HARD COPY

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
SEPTEMBER 16, 2019

SECURITIES EXCHANGE ACT OF 1934
Release No. 86287 / July 2, 2019

Admin. Proc.File No. 3-19182

In the Matter of the Application of
EQUITEC PROPRIETARY MARKETS, LLC
For Review of Disciplinary Action Taken by
CBOE

REPLY MEMORANDUM IN SUPPORT OF APPLICATION FOR REVIEW FILED BY EQUITEC PROPRIETARY MARKETS, LLC

David J. Barclay
Attorney for Equitec Proprietary Markets, LLC
111 W. Jackson Blvd., Suite 2000
Chicago, Il 60604
Telephone: (312) 692-5009
Email: dbarclay@eqtc.com

On behalf of Equitec Proprietary Markets, LLC

I. Introduction

Equitec Proprietary Markets, LLC, ("Equitec" or the "Firm") by its Counsel, David Barclay, hereby submits this brief in support of its application for review by the Securities and Exchange Commission (the "Commission").

II. Procedural Background

The Business Conduct Committee ("BCC") of the Cboe Exchange, Inc. ("Cboe" or "Exchange") instituted this proceeding under Chapter 17 of the Exchange's Rules ("Exchange Rules"). On June 2, 2015, under authorization of the BCC, FINRA Market Regulation / Legal issued a Statement of Charges in STAR No. 20150456213 ("SOC" or "Charges") against Equitec.

The SOC alleged violations of Exchange Rule 4.2 - Adherence to Law ("Exchange Rule 4.2") and 17 C.F.R. 240.15c-3-5 - Risk Management Controls for Brokers or Dealers with Market Access, (the "Rule" or "15c3-5") promulgated under the Securities Exchange Act of 1934, as amended ("Rule 15c3-5" or "Market Access Rule"). Equitec filed a timely Answer on July 10, 2015, denying all charges.

Pursuant to Exchange Rule 17.6, a two-day hearing was held in Chicago, Illinois on January 23-24, 2017 ("Hearing") before the Hearing Panel consisting of three public members of the BCC. The BCC issued its Decision and Order (the "Decision") on June 14, 2017.

On July 14, 2017 Equitec submitted a petition for review by the (the "Board") of the Cboe Exchange, Inc. ("Cboe" or the "Exchange") for review of the June 14, 2017 Decision and Order that resulted from the Business Conduct Committee ("BCC") disciplinary hearing before the BCC Hearing Panel (the "Panel") for STAR NO. 20150456213.

On April 23, 2019 the Board issued its Decision in this matter, Decision No. 19BD 01 (the "Board Decision"). The Board Decision upheld the findings of the BCC and found that CBOE Regulation has proven by a preponderance of evidence that Equitec had violated the Market Access Rule and CBOE Rule 4.2. Equitec filed a petition for review on May 23, 2019 and a brief in support on August 1, 2019 (the "Brief"). The Exchange filed a Brief in opposition to Equitec's petition on September 3, 2019 (the "Opposing Brief"). Equitec hereby submits this brief in reply to certain arguments raised in the Opposition Brief.

III. Summary of Argument

The Exchange has consistently failed to establish that the Rule requires decrementation of executed orders in order for firms to have an appropriate credit control. As previously stated, nowhere in the rule are executions mentioned. Nowhere in the adopting release is there a discussion of how, or whether, executions must be considered in a credit control. The attempts by the BCC, the Board and the Opposing Brief to try to construct a requirement out of thin air fail miserably. The Exchange, both the BCC and the Board, is misreading the Market Access Rule to require the inclusion of executions as well as orders, in a reasonably designed system of controls. There is nothing they have cited, or can cite, to support that argument.

The false assertion in the Opposition Brief is that this interpretation was readily understood from the rule and other resources (it was not) and that therefore the Exchange did not have to give notice of this interpretation of the Rule. The Exchange also inferred a method of decrementation for executed orders that was nowhere in the Rule. Further, the Exchange erred in stating that the Exchange's interpretation of the rule and its method for implementing the Rule could be reasonably implied by the Rule or its legislative history. Finally, the Exchange erred in finding that Equitec had been given adequate notice of its interpretation of the Rule.

IV. The Exchange Reasserts Its Incorrect Interpretation of the Market Access Rule

As it did in the BCC Decision and the Board Decision, in the Opposing Brief the Exchange continues to misrepresent and misinterpret the Market Access Rule. The one substantive allegation in this matter was that the Firm was required to include executions as well as orders in implementing its preset credit thresholds. This is incorrect. In relevant part the Rule states:

> §240.15c3-5 Risk management controls for brokers or dealers with market access.
>
> (b) A broker or dealer with market access, or that provides a customer or any other person with access to an exchange or alternative trading system through use of its market participant identifier or otherwise, shall establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. Such broker or dealer shall preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with §240.17a-4(e)(7).
>
> (c) The risk management controls and supervisory procedures required by paragraph (b) of this section shall include the following elements:
>
> (1) *Financial risk management controls and supervisory procedures.* The risk management controls and supervisory procedures shall be reasonably designed to systematically limit the financial exposure of the broker or dealer that could arise as a result of market access, including being reasonably designed to:
>
> (i) Prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer and, where appropriate, more finely-tuned by sector, security, or otherwise by rejecting orders if such orders would exceed the applicable credit or capital thresholds; ....
>
> (2) *Regulatory risk management controls and supervisory procedures.* The risk management controls and supervisory procedures shall be reasonably designed to ensure compliance with all regulatory requirements, including being reasonably designed to:
>
> (i) Prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis;
>
> (ii) Prevent the entry of orders for securities for a broker or dealer or customer, or other person if such person is restricted from trading those securities;
>
> (iii) Restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker or dealer....
>
> 17 C.F.R. § 240.15c3-5.

Nowhere is the term "executions" used. The Rule is designed to prevent the entry of orders. In the Opposing Brief the Exchange states, "The Board's decision is fully supported by the overall purpose and express language of the Market Access Rule, the Commissions discussions in the Market Access Rule Proposing Release and Adopting Releases, and Commission precedent involving the Rule" (Opposing Brief at p. 12). None of that is true.

As we have discussed above, nowhere are executions mentioned in the Rule. The November 15, 2010 Federal Register Release which implemented SEC Rule 15c3-5 (the "Adopting Release"), including the background and purpose of the Rule. In the Adopting Release the SEC noted "The recent proliferation of sophisticated, high speed trading technology has changed the way broker-dealers trade for their own accounts and as agents for their customers." The SEC was rightfully concerned that computer or human error could trigger extreme market disruptions such as the May 6, 2010 Flash Crash and chose to impose a requirement for "reasonably designed" financial and regulatory risk management controls. Among the requirements under the Rule were controls designed to "Prevent the entry of orders (emphasis added) that exceed appropriate pre-set credit or capital thresholds..." Nowhere is there any mention of "executions". In fact, the Adopting Release states that "...controls should measure compliance with appropriate credit or capital thresholds on the basis of orders entered rather than executions obtained". The Exchange cites of the Goldman Sachs ("GS") comments in the Adopting Release wherein GS was told it could not have a control that included only executions as proof that executions should be included (Opposing Brief at p. 15). Not only is this not a proof of that, it can't even be read to imply that executions must be included.

The Exchange's interpretation is fundamentally in conflict with this SEC guidance. On April 15, 2014 the SEC issued a Response to Frequently Asked Questions (FAQ) to provide additional

guidance on the Rule. While clarifying many issues arising from the Rule, the FAQ provided no guidance stating or even suggesting that executions must be included in order for a firm's controls to meet the requirements of the Rule. The FAQ stated that "Division staff notes that under the Rule these risk management controls are required for all orders, whether generated manually by a trader or generated automatically by a computer..." Consistent with the Rule and the Release, the FAQ contains no mention of executions. Surely if the SEC meant to include executions as well as orders it could have and would have.

The Rule is designed to protect the market and firms from the effects of orders that are entered into the market system and to "systematically limit the financial exposure of the broker or dealer that could arise as a result of market access." The decrementation of executions is not required or necessary to accomplish that goal. The Rule is not meant to replace the Net Capital Rules and addresses a different set of risks. These risks, to the firm and the market place, are entirely because of pending orders. Once an order has resulted in an execution it is no longer an order and no longer poses such risk. A trade, oxymoronically referred to by the Exchange as an "executed order" may have a result on the overall risk profile of a firm, but is irrelevant to market access. Only orders pending in the system can cause the type of harm with which the Rule is concerned.

V. Decrementation

The Opposing Brief states: "Read in full context the firm's view that it does not have to decrement executed orders against its Capital Threshold does not withstand scrutiny." (Opposing Brief at p. 15). The Exchange then goes on to support this position by quoting sections from the Proposing Release, the Adopting Release and the Knight case that do not, in fact support it. They quote language from the Proposing Release stating that broker dealers should implement controls

based on "exposure from orders entered on an exchange or ATS, rather than waiting for an execution to make that decrementation." (Adopting Release at 69802 and Opposing Brief at p. 15). They erroneously infer from that, that firms must reassess its controls after the execution. In fact, this shows a basic misunderstanding of how proprietary trading firms work. As was stated in the Brief in support of the petition, for example, an execution that closes out a position cannot still pose any risk to the firm. A firm such as Equitec has a sophisticated risk system that takes into account hedges, offsets and related positions, none of which are accounted for in the Exchange's view. In the Opposing Brief the Exchange admits that its position is simplistic, but say that the Firm did not present evidence of the controls it has in place concerning executed orders and thresholds. In other words, they found the firm's controls lacking because they didn't discuss executions. In point of fact, the Firm's actual controls involved an overall assessment of the risk imposed by each order reflecting the overall credit of the firm. That was discussed by Mr. Shimanek at the Hearing and was in the description of the Market Access controls submitted to the Exchange. Equitec believes its method for assessing credit and risk is significantly better than the simplistic method offered by the Exchange. It is disingenuous to state that the proof that the controls were lacking was that they didn't include executions, when that is the very issue that is being disputed here. To restate the basic premise of Equitec's position, a firm's controls can meet the requirements of the Rule without providing for decrementation of the threshold every time an order is executed and , in fact, a more sophisticated method of measuring exposure from orders better accomplishes that goal.

VI. The Firm had no notice of the Exchange Interpretation of Rule and it cannot be fairly or reasonably implied.

The Exchange's interpretation of the Rule was never communicated to Equitec in any way and was never set forth in any document or communication available to Equitec until the examination that led to these charges. The Exchange Act and SEC Rule 19b-4 require SROs to provide a "fair procedure" for the discipline of members or associated persons. Although the formal "requirements of constitutional due process do not apply to [SRO] proceedings," the statutory fair-procedure mandate gives rise to certain "'due-process-like'" requirements. In the opposing brief the exchange quoted language from case law stating that to meet this due process requirement it is only required that "the laws give a person of ordinary intelligence a reasonable opportunity to know what it is prohibited." (Opposing Brief at p. 18), quoting Edward John McCarthy, 56 S.E.C., 1138, 1157 (2003). That case involved completely different facts involving the rules for floor trading on the NYSE. It is worth noting that the sanction in this matter was later partially overturned, due at least in part to the ambiguity of the rules involved. McCarthy v. SEC, 406 F3d 179 (2d Cir. 2005). It is not supportive of the Exchange position in this matter. The Opposing Brief also cites Rock of Ages Corp v. Sec'y of Labor, 170 F3d 148, 156 (2nd Cir. 1999) as supportive of CBOE's position. That case, involving mining regulations concerning the use of explosives, is also inapposite. The language cites in the Opposing Brief, that a regulation passes dues process requirements "as long as a reasonably prudent pension, familiar with the conditions the regulation [is] meant to address and the objects the regulation [is] meant to achieve, has fair warning of what the regulation require[s]" is from that case but is followed by this: "because the Commission's interpretation of section 56.6311(b) is consistent with the plain meaning of the regulation and a reasonably prudent mine operator would take the Mine Act's objectives into account when determining its responsibilities to comply with a regulation promulgated thereunder." Id. Here the plain language makes no mentions of executions and

broker dealers familiar with modern trading and risk management would have no warning or expectation that the interpretation put forth by CBOE was secretly hiding in the Rule. In *In the Matter of Husky Trading LLC,* Exchange Act Release No. 60180, 2009 SEC LEXIS 2250 (June 26,2009) the Commission overturned a PHLX disciplinary ruling against a member firm even after finding the PHLX interpretation of the rule in question was reasonable, because it found that "some level of uncertainty may have existed concerning the correct interpretation of the PHLX's rules" and that this "raise[s] a question whether, during the Relevant Period, Applicants were properly on notice that their conduct was violative." ibid p. 14 That same principle is applicable here. For the Exchange to come up with this novel interpretation of the Rule and expect Equitec to have read its mind can hardly be said to be reasonably or fairly implied by the Rule, as required by SEC Rule 19b-4. Moreover, because the interpretation was never published (formally or otherwise) or even revealed until the close of the firm's examination in the spring of 2015, it simply cannot be considered sufficiently determinate to avoid running afoul of the due process clause. *Rooms v. Securities and Exchange Commission*, 444 F.3d 1208, 1214 (10th Cir. 2006) (explaining that due process requires an exchange "rule gives fair warning of the prohibited conduct before a person may be disciplined for that conduct."); *General Bond & Share Co. v. Securities and Exchange Commission*, 39 F.3d 1451, 1455 (10th Cir. 1994) same); (*Timpiano v. Securities and Exchange Commission*, 2 F.3d 453 (D.C. Cir. 1993) "a vague rule is unconstitutional because it imposes standards of conduct so indeterminate that it is impossible to ascertain just what will result in sanctions.").

VII. Sanctions are not commensurate with the alleged violations

Given that the only substantive, involving the actual Market Access control, is, as discussed above, based on a fundamental misreading of the Rule and subject to an interpretation

for which proper notice had never been given, it should be dismissed. The remaining charges all relate to alleged deficiencies in the Firm's written procedures. As such, these charges do not admit of the sanctions imposed. A survey of relevant Market Access cases on the CBOE show a range of settlements from $7,500 to $30,000 fines. (See attached table of cases). Note that most of these cases involved no controls at all, whereas here there is no allegation (other than the previously discussed issue regarding executions) that the Firm's controls were non-existent or inadequate, only that the written description of them was insufficient. Even if the one charge involving the actual control should survive, there is no basis for a fine outside of the above-referenced range. In fact, the only appropriate sanction even in that instance would be a Cautionary Action Letter or a fine at the low end ($7,500 to $10,000) of that range.

VIII. Conclusion

In conclusion we ask that the SEC reverse the decision of the Board and the BCC and order the dismissal of the charges against Equitec in this matter. Applying the *de novo* review standard it is clear that any review of the law, in this case Rule 15c3-5 as interpreted through SEC Releases and FAQ's, would lead to the inescapable conclusion that nowhere is there a requirement that execution be included in the application of the required market access filters. Moreover, no notice, as required by Rule 19b-4, of such a non-intuitive interpretation was given, and that lack of notice violated basic due process requirement. In the event the remaining alleged WSP deficiencies admit of any sanction, it should be a Cautionary Action Letter or a fine of no more than $10,000.

Respectfully submitted,

Equitec Proprietary Markets, LLC

By: _____

David J. Barclay, Esq.

Relevant CBOE Decisions Involving Rule 15c3-5

Date	Case	15c3-5 Violation	Fine
4/03/2013	Alexandria Capital Partners	No controls	$7,500
4/25/2013	AKAP,LLC	No controls	$7,500
4/25/2013	Wellington Capital	No controls	$7,500
7/29/2013	Toro Trading	No controls	$10,000
9/08/2013	Lakeshore Securities	No controls	$10,000
11/13/2013	Quiet Light Securities	No controls	$10,000
9/08/2014	Liquid Capital Markets	No controls	$10,000
9/08/2014	Quasar Trading	No controls	$10,000
9/08/2014	Vision Financial Markets	No controls/Registration violation	$20,000
10/06/2014	Chopper Securities	No controls	$10,000
12/01/2014	Group One	No controls	$10,000
12/29/2014	LiquidPoint	Inadequate controls/Failure to supervise	$22,500
4/06/2015	WTS Proprietary	No controls	$20,000
9/10/2015	Hold Brothers Capital	Inadequate controls/No annual review	$30,000
2/08/2016	ABN AMRO Clearing	Inadequate controls/Erroneous order entry	$25,000

CERTIFICATE OF SERVICE

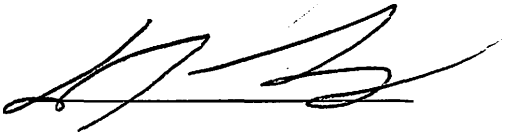
I, David J. Barclay, an attorney, do hereby certify that on September 16, 2019, I caused a copy of the foregoing document, BRIEF IN SUPPORT OF APPLICATION FOR REVIEW FILED BY EQUITEC PROPRIETARY MARKETS, LLC, to be served on the following persons through electronic mail, and US mail:

Patrick Sexton, Secretary
Office of the Secretary
Chicago Board Options Exchange, Inc.
400 South LaSalle Street, 7th Floor
Chicago, Illinois 60605
Fax: (312) 786-7919
psexton@cboe.com

Arthur B. Reinstein
Senior Vice President and Deputy General Counsel
Chicago Board Options Exchange, Inc.
400 South LaSalle Street, 7th Floor
Chicago, Illinois 60605
Fax: (312) 786-7919
areinstein@cboe.com

Andrew D. Spiwak
Senior Director-Enforcement
Financial Industry Regulatory Authority
Market Regulation/Legal
440 South LaSalle Street, 35th Floor
Chicago, Illinois 60605
Fax: (312) 583-0926
Andy.spiwak@finra.org

A copy of the same was also filed with the Secretary of the Securities and Exchange Commission.



David J. Barclay

STATEMENT OF SERVICE

I, David J. Barclay, an attorney, do hereby certify that on September 16, 2019, I caused a copy of the foregoing document, REPLY MEMORANDUM IN SUPPORT OF APPLICATION FOR REVIEW FILED BY EQUITEC PROPRIETARY MARKETS, LLC, to be served on the following persons through Fax and FedEx:

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
Office of the Secretary
100 F Street, NE
Room 10915
Washington, DC 20549-1090
Fax: (202) 772-9324

David J. Barclay

********** -COMM. JOURNAL- ********** DATE SEP-16-2019 ***** TIME 13:14 ********

MODE = MEMORY TRANSMISSION START=SEP-16 12:52 END=SEP-16 13:14

FILE NO.=480

STN NO.	COMM.	STATION NAME/EMAIL ADDRESS/TELEPHONE NO.	PAGES	DURATION
001	OK	a2027729324	001/014	00:06:32

-EQUITEC PROPRIETARY -

***** KM-F1060 ********** -3126925080 - ***** - 3126925080- *********

Resend - 2 additional pages

111 W. JACKSON BLVD.
20TH FLOOR
CHICAGO, IL 60604

FACSIMILE TRANSMITTAL SHEET

TO: Vanessa Countryman, Secretary	FROM: Equitec Proprietary Markets, LLC
COMPANY: Securities and Exchange Commission	DATE: 09/16/2019
FAX NUMBER: 202-772-9324	TOTAL NO. OF PAGES INCLUDING COVER: 14
PHONE NUMBER:	SENDER'S REFERENCE NUMBER:
RE: Release No. 86287 / July 2, 2019 - Admin. Proc. File No. 3-19182	YOUR REFERENCE NUMBER:

☑ URGENT ☐ FOR REVIEW ☐ PLEASE COMMENT ☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

REPLY MEMORANDUM IN SUPPORT OF APPLICATION FOR REVIEW FILED BY EQUITEC PROPRIETARY MARKETS, LLC

David J. Barclay
Attorney for Equitec Proprietary Markets, LLC
312-692-5009

********** -COMM. JOURNAL- ********** DATE SEP-16-2019 ***** TIME 12:34 ********

MODE = MEMORY TRANSMISSION START=SEP-16 12:26 END=SEP-16 12:34

FILE NO.=479

STN NO.	COMM.	STATION NAME/EMAIL ADDRESS/TELEPHONE NO.	PAGES	DURATION
001	OK	☎2027729324	012/012	00:07:30

-EQUITEC PROPRIETARY -

***** KM-F1060 ********** -3126925080 - ***** - 3126925080- *********

111 W. JACKSON BLVD.
20TH FLOOR
CHICAGO, IL 60604

FACSIMILE TRANSMITTAL SHEET

TO: Vanessa Countryman, Secretary	FROM: Equitec Proprietary Markets, LLC
COMPANY: Securities and Exchange Commission	DATE: 09/16/2019
FAX NUMBER: 202-772-9324	TOTAL NO. OF PAGES INCLUDING COVER: 12
PHONE NUMBER:	SENDER'S REFERENCE NUMBER:
RE: Release No. 86287 / July 2, 2019 - Admin. Proc.File No. 3-19182	YOUR REFERENCE NUMBER:

☑ URGENT ☐ FOR REVIEW ☐ PLEASE COMMENT ☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

REPLY MEMORANDUM IN SUPPORT OF APPLICATION FOR REVIEW FILED BY EQUITEC PROPRIETARY MARKETS, LLC
David J. Barclay
Attorney for Equitec Proprietary Markets, LLC
312-692-5009

Resent w/ 2 additional pages

RESEND - 2 ADDITIONAL PAGES

111 W. JACKSON BLVD.
20TH FLOOR
CHICAGO, IL 60604

FACSIMILE TRANSMITTAL SHEET

TO: Vanessa Countryman, Secretary	FROM: Equitec Proprietary Markets, LLC
COMPANY: Securities and Exchange Commission	DATE: 09/16/2019
FAX NUMBER: 202-772-9324	TOTAL NO. OF PAGES INCLUDING COVER. 14
PHONE NUMBER:	SENDER'S REFERENCE NUMBER:
RE: Release No. 86287 / July 2, 2019 - Admin. Proc.File No. 3-19182	YOUR REFERENCE NUMBER:

☑ URGENT ☐ FOR REVIEW ☐ PLEASE COMMENT ☐ PLEASE REPLY ☐ PLEASE RECYCLE

NOTES/COMMENTS:

REPLY MEMORANDUM IN SUPPORT OF APPLICATION FOR REVIEW FILED BY EQUITEC PROPRIETARY MARKETS, LLC

David J. Barclay
Attorney for Equitec Proprietary Markets, LLC
312-692-5009