducted when it assigned the credit limits to its Market Access Clients.
62. As a result, the Firm could not confirm whether the client's business, financial condition, and trading patterns warranted the initial credit limit assigned to its Market Access Clients or any subsequent increases to such credit limit.
63. The acts, practices, and conduct described above in paragraphs 57 through 62 constituted violations of SEA Rules 15c3-5(b) and (c)(1)(i), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

¹² Tier E was added during the Review Period.

Inadequate Pre-Trade Controls for Erroneous Orders

64. Despite the various pre-trade controls and filters designed to prevent the entry of erroneous orders that the Firm had in place during the Review Period, as described below, the Firm failed to implement reasonable pre-trade risk management controls as applied to orders submitted by certain Market Access Clients. Further, the Firm failed to establish and implement reasonable supervisory procedures designed to prevent the entry of erroneous orders during the Review Period, as set forth below.
65. Because INCA's pre-trade controls were unreasonable, as applied to certain Market Access Clients, it failed to prevent the transmission of 64 erroneous equity orders to the SROs and to the Exchange, resulting in the filing of 11 CEE petitions.
66. INCA's pre-trade controls were unreasonable as applied to certain Market Access Clients as set forth below.

February 1, 2016

67. INCA has four independent controls to prevent the entry of erroneous or duplicative orders: (i) a single order quantity ("SOQ") control with a default 4,000,000 share maximum; (ii) a single order notional value ("SOV") control with a default \$30,000,000 maximum; (iii) a duplicative order control with a default limit of 1,000 duplicative orders over the course of the trading day;¹³ and (iv) a price deviation check.
68. INCA's price deviation check was as follows: (i) 75% for securities priced up to \$1.99; (ii) 30% for securities priced between \$2.00 and \$4.99; (iii) 10% for securities priced at \$5.00 and higher;¹⁴ and (iv) 5% or more away from first execution on smart routed orders.
69. INCA's price deviation controls were too high to be effective for certain securities.
70. The SOQ and SOV control limits are customizable for each client. New clients, however, are initially set at the default parameters, with changes for pre-existing clients based on the given client's "historical trading profile." During the Review Period, 28% of INCA's clients had customized SOV control parameters of which 16% are set above the default, with parameters between \$35 million and \$700 million. In addition, approximately 3% of its clients had customized SOQ control

¹³ Duplicative checks are against each order's symbol, side, size, and price.

¹⁴ According to INCA, these price deviations are compared to the security's last sale at the time of order receipt.

parameters during the Review Period. Of these, 2.21% had an SOQ setting of less than the 4 million share default, and 1.11% had a setting of between 5 and 15 million shares.

71. INCA's SOQ and SOV controls were unreasonable in that the parameters were overbroad and did not consider the individual trading characteristics of the relevant security, as they employ a fixed parameter (*i.e.*, share quantity and hard dollar value) across all securities. In addition, the SOQ and SOV default parameters assigned by INCA were set too high to be effective.
72. For example, on February 1, 2016, an INCA Market Access Client submitted several short sale orders (totaling 10,800 shares) in DEF¹⁵ with limit prices between \$22.48 and \$23.01 to INCA's smart order router. INCA's Market Access Client informed INCA that its trader intended to sell at \$27.50, but instead hit sell down to \$22. The NBB at the time of the orders was \$27.53. The smart order router routed the orders to BZX and another exchange. INCA received executions on 7,505 shares at prices between \$22.50 and \$23.60.
73. INCA filed a CEE petition with BZX and the other exchange and all trades executed at or below \$23.58 were cancelled.
74. The Market Access Client responsible for this activity had the following customized control limits: (i) an SOQ of 100,000 shares maximum; (ii) an SOV of \$2,000,000; and (iii) price deviation of 20% for securities priced below \$25.00.
75. The erroneous order would not have been prevented by INCA's default SOQ, SOV, or price deviation controls, which, as noted above, were unreasonable. Moreover, the erroneous order was not prevented by the customized controls applied to this Market Access Client, which were set unduly high.
76. The acts, practices, and conduct described above in paragraphs 64 through 75 constituted violations of SEA Rules 15c3-5(b) and (c)(1)(ii), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

February 23, 2016

77. On February 23, 2016, from 09:54 through 12:50, INCA submitted 50 unique orders to BZX that exceeded BZX's On-Exchange Market Access ("OEMA") Price Collar threshold in 39 different symbols, generating an OEMA alert.¹⁶
78. The orders were from 51% up to 2,303% away from the National Best Bid and Offer ("NBBO").

¹⁵ A generic modifier has been used in place of the name of this security.

¹⁶ The OEMA alert identifies instances in which an individual equity order priced through the NBBO is entered.

79. The following is a sample of 11 of the orders:

TIME	SECURITY ¹⁷	B/S	ORDER PX.	NBB/NBO	% AWAY
11:31:56.845	GHI	B	\$209.55	\$8.72	2303%
12:49:19.903	JKL	B	\$115.56	\$6.41	1703%
12:39:38.004	JKL	B	\$33.68	\$6.39	427%
11:22:02.046	GHI	B	\$33.07	\$8.64	283%
11:24:01.879	GHI	B	\$33.07	\$8.66	282%
11:42:00.184	GHI	B	\$33.06	\$8.74	382%
09:54:54.975	MNO	B	\$26.58	\$7.73	244%
12:29:38.004	PQR	S	\$7.69	\$57.06	87%
11:49:45.175	PQR	S	\$13.96	\$57.39	76%
11:49:41.175	JKL	B	\$11.13	\$6.39	74%
11:09:40.829	PQR	S	\$15.38	\$57.57	73%

80. The 11 orders set forth above ranged in size from 14 to 100 shares and received executions either at prices at the NBB, when executed in full against resting liquidity on BZX, or at prices better than the NBB, when executed against non-displayed liquidity resting on BZX.
81. The orders were entered by a Market Access Client of the Firm using a third party algorithm from a provider, which also provided the Firm with risk management tools and technology for this Market Access Client.
82. On or about February 23, 2016, the third party provider initiated an upgrade to its trading and surveillance systems. The upgrade caused a coding error that resulted in orders sent to BZX being assigned the price of the preceding order, regardless of whether the preceding order was for the same security (*e.g.*, an order in security MNO was assigned the limit price from the previous order in security GHI). As a result, the order was priced significantly away from the NBB/NBO.
83. In addition, the coding error caused the third party's surveillance to use an incorrect reference price in assessing the percentage an order was away from the NBB/NBO. As a result, certain limit prices, which would have been rejected had the correct reference price been used, were not rejected by the third party's surveillance price deviation control.
84. INCA was unaware of the infrastructure upgrade, as it did not have direct and exclusive control of the systemic risk management controls of the third party provider. As a result, the Firm was unaware of the resulting errors and the failure of the third party provider's systemic risk management controls. The Firm only became aware of the erroneous orders when notified by the Exchange.

¹⁷ A generic modifier has been used in place of the name of these securities.

85. The acts, practices, and conduct described above in paragraphs 77 through 84 constituted violations of SEA Rules 15c3-5(b), (c)(1)(ii), and (d), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Inadequate Pre-Trade Controls for Erroneous Messaging Activity

86. On March 30 and 31, 2016, INCA sent a total of 53,381 order messages to BZX, BYX, EDGA, and EDGX in 19 different one-second periods. Its quoting activity accounted for an average of 99.50% of all order messages sent by all members of these four exchanges during the one-second windows noted and, on average, 28.77% of the total order messages it submitted for the entire day in the subject symbols. Nevertheless, INCA only executed four trades.
87. For example, in 14 instances on March 30, 2016, INCA entered bids on BZX priced equal to the NBO that were designated as post only. As such, the orders were generally not eligible to route to away market centers. In accordance with BZX Rule 11.9(g)(1),¹⁸ the bids were changed one minimum price variation below the current NBO and posted to BZX. Within a millisecond of the price change, INCA deleted the change priced bid and re-entered a new bid for a different amount at the original price. INCA would then enter a new bid and, within a millisecond of posting, delete the posting and re-enter a new bid at the original price. The pattern would continue at alternating amounts. In each instance, INCA sent more than 1,000 messages per second, but only received four executions.
88. The messaging described above was the result of a programming error by its Market Access Client's third-party vendor algorithm.
89. During the Review Period, INCA failed to have reasonably designed risk management controls, including message rate controls, to detect or prevent, among other things, high levels of erroneous message traffic on the SROs that resulted from malfunctioning algorithms, software programs or trading systems used by its Market Access Clients.
90. In addition, INCA's control pertaining to duplicative orders was too narrow in that it required such orders to be entered consecutively with the same details.
91. As a result, the message activity on March 30-31, 2016, was not rejected.

¹⁸ BZX Rule 11.9(g)(1) states: "[a]n order eligible for display by the Exchange that, at the time of entry, would create a violation of Rule 610(d) of Regulation NMS by locking or crossing a Protected Quotation of an external market will be ranked at the locking price in the BZX Book and displayed by the System at one minimum price variation below the current NBO (for bids) or to one minimum price variation above the current National Best Bid ('NBB') (for offers) ('display-price sliding')."

92. The acts, practices, and conduct described above in paragraphs 86 through 91 constituted violations of SEA Rules 15c3-5(b) and (c), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Failure to Retain Direct and Exclusive Control of Risk Management Controls and Procedures

93. From July 25, 2011 through May 31, 2012, a non-broker-dealer Market Access Client of INCA directed approximately 30,000 Intermarket Sweep Orders (“ISOs”) each day to various exchanges, including BZX using INCA’s MPID.
94. INCA had a price deviation risk control based on the percentage away from the NBBO (if available) and the percentage away from the last sale, or the security’s opening price or prior day’s closing price (in that order of priority), if the NBBO was not available. In addition, INCA had financial and regulatory pre-trade risk controls before orders are routed to an exchange under its MPID. Finally, in routing ISOs, INCA’s Market Data System (“IMDS”) consolidates and processes quote information from direct market center feeds and the UTP Securities Information Processor (“SIP”) feed to determine the best protected price. INCA’s proprietary smart order router utilizes IMDS for ISO routing decisions.
95. However, INCA permitted the above-mentioned non-broker-dealer Market Access Client to make ISO decisions based on that client’s own market data processing. To review the client’s activity, INCA sampled only nine ISOs initiated by the Market Access Client from three trading days each month and received daily emails with statistical percentage of potential trade-throughs from the client’s Compliance Department.
96. INCA’s controls and supervisory systems related to the Market Access Client’s ISO trading were unreasonable. First, INCA’s review of its Market Access Client’s ISO trading was limited to a post trade sampling of nine out of more than approximately 750,000 ISOs a month. Second, INCA relied on its Market Access Client’s controls, for which it did not retain control, to ensure that all the necessary requirements have been met before submitting ISOs.
97. The acts, practices, and conduct described above in paragraphs 93 through 96 constituted violations of SEA Rules 15c3-5(b), (c)(2)(i), and (d), and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Inadequate Periodic Reviews of the Firm’s Risk Management Controls

98. During the Review Period, INCA conducted an annual review of its risk management controls in which it compared each independent financial risk management control (*Aggregate Credit, SOV, SOQ, Price Validation, and Duplicative Orders*) against historical trade data to determine whether established parameters for its risk management controls were appropriate.

99. In conducting its annual review, INCA failed to adequately assess the overall effectiveness of its risk management controls and supervisory procedures required by SEA Rule 15c3-5.

Aggregate Credit

100. INCA analyzed pre-set credit limit thresholds by first determining how many clients had year to date “*max notional values*” (or “Largest NV order”) higher than the default credit limit (\$75,000,000), and then measured how many clients had come within a given percentage of hitting the default. In doing so, INCA utilized a client’s largest volume trade date in the prior year to determine whether assigned pre-set credit limits are appropriate, which could substantially overestimate a client’s ordinary trading activity and render INCA’s review of the appropriateness of its aggregate credit limits moot.
101. In addition, INCA only reviews client credit limits for those clients set above the Tier F default (\$75,000,000). However, approximately 80% of INCA’s clients have credit limits set at or below the Tier F default level. Thus, INCA only reviews the appropriateness of 20% of its clients’ credit limits annually.

SOV

102. INCA did not review its clients’ custom SOV parameter, despite the fact that 28% of INCA’s clients had a custom SOV parameter.
103. In addition, INCA looked at the top 5,000 orders in terms of notional value from the previous calendar year, which limited its analysis, as only 187 of its clients (approximately 12%) were responsible for the 5,000 largest orders and trade in higher notional values than other clients. Analyzing its default SOV parameter against trading for a small percentage of clients is an inadequate measure as these clients trade in higher notional values than the majority of Firm clients.
104. Finally, in its 2014 review of 2013 trading activity, only 474 of the 5,000 orders reviewed (9.48%) belonged to clients whose SOV parameters were set to the default parameter, with only one order falling within 75% of the default. The review was inadequate to support INCA’s default SOV parameter. Specifically, only a small percentage of large orders are being used to determine the adequacy of this default limit. Moreover, less than .22% of these orders¹⁹ came within 75% of the default limit, demonstrating that the default parameters were too high.

¹⁹ One of 474 orders belonging to clients set at the default \$40,000,000 SOV (calculated as $1/474 = 0.002109$ or 0.21%).

SOQ

105. Approximately 96.68% of clients are set to the default SOQ parameter of 4,000,000 shares. In its 2014 review of 2013 trade data related to the adequacy of its SOQ parameter, INCA determined that the top 5,000 orders in terms of size had an average size of 169,400 shares and belonged to clients with the default parameter. INCA's review further disclosed that no orders came within 75% of the default parameter and only one order within 50% of the default.
106. The fact that only one of 5,000 orders came within 50% of the SOQ default parameter of 4,000,000 shares demonstrates that the parameter is too high to be effective. Nevertheless, INCA did not lower such parameter.

Price Validation and Duplicative Orders

107. For its 2014 review of price validation and duplicative orders, INCA only analyzed the number of price rejects within a set one-year period, as well as the number of duplicative orders within a nine-month period to determine whether these controls corresponding parameters were appropriate.
108. This review was unreasonable. Limiting the analysis to the number of rejects attributed to each control parameter does not support the overall reasonableness of such parameters. In conducting its review, INCA should have included additional data points such as limit prices of orders received away from the market.
109. The acts, practices, and conduct described above in paragraphs 98 through 108 constituted violations of SEA Rule 15c3-5(e) and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

Failure to Maintain a Complete Record of its Risk Management Controls and Supervisory Procedures

110. Broker-dealers must maintain a complete record of its risk management controls and supervisory procedures to assist the Commission and SRO staff during examinations for SEA Rule 15c3-5 compliance.
111. During the Review Period, INCA failed to maintain a complete record of its risk management controls and supervisory procedures. For example, INCA's erroneous and duplicative order controls solely reflect the default parameters and omit the fact that the control parameters are customizable. As a result, Market Regulation had to piece together INCA's supervisory procedures and risk management controls, unnecessarily complicating and delaying its review.
112. The acts, practices, and conduct described above in paragraph 111 constituted violations of SEA Rule 15c3-5(b) and BZX Rules 5.1, 5.2, 5.3, 3.1, and 3.2.

B. The Firm also consents to the imposition of the following sanctions:

1. A censure;
2. A fine in the amount of \$1,575,000 of which \$169,100 is payable to BZX;²⁰ and
3. An undertaking requiring the Firm to address the Market Access Rule deficiencies described in this AWC and to ensure that it has implemented controls and procedures that are reasonably designed to achieve compliance with the rules and regulations cited herein.
 - a. Within 90 days of the date of the issuance of this AWC, INCA shall submit to the COMPLIANCE ASSISTANT, DEPARTMENT OF ENFORCEMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a written report, certified by a senior management Firm executive, to MarketRegulationComp@finra.org that provides the following information:
 - (i) a reference to this matter;
 - (ii) a representation that the Firm has addressed the deficiencies described above; and
 - (iii) the date this was completed.
 - b. Between 90 and 120 days after the submission of the written report, the Firm shall submit a supplemental written report to FINRA to provide an update on the effectiveness of the enhancements and changes made by the Firm to its risk management controls and procedures as describe above.
 - c. The Department of Enforcement may, upon a showing of good cause and in its sole discretion, extend the time for compliance with these provisions.
4. Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between INCA and each of the following self-regulatory organizations: The NASDAQ Stock Market LLC; NASDAQ BX, Inc.; The NASDAQ Options Market LLC; Nasdaq PHLX LLC; Cboe BYX Exchange, Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX Exchange, Inc.; Investors Exchange LLC; NYSE Arca Options, Inc.; NYSE Arca Equities, Inc.; the New York Stock Exchange LLC; NYSE American Equities LLC; NYSE American Options LLC; BOX Options Exchange LLC; and FINRA.

The Firm agrees to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. It has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

²⁰ The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.4.

The Firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

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

II.

WAIVER OF PROCEDURAL RIGHTS

The Firm specifically and voluntarily waives the following rights granted under BZX Rules:

- A. To have a Statement of Charges issued specifying the allegations against the Firm;
- B. To be notified of the Statement of Charges and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a Hearing Panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the Appeals Committee of the BZX's Board of Directors and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Regulatory Officer ("CRO"), in connection with the CRO's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of BZX Rule 8.16, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The Firm understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the CRO, pursuant to BZX Rule 8.3;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
 - 1. This AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by BZX or any other regulator against the Firm;

2. This AWC will be published on a website maintained by BZX in accordance with BZX Rule 8.18. In addition, this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record; and
 3. The Firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of BZX, or to which BZX is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which BZX is not a party.
- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by BZX, nor does it reflect the views of BZX or its staff.

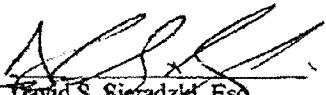
The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

2/1/18
Date


Respondent
Instinet, LLC

By: Faron Webb
Name: Faron Webb
Title: General Counsel

Reviewed by:


David S. Sieradzki, Esq.
Schulte Roth & Zabel LLP
1152 Fifteenth Street, NW Suite 850
Washington, DC 20005

2/28/2018
Date


Greg Hoogasian
Senior Vice President & Chief Regulatory Officer
Cboe BZX Exchange, Inc.

ELECTION OF PAYMENT FORM

The Firm intends to pay the fine proposed in the attached Letter of Acceptance, Waiver and Consent by the following method (check one):

☐ A Firm check or bank check for the full amount

☒ Wire transfer

Respectfully submitted,

Respondent

Instinet, LLC

2/1/18
Date

By: Faron Webb

Name: Faron Webb

Title: General Counsel