

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 98346 / September 11, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21648

In the Matter of

**SIMPLEX TRADING,
LLC**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 15(b) AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Simplex Trading, LLC (“Simplex” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. This proceeding involves Simplex Trading, LLC, a registered broker-dealer located in Chicago, Illinois that engages in proprietary options trading. From at least October 2018 through December 2020, Simplex engaged in opportunistic, proprietary options trading and executed short sales of millions of shares of the underlying stocks to hedge that trading without locating shares of those stocks to borrow in improper reliance upon the bona-fide market making exception to the locate requirement set forth in Rule 203(b)(1) of Regulation SHO. Simplex executed approximately 19,000 short sales without complying with the locate requirement during this period. As a result, Simplex willfully¹ violated Rule 203(b)(1) of Regulation SHO.

Respondent

2. Simplex was formed in February 2010 in Delaware, with its headquarters and operations in Chicago, Illinois. Simplex is registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act. Simplex operates as a proprietary trading firm and is also registered as a market maker in the symbols it trades on U.S. options exchanges.

Facts

Background

3. Rule 203(b)(1) of Regulation SHO generally prohibits a broker-dealer from accepting a short sale order in an equity security from another person, or effecting a short sale in an equity security for the broker-dealer's own account, unless the broker-dealer has: borrowed the security, entered into a bona-fide arrangement to borrow the security, or has reasonable grounds to believe that the security can be borrowed so that it can be delivered on the delivery date, and has documented compliance with the requirement. 17 CFR 242.203(b)(1). This is generally referred to as the "locate requirement."

4. Rule 203(b)(2)(iii) of Regulation SHO provides an exception to the "locate requirement" for short sales effected by a market maker in connection with "bona-fide market making activities" in the security for which the exception is claimed. 17 CFR 242.203(b)(2)(iii).

¹ "Willfully," for purposes of imposing relief under Section 15(b) of the Exchange Act "means no more than that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

This exception is available only to U.S.-registered broker-dealers who are engaged in bona-fide market making activities.

5. Section 3(a)(38) of the Exchange Act defines the term “market maker” as “any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.” The Commission has stated that for purposes of Regulation SHO, a market maker engaged in bona-fide market making is a “broker-dealer that deals on a regular basis with other broker-dealers, actively buying and selling the subject security as well as regularly and continuously placing quotations in a quotation medium on both the bid and ask side of the market.” Amendments to Regulation SHO, 73 Fed. Reg. 61690, 61698 (Oct. 17, 2008) (“2008 Amendments”).

6. The Commission has further stated that, for purposes of claiming the bona-fide market making exception to the locate requirement, a market maker must be a market maker in the security being sold, and must also be engaged in bona-fide market making in that security at the time of the short sale. *See* Amendments to Regulation SHO (Interim Final Temporary Rule), 73 Fed. Reg. 61706, 61708 n.12 (Oct. 17, 2008). Determining whether or not a market maker is engaged in bona-fide market making “depend[s] on the facts and circumstances of the particular activity” and must be made on a trade-by-trade basis. *See* 2008 Amendments at 61699 and Reporting of Securities Loans, 86 Fed. Reg. 69802, 69805 n.27 (Dec. 8, 2021).

7. In the 2008 Amendments, the Commission provided a non-exclusive set of examples of the types of activities that indicate that a market maker is engaged in bona-fide market making activities for purposes of claiming the bona-fide market making exception to the locate requirement in Rule 203(b)(1). Indicia that a market maker is engaged in bona-fide market making include: (i) if a market maker incurs economic or market risk with respect to the securities (e.g., by putting their own capital at risk to provide continuous two-sided quotes in markets); (ii) a pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers; and (iii) continuous quotations that are at or near the market on both sides and that are communicated and represented in a way that makes them widely accessible to investors and other broker-dealers. *See* 2008 Amendments at 61699.

8. Examples of the types of activities that indicate a market maker is not engaged in bona-fide market making activities include: (i) activity that is related to speculative selling strategies or investment purposes of the broker-dealer and is disproportionate to the usual market making patterns or practices of the broker-dealer in that security; (ii) where a market maker posts continually at or near the best offer, but does not also post at or near the best bid; and (iii) where a market maker continually executes short sales away from its posted quotes. *See* 2008 Amendments at 61699.

9. Further, it is incumbent on the person asserting an exemption to demonstrate eligibility for the exemption.²

Simplex's Short Sales Without Locates

10. From October 2018 through December 2020 (“relevant period”), Simplex sent continuous quotations in options strike prices where the firm was an exchange-designated market maker. While the firm’s continuous options quotes complied with various exchange requirements, they were generally posted far outside the national best bid and offer (“NBBO”) and, were generally not intended to be traded against, and were rarely traded against.

11. During the relevant period, Simplex engaged in proprietary trading by executing options trades that were not the result of the above-described quoting activity but were instead the result of sending opportunistic orders to the markets inside the NBBO, pursuant to which Simplex intended to trade for profit.

12. Thus, while regularly posting options quotes on exchanges far outside of the NBBO, Simplex continuously placed orders and executed proprietary options trades inside of the NBBO. Simplex hedged risks in connection with its opportunistic, proprietary options trading strategies by executing short sales in the underlying equity securities. These short sales were not executed in connection with the quotes posted by Simplex on the exchanges, and were not the result of bona-fide market making activities.

13. Illustrative examples of Simplex’s violative conduct include, but are not limited to:

On July 3, 2019, for an options series of Company A, Simplex posted quotes on exchanges that were not at or near the NBBO. Simplex’s average spread between its posted bid and offer was \$0.46, and the average spread for the NBBO was \$0.02. During this same time period, Simplex placed orders and executed proprietary trades for those options inside the NBBO. On the same day, Simplex sold short over 117,000 shares of the underlying stock of Company A to hedge its proprietary options trading without obtaining any locates or borrowing shares of Company A stock.

On August 2, 2019, for an options series of Company B, Simplex posted quotes that were not at or near the NBBO. Simplex’s average spread between its bid and offer was \$4.96, and the average spread for the NBBO was \$0.24. During this same time period, Simplex placed orders and executed proprietary trades for those options inside the NBBO. On the same day, Simplex sold short over 244,000 shares of the underlying stock of Company B to hedge its proprietary options trading without obtaining any locates or borrowing shares of Company B stock.

On July 10, 2020, for an options series of Company C, Simplex posted quotes that were not at or near the NBBO. Simplex’s average spread between its bid and offer was \$9.95, and the average spread for the NBBO was \$0.63. During this same time period, Simplex placed orders and

² “[T]he general rule of statutory construction that the burden of proving justification or exemption under a special exception to the prohibitions of a statute generally rests on one who claims its benefits . . .” *FTC v. Morton Salt Co.*, 334 U.S. 37, 44 (1948).

executed proprietary trades for those options inside the NBBO. On the same day, Simplex sold short over 862,000 shares of the underlying stock of Company C to hedge its proprietary options trading, without obtaining any locates or borrowing shares of Company C stock.

14 Simplex's short sales of the underlying stock did not qualify for the bona-fide market making exception to the locate requirement because Simplex was not engaged in bona-fide options market making activity at the time of its short sales in the underlying stock. In particular, Simplex did not post continuous options quotations at or near both sides of the market, and incurred limited economic or market risk because its options quotes were very rarely at or near the NBBO. Further, Simplex's short selling in the underlying stock was not bona-fide market making because it was done to hedge Simplex's speculative, proprietary options trading strategies.

15. During the relevant period, Simplex utilized a short sale pre-authorization system as an internal control with regard to compliance with the locate requirement of Regulation SHO. This pre-authorization system was intended to require Simplex's traders to obtain authorization for short sales by entering the specific number of shares of a security that they intended to sell short based on either: (1) the security's inclusion on an easy to borrow list provided by its clearing firm or (2) on Simplex having affirmatively obtained a locate before effecting the short sale for the number of shares of the security that were being sold short. However, in improper reliance upon the bona-fide market making exception, Simplex entered hundreds of thousands of shares into the pre-authorization system to execute short sales in those securities in circumstances when the securities were not on the easy to borrow list and Simplex had not affirmatively obtained locates for the number of securities that were to be sold short before effecting those short sales. As a result, Simplex did not obtain locates for thousands of short sale orders in violation of Rule 203(b) of Regulation SHO.

16. In October 2020, staff in the Commission's Division of Examinations raised concerns about Simplex's failure to comply with the locate requirement for its short sales. In approximately December 2020, Simplex changed its policies and procedures to require traders to affirmatively obtain locates for the number of shares that are expected to be sold short before effecting all short sales where the security is not on an easy to borrow list, and does not allow pre-authorization of short sales in excess of the amount of locates affirmatively obtained.

Violations

17. As a result of the conduct described above, Simplex willfully violated Rule 203(b)(1) of Regulation SHO.

Simplex's Remedial Efforts

18. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Simplex's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Simplex cease and desist from committing or causing any violations and any future violations of Rule 203(b) of Regulation SHO.

B. Respondent Simplex is censured.

C. Respondent Simplex shall, within twenty-one (21) days of the entry of this Order pay a civil monetary penalty in the amount of \$200,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Simplex as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Anne C. McKinley, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Street, Suite 1450, Chicago, IL 60604.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary