



Notice of Disciplinary Action against Two Sigma Securities, LLC, Member Organization

To: Members, Member Organizations, Participants and Participant Organizations
From: Joe Cusick, Vice President — Surveillance, NASDAQ PHLX LLCSM
DATE: April 11, 2017

Enforcement No. 2017-04; FINRA Matter No. 20130391658-10 (incl. 20140409338 and 20150462036)

On April 4, 2017, the Business Conduct Committee (the "Committee") issued a disciplinary decision against Two Sigma Securities, LLC ("SOHO" or the "Firm"), a member organization of NASDAQ PHLX LLC ("PHLX" or the "Exchange"). In connection with a Statement of Charges issued in this action, the Firm submitted an Offer of Settlement, Stipulation of Facts and Consent to Sanctions ("Offer"). Solely to settle these proceedings, and without admitting or denying the charges, the Firm consented to findings in connection with Matter Nos. 20130391658 and 20140409338 that during the period from August 9, 2012 through April 9, 2014 (the "Relevant Period"), the Firm violated Rule 15c3-5 of the Securities Exchange Act of 1934 ("Rule 15c3-5") and Exchange Rules 748 and 707 by having risk management controls and supervisory procedures not reasonably designed to manage certain aspects of the financial, regulatory and other risks associated with its business activity involving market access.¹

More specifically, the Firm failed to adequately document its risk management controls and supervisory procedures under Rule 15c3-5, contrary to Rule 15c3-5(b). For example, the Firm failed to sufficiently document certain risk controls it deployed in its written description of its risk management controls (or how they operated); lacked sufficient documentation of its basis for certain control limits; and failed to sufficiently detail its criteria for evaluating and establishing certain control limits and procedures. Furthermore, the Firm made only generic reference to certain daily and quarterly reviews by certain personnel of particular changes to risk control limits and provided insufficient detail about what the Firm's reviews for assessing the overall effectiveness of its controls and procedures entailed.

The Firm's controls as required by Rule 15c3-5(c)(1)(ii) were also inadequate in that the Firm: (a) lacked pre-order entry controls, based on the particular characteristics of the order, tailored to identify and prevent potential duplicative order entry, (b) lacked pre-order entry controls specifically tracking the number of cancel messages sent to an exchange to detect repeated cancellations within compressed time periods which could be indicative of erroneous activity, and (c) set certain order rate limits at levels too high to be reasonably expected to prevent potentially erroneous order activity.

Further, the Firm's controls and procedures for complying with regulatory requirements pursuant to Rule 15c3-5(c)(2) were inadequate. Specifically, the Firm lacked any specific controls or

¹ Concurrent disciplinary actions in connection with these matters also are being brought by FINRA and eight other exchanges, including Bats EDGA Exchange, Inc. ("EDGA"), Bats EDGX Exchange, Inc. ("EDGX"), Bats BZX Exchange, Inc. ("BZX"), The NASDAQ Stock Market LLC ("Nasdaq"), Nasdaq BX, Inc. ("BX"), New York Stock Exchange LLC ("NYSE"), NYSE Arca, Inc. ("NYSE Arca"), and NYSE MKT LLC ("NYSE MKT").

surveillance to detect and prevent potentially manipulative activity in the form of spoofing, layering, and algorithmic gaming activity, and had insufficient surveillance for potential marking of the close activity during the Relevant Period.

The Offer submitted by Respondent was accepted by the Committee and was the basis of its Decision. The Committee concurred in the sanctions consented to by them, and ordered the imposition of the following sanctions against the Firm: (i) a censure; (ii) a fine of \$65,000 specific to Matter Nos. 20130391658 and 20140409338 (to be paid jointly to the Exchange, FINRA and the previously referenced eight other exchanges, of which \$6,500 shall be paid to the Exchange),² and (iii) an undertaking requiring the Firm to update its system of risk management controls and supervisory procedures, including but not limited to its written description of risk management controls and written supervisory procedures, to address the deficiencies described above to achieve compliance with Rule 15c3-5 and Exchange Rules 748 and 707.

For more information, contact:

- Joe Cusick, Vice President — Surveillance, NASDAQ PHLX, at +1 215 496 1576

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² The concurrent Nasdaq action in this case includes an additional fine of \$25,000 to be paid to Nasdaq for additional Rule 15c3-5 findings specific to Matter No. 20150462036, which arose from a clearly erroneous filing with Nasdaq in connection with the Firm's trading in a stock symbol on that market on June 8, 2015.