UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9596 / June 6, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 72339 / June 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15912

In the Matter of LIQUIDNET, INC., Respondent.	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND 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 Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Liquidnet, Inc., ("Liquidnet" 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 Section 8A of the Securities Act of

1933 and 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:

<u>Summary</u>

1.   Liquidnet is a broker-dealer registered with the Commission and operates a block-trading alternative trading system ("ATS"), or dark pool, for large institutional investors.[1]

2.   Between 2009 and 2012, Liquidnet sought to expand its business and to find additional sources of liquidity for its ATS by offering its services to corporate issuers and control persons of corporate issuers, as well as to private equity and venture capital ("PE/VC") firms looking to execute large equity capital markets transactions. This effort was undertaken, in part, through the use of confidential information about Liquidnet customers' intentions to buy or sell securities. By improperly using that information and not keeping it confidential, Liquidnet violated the promises that it had made to its customers and failed to meet its obligations under Regulation ATS.

3.   ATSs are subject to Regulation ATS, as well as other rules, including Regulation NMS, Exchange Act Rule 15c3-5 (known as the market access rule), and other rules and regulations governing the registration and operation of broker-dealers. One important rule that protects subscribers of an ATS is Rule 301(b)(10) of Regulation ATS, which requires that an ATS establish safeguards and procedures to protect subscribers' confidential trading information and adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed. 17 C.F.R. § 242.301(b)(10). In adopting Rule 301(b)(10), the Commission recognized "the sensitive nature of the trading information subscribers send to alternative trading systems" and stated its intention that Rule 301(b)(10) "prevent the disclosure or the use of information about a customer's trading orders." <u>Regulation of Exchanges and Alternative Trading Systems</u>, Exchange Act Release No. 40760, 63 Fed. Reg. 70844, 70879 (Dec. 22, 1998) ("Adopting Release"). [2]

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[1]   An ATS is "any organization, association, person, group of persons, or system: (1) [t]hat constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Exchange Act Rule 3b-16]; and (2) [t]hat does not: (i) [s]et rules governing the conduct of subscribers other than the conduct of subscribers' trading on such [ATS]; or (ii) [d]iscipline subscribers other than by exclusion from trading." Regulation ATS, Rule 300(a), 17 C.F.R. § 242.300(a).

[2]   Indeed, the Commission noted that unless a subscriber consents, an ATS "should not disclose information regarding trading activities of such subscribers to other subscribers that could not be ascertained from viewing the [ATS's] screens directly at the time the information is conveyed." Adopting Release at 70879.

4.	Part of an ATS's compliance with Rule 301(b)(10) includes implementing adequate safeguards and procedures to protect the confidential trading information of its subscribers. These procedures must take into account the nature and structure of the interconnected businesses of the broker-dealer operating the ATS. A broker-dealer that operates an ATS may have business units separate from the ATS, but within the same legal entity or separately incorporated affiliates, that, if given access to the confidential trading information of the ATS's subscribers, could benefit from such information. This structure presents risk of misuse of subscriber information, and accordingly, the Commission highlighted the importance that ATSs "separate alternative trading system functions from other broker-dealer functions." Id.

5.	Large institutional investors, such as mutual funds, often seek to keep their trading intentions secret, as information leakage can cause unfavorable price movements and thus be costly. For example, if a mutual fund intends to buy a large quantity of a particular stock, and information about the mutual fund's intentions leaks out to the market, opportunistic traders may start buying that stock, with the view to capitalizing on the upward price movement that the mutual fund's large buy order could create. These opportunistic traders' activity, in turn, may cause a short-term price increase, and thus lead the mutual fund to pay more for the stock than the mutual fund would have paid had its trading intentions remained secret.

6.	In contrast to the so-called "lit" or "displayed" markets, such as exchanges, dark pools do not display orders residing in them.[3] Because of this feature, traders often turn to dark pools to minimize information leakage and the resulting costs.

7.	Liquidnet, which launched its ATS in 2001, operates an institutional trading network for large institutional investors seeking to execute their trades in size, with maximum anonymity and minimum information leakage. Outside the ATS, Liquidnet acts solely as an agency broker and does not engage in proprietary trading activities; nor does it have any affiliates that engage in proprietary trading.

8.	A key feature of Liquidnet's relationship with its ATS subscribers, referred to at Liquidnet as "members," is Liquidnet's electronic access to a member's order management system ("OMS"). Liquidnet's ATS system accesses a member's OMS to obtain information about the member's confidential trading intentions ("indications of interest" or "indications") and then uses that information to look for execution opportunities, or "matches," among members interested in buying and selling the same stock. If a match of indications is detected, the potential buyer and seller are invited to negotiate with each other, anonymously, through the Liquidnet system. In the course of the negotiation, the members' indications may become binding orders to buy or sell the stock. An execution occurs when the buyer and the seller agree on the transaction terms – that is,

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[3]	Most, but not all, ATSs that trade NMS stocks are dark pools. A smaller subset of ATSs, called electronic communications networks ("ECNs"), do display some of the orders in NMS stocks residing in them. An NMS stock, under Regulation NMS, is a stock "for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan." 17 C.F.R. § 242.600(b)(46).

price and quantity. Throughout this process, the Liquidnet system keeps each member's identity secret from the potential counterparty, and only reveals to the potential counterparty the information that is necessary for achieving an execution.

9.   In 2009, in an effort to find additional sources of liquidity for its ATS, Liquidnet began offering its services to corporate issuers and control persons of corporate issuers, as well as to PE/VC firms looking to execute large equity capital markets transactions with minimal market impact. Liquidnet hoped to convince these entities to trade with members in its ATS, in part, by educating them about the block opportunities available within Liquidnet by providing them with confidential information about Liquidnet members' indications and executions. The initiative – which initially included equity research and corporate access services – eventually developed into a stand-alone, small business unit called Equity Capital Markets ("ECM").[4]

10.   From the ECM initiative's launch in 2009 and through late 2011, Liquidnet allowed ECM employees to access Liquidnet members' confidential trading information. Because ECM employees neither operated the Liquidnet ATS nor were responsible for its compliance functions, their access to the confidential trading information of ATS subscribers violated the specific requirements of Regulation ATS.

11.   In addition, in marketing ECM's services to potential customers, ECM employees used member data in ways that were not disclosed to Liquidnet members and that contradicted Liquidnet's assurances to members that Liquidnet would keep their trading information confidential. For example, some ECM marketing presentations for corporate issuers included descriptive characteristics of members that had recently indicated interest in buying or selling the issuers' stocks. These descriptive characteristics included information about the members' geographic locations, approximate assets under management, and investment styles. ECM employees also contacted issuers to discuss recent trends in the issuers' stocks, and, similar to the marketing presentations, these ad-hoc reports sometimes included member descriptive characteristics, such as geographic regions and investment styles. These external communication practices were inconsistent with Liquidnet's statements to members that Liquidnet would preserve the confidentiality of its members' trading information.

12.   In addition, Liquidnet used confidential information about members' indications in two sales tools, in a manner that was not disclosed to Liquidnet members. First, from February 2010 through August 2012, Liquidnet generated alerts, called Ships Passing alerts, about missed execution opportunities between member algorithmic orders and member indications, and distributed these alerts to sales relationship managers ("RMs"). Liquidnet never disclosed to members either that the Ships Passing alerts existed or that RMs could view members' unmatched indications in connection with these alerts. Second, for a brief time in early 2012, Liquidnet RMs used an application called Aqualytics to identify members to contact about Liquidnet's recent dominance in certain stocks. In describing this application to members, Liquidnet initially failed to disclose that an RM's decision to contact a member about Liquidnet's activity in a particular stock

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[4]   During the relevant time (i.e., from the launch of the ECM initiative in 2009 through the end of November 2011), ECM's gross revenue (in total, approximately $1.66 million) accounted for less than one percent of Liquidnet's total U.S. revenue.

may have been based, in part, on that member's past and current indications of interest for the stock.

<div align="center">**Respondent**</div>

13.   **Liquidnet**, a Delaware corporation with a principal place of business in New York, New York, is a broker-dealer registered with the Commission and operates two ATSs pursuant to Regulation ATS promulgated under the Exchange Act: Negotiation ATS, Liquidnet's primary product (also referred to herein as the "Liquidnet ATS"), and H2O ATS. The Negotiation ATS provides Liquidnet members with anonymous negotiation functionality, whereas the H2O ATS provides members with auto-execution functionalities, including algorithmic order executions.

<div align="center">**Background**</div>

A.   The Liquidnet ATS and Liquidnet's Assurances of Confidentiality

14.   Liquidnet's core business is operating a block-trading ATS, or "dark pool," for members who are primarily large institutional investors.

15.   A key feature of the Liquidnet ATS is the so-called "blotter-scraping" functionality. A member grants the system electronic access to the member's OMS. The OMS contains real-time information about the member's unexecuted trading intentions – that is, what stocks the member is planning to buy or sell, in what quantities, and at what prices. When the Liquidnet system detects a potential match between two members' "buy" and "sell" intentions, the system alerts the members to the potential match and invites the members to begin an anonymous negotiation through the Liquidnet interface. An execution occurs when the negotiating members agree on trade terms. During the negotiation process, each negotiating member remains anonymous, and information is shared only to the extent necessary for the negotiation process.

16.   Anonymity and minimal information leakage are features that attract mutual funds and other large institutional investors to Liquidnet. A large institutional investor may be concerned that, if information about its trading intentions leaks out to the market, opportunistic traders may try to trade ahead of the institution, in order to take advantage of the expected price movement that a large institutional order often creates. Such opportunistic activity, in turn, may itself create a short-term price movement and thus lead the institution to trade at a less favorable price than it would have traded at, had the information about its trading intentions remained secret.

17.   At all relevant times, Liquidnet held itself out to members as a trading venue that offers anonymity and minimal information leakage. For example, in its marketing brochures, Liquidnet stated that it directly links buy-side traders with each other while "keeping information leakage to a minimum."

18.   Liquidnet also provided members with a description of its system and operations through "Liquidnet Trading Rules," which were incorporated by reference in Liquidnet's subscription agreements with members and were available to members through the Liquidnet website. The Trading Rules assured members that the Liquidnet system would maintain "complete

anonymity of every member and trader in the System during the entire lifecycle of an indication and order."

19.   In addition to its negotiation functionality, Liquidnet also offers a suite of algorithmic trading strategies and operates an agency-only trading desk, which executes orders submitted to that desk by Liquidnet members or trading desk customers who are not ATS members. The trading desk's relationship with its customers is more akin to the traditional broker-customer relationship: customers transmit orders to the trading desk employees, and the trading desk executes those orders on the customers' behalf.

B.   ECM Group and Its Marketing Strategy

20.   In 2009, in an effort to find additional sources of liquidity for the Liquidnet ATS, Liquidnet launched its ECM initiative, which later developed into a small, stand-alone ECM business unit. The goal of the initiative was to introduce Liquidnet as an execution venue for corporate issuers, control persons of corporate issuers, and PE/VC firms. In Liquidnet's view, these potential ECM customers were similar to Liquidnet's ATS customers, because, like those large institutional investors, the potential ECM customers generally had long-term, large-scale trading intentions; did not engage in opportunistic short-term trading; and sought to execute large transactions with minimal information leakage.

21.   Members of the Liquidnet executive team participated in the development of the ECM initiative and of the ECM marketing strategy described below, including by participating in the drafting and review of ECM strategy documents and by attending internal leadership meetings during which the executive team discussed updates on the ECM initiative and the internal tools described in paragraph 24.

22.   To attract this new group of potential customers, Liquidnet determined to leverage Liquidnet's access to and visibility into members' trading intentions. Specifically, in marketing its ECM business, Liquidnet emphasized that its ECM customers would be able to execute their transactions in scale, with minimal information leakage, and with the benefit of Liquidnet's insight as to the optimal time to access the market. For example, if a corporate issuer was seeking to execute a share repurchase program (a so-called "corporate buy-back"), Liquidnet could advise the issuer when there was substantial supply of the issuer's shares in the Liquidnet system, without substantial competing demand from its members. Conversely, if the issuer was seeking to sell its stock, for example, as part of a registered follow-on offering, Liquidnet could advise the issuer when there was significant demand for the stock, without substantial competing supply from its members.

23.   As part of this marketing strategy, in 2009, Liquidnet launched a desk-top application for issuers called InfraRed. InfraRed, which was offered for free to senior executives of corporate issuers, displayed, in line chart form, aggregated historical institutional demand data in the Liquidnet system as a smoothed ratio of "buy" liquidity to "sell" liquidity, capped at 5:1 (or 1:5). For example, if, over a particular time period, all Liquidnet members, in aggregate, were interested in buying three million shares of an issuer's stock, and also were interested in selling one million shares of the stock, InfraRed would depict this information as the "institutional demand"

ratio of 3:1. Because the InfraRed ratio was capped, however, if the "buy" interest increased to six million shares, while the "sell" interest remained the same, at one million shares, the "institutional demand" depicted through InfraRed would reach 5:1 and stay flat at that level. Liquidnet believed that InfraRed could serve as its "calling card" with issuers, reminding issuers about Liquidnet's ability to access institutional liquidity and to advise issuers on market conditions.

C.   ECM Employees' Access to Members' Confidential Trading Information

24.   From the launch of the ECM initiative in 2009 and through late 2011, ECM employees had access to confidential member trading information residing in the Liquidnet system. For example, ECM employees could generate detailed reports about Liquidnet members' "buy" and "sell" indications for various stocks. In addition, starting in early 2011, ECM employees could view detailed information about members' indications through an internal version of the InfraRed application ("Internal InfraRed"). Information available to ECM employees through the detailed reports and Internal InfraRed included the identity of each Liquidnet member who indicated interest to buy or sell a particular stock, as well as the number of shares that each member was interested in buying or selling.

25.   Regulation ATS promulgated under the Exchange Act governs the operations of ATSs such as the Liquidnet ATS. Rule 301(b)(10) of Regulation ATS requires that an ATS "establish adequate safeguards and procedures to protect subscribers' confidential trading information," including "[l]imiting access to the confidential trading information of subscribers to those employees of the [ATS] who are operating the system or responsible for its compliance with [Regulation ATS] or any other applicable rules."

26.   Liquidnet's ECM employees neither operated the Liquidnet ATS nor were responsible for the Liquidnet ATS's compliance with the applicable rules and regulations. Instead, ECM employees were tasked with marketing Liquidnet's block-execution abilities to corporate issuers, issuer control persons and PE/VC firms, and with serving as relationship managers for this group of customers. Moreover, ECM customers were not Liquidnet ATS subscribers, or members, and their transactions were executed solely through Liquidnet's trading desk. Thus, by giving ECM employees access to Liquidnet members' confidential trading information, the Liquidnet ATS violated Rule 301(b)(10) of Regulation ATS.

D.   ECM Employees' Use of Members' Confidential Trading Information

27.   In the very early stages of the ECM initiative, Liquidnet employees discussed Liquidnet's general plan to offer ECM services and InfraRed during member conferences and in one-on-one meetings with some members.

28.   Liquidnet also publicly announced the launch of InfraRed for issuers in 2009, and, upon request, Liquidnet representatives demonstrated and explained the InfraRed application to members. These descriptions and demonstrations, however, only focused on the issuer-facing version of InfraRed, described in detail in paragraph 23 above, which displayed aggregate institutional demand information as a smoothed and capped ratio of "buy" and "sell" liquidity. These descriptions and demonstrations did not focus on Internal InfraRed that became available to

ECM employees in early 2011. As described in paragraph 24 above, Internal InfraRed displayed much more detailed and sensitive information, such as member identities and detailed member- and symbol-specific indication information.

29.   In addition, by 2010, the ECM group's practices evolved to include uses of confidential member trading information that were not disclosed to Liquidnet members.

30.   In particular, some ECM marketing presentations for issuers included charts listing certain descriptive characteristics of those Liquidnet members that recently had either "buy" or "sell" indications for the issuers' stocks. For example, a marketing presentation delivered to an issuer on February 28, 2011, stated that, since January 1, 2011, thirty-two Liquidnet members had either "buy" or "sell" indications for the issuer's stock. This summary statement was followed by a chart, listing, for each of the thirteen "buy" investors and each of the nineteen "sell" investors, a range representing the investor's equity assets under management (e.g., 10-25 billion, 50-100 billion, 100+ billion); geographic location (such as Northeast, Midwest, West, foreign, etc.); investment style (such as value, deep value, index, etc.); and whether the investor was the issuer's "13F holder" (i.e., reported the issuer's stock in its quarterly portfolio report filed on SEC Form 13F[5]).

31.   As part of their marketing efforts, ECM employees also frequently reached out to issuers with ad-hoc reports about recent activity in the issuers' stocks, and some of these reports included descriptive characteristics of the members whose information was discussed. For example, on April 26, 2011, an ECM employee contacted an issuer with an update about two block executions on Liquidnet ATS in the issuer's stock that very morning. The ECM employee included the time, quantity and price of each of the two trades; informed the issuer that both trades involved the same seller; and noted that neither the seller nor one of the two buyers involved in the trades were among the issuer's 13F holders, but the second buyer was one of the issuer's 13F holders. The ECM employee further informed the issuer that the "seller still has considerable quantity on the books to offload" and that "[o]ne of the buyers has some residual interest to buy today."

32.   Later on that same day, April 26, 2011, upon the issuer's request for additional information, the ECM employee informed the issuer that Liquidnet "did see another new seller come in around noon today, and they're [sic] total sell [quantity] is approximately equal to your ADV [i.e., average daily volume]. They are an existing 13F holder, GARP [Growth At A Reasonable Price] style." Referring to the earlier communication, the ECM employee stated that the "seller I mentioned earlier has approximately 30% of your ADV left to sell (not a 13F holder)" and that "[b]uy interest has remained relatively constant today."

33.   In another instance, on August 29, 2011, another ECM employee contacted another issuer with an update that "Liquidnet was extremely active in [the issuer's] shares at the end of last week. We crossed nearly 1 million shares, principally between a single buyer and seller. The

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[5]   SEC Form 13F is a form on which large institutional investment managers report their portfolio holdings of certain securities. SEC Forms 13F are filed on a quarterly basis and are publicly available through the Commission's EDGAR database.

buyer is a top-20 holder who reported a reduced position at the June 30th 13-F filings. The seller is a hedge fund."

34.	In addition, ECM marketing presentations for issuers often included information about aggregate "liquidity depth" in a stock over a period of time, expressed in absolute dollar terms rather than as the smoothed and capped ratio that issuers saw through InfraRed. For example, a marketing presentation delivered to an issuer could include a chart showing the magnitude of aggregate "buy" and "sell" interest, expressed in total dollar terms, for the issuer's stock in Liquidnet's system on each day during the past few weeks.

35.	ECM employees also sometimes provided issuers with feedback on lists of institutional investors with which issuers met or were planning to meet during non-deal roadshows or investor conferences. Sometimes, ECM employees would recommend to issuers specific investors with whom issuers should meet based on those investors' recent "activity" or "interest" either in the issuer's stock or in the stock of the issuer's industry peers. On other occasions, ECM employees would provide issuers information regarding how many of the firms on the issuer's meeting or conference list were Liquidnet members and, of those, how many had had "buy" or "sell" interest in the issuer's stock.

36.	For example, on May 17, 2011, an ECM employee, in response to an inquiry from an issuer's investor relations officer preparing for a set of investor meetings, provided the following feedback:

> - Of the 11 firms you're meeting with, 7 are Liquidnet members
> - Three of the firms you're meeting with have shown overall net buy interest in your stock YTD
> - One of the firms you're meeting with has shown an overall net sell interest in your stock YTD.

37.	When an ECM customer signed on to execute transactions through Liquidnet, ECM employees used members' trading information to advise the ECM customer when to submit an order to the Liquidnet system. For example, ECM employees used member data to determine whether a particular day was a good day for an issuer to submit an order as part of the issuer's buy-back program – that is, whether there was sufficient supply of the issuer's shares in Liquidnet's system, and whether there was much competing demand from members for those shares.

38.	ECM employees also sometimes used both current and historical member trading information to identify those members who would likely be interested in trading with an ECM customer. For example, if an ECM employee working on an issuer buy-back program saw that a particular member recently had "sell" indications for the issuer's stock (but no current indications), the ECM employee would sometimes contact the RM covering that member and suggest that the RM contact the member and open a discussion about the member's current interest in selling the stock.

39.   Liquidnet's general written policies, not specific to the ECM group, prohibited any sharing of confidential member information, internally or externally, except as required in connection with an employee's performance of his or her job responsibilities. Liquidnet failed to provide ECM employees with specific guidance, however, on how this general prohibition applied to the ECM employees' internal and external communications.

40.   ECM employees developed among themselves an informal and unwritten guideline focused on protecting member anonymity. ECM employees generally adhered to the view that, in their external communication, they should not disclose either a member's identity or such information as would enable an outside person to deduce a member's identity. Consistent with this informal guideline, on multiple occasions, when issuers requested information about member identities, ECM employees declined to provide it. The ECM employees' informal guideline, however, was premised on an unduly narrow view of Liquidnet's confidentiality obligations, which required, more broadly, that Liquidnet protect its subscribers' confidential trading information – and not solely the subscribers' identity information.

E.   Liquidnet's Material Omissions About ECM and ECM Practices

41.   While the ECM group engaged in the practices described in Part D above, Liquidnet continued to assure its members that Liquidnet was protecting the confidentiality of their trading information. In Liquidnet's subscription agreements, Trading Rules, and marketing materials, Liquidnet stated that Liquidnet would preserve the anonymity of member indications and orders and would minimize information leakage.

42.   For example, in its Trading Rules, Liquidnet stated that its "System maintains complete anonymity of every member and trader in the System during the entire lifecycle of an indication and order." Liquidnet also described how an indication or an order would interact with the Liquidnet system, and to what extent information about an indication or an order would be revealed to a potential counterparty as part of the anonymous negotiation or auto-execution process.

43.   Further in the Trading Rules, Liquidnet described InfraRed as "a product that aggregates institutional sentiment, supply and demand, news sentiment, and block execution data for investor relations officers and CFOs on their stock," and that provides "all Liquidnet data … on an aggregated basis."

44.   In addition, Liquidnet informed its members, in the Trading Rules, that it had "established and implemented policies to maintain the segregation of sales, trading desk and member services functions," and provided brief descriptions of member trading information available to Liquidnet's sales, trading desk and member services personnel. For example, the Trading Rules stated that Trading Desk personnel could not view member indications, whereas sales RMs could view both members' algorithmic orders and members' matching indications, and that the RMs could contact members to facilitate negotiations.

45.   The Trading Rules did not disclose, however, either the existence of the ECM group; or the fact that ECM employees had access to detailed and confidential member trading

information; or the fact that the ECM group used that information to engage in the practices described in detail in Part D above.

46.   The omissions described above made Liquidnet's representations to members materially misleading. As noted above, Liquidnet members were concerned about information leakage and confidentiality of their trading information. Liquidnet's assurances of confidentiality and anonymity were particularly material to Liquidnet's members because the members relied on those assurances in providing the Liquidnet system with access to the members' highly sensitive, real-time indication information.

47.   Liquidnet disclosed the existence of the ECM group in the July 2011 version of the Trading Rules and referenced the existence of the ECM group in certain corporate press releases issued before that time. But the ECM group's access to and use of confidential member information remained undisclosed until December 2011, when Liquidnet first informed its members that "ECM personnel can view summary buy/sell demand information from individual Members on a symbol-by-symbol basis." This disclosure followed an inspection of Liquidnet by the staff of the Commission's Office of Compliance Inspections and Examinations, during which Commission staff raised concerns about the ECM group's access to and use of member trading information.

F.   Liquidnet's Failure to Update Form ATS Filings

48.   Rule 301(b)(2) of Regulation ATS requires an ATS to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed. 17 C.F.R. § 242.301(b)(2).

49.   As part of its Form ATS filing obligations, Liquidnet filed with the Commission its Trading Rules. As set forth in greater detail in Part E above, at certain relevant times, Liquidnet's Trading Rules provided assurances of confidentiality and anonymity and descriptions of Liquidnet's operations, policies and procedures, but failed to disclose at all relevant times the existence of the ECM group, the ECM group's access to the confidential trading information of Liquidnet ATS members, or the ECM group's uses of that information. These were material changes to the operation of the Liquidnet ATS, for which the Liquidnet ATS was required to file an amendment on Form ATS at least 20 days prior to implementation. By failing to update its filings to include this information, Liquidnet violated the requirements of Rule 301(b)(2).

G.   Failure to Properly Implement InfraRed Opt-Outs

50.   When Liquidnet launched InfraRed in 2009, approximately nineteen members requested to opt out from InfraRed – in other words, not to include their trading information in the InfraRed application. Liquidnet assured these members that they were opted out and excluded these members' trading data from the external InfraRed application that was offered to issuers.

51.   But, from the launch of the ECM initiative in 2009 and at least until November 2011, Liquidnet failed to exclude the "opted out" members' trading information from any of the internal reports and tools that the ECM group generated and used. [6] Thus, apart from the external InfraRed application provided to issuers, these members' trading information was used in the same manner as all the other members' information. For example, ECM employees described the "opted out" members' indications, executions, and descriptive characteristics in marketing materials and ad hoc reports to issuers, as well as in providing feedback to issuers on potential non-deal roadshow or conference meeting schedules.

H.   Ships Passing Alerts and Aqualytics

52.   Liquidnet improperly used its members' confidential trading information in generating and circulating Ships Passing alerts to employees, as well as in targeting members for marketing communications through an application called Aqualytics.

a.   Ships Passing Alerts

53.   Ships Passing alerts were initially implemented in 2009 as notifications to Liquidnet RMs that two members' algorithmic orders were failing to match and execute because their limit prices failed to overlap. Liquidnet established a written protocol for the RMs' contacts with members, which required that the RMs maintain the anonymity of both members involved (that is, of both the potential buyer and the potential seller). The RMs were also required to obtain member consent before discussing the member's information with a potential contra-party.

54.   In February 2010, Liquidnet expanded the Ships Passing alerts to include notifications of situations where a member's algorithmic order failed to match with a member's indication. The failure to match could be caused by a number of scenarios, including different limit prices or mismatches in the sizes of the buy and sell orders.

55.   The Liquidnet Trading Rules referenced the fact that RMs could view members' algorithmic orders and members' matching, unexecuted indications, and that RMs could contact members to facilitate negotiations.

56.   The Ships Passing alerts, however, displayed to RMs not only member algorithmic orders and member matching indications but also unmatched indications. Thus, Liquidnet's use of member data in the Ships Passing alerts was inconsistent with the Trading Rules disclosure.

57.   In addition, from at least late 2010, in distributing the Ships Passing alerts, Liquidnet failed to exclude Trading Desk personnel from the email distribution list. Thus, even though the alerts were only intended for the ATS RMs, for a time, Trading Desk employees received them as well.

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[6]   Liquidnet also failed to exclude the affiliates of four of the "opted out" members from the external InfraRed application until November 2011, due to an error in mapping member identifications in the course of a technical upgrade.

58.   Liquidnet discontinued the Ships Passing alerts in August 2012.

b.   Aqualytics

59.   In February 2012, Liquidnet rolled out an internal application for RMs called Aqualytics. Aqualytics notified RMs about significant "stories" in particular securities, such as Liquidnet's recent dominance in executions in a particular stock, or a recent block execution in a stock. Each story sent to an RM was accompanied by a list of "targets" – that is, members within that RM's sales coverage to contact about the story, followed by a brief list of reasons why that particular target was identified.

60.   The Aqualytics targeting feature was based on members' publicly available 13F filings and on their confidential execution and indications data. For example, Aqualytics could alert an RM to a recent large Liquidnet execution in a particular stock and also suggest that the RM share this story with a "target" member because that member (1) reported a large position in that stock in a recent Form 13F; (2) had no intraday indications for that stock; and (3) had a sell indication for a specified quantity of that stock a few days earlier.

61.   The purpose of the Aqualytics alerts was to encourage members to create new indications, by highlighting Liquidnet's expertise in obtaining block executions for the specific stocks that may be of interest to a particular member.

62.   On March 9, 2012, Liquidnet disclosed the existence of Aqualytics in its Trading Rules, as follows:

> With this support tool, our RMs receive notification of US stocks where Liquidnet has recently executed a significant percentage of ADV. The report identifies Members with 13F holdings in these stocks and Members that have recently executed in these stocks through Liquidnet, so the RM can notify the Member of Liquidnet's activity in these names. The objective is to provide Members additional opportunities to interact in stocks where Liquidnet has been successful in matching large blocks. A member can opt out of this functionality by contacting its RM.

Liquidnet did not disclose, however, that members may have been targeted for Aqualytics alerts, in part, based on their past or current indications.

63.   On May 1, 2012, Liquidnet amended its Trading Rules section on Aqualytics, adding the statement that "[i]n identifying members, the [Aqualytics] report may also include limited member indication information for the relevant stock." Liquidnet discontinued Aqualytics in June 2012.

Violations

64.   As a result of the conduct described above, Liquidnet willfully[7] violated:

a.   Section 17(a)(2) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;

b.   Rule 301(b)(2) of Regulation ATS, which requires an ATS to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, within 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed; and

c.   Rule 301(b)(10) of Regulation ATS, which requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information and to adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed.

Liquidnet's Remedial Efforts

65.   In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Liquidnet, including the development of a program that provides members with direct control over use of their data within the Liquidnet system.

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[7]   A willful violation of the securities laws means merely "'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.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

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 Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A.   Liquidnet cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Rules 301(b)(2) and 301(b)(10) of Regulation ATS promulgated under the Exchange Act.

B.   Liquidnet is censured.

C.   Liquidnet shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $2,000,000.00 to the Securities and Exchange Commission. 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 Liquidnet 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 Amelia Cottrell, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

By the Commission.

Jill M. Peterson
Assistant Secretary

15