



DISCIPLINARY DECISION

Cboe BZX Exchange, Inc.

Star No. 2015045755516/File No. USRI-7313

Douglas A. Sanzone

Pursuant to Exchange Rule 8.3, attached to and incorporated as part of this Decision is a Letter of Consent.

Applicable Rule(s)

- BZX Rules 3.1 – Business Conduct of Members and 5.1 – Written Procedures

Sanction

- A bar in all capacities.

Effective Date

June 5, 2020

/s/ Greg Hoogasian

Greg Hoogasian, CRO, SVP

Cboe BZX Exchange, Inc.
LETTER OF CONSENT
Star No. 2015045755516
File No. USRI-7313

In the Matter of:

Douglas A. Sanzone
Block 2, Apt. 15 Triq Il Mediterran
Valletta 1723, Malta

Respondent.

Pursuant to the provisions of Cboe BZX Exchange, Inc. ("BZX" or the "Exchange") Rule 8.3, Douglas A. Sanzone ("Sanzone" or "Respondent") submits this Letter of Consent for the purposes of proposing a settlement of the alleged rule violations described below.

Respondent neither admits nor denies the allegations for Star No. 2015045755516/File No. USRI-7313, and the stipulation of facts and findings described herein do not constitute such an admission.

BACKGROUND

1. Respondent entered the securities industry in 1988. In July 2011, Sanzone and several business partners founded Bayes Capital LLC (CRD No. 159644) ("Bayes" or the "firm"), which became a Registered Broker-Dealer and was a Member of the Exchange starting on January 15, 2015. Respondent registered with the Exchange as, *inter alia*, a General Securities Principal ("GP") at Bayes on January 15, 2015. Bayes filed a Uniform Request for Broker-Dealer Withdrawal (Form BDW) on May 4, 2018, and its registration with the Exchange was terminated on July 12, 2018. On July 2, 2018, the firm filed a Form U5 on behalf of Respondent, which terminated all of his registrations with the Exchange effective that date.
2. Respondent is not currently employed in the securities industry and is not registered or associated with any Member of the Exchange. He remains subject to the jurisdiction of the Exchange pursuant to BZX Rule 8.1(b).
3. This matter originated from surveillance by the Financial Industry Regulatory Authority's ("FINRA") Department of Market Regulation, Quality of Markets, on behalf of FINRA, BZX and other self-regulatory organizations ("SROs").

VIOLATIVE CONDUCT

Applicable Rules

4. During all relevant periods herein, the following rules were in full force and effect: Exchange Rules 3.1 – Business Conduct of Members and 5.1 – Written Procedures.
5. Exchange Rule 3.1 provided that “[a] Member, in the conduct of [its] business, shall observe high standards of commercial honor and just and equitable principles of trade.”
6. Exchange Rule 5.1 provided “[e]ach Member shall establish, maintain and enforce written procedures [“WSPs”] which will enable it to supervise properly the activities of associated persons of the Member and to assure their compliance with applicable securities laws, rules, regulations and statements of policy promulgated thereunder, with the rules of the designated self-regulatory organization, where appropriate, and with Exchange Rules.”

Sanzone and his Business Partner Launched Bayes’s Direct Market Access Business Without Conducting Appropriate Due Diligence

7. Between November 2014 and July 2, 2018, Bayes was a small firm that provided direct market access to U.S. securities markets for several of its customers. Prior to November 2014, the firm conducted an agency-only business for a handful of institutional customers. The firm did not provide direct market access, and its business was struggling financially.
8. Sanzone and the firm’s former Chief Executive Officer (“CEO”) and Chief Compliance Officer (“CCO”) (the “Business Partner”) were two primary decision-makers in all aspects of the firm’s business between November 2014 and July 2, 2018. Sanzone was both an owner of the firm and the firm’s Head of Trading. He succeeded his Business Partner as the firm’s CEO and CCO in December 2016. Before Sanzone became the firm’s CEO and CCO, his Business Partner had delegated supervisory responsibility to Sanzone for Bayes’s supervisory program as it related to supervision of customer trading and compliance with Rule 15c3-5 – Risk Management Controls for Brokers or Dealers with Market Access, promulgated under Section 15(c)(3) of the Securities Exchange Act of 1934, as amended (“Rule 15c3-5”).
9. In mid-2014, a market access control vendor (the “Market Access Control Vendor”) presented the firm with a potentially lucrative package deal. Bayes would receive order flow routed from an unaffiliated broker-dealer (“BD1”) and its customers, including an unregistered foreign-day trading entity and non-FINRA/SRO member (“Customer X”). Customer X was under common ownership and control with the Market Access Control Vendor. BD1’s order flow was conditioned upon Bayes using the Market Access Control Vendor’s proprietary risk management system

and controls to manage the firm's direct market access business.

10. In the Adopting Release of Rule 15c3-5, as well as subsequent guidance, the SEC explained that Rule 15c3-5 requires market access providers to perform "appropriate due diligence" on their market access control vendors. The due diligence may include, *inter alia*, a review of publicly available information about the ownership and material business relationships of market access control vendors and market access customers, follow up on any information that may indicate a lack of independence between market access control vendors and market access customers, and requests to market access control vendors and market access customers to certify their independence from each other.¹
11. The package deal proposed by the Market Access Control Vendor should have raised concerns for Sanzone and his Business Partner about potential conflicts of interest between the Market Access Control Vendor and Customer X per the guidance set forth in the Adopting Release of Rule 15c3-5.
12. For instance, prior to Bayes providing direct market access to BD1 and Customer X, Sanzone and his Business Partner received emails and other documents showing that the Market Access Control Vendor and Customer X were under common ownership and control. Neither Sanzone nor his Business Partner, however, took proper steps to mitigate the potential conflict of interest posed by allowing Customer X to route order flow through the Market Access Control Vendor's proprietary pre-trade risk controls.
13. In November 2014, without conducting appropriate due diligence with respect to the potential conflict of interest between the Market Access Control Vendor and Customer X, nor collecting any due diligence documentation relating to BD1 or BD1's unregistered foreign-day trading customers, Sanzone and his Business Partner launched Bayes's direct market access business pursuant to the package deal proposed by the Market Access Control Vendor. Thus, the Bayes began providing direct market access to day-trading groups that routed orders through BD1, including Customer X.
14. BD1, and in particular Customer X, immediately became the primary source of order flow and revenue to Bayes. In 2015 and 2016, order flow from BD1 generated over 92 percent of the firm's total commissions, with order flow from Customer X alone constituting approximately 60 percent of that order flow. The trading volume resulted in discounts and preferential pricing at various exchanges, which made this order flow more lucrative to the firm. Further, the revenues earned by the firm routing order flow from BD1, including Customer X, dwarfed revenues it earned

¹ E.g., SEC, *Risk Management Controls for Brokers or Dealers with Market Access*, Release No. 34-63241 (Nov. 3, 2010); see also SEC Division of Trading and Markets, *Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access* (Apr. 15, 2014), available at <https://www.sec.gov/divisions/marketreg/faq-15c-5-risk-management-controls-bd.htm>.

from other customers.

Sanzone Failed to Establish, Maintain and Enforce WSPs to Properly Supervise the Firm's Direct Market Access Business

15. Pursuant to Bayes's December 2014 WSPs, Sanzone's Business Partner, the firm's then-CEO and CCO, was responsible for establishing and maintaining the firm's supervisory system and policies and procedures for all areas of the firm, including the direct market access business. Starting in November 2014, however, Sanzone's Business Partner delegated to, and wholly relied on, Sanzone to establish the firm's risk controls under Rule 15c3-5, as well as to supervise and conduct trade surveillance of Bayes's direct market access business and customer trading activity. Sanzone was therefore required to establish, maintain and enforce WSPs to enable Bayes to supervise properly the activities of associated persons and to assure their compliance with applicable BZX Rules and federal securities laws and regulations, to reasonably investigate red flags of potential misconduct (including potentially manipulative trading), and to take reasonable action when such misconduct has occurred.
16. Before Sanzone and his Business Partner launched the firm's direct market access business, FINRA had issued public guidance regarding risks related to foreign day traders manipulating U.S. markets.²
17. Sanzone, like his Business Partner, had no experience in establishing or managing a direct market access business. Sanzone also had no experience reviewing or supervising trade surveillance of high-volume, direct market access customer order flow or the order flow of foreign day traders.
18. In establishing the firm's market access controls, Sanzone instead relied on guidance from the Market Access Control Vendor when setting its pre-trade controls to filter trading activity of direct market access customers, including Customer X. Further, the Market Access Control Vendor had the ability, without requiring input or approval from Bayes, to suspend or re-enable access at an account level through its platform. The Market Access Control Vendor also had the exclusive ability to make intraday adjustments to the financial management controls within its platform. Moreover, Sanzone relied on guidance from BD1 with respect to setting the firm's market access controls and limits for individual accounts, including specifically with respect to Customer X.
19. Further, Bayes's supervisory system relied on (a) the Market Access Control Vendor's pre-trade risk controls and (b) Sanzone's manual review of reports generated by the vendor of rejected orders as the firm's supervisory system with respect to potentially manipulative trading activity by direct market access customers. The rejected orders, however, numbered in the millions. For example,

² See FINRA's 2013 Priorities Letter (Jan. 11, 2013); see also FINRA's 2014 Priorities Letter (Jan. 2, 2014).

from December 2014 through January 2016 alone, there were more than 5.4 million rejected orders on a pre-trade basis from BD1, a substantial portion of which may have related to potential layering³ or spoofing⁴ activity from Customer X. Despite the massive volume of rejected orders, there is only one documented instance in which Bayes contacted BD1 in relation to a review of a rejection report.

20. Neither Sanzone nor anyone else at Bayes conducted post-trade reviews for potentially manipulative trading by direct market access customers until approximately May 2016, after FINRA alerted the firm of its obligation to do so. Thereafter, Bayes hired a compliance analyst to be responsible for implementing and conducting the firm's post-trade reviews. The analyst, however, had no relevant experience or background in trade surveillance. The analyst reported directly to Sanzone, but Sanzone failed to properly supervise him. Sanzone never instructed the analyst to conduct testing of the post-trade reviews or their functionality. Nor did Sanzone know whether the analyst had ever conducted such testing. In addition to implementing the post-trade reviews, the analyst was also responsible for performing such reviews. Despite the analyst's lack of experience in trade surveillance, Sanzone failed to train him properly to perform such reviews.

Sanzone Failed to Properly Supervise Order Flow from BD1

21. In September 2015, less than a year after launching its direct market access business, Bayes received the first of many regulatory inquiries regarding the firm's market access controls, supervisory procedures, and surveillances to detect and prevent potentially manipulative trading activity by direct market access customers.
22. Then, in February 2016, BD1 was censured and fined in settled disciplinary proceedings brought by FINRA, BZX, and multiple exchange SROs for, *inter alia*, BD1's failure to supervise direct market access customers for potential layering, spoofing, and other trading violations. The disciplinary proceedings against BD1 were public, yet Bayes failed to perform any additional scrutiny of BD1's customers' account activity routed through Bayes.
23. On February 29, 2016, FINRA notified Bayes, including Sanzone, that it had determined that the firm's pre-trade risk management controls were not in

³ 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 at or away from the National Best Bid and Offer ("NBBO") 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.

⁴ Similar to layering, spoofing involves placement of non-bona fide orders, generally inside the existing NBBO, with the intention of briefly triggering some type of response from another market participant, followed by cancellation of the non-bona fide order, and the entry of an order on the other side of the market.

compliance with Rule 15c3-5, that the firm did not conduct reasonable post-trade analysis, and that the firm had failed to demonstrate direct and exclusive control of its direct market access business.

24. In July 2016, the firm updated its WSPs to include, among other things, a Market Access Committee (“MAC”), led by Sanzone, which became responsible for the firm’s compliance with Rule 15c3-5. The MAC was responsible for, *inter alia*, ensuring that no material business or other relationship with a market access customer existed that could interfere with the provision of effective risk management controls to Bayes. Despite the new WSPs, his role as the leader of the MAC, and information that should have put him on notice of the common ownership and control of the Market Access Control Vendor and Customer X, Sanzone continued to fail to take reasonable steps to ensure that the Market Access Control Vendor was independent from Customer X.
25. Despite the multiple red flags regarding potentially manipulative activity as described above, all of which Sanzone knew or should have known related to potentially manipulative activity involving order flow routed through BD1, Sanzone failed to perform proper supervisory oversight on order flow from BD1. Sanzone, therefore, allowed the potentially manipulative activity to continue.

Sanzone Failed to Properly Supervise Order Flow from BD2

26. In October 2016, Customer X moved its account from BD1 to another introducing broker (“BD2”). Sanzone and his Business Partner thereupon established a market access arrangement with BD2, and BD2 started sending order flow to Bayes, including from Customer X.
27. BD2 had previously been censured and fined in a settled disciplinary proceeding brought by an exchange SRO in February 2015 for, *inter alia*, failing to have reasonable supervisory procedures and controls in place designed to achieve compliance with rules against potentially manipulative trading practices by market access customers. The disciplinary proceeding against BD2 was also public, yet Bayes failed to perform any additional scrutiny of BD2’s customers’ account activity routed through Bayes.
28. Despite the disciplinary proceeding against BD2, which Sanzone knew or should have known about, Sanzone failed to perform appropriate due diligence or supervisory oversight on order flow from BD2. As a result, Bayes continued to allow its direct market access customers to flood U.S. trading markets with potentially manipulative activity.

Despite Red Flags, Sanzone Agreed to Take on Customer X as a Direct Customer of Bayes

29. In December 2016, Sanzone became the firm’s CEO, a position he held through June 2018. During that time, Sanzone retained responsibility for supervising the

firm's direct market access business and trading activity.

30. In or about January 2017, BD2 requested that Bayes agree to have Customer X route its order flow directly to Bayes, rather than through BD2, because BD2 stated that it was concerned about risks relating to Customer X's order flow.
31. Despite concerns about potentially problematic order flow from Customer X and knowledge of the common ownership of Customer X and the Market Access Control Vendor, Sanzone agreed to take on Customer X as a direct customer of the firm. As a result, Customer X continued to route potentially manipulative trades to U.S. trading markets through Bayes.
32. Moreover, after onboarding Customer X as a direct customer, Sanzone did not make reasonable changes to the risk management controls supplied by the Market Access Control Vendor as they applied to Customer X's trading.
33. It was only in May 2017, after Sanzone and others at Bayes attended a meeting with FINRA and several exchange SROs, including BZX, regarding Customer X's problematic order flow, when Bayes terminated its relationship with Customer X. Bayes nonetheless continued providing direct market access to other customers who also routed potentially manipulative trades to U.S. trading markets until the firm ceased to operate in July 2018.
34. During the period of January 15, 2015 through July 2, 2018, based on the acts, practices and conduct described in paragraphs 7 through 33, Sanzone violated Exchange Rules 3.1 and 5.1.

SANCTIONS

35. Respondent does not have any prior relevant disciplinary history.
36. In light of the alleged rule violations described above, Respondent consents to the imposition of the following sanctions:
 - a. A bar in all capacities.

If this Letter of Consent is accepted, Respondent acknowledges that he shall be bound by all terms, conditions, representations and acknowledgements of this Letter of Consent, and, in accordance with the provisions of Exchange Rule 8.3, waives the right to review or to defend against any of these allegations in a disciplinary hearing before a Hearing Panel. Respondent further waives the right to appeal any such decision to the Board of Directors, the SEC, a U.S. Federal District Court, or a U.S. Court of Appeals.

Respondent 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 Letter of Consent, or other consideration of this Letter of Consent, including

acceptance or rejection of this Letter of Consent. Respondent further waives any claim that a person violated the *ex parte* prohibitions of Exchange Rule 8.16, in connection with such person's participation in discussions regarding the terms and conditions of this Letter of Consent, or other consideration of this Letter of Consent, including its acceptance or rejection.

Respondent understands that submission of this Letter of Consent is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the CRO, pursuant to Exchange Rule 8.3. If the Letter of Consent is not accepted, it will not be used as evidence to prove any of the allegations against Respondent.

Respondent understands and acknowledges that acceptance of this Letter of Consent will become part of his disciplinary record and may be considered in any future actions brought by Cboe or any other regulator against Respondent. The Letter of Consent will be published on a website maintained by the Exchange in accordance with Exchange Rule 8.18.

Respondent understands that he may not deny the charges or make any statement that is inconsistent with the Letter of Consent. Respondent may attach a Corrective Action Statement to this Letter of Consent that is a statement of demonstrable corrective steps taken to prevent future misconduct. Any such statement does not constitute factual or legal findings by the Exchange, nor does it reflect the views of the Exchange or its staff.

Respondent certifies that he has read and understands all the provisions of this Letter of Consent and has been given a full opportunity to ask questions about it; that he has agreed to the Letter of Consent's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce him to submit it.

Date: 23 May 2020

Respondent, Douglas A. Sanzone



Reviewed by:



James E. Green
Counsel for Respondent