

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014041859401**

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

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

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Citadel Securities LLC ("Citadel Securities" 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 Citadel Securities alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Citadel Securities 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

Citadel Securities has been a FINRA member firm since February 2005. Citadel Securities is headquartered in Chicago, Illinois, and has 6 branch offices and approximately 380 registered individuals. Citadel Securities primarily engages in market making and provides execution services in U.S. equities, options, government securities, and foreign exchange products to millions of customers through its broker-dealer clients.

RELEVANT DISCIPLINARY HISTORY

Citadel Securities does not have any relevant disciplinary history with the Securities and Exchange Commission, any state securities regulators, FINRA, or any other self-regulatory organization.

OVERVIEW

FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders) and FINRA Rule 6460 (Display of Customer Limit Orders) are designed to, among other things, protect customer orders, promote market transparency, and increase quote competition.

In November 2011, Citadel Securities established an Over-the-Counter equity trading desk (the “OTC Desk”) that received orders from the Firm’s broker-dealer clients on behalf of their customers.¹ The Firm sought to program the OTC Desk trading systems to comply with the Trading Ahead and Limit Order Display Rules by providing customer orders automated order protection, quote display, and execution. The OTC Desk, however, implemented controls, settings and processes that removed hundreds of thousands of mostly larger customer orders from those logics. While those controls, settings and processes had multiple purposes, they shared a principal purpose of directing OTC customer orders for manual review and/or handling. Impacted orders were rendered inactive until the completion of a manual trader review. From at least September 2012 to mid-September 2014, the OTC Desk, in many instances, traded ahead of those inactive OTC customer orders in violation of FINRA Rule 5320 and failed to display them as required by FINRA Rule 6460. In addition, from at least October 2012 to September 2018, the OTC Desk failed to display certain customer limit orders as required by FINRA Rule 6460 because of other systems and programming logic.

The Firm failed to establish a supervisory system, including written supervisory procedures (“WSPs”), reasonably designed to achieve compliance with Trading Ahead and Limit Order Display Rules for OTC customer orders. Among other things, Citadel Securities did not establish WSPs requiring supervisory reviews of OTC customer orders for compliance with FINRA Rules 5320 and 6460, nor did the Firm establish any supervisory reports or other tools to allow supervisors to monitor whether OTC customer orders were handled in compliance with those rules, until October 2014 and June 2015, respectively. Furthermore, the reports the Firm implemented with respect to the display of OTC customer limit orders in June 2015 were not reasonably designed to achieve compliance with FINRA Rule 6460.

By virtue of the conduct described herein, Citadel Securities violated NASD Rule 3010(a) and (b) (for conduct before December 1, 2014); FINRA Rule 3110(a) and (b) (for conduct on and after December 1, 2014); FINRA Rule 5320(a) and (b); FINRA Rule 6460; and FINRA Rule 2010.²

¹ For simplicity, these orders are referred to herein as “customer orders.”

² FINRA Rule 2010 requires a member firm, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade. Any violation of FINRA Rules 3110, 5320, or 6460, or NASD Rule 3010 also constitutes a violation of FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Citadel Securities Traded Ahead of Certain Inactive OTC Customer Orders

FINRA Rule 5320(a) provides that “a member that accepts and holds an order in an equity security from its own customer or a customer of another broker-dealer without immediately executing the order is prohibited from trading that security on the same side of the market for its own account at a price that would satisfy the customer order, unless it immediately thereafter executes the customer order up to the size and at the same or better price at which it traded for its own account.” “Immediately” is not defined in the rule, but FINRA has provided guidance that it requires execution as quickly as possible and generally within one minute under normal market conditions.³

At the inception of the OTC Desk in November 2011, Citadel Securities programmed the OTC equity trading systems with automated order protection logic designed to comply with FINRA’s Trading Ahead Rule. However, from September 2012 through mid-September 2014, Citadel Securities employed pre-trade controls, settings and processes that removed hundreds of thousands of OTC customer orders from that logic. While those controls, settings and processes had multiple purposes, they shared a principal purpose of directing mostly larger OTC customer orders for manual review and/or handling. Impacted orders were rendered inactive until the completion of a manual trader review. While OTC customer orders were inactive, Citadel Securities, in many instances, as part of its market making activities, traded for its own account on the same side of the market at prices that would have satisfied the orders, without immediately thereafter executing them up to the size and at the same or better price as it traded for its own account.

To assess the potential trading ahead impact, FINRA reviewed Citadel Securities’ handling of OTC customer orders in an inactive state awaiting manual trader review during the sample month of February 2014. Based on this review, in 559 instances, Citadel Securities traded ahead of 415 inactive OTC customer orders.

By virtue of the foregoing, Citadel Securities violated FINRA Rules 5320(a) and 2010.

³ NASD Notice to Members 06-03 provided guidance relating to NASD Rule 2111, a predecessor of FINRA Rule 5320, including:

If a firm trades through a customer market order that it has accepted, the Rule provides that it must immediately execute such market order. To meet this obligation, a firm must execute the market order as quickly as possible. ... As described in more detail in *NTM 98-78*, under appropriate circumstances, orders need not be filled within one minute if activated during unusual market conditions and if all reasonable steps are taken to execute the transaction as soon as possible following activation.

In Regulatory Notice 11-24, FINRA stated, “Consistent with existing policy, where a provision of new FINRA Rule 5320 is not substantively different from NASD IM-2110-2 or NASD Rule 2111, previously issued interpretations generally will continue to apply (unless rescinded or updated by FINRA).”

Citadel Securities Failed to Consistently Apply Its Written Methodology to Certain OTC Customer Orders

FINRA Rule 5320(b) requires a member to have a written methodology in place governing the execution and priority of all pending orders that is consistent with FINRA Rules 5320 and 5310, and to ensure that the methodology is consistently applied. Citadel Securities' methodology provided, in pertinent part, that principal executions would be allocated first to pending held customer "orders that c[ould] be satisfied by the execution price, in price-time priority."⁴

From at least September 2012 through mid-September 2014, Citadel Securities failed to ensure that its written methodology was applied consistently to OTC customer orders. For OTC customer orders rendered inactive by the aforementioned controls, settings and processes, execution priority depended on when OTC Desk traders manually reviewed and handled the orders, not just the price-time priority described in the Firm's written methodology. The time it took OTC Desk traders to manually handle customer orders ranged based on market factors and their various other responsibilities on the desk. For example, FINRA reviewed Citadel Securities' handling of an impacted OTC customer order on the sample date of March 11, 2014, and identified 17 OTC customer orders executed inconsistent with its written methodology, as well as 52 trades effected for the Firm's own account ahead of the impacted OTC customer order in violation of FINRA Rule 5320(a).

By virtue of the foregoing, Citadel Securities violated FINRA Rule 5320(a) and (b), and FINRA Rule 2010.

Citadel Securities Failed to Display Certain OTC Customer Limit Orders

FINRA Rule 6460(a) requires each OTC Market Maker displaying a priced quotation in any OTC Equity Security in an inter-dealer quotation system to publish immediately a bid or offer that reflects: (1) the price and the full size of each customer limit order held by the OTC Market Maker that is at a price that would improve the bid or offer of such OTC Market Maker in such security; and (2) the full size of each customer limit order held by the OTC Market Maker that: (i) is priced equal to the bid or offer of such OTC Market Maker for such security, (ii) is priced equal to the best bid or best offer of the inter-dealer quotation system in which the OTC Market Maker is quoting, and (iii) represents more than a de minimis change in relation to the size associated with the OTC Market Maker's bid or offer.

FINRA Rule 6460 does not define "immediately." However, guidance provides that absent an exception, firms must display customer limit orders "as soon as is practicable after receipt which, under normal market conditions, would require display no later than

⁴ Price-time priority means that the Firm first prioritized orders for execution based on price, and then prioritized orders at the same price based on earliest time of receipt.

30 seconds after receipt.”⁵ While OTC market openings are generally not viewed as “normal market conditions” for this purpose, customer “limit orders held at the opening must be displayed as soon as practicable under the circumstances.”⁶

FINRA has provided guidance addressing the circumstance where display of a customer limit order would cause an OTC Market Maker to display a locking or crossing quotation:

FINRA expects firms’ policies and procedures to require the quoting participant to make “reasonable efforts” to first contact or route an order to execute against the full displayed size of any quotation before locking or crossing that quotation. ... If a firm has made reasonable attempts to access another firm’s already-existing quotation but is unable to do so, such firm may then display its quotation, even if it would lock or cross the quotation of the other firm.⁷

FINRA has also provided guidance that systematically delaying display violates FINRA Rule 6460. FINRA Regulatory Notice 10-42 provides, “[A]ny systematic delay in the display of customer limit orders, regardless of how long, would constitute a violation of FINRA’s limit order display rule.”⁸

At the inception of the OTC Desk in November 2011, Citadel Securities programmed its trading systems to immediately display non-marketable customer limit orders that would improve its displayed quotation and met the minimum quotation size requirements of FINRA Rule 6433. For marketable OTC customer limit orders, on the other hand, Citadel Securities programmed its systems to immediately execute them principally and/or immediately send outbound OTC Link messages attempting to execute them against quotations displayed by other market makers.⁹

Despite the foregoing, there were various circumstances where OTC customer limit orders that required display under FINRA Rule 6460 were handled manually or were subject to delayed automated handling, which, in certain instances, resulted in the Firm failing to handle the orders in compliance with FINRA Rule 6460. First, as described above, the OTC Desk employed certain controls, settings and processes that rendered mostly larger customer orders inactive pending a manual trader review. Second, Citadel Securities allowed OTC traders to disable the system component that automatically sent

⁵ FINRA Regulatory Notice 10-42, at 5 (Sept. 2010).

⁶ NASD Regulatory & Compliance Alert: “Automated Systems for Compliance with the Limit Order Display Rule” (Mar. 1998); SEC Division of Market Regulation, *Interpretative Guidance on the Order Execution Rules*, at 3 (Nov. 22, 1996).

⁷ FINRA Regulatory Notice 10-42, at 7 (Sept. 2010); *see also* FINRA Rule 6437(b) (defining “crossing quotation” and “locking quotation”).

⁸ FINRA Regulatory Notice 10-42, at n.11 (Sept. 2010); *see also* NASD Notice to Members 99-99, at 751 (Dec. 1999) (“[U]nder no circumstances can a firm intentionally delay—or rely on an automated system that is programmed to delay—the display of limit orders as a matter of course”).

⁹ OTC Link LLC is an inter-dealer quotation system that provides subscribing broker-dealers, like Citadel Securities, messaging capability for the purpose of trade negotiation.

OTC Link messages on a symbol-by-symbol basis, causing marketable limit orders in disabled symbols to be handled manually. Third, from February 2016 to December 2017, Citadel Securities programmed its systems, in the event that an outbound OTC Link message expired after 30 seconds leaving the order unexecuted, to systematically delay sending another outbound OTC Link message to the same unresponsive market maker for 3 seconds, resulting in a delay of 33 seconds between the Firm's outbound OTC Link messages. The three-second delay was to allow the unresponsive market maker an opportunity to update its quotation. Finally, Citadel Securities' display of customer limit orders was sometimes delayed due to market data issues or because manual trader intervention was required as part of its internal opening cross process.

FINRA reviewed 467 OTC customer limit orders handled by Citadel Securities during the period October 2012 through September 2018, and determined that Citadel Securities violated FINRA Rule 6460 with respect to 215 of those orders as follows:

- For 126 marketable orders, Citadel Securities did not make reasonable efforts to execute against the existing quotation within 30 seconds of order receipt (or as soon as practicable after the open for some orders), which would have allowed Citadel Securities to display the orders. Citadel Securities also did not take alternative steps of immediately executing, routing, or cancelling those orders upon receipt.
- For 49 non-marketable orders, Citadel Securities failed to immediately display, execute, route or cancel the orders within 30 seconds after receipt (or as soon as practicable after the open for some orders).
- For 36 marketable orders, Citadel Securities failed to make a subsequent attempt to access the quote of another market maker within 30 seconds after sending a prior OTC Link message.
- For four non-marketable orders, Citadel Securities immediately displayed the price, but not the full size of the orders, in its quote.

By virtue of the foregoing, Citadel Securities violated FINRA Rules 6460 and 2010.

Citadel Securities' Supervisory Failures

FINRA Rule 3110(a), and its predecessor NASD Rule 3010(a), require member firms to establish and maintain a system, including written procedures, reasonably designed to supervise the activities of their associated persons and to achieve compliance with applicable securities laws and regulations, and with applicable FINRA Rules.¹⁰ FINRA Rule 3110(b), and its predecessor NASD Rule 3010(b), require member firms to establish, maintain, and enforce written procedures to supervise the types of business in which they engage and the activities of their associated persons that are reasonably

¹⁰ FINRA Rule 3110 replaced NASD Rule 3010 effective on December 1, 2014.

designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA Rules.

From November 2011 to October 2014, Citadel Securities failed to establish and maintain a supervisory system for the OTC Desk, including WSPs, reasonably designed to achieve compliance with the Trading Ahead Rule and the requirement to ensure that its written methodology was consistently applied. In November 2011, Citadel Securities established written procedures describing FINRA Rule 5320 and instructing personnel to comply therewith. However, during this period, Citadel Securities did not establish WSPs requiring supervisory reviews of OTC customer orders for compliance with FINRA Rule 5320(a) or (b), nor did the Firm establish any supervisory reports or other tools to allow supervisors to monitor whether customer orders were handled, either by the OTC Desk trading systems or manually by OTC Desk traders, in compliance with these requirements.¹¹

From November 2011 to mid-June 2020, Citadel Securities failed to establish and maintain a supervisory system, including WSPs, reasonably designed to achieve compliance with the Limit Order Display Rule. Prior to June 2015, Citadel Securities did not establish any WSPs requiring supervisory reviews of OTC customer limit orders for compliance with FINRA Rule 6460, nor did the Firm establish any supervisory reports or other tools to allow supervisors to monitor whether customer limit orders were handled, either by the OTC Desk trading systems or manually by OTC Desk traders, in compliance with FINRA Rule 6460. In June 2015, the Firm established display supervisory reports and WSPs requiring OTC Desk supervisors to review those reports. Nonetheless, from June 2015 to mid-June 2020, Citadel Securities' display supervisory system remained unreasonable because it excluded certain categories of OTC customer limit orders from its reports and the ensuing supervisory reviews. For example, Citadel Securities excluded marketable OTC customer limit orders that, if displayed, would have locked or crossed another market maker's quotation, so long as the Firm made a *single* attempt within 30 seconds after receipt to execute against the existing quotation by sending an outbound OTC Link message. This was not consistent with the guidance in Regulatory Notice 10-42 to make "reasonable efforts" to execute against an existing quotation before locking or crossing it, nor with Citadel Securities' own written procedures requiring such "reasonable efforts." Because of this exclusion, as well as other limitations to its reports, Citadel Securities did not perform reasonable supervisory reviews of the majority of the FINRA Rule 6460 violations described herein.

Citadel Securities allowed its OTC Desk traders to override its automated order handling logics to direct orders for manual review and handling. From January 9, 2013 to August 7, 2015, OTC Desk traders could set quantity thresholds on a symbol-by-symbol basis for sending customer orders for manual review and handling. As a result, those customer orders were rendered inactive and not covered by the Firm's automated order protection, display and execution logics, until they were manually reviewed by an OTC Desk trader.

¹¹ Citadel Securities performed routine monitoring of the OTC Desk trading systems for, among other things, latencies and disruptions, but this monitoring was not directed at whether customer orders were handled in compliance with FINRA Rules 5320 and 6460.

From November 2011 to April 2018, OTC Desk traders were permitted to disable the system component that automatically sent OTC Link messages on a symbol-by-symbol basis. As a result, marketable customer orders in disabled symbols were handled manually. Citadel Securities did not establish any supervisory system or written procedures with respect to the implementation, review, or modification of these overrides by OTC Desk traders.

By virtue of the foregoing, Citadel Securities violated NASD Rule 3010(a) and (b) (for conduct before December 1, 2014); FINRA Rule 3110(a) and (b) (for conduct on and after December 1, 2014); and FINRA Rule 2010.

B. Citadel Securities also consents to the imposition of the following sanctions:

1. A censure;
2. A fine of \$700,000; and
3. The Firm agrees to comply with the following undertakings:
 - a. Restitution. The Firm will provide restitution to each corresponding Firm client for the customer orders that it executed at prices worse than it traded for its own account as a result of the FINRA Rule 5320(a) violations described in Section I.A above (the “Eligible Orders”).
 - i. Within 60 calendar days of the Notice of Acceptance of this AWC, the Firm will submit to FINRA a schedule of each Firm client with Eligible Orders identified for restitution and include the details of the total dollar amounts of restitution that will be provided to each Firm client for each Eligible Order using the methodology previously reviewed by FINRA. For each Eligible Order, the Firm will provide restitution, plus interest, from the date of order execution through the payment date at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2).
 - ii. A registered principal on behalf of the Firm shall submit satisfactory proof of payment of restitution and pre-judgment interest (separately specifying the date and amount paid to each Firm client for each Eligible Order) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of a registered principal of Citadel Securities. The email must identify the Firm and the case number, and include a copy of the check, money order or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 calendar days after the Notice of Acceptance of this AWC.
 - iii. The Firm shall request that each client: (1) make reasonable and documented efforts to locate and provide restitution to each customer

associated with an Eligible Order; (2) forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided; and (3) provide written confirmation to Citadel Securities within 150 calendar days after the Notice of Acceptance of this AWC that the client has (a) made such reasonable and documented efforts, and (b) forwarded undistributed restitution and interest to the appropriate state authority, if applicable. Within 180 calendar days after the Notice of Acceptance of this AWC, or such additional period agreed to by a FINRA staff member in writing, the Firm shall provide such written confirmations to FINRA in the manner described above.

- iv. The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.
- v. Restitution payments shall be preceded or accompanied by a letter, not unacceptable to FINRA staff, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

- b. Certification. Within 120 calendar days of the Notice of Acceptance of this AWC, a duly authorized Senior Officer of Citadel Securities shall submit to FINRA's Department of Enforcement a written certification that (i) Citadel Securities has completed a review of its systems, policies, and procedures regarding the display of OTC customer limit orders, and (ii) as of the date of the certification, Citadel Securities' systems, policies, and procedures are reasonably designed to achieve compliance with FINRA rules and the federal securities laws and regulations applicable to the display of OTC customer limit orders. The certification shall be submitted by letter addressed to Shanyn Gillespie, Principal Counsel, at the address below.

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

The Firm specifically and voluntarily waives any right to claim an inability 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

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

- A. To have a Complaint issued specifying the allegations against it;
- 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, the Firm 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.

The Firm 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

Citadel Securities 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 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 action 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. 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 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. 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 FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Respondent 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 it to submit it.

July 9, 2020

Date

Citadel Securities LLC
Respondent

By: Steve Luparello

Print Name: Steve Luparello

Title: General Counsel

Reviewed by:

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

Accepted by FINRA:

July 16, 2020

Date

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

Shanyn Gillespie
Shanyn L. Gillespie
Principal Counsel
FINRA
Department of Enforcement
15200 Omega Drive, Suite 300
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