

BATS BZX EXCHANGE, INC.
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20120347730-03

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

RE: Interactive Brokers LLC, Respondent
Broker-Dealer
CRD No. 36418

Pursuant to Rule 8.3 of the Rules of Bats BZX Exchange, Inc. ("BZX" or the "Exchange"), Interactive Brokers LLC ("IBKR" 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

IBKR is a Connecticut limited liability company with its principal place of business located in Greenwich, Connecticut. The Firm acts as an agency broker-dealer, providing market access, execution, and clearing services to market participants ("Market Access Customers") for a wide variety of electronically traded products, including stocks, options, futures, forex, bonds, and funds worldwide.

The Firm has been registered with BZX since August 18, 2008, and with FINRA since January 6, 1995, and its registrations remain in effect.

RELEVANT PRIOR DISCIPLINARY HISTORY

1. In April 2013 the Firm was fined a total of \$82,500 and issued an undertaking in two related matters for its failure to adequately supervise customer trading for potentially manipulative activity, including wash sales, pre-arranged trades and marking-the-close, during the periods of December 1, 2009 through May 17, 2010, and October 8, 2010 through March 18, 2011, in violation of NASD Rule

3010, FINRA Rule 2010, and NASDAQ Rules 2110 and 3010. *See* FINRA Matter No. 20100234784 (April 5, 2013)(Firm fined \$57,500); *and* NASDAQ Matter No. 20110274228 (April 5, 2013)(Firm fined \$25,000).

SUMMARY

2. In Matter No. 20140399418, the Trading and Financial Compliance Examination (“TFCE”) Section (formerly TMMS) of FINRA’s Department of Market Regulation (“Market Regulation”) conducted reviews of Clearly Erroneous Executions (“CEEs”) during 2014, and the Firm’s compliance with Rule 15c3-5 of the Securities Exchange Act of 1934 (“SEA”) (the “Market Access Rule”).¹
3. In Matter No. 20130392978, the Chicago Equities Section of Market Regulation conducted reviews of potentially violative or manipulative trading activity by IBKR customers that occurred on the Exchange between August 1, 2013 and July 30, 2015, and the Firm’s compliance with the Market Access Rule.
4. In Matter No. 20140407291, the Chicago Equities Section of Market Regulation conducted reviews of potentially violative or manipulative trading activity by IBKR customers that occurred on the Exchange between July 1, 2013 and December 31, 2015, and the Firm’s compliance with the Market Access Rule.
5. The above matters, as well as Matter No. 20120347730, were part of investigations conducted by Market Regulation, on behalf of the Exchange and other self-regulatory organizations, including Bats EDGA Exchange, Inc., Bats EDGX Exchange, Inc., NASDAQ Stock Market LLC, and NYSE Arca, Inc. (“NYSE Arca”) (collectively, the “SROs”), that reviewed 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, and 3.1, during the period of July 1, 2013 through at least January 31, 2016 (the “Review Period”).
6. As a result of Market Regulation’s investigations, it was determined that, during the Review Period, IBKR failed to establish, document, and maintain a system of risk management controls and supervisory procedures, including written supervisory procedures and an adequate system of follow-up and review, reasonably designed to manage the financial, regulatory, and other risks of its market access business.
7. Specifically, from January 1, 2014 through at least January 31, 2016, the Firm failed to establish, document, and maintain a system of 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, in

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

violation of SEA Rules 15c3-5(b) and (c)(1)(ii), and BZX Rules 5.1, 5.2, 5.3, and 3.1.

8. In addition, from July 1, 2013 through at least December 31, 2015, the Firm failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements, including supervising customer trading to detect and prevent potentially violative and manipulative activity, in violation of SEA Rules 15c3-5(b) and (c)(2), and BZX Rules 5.1, 5.2, 5.3, and 3.1.

FACTS AND VIOLATIVE CONDUCT

9. 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
10. 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.
11. During the Review Period, SEA Rule 15c3-5(c)(2) specifically required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements.
12. 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 its books and records for the time period required by SEC Rule 17a-4(e)(7) (emphasis added).³ The required written description is intended, among other things, to assist SEC and SRO staff to assess the broker-dealer's compliance with the rule. Exchange Act Release No. 34-63241, 75 Fed. Reg. 69792, 69812 (Nov. 15, 2010).

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." 17 C.F.R. § 240.15c3-5, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010).

³ See 17 C.F.R. § 240.15c3-5(b). 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).

13. 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 ensure compliance with applicable securities laws and regulations and BZX Rules.
14. 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.

IBKR Systems

15. During the Review Period, IBKR was a significant market access provider, acting as the gateway to U.S. securities markets and executing nearly 1 million trades per day for its Market Access Customers.
16. During the Review Period, all IBKR customer orders were entered into the Firm's gateway to the Firm's order management and routing systems, which applied certain rate-limit filters to all incoming orders. The orders were then checked against a number of credit and capital criteria, and if the orders passed these criteria, they were sent to the Firm's order routing system.
17. The order routing system applied certain pre-trade controls prior to routing an order to a market center, including price, size/quantity, and anti-wash-trade controls. The order routing system then routed customer orders to the appropriate market center(s) via the Firm's exchange gateways, which applied an additional layer of filters, including price, size/quantity and rate limits.⁴

Pre-Trade Erroneous Order Controls

Pre-trade Price Controls

18. Although the Firm implemented a number of pre-trade price controls to prevent the entry of erroneous orders during the Review Period,⁵ IBKR's pre-trade price controls were inadequate.
19. There were several primary deficiencies in IBKR's pre-trade price controls. First, prior to April 2014, IBKR did not have any pre-trade price control for orders entered outside of regular market hours when typically there is no last sale or NBBO to use as a reference price. In addition, prior to November 2014 there

⁴ The exchange gateways also prevent the entry of orders that exceed a maximum gross value of all orders they expect to execute on a particular market based on historical transaction levels.

⁵ The controls were designed to cap orders to a price within a certain percentage or distance of the current market, i.e., generally, the last sale and/or National Best Bid and Offer ("NBBO").

were gaps in the application of the Firm's pre-trade price controls outside of regular trading hours.

20. Second, the Firm's pre-trade price controls as designed did not reasonably prevent, on an order by order basis, the entry of erroneous orders to the market. IBKR's pre-trade price controls re-price or "cap" limit orders to prices that are within a certain percentage of the current market or prior close based upon defined parameters⁶ and submit such orders to an Exchange or ATS. However, the Firm did not provide a mechanism by which to ensure that a re-priced or capped order fit within a customer's intended limit price, by confirming with the customer whether the new price of the order was intended or acceptable and thus was not erroneous. As a result, IBKR's pre-trade price controls still permitted certain potentially erroneous orders to enter the market.

Pre-trade Size Controls

21. In November 2012, the Firm implemented pre-trade size controls to prevent the entry of erroneous orders, which included an order size filter. However, during the Review Period, prior to August 2016, these pre-trade size controls were inadequate as the parameters for the order size filter were too wide to effectively prevent erroneously entered orders for securities that were not actively traded as the controls failed to take into account the individual characteristic of the securities, such as the average daily trade volume ("ADTV").

Written Supervisory Procedures for Erroneous Orders

22. In addition, prior to at least December 31, 2014, the Firm's written supervisory procedures failed to provide for the supervisory steps and reviews to be taken by the appropriate supervisor when conducting reviews of the Firm's pre-trade price or size controls to prevent the entry of erroneous orders.
23. The acts, practices, and conduct described above in paragraphs 15 through 22 constitute violations of SEA Rules 15c3-5(b) and (c)(1)(ii), and BZX Rules 5.1, 5.2, 5.3, and 3.1.

Supervision of Customer Trading

24. Although at various points during the Review Period IBKR implemented a series of post-trade surveillance reports and reviews to monitor customer trading activity to detect and prevent potentially violative or manipulative trading activity, including for wash trades, pre-arranged trading, layering⁷ or spoofing,⁸ marking

⁶ IBKR's pre-trade price controls do not re-price or cap orders to prices that are inferior to the limit price the customer entered.

⁷ Layering is a manipulative trading tactic designed to induce other market participants into executing trades at artificial prices. Layering generally involves, but is not limited to, a form of market manipulation in which multiple,

the close, insider trading, and MOC/LOC activity, IBKR failed to adequately supervise its customers' trading to detect and prevent certain kinds of potentially violative activity over a span of approximately two and one-half years.

25. There were several identified deficiencies with certain of IBKR's surveillance reports and reviews. To begin with, prior to July 30, 2015, the Firm had no specific, dedicated surveillance reports or reviews specifically designed to detect unusual patterns of cancellations, including spoofing or layering. For example, between August 2013 and October 2014, potentially violative spoofing activity was identified to have occurred in 10 symbols over 9 trade dates involving a combination of illiquid securities, execution prices away from the NBBO, odd-lot orders and executions, and round-trips that left the initial buyer flat.⁹ IBKR failed to detect this potentially violative activity.
26. In addition, as of December 31, 2015, the Firm 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 which could be indicative of manipulative trading. For example, Staff reviewed 32 instances of potential pre-arranged trading between an IBKR customer located in China and two customers of another broker-dealer in 5 symbols on 4 trade dates in July and August 2013. The trades appeared coordinated, with IBKR's customer consistently entering hidden orders in illiquid securities during the post-core trading session, at unusually high or low prices outside the ranges observed during core sessions, in close proximity with orders entered by the other participants. IBKR's systems did not detect this activity.
27. Finally, as of December 31, 2015, the Firm's marking the close surveillance was deficient. IBKR's surveillance detected executions in thinly traded stocks within the last 20 minutes of a security's close over rolling periods of days. However, because the surveillance was designed to detect only patterns of potential marking activity and was not designed to also capture instances of such activity on key individual trade dates (*e.g.*, month-end, quarter-end, year-end, etc.), IBKR's surveillance was inadequate.

non-bona fide limit orders are entered on one side of the market at various price levels in order to create the appearance of a change in the levels of supply and demand, thereby artificially moving the price of the security. An order is then executed on the opposite side of the market at the artificially created price, and the non-bona fide orders are immediately cancelled. The activity is often then repeated on the opposite side of the market.

⁸ Spoofing is also a manipulative trading tactic designed to induce other market participants into executing trades at artificial prices. Spoofing generally involves, but is not limited to, a form of market manipulation that involves the market manipulator placing non-bona fide orders with the intention of cancelling those orders once they have triggered some type of market movement and/or response from other market participants, from which the market manipulator might briefly benefit by trading bona fide orders.

⁹ Because the Exchange lacked jurisdiction over the individual persons or entities responsible for the underlying trading activity, Staff referred all of the conduct to the SEC for further review.

28. The acts, practices, and conduct described above in paragraphs 24 through 27 constitute violations of SEA Rules 15c3-5(b) and (c)(2), and BZX Rules 5.1, 5.2, 5.3, and 3.1.

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

1. A censure;
2. A fine in the amount of \$450,000, of which \$40,000 is payable to BZX;¹⁰ 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 this AWC, IBKR shall submit to the COMPLIANCE ASSISTANT, LEGAL SECTION, MARKET REGULATION DEPARTMENT, 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. The Department of Market Regulation 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 IBKR and each of the following self-regulatory organizations: Bats EDGA Exchange, Inc., Bats EDGX Exchange, Inc., NASDAQ Stock Market LLC, and NYSE Arca.

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.

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.

¹⁰ The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.4.

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 it;
- 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 prejudice 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.

03/22/2017
Date

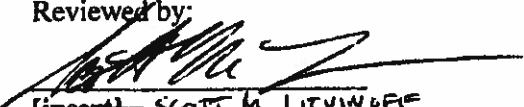
Interactive Brokers LLC, Respondent

By: 

Name: SCOTT M. LITVINOFF

Title: Chief Regulatory Counsel &
Associate General Counsel

Reviewed by:


~~(insert)~~ SCOTT M. LITVINOFF
Counsel for Respondent

5/17/2017
Date


Greg Hoogasian
Senior Vice President & Chief Regulatory Officer
Bats 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; or
- Wire transfer.

03/22/2017
Date

Respectfully submitted,
Respondent Interactive Brokers LLC

By: 

Name: SCOTT M. LITVINOFF

Title: Chief Regulatory Counsel &
Associate General Counsel