

**NASDAQ PHLX LLC  
NOTICE OF ACCEPTANCE OF AWC**

**Certified, Return Receipt Requested**

**TO: Instinet, LLC  
Mr. Faron Webb  
General Counsel  
Worldwide Plaza  
309 West 49th Street  
New York, NY 10019**

**FROM: Nasdaq PHLX LLC (“PHLX”)  
c/o Financial Industry Regulatory Authority (“FINRA”)  
Department of Enforcement  
9509 Key West Avenue  
Rockville, MD 20850**

**DATE: April 11, 2018**

**RE: Notice of Acceptance of Letter of Acceptance, Waiver and Consent No. 20130368360-03**

**Please be advised** that your above-referenced Letter of Acceptance, Waiver and Consent (“AWC”) has been accepted on April 11, 2018 by the PHLX Review Council’s Review Subcommittee, or by the Office of Disciplinary Affairs on behalf of the PHLX Review Council, pursuant to PHLX Rule 9216. A copy of the AWC is enclosed herewith.

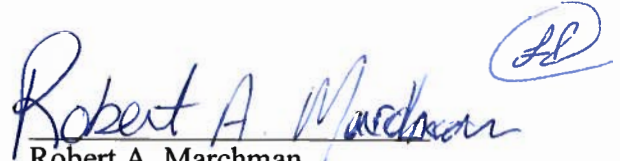
You are again reminded of your obligation, if currently registered, immediately to update your Uniform Application for Broker-Dealer Registration (“Form BD”) to reflect the conclusion of this disciplinary action. Additionally, you must also notify FINRA (or PHLX if you are not a member of FINRA) in writing of any change of address or other changes required to be made to your Form BD.

You are reminded that Section I of the attached Letter of Acceptance, Waiver, and Consent includes an undertaking. In accordance with the terms of the AWC, a registered principal of the firm is required to notify the Compliance Assistant, Department of Enforcement, 9509 Key West Avenue, Rockville, MD 20850, of completion of the undertaking.

You will be notified by the Registration and Disclosure Department regarding sanctions if a suspension has been imposed and by Nasdaq’s Finance Department regarding the payment of any fine if a fine has been imposed.

Instinet, LLC  
Page 2

If you have any questions concerning this matter, please contact Michael W. Bautz, Senior Counsel,  
at (646) 430-7032.

A handwritten signature in blue ink that reads "Robert A. Marchman". To the right of the signature is a circular stamp containing the initials "RM".

Robert A. Marchman  
Executive Vice President  
Department of Enforcement, FINRA

Signed on behalf of PHLX

Enclosure

FINRA District 10 – New York  
Michael Solomon  
Senior Vice President and Regional Director  
(Via email)

David S. Sieradzki, Esq.  
Counsel for Respondent  
Schulte Roth & Zabel LLP  
1152 Fifteenth Street, NW  
Suite 850  
Washington, DC 20005

**NASDAQ PHLX LLC**  
**LETTER OF ACCEPTANCE, WAIVER AND CONSENT**  
**NO. 2013036836003**

TO: Nasdaq PHLX LLC  
c/o Department of Enforcement  
Financial Industry Regulatory Authority ("FINRA")

RE: Instinet, LLC, Respondent  
Broker-Dealer  
CRD No. 7897

Pursuant to Rule 9216 of Nasdaq PHLX LLC ("PHLX" or the "Exchange") Code of Procedure, Instinet, LLC ("INCA" 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, PHLX 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 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**

The Firm has been a broker-dealer registered with the Securities and Exchange Commission (the "Commission") and PHLX since April 25, 1979. Both registrations remain in effect. The Firm, among other things, provides market access and execution services to institutional market participants ("Market Access Clients") for a wide variety of products. In or about February 2007, INCA was acquired by Nomura Holdings, Inc., which shifted the majority of its global equities execution business to INCA in December 2012.

The Firm has no relevant disciplinary history.

**SUMMARY**

1. In Matter 20130376217, the Trading Analysis Section ("Trading Analysis") of FINRA's Department of Market Regulation ("Market Regulation") reviewed

STAR No. 20130368360 (incl. merged STAR Nos. 20130376217, 20130382620, 20130384257, 20130386900, 20130395417, 20140399233, 20140402026, 20140416803, 20140422166, 20140430948, 20140435161, 20140436283, 20150451541, 20150463006, 20150463452, 20150481875, 20150482156, 20160502382, 20160504175, 20160509709, 20160514500, 20160521544, 20160525489, 20160526107, 20170543142, 20170545607, 20170551643, 20170554299, 20170555223, 20170561010, 20160485810, and 20160512438) (MWB)

potential layering, spoofing, and wash trades by the Firm's Market Access Clients from July 17, 2013 through May 29, 2015, and the Firm's compliance with Rule 15c3-5 of the Securities Exchange Act of 1934 ("SEA") (the "Market Access Rule").<sup>1</sup>

2. In Matter No. 20150463452, the Market Manipulation Investigations Group of Market Regulation reviewed the Firm's layering and spoofing surveillances and exception reports in effect from April 2015 through April 2016, and the Firm's compliance with the Market Access Rule.
3. In Matter No. 20150482156, Trading Analysis reviewed the Firm's procedures, systems and controls related to potential layering, pre-opening spoofing, intraday spoofing, and wash trades in place from January 1, 2015 through May 31, 2017, and the Firm's compliance with the Market Access Rule.
4. The above matters were part of investigations conducted by Market Regulation on behalf of the Exchange and other self-regulatory organizations, including The NASDAQ Stock Market LLC; NASDAQ BX, Inc.; The NASDAQ Options Market LLC; Cboe BZX Exchange, Inc.; Cboe BYX Exchange, Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX Exchange, Inc.; Investors Exchange LLC; NYSE Arca Options, Inc.; NYSE Arca Equities, Inc.; the New York Stock Exchange LLC; NYSE American Equities LLC; NYSE American Options LLC; BOX Options Exchange LLC; and FINRA (collectively, the "SROs"), to review the Firm's compliance with the Market Access Rule and the supervisory rules of the SROs, including Exchange Rules 707 and 748(b), (d), (g), and later (h),<sup>2</sup> during the period of August 2012 through at least November 2017 (the "Review Period").
5. As a result of Market Regulation's investigations, it was determined that, during the Review Period, the Firm failed to establish, document, and maintain a system of risk management controls and supervisory procedures, including written supervisory procedures ("WSPs") 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, during the Review Period, the Firm failed to ensure compliance with all regulatory requirements, including supervising client trading to detect and prevent potentially violative layering, spoofing, and wash trading in violation of SEA Rules 15c3-5(b), (c)(2), and (c)(2)(iii), and Exchange Rules 707 and 748(b), (d), (g), and later (h).

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

<sup>2</sup> Exchange Rule 748(g) was renumbered as Exchange Rule 748(h), effective November 23, 2012.

## FACTS AND VIOLATIVE CONDUCT

### Applicable Rules

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 management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of their market access business.<sup>3</sup>
8. During the Review Period, SEA Rule 15c3-5(c)(2) required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements to, among other things, prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis and restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the market access broker-dealer.
9. During the Review Period, SEA Rule 15c3-5(c)(2)(iii) specifically required market access broker-dealers to have regulatory risk management controls and supervisory procedures reasonably designed to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker or dealer.
10. During the Review Period, Exchange Rule 707 prohibited members and member organizations from engaging in acts or practices inconsistent with just and equitable principles of trade.
11. During the Review Period, Exchange Rule 748(b) required member organizations to “provide for appropriate supervisory control . . . of the organization and compliance with securities’ [*sic*] laws and regulations, including the By-Laws and Rules of the Exchange . . .” Member organizations are required to “provide for appropriate written procedures of supervision and control; and . . . [e]stablish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.”
12. During the Review Period, Exchange Rule 748(d) required “[e]ach person with supervisory control . . . [to] reasonably discharge his duties and obligations in connection with such supervision and control to prevent and detect insofar as practicable, violations of the applicable securities laws and regulations, including the By-Laws and Rules of the Exchange.”

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<sup>3</sup> 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.” 75 Fed. Reg. at 69792.

13. During the Review Period, Exchange Rule 748(g), and later (h), required member organizations to establish, maintain, and enforce written supervisory procedures reasonably designed to prevent and detect violations of securities laws and regulations, including the Exchange's By-Laws and Rules.

### **Inadequate Supervision of Customer Trading**

#### **Access to Trading Systems**

14. Pursuant to the Firm's written "Know Your Customer" procedures, when opening a new account, the New Account Sales Supervisor is required to obtain certain account information, complete a New Account form and confirm, in writing, the names of persons authorized to trade the account. However, from January 2013 through December 2013, the Firm failed to enforce this procedure.
15. Specifically, for the account of two of its Market Access Clients, the Firm only pre-approved and authorized the principals of the client. The Firm failed to pre-approve the individual traders utilizing the Firm's MPID to access the market through the clients and, therefore, did not know the identity of the underlying trader.
16. In addition, because the Firm did not know the identity of the underlying traders, it had no means of verifying its Market Access Client's representation that a particular trader had been truly terminated or whether a disabled trader had been given a new trader ID for the client to access U.S. markets via the Firm's systems after the trader had been terminated.
17. Accordingly, the Firm failed to have risk management controls and supervisory procedures to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker-dealer.
18. The acts, practices, and conduct described above in paragraphs 14 through 17 constituted violations of SEA Rules 15c3-5(b) and (c)(2)(iii), and Exchange Rules 707 and 748(b), (d), (g), and later (h).

#### **Wash Trading**

19. During the Review Period, the Firm had two systemic controls to detect potential wash trading by its customers: (i) a system operated by its parent company, Nomura Securities International; and (ii) its own proprietary alert system.
20. However, the Firm was unable to determine if the noted exceptions were valid for the Market Access Clients noted above. Specifically, for those Market Access Clients, the Firm did not know the identity of the underlying trader utilizing its MPID and, therefore, was unable to determine if the same trader was on both sides of a transaction or if one trader was using multiple trader IDs to engage in wash trading.

21. As a result, the Firm relied on its Market Access Clients to determine if beneficial ownership had changed during the relevant trade and report the occurrence of wash trading. However, the Firm took wholly inadequate steps to follow-up with the Market Access Clients to verify that beneficial ownership had changed when a wash trade exception was detected.
22. The acts, practices, and conduct described above in paragraphs 19 through 21 constituted violations of SEA Rules 15c3-5(b) and (c)(2), and Exchange Rules 707 and 748(b), (d), (g), and later (h).

#### Equities Layering<sup>4</sup> and Spoofing<sup>5</sup>

23. During the Review Period, the Firm employed a proprietary alert system to detect potential layering and spoofing by its Market Access Clients. For certain Market Access Clients that previously had accounts with Nomura, the Firm also relied upon a third-party surveillance operated by Nomura.
24. However, the Firm's proprietary alert system improperly excluded potential instances of layering or spoofing where a market participant enters and cancels a series of orders that improve the National Best Bid ("NBB") or National Best Offer ("NBO"), ignoring a significant number of non-bona fide orders entered as part of a potential layering or spoofing strategy.
25. For exceptions detected by the Firm's proprietary alert system, the Firm's Compliance Department reviewed a sample and, where it was determined to be necessary, forwarded the exception to the relevant business side supervisor for follow-up with the client.
26. However, there were several deficiencies with the Firm's follow-up and review of exceptions flagged by its proprietary surveillance systems. The Firm's WSPs failed to describe the steps to be taken in addressing an exception. Specifically, the Firm's WSPs: (i) did not describe the business side supervisor's role in the review of layering exceptions; (ii) failed to document the steps requiring the suspicious alerts to be sent to the business supervisor or describe the business supervisor's responsibility when receiving the client's response; (iii) failed to

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<sup>4</sup> 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 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.

<sup>5</sup> Spoofing" is a manipulative trading tactic designed to induce other market participants into executing trades. Spoofing is a form of market manipulation that generally involves, but is not limited to, the market manipulator placing an order or orders with the intention of cancelling the order or orders once they have triggered some type of market movement and/or response from other market participants, from which the market manipulator might benefit by trading on the opposite side of the market.

provide guidance in conducting sampling; (iv) failed to outline that the business side supervisor will investigate the alerts beyond any initial determinations by Compliance; and (v) failed to state where documentation of any such review will be maintained.

27. There were no WSPs to address exceptions detected by Nomura's third-party surveillance system. In the absence of any written guidance, INCA personnel engaged in an undocumented process whereby Nomura's Compliance Department would forward layering exception reports to the Firm's Compliance Department and the relevant business-side desk supervisor to follow-up with the relevant Market Access Client. The business-side desk supervisor would review any explanation or information provided by the relevant Market Access Client with Compliance and take any further necessary action. The business-side desk supervisor and the Firm's Compliance Department failed to take adequate action to review the explanations provided by the relevant Market Access Client.
28. As a result, six Market Access Clients were allowed to engage in potential layering and spoofing unabated despite regularly appearing on the Firm's and Nomura's exception reports.
29. For example, from April 2013 through December 2013,<sup>6</sup> a Market Access Client of the Firm generated approximately 694 layering and spoofing exceptions on Nomura's third party surveillance.
30. Likewise, from January 2013 to on or about October 22, 2013,<sup>7</sup> another Market Access Client generated approximately 6,288 layering and spoofing alerts on the Firm's proprietary surveillance system. During this time period, all the Firm clients, in total, generated approximately 10,107 layering and spoofing alerts. Thus, the Market Access Client was responsible for approximately 60% of all the Firm's layering and spoofing alerts.
31. The acts, practices, and conduct described above in paragraphs 23 through 30 constituted violations of SEA Rules 15c3-5(b) and (c)(2), and Exchange Rules 707 and 748(b), (d), (g), and later (h).

#### Spoofing the Open by the Firm's Market Access Clients

32. During the Review Period, the Firm had procedures and controls to detect potential instances of spoofing prior to the open. Beginning in January 2014, INCA had an exception report that identified any instance in which a customer placed an order and cancelled the order prior to 9:30 a.m., where the cancellation quantity exceeded 5% of the security's 30-day average daily volume ("ADV").

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<sup>6</sup> The Firm terminated the account on December 31, 2013.

<sup>7</sup> The Firm terminated the account on October 22, 2013.



33. However, in certain instances when an exception was triggered, the Firm failed to conduct an adequate follow up and review.
34. For example, from April 7, 2015 through June 29, 2016, a Market Access Client of the Firm generated approximately 279 pre-opening spoofing exceptions. Despite the number of exceptions, the Firm failed to take adequate steps to address this Market Access Client's pre-opening activity.
35. The acts, practices, and conduct described above in paragraphs 32 through 34 constituted violations of SEA Rules 15c3-5(b) and (c)(2), and Exchange Rules 707 and 748(b), (d), (g), and later (h).

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

1. A censure;
2. A fine in the amount of \$1,575,000 of which \$59,700 is payable to PHLX;<sup>8</sup> 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 the issuance of this AWC, INCA<sup>4</sup> shall submit to the COMPLIANCE ASSISTANT, DEPARTMENT OF ENFORCEMENT, 9509 KEY WEST AVENUE, ROCKVILLE, MD 20850, a written report, certified by a senior management Firm executive, to [MarketRegulationComp@finra.org](mailto: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. Between 90 and 120 days after the submission of the written report, the Firm shall submit a supplemental written report to FINRA to provide an update on the effectiveness of the enhancements and changes made by the Firm to its risk management controls and procedures as describe above.
  - c. The Department of Enforcement may, upon a showing of good cause and in its sole discretion, extend the time for compliance with these provisions.

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<sup>8</sup> The balance of the sanction will be paid to the self-regulatory organizations listed in Paragraph B.4.

4. Acceptance of this AWC is conditioned upon acceptance of similar settlement agreements in related matters between INCA and each of the following self-regulatory organizations: The NASDAQ Stock Market LLC; NASDAQ BX, Inc.; The NASDAQ Options Market LLC; Cboe BZX Exchange, Inc.; Cboe BYX Exchange, Inc.; Cboe EDGA Exchange, Inc.; Cboe EDGX Exchange, Inc.; Investors Exchange LLC; NYSE Arca Options, Inc.; NYSE Arca Equities, Inc.; the New York Stock Exchange LLC; NYSE American Options LLC; NYSE American Equities LLC; BOX Options Exchange LLC and FINRA.

The Firm agrees to pay the monetary sanction(s) in accordance with its executed Election of Payment Form.

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 FINRA staff.

## II.

### WAIVER OF PROCEDURAL RIGHTS

The Firm 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 PHLX Review Council 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, the PHLX Review Council, or any member of the PHLX 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.

The Firm 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**

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 FINRA's Department of Enforcement and the PHLX 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 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 PHLX or any other regulator against the Firm;
  - 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; 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 PHLX, or to which PHLX is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's right to take legal or factual positions in litigation or other legal proceedings in which PHLX 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 PHLX, nor does it reflect the views of PHLX 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.

2/11/18  
Date

Respondent  
Instinet, LLC

By: Faron Webb  
Name: Faron Webb  
Title: General Counsel

Reviewed by:

[Signature]  
David S. Sieradzki, Esq.  
Schulte Roth & Zabel LLP  
1152 Fifteenth Street, NW Suite 850  
Washington, DC 20005

Accepted by PHLX:

4/11/2018  
Date

[Signature]  
Robert A. Marchman  
Executive Vice President  
Department of Enforcement

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

**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

Respectfully submitted,

Respondent

Instinet, LLC

2/1/18  
Date

By: Faron Webb

Name: Faron Webb

Title: General Counsel

**Billing and Payment Contact**

Please enter the billing contact information below. Nasdaq MarketWatch will contact you with billing options and payment instructions. ***Please DO NOT submit payment until Nasdaq has sent you an invoice.***

Billing Contact Name: \_\_\_\_\_

Billing Contact Address: \_\_\_\_\_

Billing Contact Email: \_\_\_\_\_

Billing Contact Phone Number: \_\_\_\_\_

STAR No. 20130368360 (incl. merged STAR Nos. 20130376217, 20130382620, 20130384257, 20130386900, 20130395417, 20140399233, 20140402026, 20140416803, 20140422166, 20140430948, 20140435161, 20140436283, 20150451541, 20150463006, 20150463452, 20150481875, 20150482156, 20160502382, 20160504175, 20160509709, 20160514500, 20160521544, 20160525489, 20160526107, 20170543142, 20170545607, 20170551643, 20170554299, 20170555223, 20170561010, 20160485810, and 20160512438) (MWB)