

**NASDAQ PHLX LLC  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2015046278301**

TO: Nasdaq Phlx LLC  
c/o Department of Enforcement  
Financial Industry Regulatory Authority (“FINRA”)

RE: Citadel Securities LLC, Respondent  
Member Firm  
CRD No. 116797

Pursuant to Rule 9216 of Nasdaq Phlx LLC (“Phlx”) Code of Procedure,<sup>1</sup> Citadel Securities LLC (“Citadel Securities,” the “firm,” or “Respondent”) 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, Phlx will not bring any future actions against the Respondent alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. Respondent 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 Phlx, or to which Phlx 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 Phlx:

**BACKGROUND**

Citadel Securities is a U.S. broker-dealer and a market maker in equity securities and U.S.-listed options. It became a member of Phlx in December 2003 and its registration remains in effect. The firm, which employs approximately 450 registered individuals, maintains its headquarters in Chicago, IL and has seven other branch offices.

**RELEVANT PRIOR DISCIPLINARY HISTORY**

On October 23, 2015, the Cboe Exchange, Inc. (“Cboe”) Business Conduct Committee issued a decision sanctioning Citadel Securities \$100,000 for violations of Rule 15c3-5(c) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Cboe Rule 4.2 as the firm failed to establish appropriate pre-set credit thresholds and failed to have in place a system of risk management controls and supervisory procedures reasonably designed to prevent the entry of erroneous orders by rejecting orders that exceeded appropriate price or size parameters or that assured appropriate surveillance personnel received immediate post-trade execution reports.

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<sup>1</sup> Series 9000 of The Nasdaq Stock Market LLC Rules are incorporated by reference into Phlx Rule General 5, Section 3, and are thus Phlx Rules and thereby applicable to Phlx members, member organizations, persons associated with member organizations, and other persons subject to the Exchange’s jurisdiction.

On June 16, 2014, FINRA, Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., The Nasdaq Stock Market LLC, and NYSE Arca, Inc. sanctioned the firm \$800,000 and imposed an undertaking for violations of Exchange Act Rule 15c3-5 and relevant supervision rules as Citadel Securities failed to establish, maintain, and enforce supervisory procedures and risk management controls reasonably designed to check for order accuracy, reject orders that exceeded appropriate price and/or size parameters, reject duplicate orders, and monitor appropriate message level activity.

### **SUMMARY**

This matter arose from reviews conducted by FINRA’s Department of Market Regulation, on behalf of Phlx and other self-regulatory organizations (“SROs”).<sup>2</sup> The conduct described herein occurred between August 15, 2014 and May 2020 (the “review period”), or more specific time periods within the review period as described below.

During the review period, Citadel Securities had market access, as defined in Exchange Act Rule 15c3-5. As such, the firm was required 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 this business activity. In certain scenarios, however, Citadel Securities’s risk management controls and supervisory procedures were not reasonably designed to prevent the entry of erroneous orders, in violation of Exchange Act Rule 15c3-5, Phlx Rules 707 and 748 (for conduct that occurred prior to February 3, 2020), and Phlx General 9, Sections 20 and 1(c) (for conduct that occurred on or after February 3, 2020).

### **FACTS AND VIOLATIVE CONDUCT**

1. Exchange Act Rule 15c3-5(b) requires broker-dealers with 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 this business activity.”
2. Exchange Act Rule 15c3-5(c)(1)(ii) requires broker-dealers with market access to establish written supervisory procedures (“WSPs”) and financial risk management controls that are reasonably designed to “[p]revent 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.”
3. Phlx Rule 748, now General 9, Section 20, requires members and member organizations to “establish, maintain, and enforce written supervisory procedures, and a system for applying such procedures, to supervise the types of business(es) in which the member or member organization engages in and to supervise the activities of all registered representatives, employees and associated persons. The written supervisory procedures and the system for applying such procedures shall reasonably be designed

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<sup>2</sup> The other SROs include Cboe BYX Exchange, Inc., Cboe BZX Exchange, Inc., Cboe EDGA Exchange, Inc., Cboe EDGX Exchange, Inc., The Nasdaq Stock Market LLC; Nasdaq BX, Inc., Nasdaq GEMX, Inc., Nasdaq ISE, LLC, Nasdaq MRX LLC, The Nasdaq Options Market LLC, The New York Stock Exchange LLC, and NYSE Arca Inc.

to prevent and detect, insofar as practicable, violations of the applicable securities laws and regulations, including the By-Laws and Rules of the Exchange.”<sup>3</sup>

4. Phlx Rule 707, now General 9, Section 1(c), requires members, member organizations, and persons associated with or employed by a member or member organizations to not engage in conduct inconsistent with just and equitable principles of trade.<sup>4</sup>

#### The Firm Did Not Apply Certain Pre-Trade Erroneous Order Controls to Certain Options Limit Orders

5. From August 15, 2014 through May 2, 2018, the firm’s pre-trade erroneous order controls applicable to option limit orders included a price control (the “Price Control”) that would reject limit orders that were priced at a certain percentage away from the National Best Bid or Offer (“NBBO”).<sup>5</sup> However, from August 2014 through November 2017, when an option order was canceled and replaced, the Price Control was not applied to the replaced option order. Moreover, from August 15, 2014 through June 2015, the Price Control was not applied to option orders placed prior to market open, and from August 15, 2014 through May 2017, this control was not applied to child option orders.<sup>6</sup>
6. After the Price Control was applied to option orders placed prior to market open starting in June 2015, if a pre-open option limit order that was determined not to be erroneous was re-routed to another exchange at or after market open, this price control was not reapplied to the re-routed option limit order. As a result, option limit orders received prior to the market open that were later re-routed to various markets were not subjected to reasonably designed pre-trade erroneous order controls.
7. For example, on May 17, 2017 at 6:50:02 a.m., the firm received an option limit order to buy 2 XYZ May 109 puts at \$0.55.<sup>7</sup> The order as received was not erroneous and was priced within the firm’s price control threshold, as the end-of-day quote on the prior trading day was \$0.44 x \$0.46. At 7:43:06 a.m., the firm routed the order to The Nasdaq Options Market LLC (“NOM”). When the opening print occurred at 9:30:41 a.m., the NBBO was \$2.22 x \$2.40. At 9:30:42 a.m., the NBBO was \$1.18 x \$3.60. At 9:32:07 a.m., the firm’s order remained unexecuted on NOM. The firm canceled the order on NOM and, at 9:32:08 a.m., re-routed it to Cboe EDGX Exchange, Inc. with the original limit price of \$0.55, without reapplying the price control. The NBBO at the time was \$2.14 x \$2.60. Because the firm did not re-apply the price control to option limit orders that were re-routed after the market opened, this order was sent to the market at a price that was not reasonably related to the current NBBO. This issue did not result in any Clearly Erroneous Filings.

<sup>3</sup> As of February 3, 2020, Phlx Rule 748 was renumbered to Phlx General 9, Section 20.

<sup>4</sup> As of February 3, 2020, Phlx Rule 707 was renumbered to Phlx General 9, Section 1(c).

<sup>5</sup> A limit order is an order to purchase or sell a security at, or better than, a stated price.

<sup>6</sup> A “parent” order is the full order size, and may be executed by slicing the order into smaller lots, or “child” orders.

<sup>7</sup> A generic symbol is used in place of the name of the referenced security.

Certain Pre-Trade Price and Size Controls Were Not Reasonably Designed Because the Accompanying Procedures Were Not Sufficiently Detailed

8. From August 15, 2014 through May 2, 2018, the firm applied certain pre-trade erroneous order controls that incorporated soft blocks for certain broker-dealer options orders. In contrast to a hard block, which generally prevents an order from being submitted by automatically rejecting it, a soft block prevents an order from being routed to a market center until it is either overridden or confirmed by a person.
9. From August 15, 2014 through May 2, 2018, Citadel Securities had in place soft blocks that were triggered when the parameters of the applicable price or size controls were met. Once triggered, the subject orders were required to be manually reviewed by certain firm personnel dedicated to this task to determine whether the order should be rejected or submitted to a market center.
10. From August 15, 2014 through November 2016, the firm's procedures failed to provide sufficient detail concerning how firm personnel were to review soft block alerts. The firm's procedures did not sufficiently detail the steps firm personnel were to take when reviewing a subject order or the circumstances under which a soft block should be overridden or confirmed. Furthermore, from August 15, 2014 through October 2019 for options orders, the firm failed to require that those persons responsible for reviewing soft block alerts contemporaneously document their review of orders that triggered a soft block, including documenting the rationale for releasing the subject orders into the market after completing the manual review.
11. Because the firm's procedures did not require a reasonable review of the orders that triggered soft block alerts or require the person reviewing soft block alerts to contemporaneously document the rationale for resolving such alerts, the applicable pre-trade erroneous order controls were not reasonably designed. This issue did not result in any Clearly Erroneous Filings.

Delays in Processing Market Data Updates Impacted the Efficacy of Certain Pre-Trade Erroneous Order Controls

12. Additionally, during the review period, the firm applied certain pre-trade erroneous order controls to options market orders. However, delays in processing market data updates reduced the effectiveness of the firm's controls in times of volatility.
13. For example, on March 3, 2020, after the Federal Reserve Bank announced an interest rate cut at 10:00 a.m., the firm received a number of market orders in two options classes from other broker-dealers and applied its pre-trade erroneous order controls to these orders upon receipt. These orders were not erroneously submitted to the firm. However, the firm experienced delays in processing the market data updates that ensued following the announcement of the interest rate cut. As such, the bid-ask spread drastically widened during this time but because the firm's controls referenced stale data, the market orders routed by the firm, even though not erroneous, were executed at erroneous prices. As a result, the firm filed six obvious error petitions with Phlx, one trade was busted on Phlx, and the price of six trades were adjusted on Phlx. Because the firm's pre-trade erroneous order controls for options market orders

did not reference accurate market data, they were not reasonably designed to prevent the entry of erroneous orders.

14. As a result of the firm's failure to establish and maintain reasonable 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, the firm, during the review period, violated Section 15(c)(3) of the Exchange Act and Rules 15c3-5(b) and (c)(1)(ii) thereunder, Phlx Rules 707 and 748 (for conduct that occurred prior to February 3, 2020), and Phlx General 9, Sections 20 and 1(c) (for conduct that occurred on or after February 3, 2020).

B. Respondent also consents to the imposition of the following sanctions:

1. A censure;
2. A fine of \$15,000;<sup>8</sup> and
3. An undertaking to revise the firm's risk management controls and supervisory procedures with respect to the areas of 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 herein. Within 90 business days of acceptance of this AWC, a registered principal of the Firm shall submit to Carly Kostakos, Senior Counsel a signed, dated letter, or an email from a work-related account of the registered principal to Carly.Kostakos@finra.org, providing the following information: (a) a reference to this matter; (b) a representation that the Firm has addressed and corrected the deficiencies described above, including the specific measures or enhancements taken to address those deficiencies; and (c) the date the deficient controls and procedures were addressed and corrected by the Firm.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent agrees to pay the monetary sanction in accordance with its executed payment form.

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

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

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<sup>8</sup> Citadel Securities consents to a fine payable to Phlx and the SROs referenced in footnote 2 above, totaling \$225,000.

## II.

### WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under Phlx's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against the firm;
- B. To be notified of the Formal Complaint 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 Exchange Review Council and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Regulatory Officer, the Exchange Review Council, or any member of the Exchange Review Council, 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 acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, 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

Respondent 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 FINRA's Department of Enforcement and the Exchange Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to Phlx Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Respondent; and
- C. If accepted:
  - 1. This AWC will become part of the Respondent's permanent disciplinary record and may be considered in any future actions brought by Phlx or any other regulator against the Respondent;

2. Phlx may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Phlx Rule 8310 and IM-8310-3;<sup>9</sup> and
  3. Respondent 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. Respondent may not take any position in any proceeding brought by or on behalf of Phlx, or to which Phlx is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Respondent's right to take legal or factual positions in litigation or other legal proceedings in which Phlx is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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 Phlx, nor does it reflect the views of Phlx or its staff.

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<sup>9</sup> Series 8000 of The Nasdaq Stock Market LLC Rules are incorporated by reference into Phlx Rule General 5, Section 2, and are thus Phlx Rules and thereby applicable to Phlx members, member organizations, persons associated with member organizations, and other persons subject to the Exchange's jurisdiction.

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 the firm 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.

December 23, 2021

\_\_\_\_\_  
Date

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Citadel Securities LLC  
Respondent

By: Scott Klein

Print Name: Scott Klein

Title: Chief Compliance Officer and Senior Deputy GC

Reviewed by:

Paul R. Eckert

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Paul R. Eckert, Esq.  
Counsel for Respondent  
Wilmer Cutler Pickering Hale and Dorr LLP  
1875 Pennsylvania Avenue, NW  
Washington, DC 20006

Accepted by Phlx:

December 27, 2021

\_\_\_\_\_  
Date

Carly M. Kostakos

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Carly M. Kostakos  
Senior Counsel  
Department of Enforcement

Signed on behalf of Phlx, by delegated  
authority from the Director of ODA