

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70740 / October 22, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30753 / October 22, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14853

In the Matter of

**OX Trading, LLC,
optionsXpress, Inc., and
Thomas E. Stern**

Respondents.

**ORDER MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT
OF 1934 AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940
AS TO THOMAS E. STERN**

I.

On April 19, 2012, the Securities and Exchange Commission (“Commission”) instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against Thomas E. Stern (“Respondent” or “Stern”).

II.

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 him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. SUMMARY

1. These proceedings arise out of registration violations relating to OX Trading, LLC ("OX Trading"), which, during the relevant period, was a subsidiary of optionsXpress Holdings, Inc. ("Holdings"). OX Trading was formed in 2007 to provide customers of optionsXpress, Inc. ("optionsXpress"), a registered broker-dealer that was also a subsidiary of Holdings, price improvement on their orders via internalization of options trades. OX Trading provided price improvement by becoming the counterparty to certain customer orders of optionsXpress. As a result of taking the customers' trades, OX Trading established positions which it then would try to hedge in such a way as to make a profit.

2. Stern, OX Trading's Chief Financial Officer and Chief Compliance Officer ("CFO") and optionsXpress' CFO, registered OX Trading with the Commission as a dealer effective February 1, 2008. At the time, OX Trading was a member of the Chicago Board Options Exchange ("CBOE"). As a member of the CBOE, OX Trading was required to be audited on an annual basis. OX Trading, however, refused to pay for an audit and, instead, Stern terminated OX Trading's membership with the CBOE effective March 2, 2009. After the Commission notified OX Trading a few months later that it could not be a registered dealer unless it was a member of an exchange or FINRA, Stern deregistered OX Trading. OX Trading's registration with the Commission ended on October 17, 2009. OX Trading, however, continued to operate in the same manner as it did when it was registered with the Commission and a member of the CBOE, except that it conducted its trading through a customer portfolio margin account at optionsXpress.

3. During a portfolio margin examination in late 2009, CBOE discovered the account and told Stern, in April 2010, that OX Trading was required to register as a dealer. Stern, however, did not file OX Trading's registration application with the Commission until July 20, 2010. OX Trading's registration did not become effective until November 16, 2010, because OX Trading failed to become a member/permit holder of an exchange until that date.

4. Accordingly, as Chief Administrative Law Judge Brenda Murray found on September 5, 2012, from October 17, 2009 to November 16, 2010, OX Trading violated Section 15(a) of the Exchange Act which makes it unlawful to induce or attempt to induce any purchase or sale of a security unless such a dealer is registered. Further, from March 2, 2009 to November 16, 2010, OX Trading violated Section 15(b)(8) of the Exchange Act which makes it unlawful for a dealer to effect any transaction in any security (other than commercial paper, bankers' acceptances, or commercial bills) unless it is a member of a registered national securities association or effects transactions solely on a national exchange of which it is a member. Stern caused and aided and abetted OX Trading's violations of Sections 15(a) and 15(b)(8) of the Exchange Act as he knew or should have known that his acts or omissions as described above would contribute to these violations.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

B. RESPONDENT

5. Stern, 68, of Chicago, IL, was the Chief Financial Officer, Secretary, Director, and Chief Compliance Officer of OX Trading; the Chief Financial Officer of optionsXpress; the Chief Administrative Officer of Holdings; the President and Chief Executive Officer, Chief Compliance Officer and Director of optionsXpress International, Inc.; and the Chief Financial Officer and Director of brokersXpress, LLC. At the time of the events herein, he was a board member of the Options Clearing Corporation. He holds Series 3, 4, 7, 24, 27, and 63 licenses.

C. OTHER RELEVANT ENTITIES

6. OX Trading is currently an inactive Delaware limited liability company. OX Trading had its principal place of business in Chicago, IL. It was created to provide price improvement to customers of optionsXpress. It is a subsidiary of Holdings. On September 1, 2011, after the relevant time period, Holdings became a wholly-owned subsidiary of The Charles Schwab Corporation (“Schwab”). After being acquired by Schwab, OX Trading ceased doing business in any capacity in February 2012.

7. optionsXpress is a Delaware corporation with a principal place of business in Chicago, IL. optionsXpress is a self-clearing, retail, on-line broker specializing in options and futures. It is registered with the Commission, the Financial Industry Regulatory Authority (“FINRA”), CBOE, various stock exchanges, and 53 states and territories. optionsXpress is a subsidiary of Holdings. On September 1, 2011, Holdings became a wholly-owned subsidiary of Schwab.

D. FINDINGS

OX Trading Is Registered as a Broker-Dealer

8. OX Trading was formed in August 2007 with Stern as the Chief Financial Officer. Stern also served as OX Trading’s Chief Compliance Officer, responsible for the entity’s “regulatory functions,” including its legal formation and ensuring its proper registration status.

9. OX Trading was created to provide price improvement on orders from optionsXpress’ customers and to profit from those trades. The idea originated with the head of optionsXpress’ order desk. He felt that price improvement would be beneficial for optionsXpress’ customers and a way to generate profit for Holdings.

10. Price improvement generally means the execution of an order at a price better than the public quote at the time the market center received the order.

11. OX Trading was registered with the Commission as a broker-dealer as of February 1, 2008 and became a member of CBOE. According to Stern, it was his decision to have OX Trading register.

12. After becoming registered as a broker-dealer, OX Trading received electronic requests for quotes (“RFQs”) from optionsXpress. These RFQs allowed OX Trading to determine whether it wanted to be the counterparty to an optionsXpress customer’s order. Generally, the decision whether or not to be a counterparty to the optionsXpress customer trade was done automatically through a computerized system.

13. Although the decision whether or not to be a counterparty to the optionsXpress customer trade was generally done automatically, on at least one occasion, optionsXpress’ head trader directed OX Trading to take the trade of an optionsXpress customer who he believed “deserved an execution” but who was “not getting executed in the marketplace.”

14. If OX Trading wanted to act as the counterparty to an optionsXpress customer order, OX Trading would send a notice back to optionsXpress with an order identifying an exchange to which the order should be sent. optionsXpress would then send a paired trade to one of several price improvement auctions offered by various exchanges, such as CBOE’s Automated Improvement Mechanism (“AIM”). If OX Trading chose not to be the counterparty on an order, optionsXpress would route the trade to an exchange. Although CBOE’s AIM system was the first auction mechanism used by OX Trading, it later began using the NASDAQ Options Market system (no later than May 2009); International Stock Exchange’s Price Improvement Mechanism (no later than early 2008); and BATS (no later than the fall of 2010).

15. OX Trading was not a member of FINRA during the relevant time period and was not, and has never been, a member of any exchange other than CBOE.

16. OX Trading earned revenue when it traded as a counterparty to optionsXpress customer orders and hedges the positions created by those trades. According to OX Trading’s head trader: “The entity’s desire is to make money, so after we price improve a customer order we end up having a position. And we manage those positions in such a way to . . . capture profit within those trades. . . . OX Trading makes money if it sells an option at one price and buys it at a lower price and sells it at a higher price.”

17. Holdings’ former CEO described OX Trading similarly: “[OX Trading] generates revenue by trading, by entering into primarily options positions and hedging those positions and either letting them expire or trading out of them and generating profit by buying low and selling high or selling high and buying low.”

18. Stern described OX Trading as a liquidity provider.

19. Internal OX Trading documents described OX Trading as providing a “2 sided market.”

OX Trading Deregisters

20. On December 31, 2008, an examiner in CBOE’s Department of Member Firm Regulation (“DMFR”) sent an email to Stern asking why OX Trading lost more than 15% of its excess net capital in November 2008. The CBOE examiner also asked OX Trading to complete

a Member Questionnaire and inquired whether OX Trading only conducted proprietary trading or whether it also acted as a market maker.

21. Stern completed the questionnaire stating that OX Trading conducted only proprietary trading. The questionnaire did not list an outside auditor for the firm and stated that OX Trading facilitated “optionsXpress, Inc.’s customer in getting solicited by optionsXpress, Inc. for better than NBBO fill on CBOE AIM system. No other primary trades other than to hedge or liquidate the above.” Stern did not respond to the examiner’s inquiry about the November 2008 loss.

22. The CBOE examiner again asked Stern for a detailed explanation of OX Trading’s November loss and told Stern that OX Trading was required to have an annual audit based on its CBOE membership status.

23. Stern responded that the loss was “due to the conversion from the inventory range to the customer range because of our desire for optionsXpress, Inc. the clearing firm, to be able to classify its margin debit receivable from OX Trading as a ‘good’ asset.” However, internal OX Trading emails indicate that at least part of the loss was due to poor trading performance.

24. Despite CBOE’s request, OX Trading refused to pay for an audit and Stern subsequently decided to terminate OX Trading’s CBOE membership.

25. On February 2, 2009, Stern notified CBOE that “OX Trading has given notice to its lessor to terminate its [CBOE membership] lease. Once the lease is terminated, OX Trading will cease to be a CBOE member and a broker-dealer.” Then on February 25, 2009, Stern again notified CBOE that “[w]e will cease being a BD on Saturday.”

26. OX Trading ceased being a member of CBOE on March 2, 2009. Despite terminating its CBOE membership, OX Trading continued to conduct the same trading, but through a customer portfolio margin account at optionsXpress. Stern did not inform the CBOE that OX Trading would continue its operations as a customer of optionsXpress.

27. On May 11, 2009, the Commission’s Division of Trading and Markets Office of Financial Responsibility (“OFR”) notified OX Trading that “[b]roker-dealers who only transact business on an exchange must be a member of that exchange” and “[t]herefore, unless you can demonstrate within 35 days of receipt of this letter that you have applied for membership with an exchange or the FINRA, your registration with the Commission will be cancelled.” OFR then cautioned: “Please note that you may not engage in the securities business unless you are a member of an exchange or the NASD and that merely having made application for membership will not satisfy the legal requirement.” On June 17, 2009, OFR sent a second letter to OX Trading containing the same admonitions.

28. According to an email sent by Stern, OX Trading “stalled as long as we could,” but finally on August 18, 2009, Stern filed a form with the Commission to deregister OX Trading as a broker-dealer. The deregistration became effective October 17, 2009.

29. OX Trading continued to trade through a customer portfolio margin account at optionsXpress.

OX Trading Reregisters as a Broker-Dealer

30. In late 2009, CBOE's DMFR was conducting a routine portfolio margin exam of optionsXpress when they identified an account that was engaged in a significant amount of trading. As part of the exam, a CBOE examiner asked if any subsidiary of Holdings traded with its own capital and cleared through optionsXpress. Stern replied: "No brokerage subsidiary of optionsXpress Holdings, Inc. does any proprietary trading or makes trades with its own capital."

31. On February 3, 2010, CBOE notified Stern that CBOE would like to discuss why OX Trading was being treated as a customer account.

32. On February 8, 2010, Stern and several others from optionsXpress met with CBOE to discuss the registration status of OX Trading.

33. On April 16, 2010, CBOE sent a letter to optionsXpress' Chief Compliance Officer asking for a written statement detailing the reasons why OX Trading was not registered as a broker-dealer, including a legal analysis on which the decision was based.

34. The Compliance Officer forwarded the letter to Stern who replied: "Ask him/them to direct it to OX Trading" adding that "I am happy to spin this however it needs to be." The Compliance Officer then asked CBOE to send the letter to Stern. On April 20, 2010, CBOE resent the same letter, but addressed it to Stern.

35. Stern responded in a letter dated April 23, 2010. Instead of providing an explanation as to OX Trading's registration status, the letter contained factual inaccuracies and no legal opinion or analysis.

36. CBOE responded to Stern's letter on April 27, 2010 and asked again for an explanation of why OX Trading believed it was not required to register as a broker-dealer and for a legal opinion to support its belief. Stern did not provide an explanation or a legal opinion.

37. On June 17, 2010, CBOE sent a letter to Stern stating that CBOE believed OX Trading was functioning as a dealer and was required to register as a broker-dealer. CBOE asked OX Trading to either cease operations or obtain a written opinion from the Commission confirming that OX Trading was not required to register. CBOE asked OX Trading to respond by June 22, 2010.

38. OX Trading did not respond until June 29, 2010, when its outside counsel asked for an extension of time within which to respond. Stern separately emailed the Director of CBOE's DMFR asking whether there was an "unofficial" way to resolve the matter and stating that it looked like OX Trading was "being penalized for trading only on AIM." OX Trading was not trading only on AIM.

39. On June 30, CBOE explained to optionsXpress' counsel that "[t]he characteristic that we see as primary in deeming OX Trading a 'dealer' is that it engages in a business of buying and selling securities for its own account. Moreover, this business is conducted entirely with optionsXpress, Inc. customer accounts."

40. In early July 2010, Stern contacted the Commission about reactivating OX Trading's registration noting that "we have no desire to apply for a no-action letter." At the same time, OX Trading's outside counsel sent a letter to CBOE offering to apply for dealer registration with the Commission and to obtain access/membership with an exchange.

41. On July 20, 2010, OX Trading filed an application for registration with the Commission and was granted conditional approval on August 26, 2010. For its SEC registration to become effective, OX Trading was required to be a member of FINRA or an exchange.

42. On October 6, 2010, OX Trading filed an application with CBOE. The application was approved on November 9, 2010 and the necessary access permits were issued on November 12, 2010. However, OX Trading requested an effective date of December 1 so "we don't get charged [for November]." Nevertheless at CBOE's insistence, the SEC registration and CBOE trading permit became effective on November 16, 2010.

43. From March 2, 2009 to November 16, 2010, OX Trading executed approximately 1.3 million trades. Its gross revenues from March 2009 to November 2010 were approximately \$3.9 million.

E. VIOLATIONS

44. As a result of the conduct described above, Stern caused and willfully aided and abetted OX Trading's violation of Section 15(a) of the Exchange Act which makes it unlawful to induce or attempt to induce any purchase or sale of a security unless such a dealer is registered.

45. As a result of the conduct described above, Stern caused and willfully aided and abetted OX Trading's violation of Section 15(b)(8) of the Exchange Act which makes it unlawful for a broker-dealer to effect any transaction in any security (other than commercial paper, bankers' acceptances, or commercial bills) unless it is a member of a registered national securities association or effects transactions solely on a national exchange of which it is a member.

F. UNDERTAKING

46. Respondent undertakes to withdraw his Petition for Review of the Initial Decision issued on June 7, 2013 in the *Matter of optionsXpress, Inc., et al.*, Administrative Proceeding File No. 3-14848 ("Initial Decision") and acknowledges that upon this withdrawal the Commission may enter an order that the Initial Decision has become final as to him.

47. In determining whether to accept the Offer, the Commission has considered this undertaking and determined not to impose any additional sanctions against Stern beyond those set forth in Section IV, in view of the sanctions contained in the optionsXpress Initial Decision.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 15(a) and 15(b)(8) of the Exchange Act.

B. Respondent shall, within fourteen days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the United States Treasury. 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 Thomas E. Stern 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 Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, U.S. Securities and Exchange Commission, The Mellon Independence Center, 701 Market Street, Philadelphia, PA 19106-1532.

By the Commission.

Elizabeth M. Murphy
Secretary