

BATS EDGA EXCHANGE, INC.
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20120347730-04

TO: Bats EDGA 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 EDGA Exchange, Inc. ("EDGA"), 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, EDGA 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 EDGA, or to which EDGA 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 EDGA:

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 EDGA since May 25, 2010, and with FINRA since January 6, 1995, and its registrations remain in effect.

RELEVANT PRIOR DISCIPLINARY HISTORY

- I. 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. 20130358268, 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 2013, and the Firm’s compliance with Securities Exchange Act of 1934 (“SEA”) (the “Market Access Rule”).¹
3. In Matter No. 20140399418, the TFCE Section of Market Regulation conducted reviews of CEEs during 2014, and the Firm’s compliance with the Market Access Rule.
4. 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 BZX 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 EDGA Rules 5.1, 5.2, 5.3, and 3.1, during the period of January 1, 2013 through at least January 31, 2016 (the “Review Period”)
5. 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.
6. Specifically, from January 1, 2013 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 violation of SEA Rules 15c3-5(b) and (c)(1)(ii), and EDGA Rules 5.1, 5.2, 5.3, and 3.1.

FACTS AND VIOLATIVE CONDUCT

7. 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

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).

management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of their market access business.²

8. 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.
9. 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).
10. During the Review Period, EDGA 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 EDGA Rules.
11. During the Review Period, EDGA 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

12. 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.
13. 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.

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).

14. 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

15. 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.
16. 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 were gaps in the application of the Firm's pre-trade price controls outside of regular trading hours.
17. 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

18. 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

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").

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.

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

19. 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.
20. The acts, practices, and conduct described above in paragraphs 12 through 19 constitute violations of SEA Rules 15c3-5(b) and (c)(1)(ii), and EDGA 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 \$12,500 is payable to EDGA;⁷ 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-

⁷ The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.4.

regulatory organizations: Bats BZX 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 EDGA.

II.

WAIVER OF PROCEDURAL RIGHTS

The Firm specifically and voluntarily waives the following rights granted under EDGA 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 EDGA'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 EDGA 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 EDGA 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 EDGA or any other regulator against the Firm;
2. This AWC will be published on a website maintained by EDGA in accordance with EDGA 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 EDGA, or to which EDGA 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 EDGA 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 EDGA, nor does it reflect the views of EDGA or its staff.

[continued on next page]

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: 

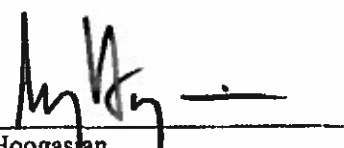
Name: SCOTT M LITVINOFF

Title: Chief Regulatory Counsel &
Associate General Counsel

Reviewed by:


Counsel for Respondent

5/17/2017
Date


Greg Hoogasian
Senior Vice President & Chief Regulatory Officer
Bats EDGA 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;

03/22/2017
Date

Respectfully submitted,
Respondent Interactive Brokers LLC

By: 

Name: Scott M. Litvinoff

Title: Chief Regulatory Counsel &
Associate General Counsel