

Response to The NASDAQ BX, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Provide a Process for an Expedited Suspension Proceeding and Adopt a Rule to Prohibit Disruptive Options Quoting and Trading Activity, File Number SR-BX-2016-036

In June 2016, we responded to the SEC request for comment on a similar proposal from the NASDAQ BX parent, NASDAQ, for new rules to prohibit disruptive quoting and trading activity. The NASDAQ BX proposal contains substantially similar wording, cites the same examples of abusive trading that were discovered and watched in real-time by Self-Regulatory Organizations (“SROs”) without being halted and fails to name any prohibitions from the Exchange Rules or SEC rules and regulations stopping NASDAQ BX from enforcing its’ duties to protect investors and the markets from known fraud. Therefore, this NASDAQ BX proposal raises the same questions we posed regarding the previous NASDAQ proposal.¹

As previously stated, the proposals from the NASDAQ and now NASDAQ BX acknowledge two very sobering realities of the functioning of today’s securities markets: 1) SROs can and do detect/observe and follow illegal behavior in the U.S. markets in real-time, or near real-time, and 2) if they act upon it they take years to resolve the issues as they continue to watch the same participants actively engaging in the illegal activity in real-time.

The SROs are mandated by Congress to protect investors and enforce all federal securities laws, rules and regulations and their own rules. Like the NASDAQ, NASDAQ BX has proposed these new rules to allow it to prohibit disruptive trading (specifically layering and spoofing type activity), with an expedited suspension.

Spoofing and layering has previously been defined by the SEC as market manipulation. We do not believe NASDAQ BX should be creating new rules to isolate specific types of manipulative or disruptive activity outside of the general intent of Congress.

Since the inception of the 1930s Securities and Exchange Acts, market regulators have considered activity that artificially influences bids/offers to entice purchases and sales or alter prices as illegal (i.e. including spoofing and layering type activity).²

¹ *Response to The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Provide a Process for an Expedited Suspension Proceeding and Adopt a Rule to Prohibit Disruptive Quoting and Trading Activity, File Number SR-NASDAQ-2016-074*, dated June 1, 2016
<https://www.sec.gov/comments/sr-nasdaq-2016-074/nasdaq2016074-1.pdf>

Follow-Up Response to The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Provide a Process for an Expedited Suspension Proceeding and Adopt a Rule to Prohibit Disruptive Quoting and Trading Activity, File Number SR-NASDAQ-2016-074, dated June 21, 2016
<https://www.sec.gov/comments/sr-nasdaq-2016-074/nasdaq2016074-2.pdf>

²As an example, see NASD Regulation, Inc., Office Of Hearing Officers Department Of Enforcement v. Stephen Carlson, et al., Disciplinary Proceeding No. CAF980002 (CRD # 1008099), Hearing Panel Decision as to Respondents John Fiero and Fiero Brothers, Inc. (CRD # 1190133) (CRD # 27269) New York, NY, December 6, 2000 <http://www.finra.org/sites/default/files/OHODDecision/p006659.pdf>

The Fiero Respondents were charged with alleged violations of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120, 2110 and 3370.

The NASD Hearing Panel has quoted a 1977 U.S. Supreme Court decision:³

“In enacting section 10(b) [of the Exchange Act], ‘Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.’” United States v. Regan, 937 F.2d 823, 829 (2d Cir. 1991), quoting Santa Fe Industries v. Green, 430 U.S. 462, 477 (1977).”

As shown below, rules currently exist for the NASDAQ BX to stop a wide variety of illegal activity in an expedited time period, including pre-execution layering and spoofing. Additionally, NASDAQ BX has a Regulatory Services Agreement with FINRA and FINRA also has existing rules/tools that allow it to halt disruptive and manipulative trading of any nature across all exchanges by FINRA members, including through cease and desist orders.

In other words, both NASDAQ BX and FINRA have the ability and duty to maintain fair and orderly markets and temporarily suspend a member firm executing or facilitating a pattern and practice of abusive behavior that is harmful to investors or the market.

Given the tools already exist for both NASDAQ BX and FINRA; we question the necessity and relevance to have an additional rule for these specific types of illegal activity that allows the NASDAQ BX to halt disruptive and manipulative trading. Is this proposal intended to provide an appearance of active, tough enforcement without changing the SRO’s actual enforcement program, which recent history shows to be a minimalist approach taking significant time to implement against its’ members acting abusively?

Will the new NASDAQ BX and NASDAQ rules generate any enforcement actions in a faster time frame? Under the existing rules NASDAQ BX, NASDAQ, FINRA and the other SROs have not provided real-time enforcement, which is confirmed by NASDAQ BX’s arguments set forth in the new rules.

There are endless examples of abusive manipulative trading occurring across the markets that the SROs claim they can detect in real-time, or almost real-time, that go unchecked for years. How will these proposed rules change the NASDAQ BX/FINRA enforcement regime that has been highly criticized within the securities industry for having very serious and obvious conflicts of interest?

Again, NASDAQ BX appears to have all the necessary tools available to halt the alleged illegal activity it was watching on a continuous basis. Moreover, FINRA, as an agent of the NASDAQ BX and the overall industry supervisor also had/has the tools available.

NASDAQ BX Rules

Below are the applicable NASDAQ BX and FINRA rules that already exist and apply to NASDAQ BX and FINRA members. The NASDAQ BX did not explain how the newly proposed rules supplement NASDAQ BX’s and its’ enforcement partner, FINRA’s, existing authority under NASDAQ BX rules 9290, 9556, 9810 and 9860, other than giving an illusion that something will/has changed. The new rules appear to add little or nothing to the ability of

³ Hearing Panel Decision as to Respondents John Fiero and Fiero Brothers, Inc. (CRD # 1190133) (CRD # 27269) New York, NY, December 6, 2000 <http://www.finra.org/sites/default/files/OHODDecision/p006659.pdf>

NASDAQ BX and FINRA to enforce securities laws and their own rules through their already existing tools to stop abusive and egregious behavior against companies and their shareholders.⁴

9290. Expedited Disciplinary Proceedings

For any disciplinary proceeding, the subject matter of which also is subject to a temporary cease and desist proceeding initiated pursuant to Rule 9810 or a temporary cease and desist order, hearings shall be held and decisions shall be rendered at the earliest possible time. An expedited hearing schedule shall be determined at a pre-hearing conference held in accordance with Rule 9241.

9556. Failure to Comply with Temporary and Permanent Cease and Desist Orders

(a) Notice of Suspension, Cancellation or Bar

If a member, person associated with a member or person subject to the Exchange's jurisdiction fails to comply with a temporary or permanent cease and desist order issued under the Rule 9200, 9300 or 9800 Series, the Exchange's Regulation Department staff — after receiving written authorization from the Chief Regulatory Officer — may issue a notice to such member or person stating that the failure to comply with the temporary or permanent cease and desist order within seven days of service of the notice will result in a suspension or cancellation of membership or a suspension or bar from associating with any member.

9800. Temporary Cease and Desist Orders

9810. Initiation of Proceeding

(a) Department of Enforcement or Department of Market Regulation

With the prior written authorization of FINRA's Chairman and CEO or FINRA's Senior Vice President for Regulatory Policy and Programs, the Department of Enforcement or the Department of Market Regulation may initiate a temporary cease and desist proceeding with respect to alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder; SEC Rules 15g-1 through 15g-9; Equity Rule 2110 (if the alleged violation is unauthorized trading, or misuse or conversion of customer assets, or based on violations of Section 17(a) of the Securities Act of 1933); Equity Rule 2120; or Equity Rule 2150 (if the alleged violation is misuse or conversion of customer assets). The Department of Enforcement or the Department of Market Regulation shall initiate the proceeding by serving a notice on a member or associated person (hereinafter "Respondent") and filing a copy thereof with the Office of Hearing Officers. The Department of Enforcement or the Department of Market Regulation shall serve the notice by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Department of Enforcement or the Department of Market Regulation shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

⁴ The proposed rule may allow the NASDAQ authority to sign a cease and desist order without obtaining a FINRA executive signatory. However, they have working agreements with each other, thus this change alters little in their current ability to impose expedited suspensions.

9860. Violation of Temporary Cease and Desist Orders

A Respondent who violates a temporary cease and desist order imposed under this Rule Series may have its association or membership suspended or canceled under Rule 9556. The Chief Regulatory Officer of the Exchange must authorize the initiation of any such proceeding in writing.

FINRA Rules

9290. Expedited Disciplinary Proceedings

For any disciplinary proceeding, the subject matter of which also is subject to a temporary cease and desist proceeding initiated pursuant to Rule 9810 or a temporary cease and desist order, hearings shall be held and decisions shall be rendered at the earliest possible time. An expedited hearing schedule shall be determined at a pre-hearing conference held in accordance with Rule 9241.

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If a member, person associated with a member or person subject to FINRA's jurisdiction fails to comply with a temporary or permanent cease and desist order issued under the Rule 9200, 9300 or 9800 Series, FINRA staff, after receiving written authorization from FINRA's Chief Executive Officer or such other senior officer as the Chief Executive Officer may designate, may issue a notice to such member or person stating that the failure to comply with the temporary or permanent cease and desist order within seven days of service of the notice will result in a suspension or cancellation of membership or a suspension or bar from associating with any member.

9800. TEMPORARY CEASE AND DESIST ORDERS

9810. Initiation of Proceeding

(a) Department of Enforcement or Department of Market Regulation

With the prior written authorization of FINRA's Chief Executive Officer or such other senior officers as the Chief Executive Officer may designate, the Department of Enforcement or the Department of Market Regulation may initiate a temporary cease and desist proceeding with respect to alleged violations of Section 10(b) of the Exchange Act and SEA Rule 10b-5 thereunder; SEA Rules 15g-1 through 15g-9; FINRA Rule 2010 (if the alleged violation is unauthorized trading, or misuse or conversion of customer assets, or based on violations of Section 17(a) of the Securities Act); FINRA Rule 2020; or FINRA Rule 4330 (if the alleged violation is misuse or conversion of customer assets). The Department of Enforcement or the Department of Market Regulation shall initiate the proceeding by serving a notice on a member or associated person (hereinafter "Respondent") (or upon counsel representing the Respondent, or other person authorized to represent others under Rule 9141, when counsel or other person authorized to represent others under Rule 9141 agrees to accept service for the Respondent) and filing a copy thereof with the Office of Hearing Officers. The Department of Enforcement or the

Department of Market Regulation shall serve the notice by personal service, overnight commercial courier, facsimile, or email. If service is made by facsimile or email, the Department of Enforcement or the Department of Market Regulation shall send an additional copy of the notice by personal service or overnight commercial courier. Service is complete upon sending the notice by facsimile or email, sending the notice by overnight courier or delivering it in person, except that, where duplicate service is required, service is complete when the duplicate service is complete. The notice shall be effective when service is complete.

9860. Violation of Temporary Cease and Desist Orders

A Respondent who violates a temporary cease and desist order imposed under this Rule Series may have its association or membership suspended or canceled or be subject to any fitting sanction under Rule 9556. FINRA's Chief Executive Officer or such other senior officer as the Chief Executive Officer may designate must authorize the initiation of any such proceeding in writing.