

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013036836015**

TO: Department of Enforcement
Financial Industry Regulatory Authority (“FINRA”)

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

Pursuant to FINRA Rule 9216 of FINRA’s 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, FINRA will not bring any future actions against 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 FINRA, or to which FINRA 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 FINRA:

BACKGROUND

The Firm has been a broker-dealer registered with the Securities and Exchange Commission (the “Commission”) since April 25, 1979, and registered with FINRA since January 14, 1980. 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 does not have a relevant disciplinary history.

SUMMARY

1. In Matter Nos. 20130368360 and 20130384257, the New York Equities Section of FINRA’s Department of Market Regulation (“Market Regulation”) reviewed pre-opening spoofing by the Firm from August 2012 through December 2012, and

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)

the Firm's compliance with Rule 15c3-5 of the Securities Exchange Act of 1934 ("SEA") (the "Market Access Rule").¹

2. In Matter 20130376217, the Trading Analysis Section ("Trading Analysis") of Market Regulation reviewed potential layering and wash trades by the Firm's Market Access Clients from July 17, 2013 through May 29, 2015, and the Firm's compliance with the Market Access Rule.
3. In Matter No. 20150463452, the Market Manipulation Investigations Group of Market Regulation reviewed the Firm's layering surveillances and exception reports in effect from April 2015 through April 2016, and the Firm's compliance with the Market Access Rule.
4. 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.
5. The above matters were part of investigations conducted by Market Regulation on behalf of FINRA and other self-regulatory organizations, including The NASDAQ Stock Market LLC; NASDAQ BX, Inc.; The NASDAQ Options Market LLC; Nasdaq PHLX 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; and BOX Options Exchange LLC (collectively, the "SROs"), to review the Firm's compliance with the Market Access Rule and the supervisory rules of the SROs, including NASD Rule 3010 (for conduct prior to December 1, 2014) and FINRA Rules 3110 (for conduct on or after December 1, 2014) and 2010 during the period of August 2012 through at least November 2017 (the "Review Period").
6. As a result of Market Regulation's investigations, it was determined that, during the Review Period, INCA 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.
7. 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), NASD Rule 3010 (for conduct prior

¹ 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).

to December 1, 2014), and FINRA Rules 3110 (for conduct on or after December 1, 2014) and 2010.

FACTS AND VIOLATIVE CONDUCT

Applicable Rules

8. 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.²
9. 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.
10. 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.
11. SEA 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).³ The required written description is intended, among other things, to assist Commission and SRO staff to assess the broker-dealer’s compliance with the rule.⁴
12. NASD Rule 3010 (for conduct prior to December 1, 2014) and FINRA Rule 3110 (for conduct on or after December 1, 2014) required, among other things, that

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.” 75 Fed. Reg. at 69792.

³ See 17 C.F.R. § 240.15c3-5(b) (emphasis added). 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).

⁴ 75 Fed. Reg. at 69812.

each member firm establish, maintain, and enforce written procedures to enable it to properly supervise the activities of associated persons to assure compliance with applicable securities laws and regulations, and FINRA Rules.

13. During the Review Period, FINRA Rule 2010 provided that member firms, in the conduct of their business, shall observe high standards of commercial honor and just and equitable principles of trade.

Inadequate Supervision of Customer Trading

Spoofing⁵ the Open by INCA's Market Access Clients

14. During the Review Period, prior to January 2014, INCA had procedures and controls to detect potential instances of spoofing prior to the open. Specifically, 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 10% of the security's 30-day average daily volume ("ADV"). However, the exception report only generated exceptions on a per order/cancellation basis and failed to take into account multiple non-bona fide orders by the same customer. Thus, an exception would trigger only if an individual order/cancellation exceeded 10% of the relevant security's ADV.
15. Notwithstanding the exception report, on a number of occasions from August 2012 through January 2014, INCA failed to detect non-bona fide orders entered by two Market Access Clients that exceeded 10% of the relevant security's ADV. This was due to a programming flaw with its control that replaced the comma used as the thousands place separator for share quantity with a period. For example, an order for 100,000 shares would be identified as an order for 100 shares, understating the number of shares at issue for that order.
16. As a result of INCA's unreasonable controls, INCA failed to detect 75 potential instances of pre-opening spoofing by these two Market Access Clients.
17. For example, on January 4, 2013, INCA's Market Access Client entered three market on open orders between 09:04:02 and 09:04:08 to buy 10,000 shares, 50,000 shares, and 20,000 shares of ABC,⁶ respectively. Subsequently, the Market Access Client entered a fourth market on open order to buy 30,000 shares at 09:20:24 for a total of 110,000 shares. Between 09:21:30 and 09:28:50, the Market Access Client executed multiple short sales orders for a total of 9,000 shares at prices ranging from \$19.84 down to \$19.69. Thereafter, between

⁵ "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.

⁶ A generic modifier has been used in place of the name of this security.

9:26:08 and 9:28:53, the Market Access Client cancelled the four buy orders and then covered its short position on the open at the opening price of \$19.60, for a combined realized profit of approximately \$1,141.

18. The 30-day ADV for ABC was 690,127. Thus, the four market on open orders totaling 110,000 shares represented approximately 15.94% of the 30-day ADV. However, INCA failed to detect the orders and cancellations since no single orders exceeded 10% of ABC's 30-day ADV.
19. INCA corrected the programming error and, in January 2014, reduced the thresholds for two of its Market Access Clients from 10% to 5%, but still did not aggregate orders. Thus, an exception would trigger only if an individual (not aggregated) order/cancellation from these customers exceeded 5% of the relevant security's ADV.
20. In certain instances when an exception was triggered, INCA failed to conduct an adequate follow up and review.
21. For example, from April 7, 2015 through June 29, 2016, a Market Access Client of INCA generated approximately 279 pre-opening spoofing exceptions. Despite the number of exceptions, INCA failed to take adequate steps to address this Market Access Client's pre-opening activity.
22. The acts, practices, and conduct described above in paragraphs 14 through 21 constituted violations of SEA Rules 15c3-5(b) and (c)(2), NASD Rule 3010 (for conduct prior to December 1, 2014), and FINRA Rules 3110 (for conduct on or after December 1, 2014) and 2010.

Access to Trading Systems

23. Pursuant to INCA'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, INCA failed to enforce this procedure.
24. Specifically, for the account of two of its Market Access Clients, INCA only pre-approved and authorized the principals of the client. INCA failed to pre-approve the individual traders utilizing INCA's MPID to access the market through the clients and, therefore, did not know the identity of the underlying trader.
25. In addition, because INCA 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 INCA's systems after the trader had been terminated.

26. 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.
27. The acts, practices, and conduct described above in paragraphs 23 through 26 constituted violations of SEA Rules 15c3-5(b) and (c)(2)(iii), NASD Rule 3010 (for conduct prior to December 1, 2014), and FINRA Rules 3110 (for conduct on or after December 1, 2014) and 2010.

Wash Trading

28. During the Review Period, INCA 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.
29. However, INCA was unable to determine if the noted exceptions were valid for the Market Access Clients noted above. Specifically, for those Market Access Clients, INCA 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.
30. As a result, INCA 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, INCA 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.
31. The acts, practices, and conduct described above in paragraphs 28 through 30 constituted violations of SEA Rules 15c3-5(b) and (c)(2), NASD Rule 3010 (for conduct prior to December 1, 2014), and FINRA Rules 3110 (for conduct on or after December 1, 2014) and 2010.

Equities Layering and Spoofing⁷

32. During the Review Period, INCA employed a proprietary alert system to detect potential layering and spoofing by its Market Access Clients. For certain Market

⁷ “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.

Access Clients that previously had accounts with Nomura, INCA also relied upon a third-party surveillance operated by Nomura.

33. However, INCA'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.
34. For exceptions detected by INCA's proprietary alert system, INCA'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.
35. However, there were several deficiencies with INCA's follow-up and review of exceptions flagged by its proprietary surveillance systems. INCA's WSPs failed to describe the steps to be taken in addressing an exception. Specifically, INCA'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 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.
36. 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.
37. As a result, six Market Access Clients were allowed to engage in potential layering and spoofing unabated despite regularly appearing on INCA's and Nomura's exception reports.
38. For example, from April 2013 through December 2013,⁸ a Market Access Client of INCA generated approximately 694 layering and spoofing exceptions on Nomura's third-party surveillance.

⁸ INCA terminated the account on December 31, 2013.

39. Likewise, from January 2013 to on or about October 22, 2013,⁹ another Market Access Client generated approximately 6,288 layering and spoofing alerts on INCA's proprietary surveillance system. During this time period, all INCA clients, in total, generated approximately 10,107 layering and spoofing alerts. Thus, the Market Access Client was responsible for approximately 60% of all INCA's layering and spoofing alerts.
40. The acts, practices, and conduct described above in paragraphs 32 through 39 constituted violations of SEA Rules 15c3-5(b) and (c)(2), NASD Rule 3010 (for conduct prior to December 1, 2014), and FINRA Rules 3110 (for conduct on or after December 1, 2014) and 2010.

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

1. A censure;
2. A fine in the amount of \$1,575,000 of which \$59,500 is payable to FINRA,¹⁰ 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 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 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.

⁹ INCA terminated the account on October 22, 2013.

¹⁰ 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; Nasdaq PHLX 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; and BOX Options Exchange LLC.

Respondent 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. Respondent 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. A bar or expulsion shall become effective upon approval or acceptance of this AWC.

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the 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 National Adjudicatory Council ("NAC") 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 Legal Officer, the NAC, or any member of the NAC, 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 FINRA Rule 9143 or the separation of functions prohibitions of FINRA 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 the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (“ODA”), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; 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 FINRA or any other regulator against the Firm;
 - 2. This AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. 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 FINRA, or to which FINRA 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 FINRA 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. 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 FINRA, nor does it reflect the views of FINRA 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.

2/1/18
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 FINRA:

4/11/2018
Date

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

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