

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 76029 / September 30, 2015**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-16851**

**In the Matter of**  
  
**LATOUR TRADING LLC**  
  
**Respondent.**

**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 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 (the “Commission”) deems it appropriate and in the public interest that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (the “Exchange Act”) against Latour Trading LLC (“Latour” 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 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 Cease-and-Desist Proceedings, Pursuant to Section 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:

**INTRODUCTION**

1. Much of the order flow in today’s securities markets is typified by high-speed, high-volume, automated trading, with orders routed for execution in milliseconds or even

microseconds.<sup>1</sup> Market participants that engage in high-speed algorithmic trading use automated processes to generate orders, check for compliance with the securities laws, and transmit orders to the market. When these processes are designed or implemented incorrectly, the result can be that a market participant quickly sends to the market large numbers of orders in violation of applicable rules and regulations, such as Regulation National Market System (“Reg NMS”) and the Market Access Rule (Rule 15c3-5 under the Exchange Act). Both of these regulations have requirements and protections that are important to the fair and efficient operation of the securities markets.

2. From October 2010 through August 2014, Latour Trading LLC (“Latour”) sent approximately 12.6 million Intermarket Sweep Orders (“ISOs”) that did not comply with the requirements of Reg NMS. These orders totaled over 4.6 billion shares, had a notional value of approximately \$116 billion, and caused over 1.1 million trade-throughs and 1.7 million locked or crossed markets.<sup>2</sup> Latour’s non-compliant ISOs resulted predominantly from a software coding change made by Latour’s parent company in July 2011, without Latour’s knowledge or approval, to a portion of the trading infrastructure that it shared with Latour. This coding change introduced an error into the software Latour used to send ISOs to the market. In addition, beginning in October 2010, Latour made a series of changes to its ISO routing logic that caused it to send ISOs to the market, under certain circumstances, that did not comply with the requirements of Reg NMS. Finally, throughout the relevant time period, Latour did not have adequate post-trade surveillance tools in place to detect its millions of non-compliant ISOs. Latour corrected many of these issues by October 2012, but the firm sent an additional approximately 322,000 non-compliant ISOs until August 2014, when it had addressed the remaining issues.

3. Latour violated both Rule 15c3-5 and Reg NMS. First, Latour violated the provision of Rule 15c3-5 that requires brokers and dealers with market access to have “direct and exclusive control” over their “financial and regulatory risk management controls.”<sup>3</sup> Second, Latour violated the provisions of Rule 15c3-5 that require brokers and dealers to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access activity, including reasonably designed regulatory risk management controls.<sup>4</sup> Third, Latour violated Rule 611(c) of Reg NMS, which requires that brokers and dealers take reasonable steps to establish that the ISOs they send to trading centers satisfy the requirements for such orders under Reg NMS.

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<sup>1</sup> Risk Management Controls for Brokers or Dealers with Market Access, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (final rule release) (“Rule 15c3-5 Adopting Release”).

<sup>2</sup> The terms ISOs, trade-throughs, locked markets, and crossed markets are explained below at paragraphs 7 – 11.

<sup>3</sup> 17 C.F.R. § 240.15c3-5(d).

<sup>4</sup> 17 C.F.R. § 240.15c3-5(b) and (c)(2)(i).

## FACTS

### **A. Respondent**

4. Latour Trading LLC (“Latour”), a U.S.-based broker-dealer, has been registered with the Commission since July 2009. Latour does not have any customers and engages only in proprietary trading. Until January 2014, Latour was wholly owned by Tower Research Capital Investments LLC, and its managing member was Tower Research Capital LLC (“Tower Research”), a firm that engages in quantitative investment strategies through affiliates (“trading teams”) that trade on multiple domestic and foreign markets. In January 2014, Tower Research Capital Investments LLC assigned all of the issued and outstanding interests of Latour to Tower Research.

5. Latour uses high-frequency algorithmic trading strategies to conduct its proprietary trading in Exchange Traded Funds (“ETFs”) and equity securities. During the period from October 2010 to April 2015, Latour sent over 12.8 billion orders to U.S. exchanges, approximately 233 million orders on average per month. During this same time period, Latour sent over 1 billion ISOs to U.S. exchanges, approximately 19 million ISOs on average per month. Latour’s ISOs were much more likely to be executed than its non-ISOs. While approximately 7% of Latour’s total orders received at least a partial execution, nearly 62% of its ISOs received at least a partial execution. Approximately, 12.3 million of Latour’s 12.6 million non-compliant ISOs occurred between October 2010 and October 2012, comprising approximately 2.32% of the ISOs it sent during that time period and approximately 0.16% of its overall orders.

### **B. Regulatory Requirements**

#### **Rule 15c3-5**

6. The Commission adopted Rule 15c3-5 to require that brokers or dealers, as gatekeepers to the financial markets, “appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.”<sup>5</sup> Rule 15c3-5(d) generally provides that the financial and regulatory risk management controls and supervisory procedures required by the rule must be under the “direct and exclusive control” of the broker or dealer. Rule 15c3-5(b) requires that brokers or dealers with market access must establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access activity. Rule 15c3-5(c)(2)(i) requires that brokers or dealers with market access must have controls and procedures reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis. Such regulatory requirements include the conditions that must be satisfied under Reg

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<sup>5</sup> Rule 15c3-5 Adopting Release at 69792.

NMS before an order can be marked as an ISO.<sup>6</sup>

## Reg NMS

7. Rule 611 of Reg NMS, also known as the Order Protection Rule, establishes protection against trade-throughs for all NMS stocks<sup>7</sup> across multiple trading centers. A trade-through occurs when a trading center executes an order at a price that is inferior to the price of a protected quotation displayed at another trading center. Protected quotations generally are the best bids and offers displayed by a national securities exchange or a national securities association.<sup>8</sup> Rule 611 promotes dual objectives: supporting competition among multiple trading centers while also linking those trading centers into a unified system so that orders themselves can compete.<sup>9</sup>

8. ISOs are an exception to the trade-through prohibition reflected in Rule 611. The ISO exception contemplates a market participant seeking to access multiple price levels at different trading centers at the same time.<sup>10</sup> Rule 600(b)(30) defines an ISO as a limit order that meets the following requirements: (1) the limit order is identified as an ISO; and (2) simultaneously with the routing of the limit order, one or more additional limit orders, as necessary, are routed to execute against all better-priced protected quotations displayed by other trading centers up to their displayed size. These additional orders also must be marked as ISOs.

9. A trading center that receives an ISO may execute the order immediately, even if doing so would appear from the perspective of the trading center to trade-through the protected quotations at one or more other trading centers.<sup>11</sup> Under Rule 611, by marking an order as an ISO, a broker or dealer represents to a trading center that it has sent all of the necessary orders to execute against the pertinent protected quotations displayed at other trading centers. Rule 611(c) imposes an affirmative obligation on brokers or dealers sending ISOs to take reasonable steps to establish that they have satisfied the requirements of sending an ISO, i.e., sending all of the necessary orders to execute against the pertinent protected quotations.<sup>12</sup>

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<sup>6</sup> *See id.* at 69803.

<sup>7</sup> *See* 17 C.F.R. § 242.600(b)(46) and (47) (defining “NMS stock” and “NMS security”).

<sup>8</sup> *See* 17 C.F.R. §242.600(b)(57), (58) (defining “protected bid,” “protected offer,” and “protected quote”).

<sup>9</sup> *See* Regulation NMS, 70 Fed. Reg. 37496, 37498 (June 29, 2005) (“Reg NMS Adopting Release”).

<sup>10</sup> *See id.* at 37523 (“The Commission also included in the reproposal paragraphs (b)(5) and (b)(6) of Rule 611 that provided exceptions for intermarket sweep orders that respond to the need of market participants to access multiple price levels simultaneously at different trading centers.”).

<sup>11</sup> *See id.* (“Paragraph (b)(5) allows a trading center to execute immediately any order identified as an intermarket sweep order, without regard for better-priced protected quotations displayed at one or more other trading centers.”); *see also id.* at 37536 (illustration of operation of ISO exception).

<sup>12</sup> 17 C.F.R. § 242.611(c) and § 242.600(b)(30).

10. Rule 610 of Reg NMS, known as the Access Rule, also has relevance for ISOs. Rule 610(d), in particular, requires national securities exchanges and associations to implement written rules that require their members to reasonably avoid displaying, and prohibit them from engaging in a pattern or practice of displaying, quotes that lock or cross protected quotations. This requirement promotes “fair and orderly markets by establishing that the first protected quotation at a price is entitled to an execution at that price instead of being locked or crossed by a quotation on the other side of the market.”<sup>13</sup> These exchange rules generally provide an exception if the member designates the order that it wishes to have displayed as an ISO and simultaneously sends other ISOs to execute against any equally- or better-priced quotations displayed at other trading centers, thereby taking reasonable measures to avoid displaying, or engaging in a pattern or practice of displaying, quotes that result in locked or crossed markets.<sup>14</sup>

11. Generally, the failure by a market participant to comply with the ISO requirements under Rule 611 and exchange rules adopted pursuant to Rule 610 can result in potential consequences to other market participants who lose executions that they otherwise might have received. In addition, in some instances, other market participants might not receive rebates that they otherwise might have obtained. For example, a non-compliant ISO could execute against a worse-priced, contra-side order at one trading center while a better-priced, contra-side order at another trading center remains unexecuted. Additionally, a non-compliant ISO could create a locked market because the market participant did not send an ISO to execute against an equally-priced, contra-side order displayed at another trading center. In both scenarios, the contra-side order might not receive the execution and/or the rebate that it otherwise might have received. Moreover, depending on a trading center’s priority rules, a non-compliant ISO could receive execution priority over an equally-priced, same-side order that had been submitted to the trading center earlier but not displayed because it would have locked a protected quotation.

### C. Latour’s Use of ISOs

12. Latour employs ISOs in two principal contexts. First, Latour uses ISOs to hedge positions that it acquires. Sending a set of ISOs enables Latour to access the best-priced quotations available at multiple trading centers simultaneously, thereby acquiring the desired number of shares needed to hedge a position quickly and at the lowest cost possible. Second, Latour places post-only ISOs<sup>15</sup> through which it will receive exchange rebates when incoming orders execute against its posted ISOs.

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<sup>13</sup> Reg NMS Adopting Release at 37503.

<sup>14</sup> See, e.g., BATS Exchange Rule 11.20(b) and (d)(3), available at [http://cdn.batstrading.com/resources/regulation/rule\\_book/BATS\\_Exchange\\_Rulebook.pdf](http://cdn.batstrading.com/resources/regulation/rule_book/BATS_Exchange_Rulebook.pdf).

<sup>15</sup> A post-only ISO is an ISO that also is marked with a modifier offered by exchanges, generally referred to as “post-only” or “add liquidity only.” A post-only order is an order that only will execute if it first is added, or “posted,” to the exchange’s order book and then, after being posted, is matched with another order. Because post only-orders will not be matched with an order that already is present on the exchange’s order book, such orders are often defined as orders that will not remove liquidity.

13. As part of its automated process for sending ISOs, Latour generates a “snapshot” of the protected quotations displayed at each U.S. exchange, as reflected in the market quote data that it receives.<sup>16</sup> Based on this snapshot, Latour determines which ISOs it must send to satisfy the requirements of Reg NMS. As explained above, if Latour is using a set of ISOs to execute against multiple layers of displayed liquidity, Latour must send as many ISOs as necessary, consistent with Rule 611 of Reg NMS, to remove any better-priced protected quotations. If Latour is using a set of ISOs to display a post-only order, it must comply with the rules adopted by exchanges under Rule 610 of Reg NMS and send ISOs to remove any equal- or better-priced protected quotations.<sup>17</sup>

14. Latour has developed and maintains source code for its trading software that contains the decisional parameters it believes necessary to achieve compliance with these requirements. This ISO routing logic is applied on a high-speed automated basis to the millions of ISOs that Latour sends each day.

#### **D. Software Coding Change Resulted in ISOs that Did Not Comply with Reg NMS**

##### **Latour’s Trading Infrastructure**

15. Latour and each of the individual Tower Research trading teams build and maintain the software source code for their respective trading strategies, including the code they use to generate orders. To reach trading centers, however, the orders first pass through additional software code and trading infrastructure maintained by the Core Engineering department within Tower Research, Latour’s parent.<sup>18</sup> For example, Core Engineering maintains a trade server application, which is a computerized process that translates Latour’s orders from Latour’s internal formats into the order message formats required by exchanges. The trade server application also applies Latour’s financial risk management controls required under Rule 15c3-5 of the Exchange Act.

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<sup>16</sup> Latour primarily relies on direct feeds that it receives from various exchanges to obtain quotation data, and it uses the quotations distributed by the Securities Information Processor (the “SIP”) for two smaller-volume exchanges.

<sup>17</sup> An exchange that receives a post-only ISO generally will display the order even if it would appear to lock a protected quotation of another trading center based upon its reliance on the broker-dealer sending the order to also send ISOs to execute against any equally-priced protected quotations. These concepts are discussed in response to Question 5.02 of the Responses to Frequently Asked Questions Concerning Rule 611 and 610 of Regulation NMS, which were prepared by the staff of the Division of Trading and Markets (April 4, 2008 update) (available at <https://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm>) (“Reg NMS FAQs”) (“The ISO exception to the SRO lock/cross rules, in contrast, requires that ISOs be routed to execute against all protected quotations with a price that is *equal* to the display price (*i.e.*, those protected quotations that would be locked by the displayed quotation), as well as all protected quotations with prices that are better than the display price (*i.e.*, those protected quotations that would be crossed by the displayed quotation).”).

<sup>18</sup> Tower Research-affiliated trading teams do not use Latour to access the market.

16. Portions of the software code within the trade server application are used by both Latour and Tower Research trading teams. Latour and each Tower Research trading team have trade server applications dedicated to their respective order flow, but the trade server software is managed in a common code base. Only Core Engineering developers have access to the trade server, including the common code base. If Latour needs to modify the software code in the trade server application, it must have a Core Engineering developer make the desired change.

17. Latour recognized that changes to the common code base in the trade server application could inadvertently affect the processing of Latour's orders. To address this risk, Latour relied on a system of controls and procedures. For instance, only a small number of Core Engineering personnel specifically approved by Latour could update the trade server applications used in production by Latour. Latour communicated with these personnel regarding Latour's use of the common code base. Core Engineering personnel were expected to inform Latour of any change to the common code base that might affect Latour, in which case, Latour would review the change for potential problems and recommend any necessary adjustments. If Core Engineering personnel decided that a change to the common code base would not affect Latour, they typically would not give Latour notice of the change.

18. The effectiveness of this system depended on the Core Engineering developers being sufficiently familiar with Latour's systems to assess the potential impact of changes to the common code base, recognizing when a change affected Latour, and informing Latour. As described below, this process proved inadequate.<sup>19</sup>

### **Latour's Use of Directed ISOs and a New Messaging Protocol**

19. During the relevant time period, Latour was not a member of and thus could not send orders directly to the Chicago Stock Exchange ("CHX"), the National Stock Exchange ("NSX"), and the American Stock Exchange (later renamed "NYSE MKT"). Accordingly, when Latour was required under Reg NMS to send an ISO to one of these exchanges, it sent a "directed ISO" to one of the exchanges operated by BATS Global Markets, Inc. ("BATS"). A directed ISO instructs BATS to route the ISO upon receipt to the exchange specified in the order instructions (in this case, CHX, NSX, or NYSE MKT).

20. In the spring of 2011, Latour and Core Engineering began preparations to deploy a new internal messaging protocol within Latour. This messaging protocol governed the manner in which Latour's orders were communicated by Latour's trading algorithms to the trade server applications managed by Core Engineering. The trade server applications first translated the orders it received from Latour's algorithms into a format used by the trade server for processing purposes and then applied various checks, including Latour's financial risk management controls required by Rule 15c3-5. The trade servers next translated the orders again, this time into the appropriate order message format used by the respective exchange. After this last translation occurred, the trade server sent the order message to the pertinent exchange.

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<sup>19</sup> Latour subsequently has taken steps to address its control over its regulatory and financial risk management controls and supervisory procedures.

21. Core Engineering deployed the new messaging protocol to Latour in stages, beginning in June 2011. After the initial stage of the deployment in June 2011, Latour verified that its directed ISOs were being properly translated by the trade server into order messages and that they reached their intended destinations at CHX, NSX, or NYSE MKT. Latour did so by confirming with BATS that BATS had received a sample set of directed ISOs and had routed them to the specified destination exchange. Latour did not conduct any further such testing as Tower Research continued the deployment. By March 2012, Latour was using the new protocol for the majority of its ISOs.

### **Routing Destination Erroneously Dropped from Directed ISOs Using the New Messaging Protocol**

22. In June 2011, shortly after Latour began using the new internal messaging protocol for a portion of its ISOs, a Core Engineering developer made a change to the trade server common code base used to send messages to the BATS exchanges. The Core Engineering developer made this change at the request of a Tower Research trading team. The change was viewed within Core Engineering as a routine modification to the BATS trade server application. In July 2011, the modified software code was released for Latour when its BATS trade server application was upgraded.

23. In the course of examining the software code to make the requested change, the Core Engineering developer observed a difference in how the code translated orders to be sent to BATS' U.S. exchanges as compared to those to be sent to BATS' European exchange. The developer then eliminated some of the code sequences that he believed created an operational inefficiency.

24. The code sequences that the Core Engineering developer eliminated, however, were crucial to the proper translation of directed ISOs that Latour sent to the trade server application using the new internal messaging protocol. In particular, as a result of the coding change, which went into effect in July 2011, the BATS trade server application dropped the routing destination when it translated any such directed ISO into an order message to send to BATS.

25. The Core Engineering developer did not understand that the changes he made to the code sequences would affect the directed ISOs generated by Latour's trading algorithms. Although Latour and Core Engineering had given the developer some information regarding the new internal messaging protocol, he was not sufficiently familiar with the details of the protocol's operation to recognize that his coding change might affect Latour's orders. As a result, he did not apprise Latour of the change.

### **Impact of Coding Change on Latour's Use of Directed ISOs**

26. As a result of the change, certain directed ISOs that Latour sent to BATS did not

have a routing instruction.<sup>20</sup> In the absence of an instruction to route the orders to another exchange, BATS either executed the orders or canceled them, depending upon whether it had liquidity that could satisfy the order. As a result, directed ISOs that Latour needed to send to CHX, NSX, and NYSE MKT in order to comply with Reg NMS did not reach those destinations.

27. In many instances, the affected ISOs were part of ISO decision sets in which Latour also sent ISOs to other exchanges to execute against quotes at prices inferior to the protected quotation that was supposed to be taken out by the directed ISO. In such situations, both the directed ISO and the other ISOs failed to satisfy the requirements of Reg NMS because Rule 600(b)(30) of Reg NMS requires *all* necessary ISOs to be sent in order for *each* ISO to be compliant. Further, whenever the exchanges receiving these other ISOs executed them in reliance on the order's designation as an ISO, and the quote at CHX, NSX, or NYSE MKT that Latour had intended to execute against remained available, a trade-through occurred.

28. In other instances, the directed ISOs were part of ISO decision sets in which Latour needed to execute against a protected quotation in order to post ISOs at other exchanges at prices that would otherwise lock or cross the protected quotations. In these instances, Latour violated exchange rules adopted under Rule 610 of Reg NMS that require exchange members to reasonably avoid displaying, and prohibit them from engaging in a pattern or practice of displaying, orders that lock or cross protected quotations.

### **Discovery of the Directed ISO Problem**

29. In October 2012, Latour received a regulatory inquiry from FINRA regarding certain of its ISOs that appeared to trade through protected quotations. In reviewing these potential trade-throughs, Latour discovered the problem in the software code that affected its directed ISOs. By that point, Latour had sent approximately 9.3 million non-compliant ISOs over 15 months as a result of the directed ISO issue. Latour fixed the coding issue within hours of discovering the problem.

## **E. Latour's Reliance on Previously-Sent ISOs Resulted in ISOs that Did Not Comply with Reg NMS**

### **Overview**

30. Between October 2010 and October 2012, Latour sent approximately 3 million non-compliant ISOs due to flaws in its ISO routing logic. Latour's problems with its ISO routing logic stemmed from the firm's efforts to use the information available to it to identify instances in which the protected quotations it saw in its quote snapshots were "stale," i.e., no longer available. Latour's risk management system assumed certain fill rates for its ISOs, and these assumptions affected its hedging activities. Using these fill rate assumptions on orders that, in actuality, had little chance of being filled (because the quotes they targeted no longer

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<sup>20</sup> The change did not affect the translation of directed ISOs sent to the trade server using the old internal messaging protocol. Latour did not use the new internal messaging protocol for a majority of its ISOs until March 2012.

were available) could adversely impact Latour's risk management.

31. Latour recognized that there could be instances in which a protected quotation for an exchange appearing in Latour's current quote snapshot had, in fact, been removed, even though Latour had not yet received a market data update from the exchange reflecting this information. When Latour developed its initial ISO routing logic in late 2009, it included a functionality that allowed it to rely for up to one second on a canceled (or partially canceled) ISO that it had previously sent to an exchange, even though Latour's quote snapshot for that exchange still showed the same protected quotation.<sup>21</sup> In such instances, the cancellation reflected that either some other market participant had removed the protected quotation before Latour's ISO reached the exchange or the order underlying the protected quote had been canceled. Latour relied on the cancellation of its previously-sent ISO and not on its quote snapshot, which, possibly due to latencies in the dissemination of quote updates, did not yet reflect a new protected quotation.<sup>22</sup> In another part of its ISO routing logic, Latour embedded a "failsafe" timer, which was intended to limit to one second the maximum amount of time that Latour could rely on any previously-sent ISO irrespective of whether that ISO was cancelled or executed.

32. Latour modified its ISO routing logic in October 2010 to sometimes also rely on the execution of previously-sent ISOs to ignore a protected quotation reflected in a snapshot for a new ISO decision. Based on its experiences at one exchange, Latour believed that previously-sent ISOs sometimes executed against and, thereby, removed protected quotations, but Latour's new quote snapshot did not reflect a new protected quotation for that exchange due to data feed latencies. Latour modified its ISO routing logic to permit it to rely on any executed previously-sent ISO until it received an updated quote from the pertinent exchange.

### **Problems with Latour's Reliance on Executed Previously-Sent ISOs**

#### Issues with Waiting for Quote Updates

33. Latour's October 2010 modification to its ISO routing logic did not account for two situations in which system latencies were not the reason that the same protected quotation persisted in the quote snapshot after an execution of a previously-sent ISO.

34. First, Latour failed to account for circumstances in which it sent an ISO to

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<sup>21</sup> If, during this one-second period, Latour received a market update that indicated that the pertinent exchange was displaying a new protected quotation, Latour would immediately cease relying upon the previously-sent ISO.

<sup>22</sup> In adopting this functionality, Latour relied upon written guidance provided by the Division of Trading and Markets. See Reg NMS FAQs, Question 4.06 ("Yes, waiting one full second to route a new ISO to an unchanged price at a trading center (after receiving a no-fill or partial fill cancellation of a previous ISO seeking to execute against a protected quotation at such trading center) would qualify as a reasonable policy and procedure under Rule 611(a)(1) to prevent trade-throughs, as well as a reasonable step under Rule 611(c) to establish that orders meet the requirements for ISOs set forth in Rule 600(b)(30).").

execute against a protected quotation but its order executed against a better-priced, non-displayed order (i.e., a hidden order) instead of the protected quotation. Such executions did not result in any changes to the protected quotations because the protected quotations had not been removed. Yet, because Latour was waiting to see a change to that protected quotation in the quote data before it stopped relying on the previously-sent ISO, Latour did not send a new ISO when it was required to do so under Reg NMS or exchange rules adopted pursuant to Rule 610 of Reg NMS.

35. Second, with regard to certain exchanges, Latour failed to account for executions against protected quotations that were the initial displayed quantity of a reserve order.<sup>23</sup> So long as such an order has sufficient quantity in reserve, an execution will result in the protected quotation being immediately replenished at the same price and quantity. The exchange then sends data indicating that a new displayed protected quotation exists at the same price and quantity. In the quote snapshot assembled for a new ISO decision, such a replenished protected quotation will bear a new timestamp. However, for three exchanges, the Tower Research data servers used by Latour had not been programmed to recognize the replenishment of a reserve order. As a result, for these exchanges, the new quote snapshot reflected a protected quotation with the same timestamp as the one used for the previous ISO decision. Latour erroneously assumed that the executed previously-sent ISO removed that quotation, but that, owing to latencies, the exchange had not yet sent an updated quote. Latour therefore did not send a new ISO when it was required to do so under Reg NMS or exchange rules adopted pursuant to Rule 610 of Reg NMS.

#### Latour Mitigated But Did Not Fix the Problem Until August 2014

36. Beginning in September 2011, Latour noticed that its quote snapshots did not account for executions against reserve orders on certain exchanges, and Latour made a series of adjustments to its ISO routing logic as it pertained to its reliance on executed previously-sent ISOs. These alterations to Latour's ISO routing logic significantly reduced the number of non-compliant ISOs that resulted from Latour's reliance on executed previously-sent ISOs. Nevertheless, Latour did not fully address instances involving executions against reserve and non-displayed orders until August 2014, when the firm stopped relying in any circumstances on a fully-executed previously-sent ISO in subsequent ISO routing decisions.

#### **Latour's "Failsafe" Control Was Not Implemented Correctly**

37. Latour's ISO routing logic included a "failsafe" control to limit the maximum period of time during which it would rely on executed previously-sent ISOs. From late 2009 through January 2013, Latour intended for the maximum period of reliance to be one second. In January 2013, Latour reduced the maximum period to 50 milliseconds.

38. However, Latour did not properly implement the failsafe from late 2009, when it

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<sup>23</sup> A reserve order is an order that allows market participants to display only a fraction of their entire order, and then replenish the component of the order that is displayed as it gets executed. *See, e.g.*, NASDAQ Equity Rule 4703(h) available at <http://nasdaq.cchwallstreet.com>.

was first deployed, until October 2012. During this time period, the control did not check the age of a previously-sent ISO at the time of each new ISO decision. Instead, as the “failsafe” was coded, Latour checked the age of a previously-sent ISO only if Latour had received an update to the protected quote against which Latour had sent the previously-sent ISO. Owing to the problems with executions against hidden and reserve orders, waiting for a quote update before checking the age of a previously-sent ISO rendered the “failsafe” ineffective to prevent non-compliant ISOs in those situations.

39. Latour discovered the implementation problem with its failsafe control in October 2012, when the firm responded to the regulatory inquiry described above in paragraph 29. Latour revised the coding for its failsafe so that it tested the age of a previously-sent ISO when it assembled the quote snapshot for a new ISO decision. This change prevented Latour from relying on an executed previously-sent ISO for more than one second. In January 2013, Latour shortened this maximum reliance period to 50 milliseconds. However, these changes still permitted Latour’s unwarranted reliance for periods of less than one second (or 50 milliseconds) on previously-sent ISOs that executed against hidden orders and the reserve orders at certain exchanges.<sup>24</sup>

### **Problems with Reliance on Directed Previously-Sent ISOs**

40. In some instances, the previously-sent ISO upon which Latour’s ISO routing logic relied was a directed ISO that had not reached its intended destination due to the translation error caused by the coding change (discussed above in paragraphs 15 - 29). To the extent that the protected quotation at the intended destination remained available and superior in price at the time, the ISOs that Latour sent as part of that subsequent ISO decision failed to comply with Reg NMS. Further, during the period that the “failsafe” timeout was incorrectly implemented, Latour’s unwarranted reliance on such directed ISOs could continue for periods longer than one second, potentially affecting multiple subsequent ISO decisions.

### **F. Latour’s Post-Trade Surveillance Tools Were Inadequate**

41. Latour’s use of directed ISOs and its reliance on executed previously-sent ISOs were important elements of its ISO routing procedures. Latour’s automated, post-trade surveillance tools were inadequate to determine whether these components were functioning as intended or to detect malfunctions in its systems that could affect ISOs before Latour sent them to the market.

42. Latour’s post-trade surveillance tools did not use the ISOs that Latour sent to the exchanges. Instead, Latour chose to use its internal version of the ISOs as they existed before they were translated into the unique messaging formats used by the respective recipient exchanges. As a result of using this pre-translation version, Latour applied its post-trade regulatory compliance tools to the orders it *intended* to send to the exchanges and not the orders

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<sup>24</sup> Latour continued to rely improperly on previously-sent ISOs for which it had received executions against non-displayed or reserve orders, resulting in approximately 322,000 non-compliant ISOs between November 2012 and August 2014.

that it *actually sent*. Accordingly, Latour did not detect that the ISOs it intended to send to BATS as directed ISOs did not, in fact, reach their necessary destinations.

43. Latour had several other means at its disposal for detecting the directed ISO problem. For example, Latour received execution reports from BATS that explicitly provided the venue where the order had been executed. These reports indicated that BATS executed these orders, not the intended venues. These reports also contained information regarding the fees or rebates associated with the transaction, which also indicated whether an order was executed on BATS or routed and executed elsewhere. Upon discovering the directed ISO issue in October 2012, Latour implemented an automated, post-trade control to check this field in BATS execution messages to enable it to detect the failure of a directed ISO to reach its intended destination.

44. Similarly, Latour had information available to it that would have enabled the firm to recognize that some of its previously-sent ISOs had not executed against the pertinent protected quotation. For example, any previously-sent ISO that executed against a hidden order did so at a price different from that of the pertinent protected quotation. Latour knew both of these relevant prices, but Latour did not compare this data or otherwise use it to determine when the firm could not rely on executed previously-sent ISOs. Latour also did not check for the unwarranted reliance on previously-sent ISOs that executed against reserve orders. The one second “failsafe” control could have limited the number of instances in which Latour improperly relied on executed previously-sent ISOs. Until October 2012, however, this pre-order control did not function as intended, and Latour had no post-trade surveillance tool to detect this failure. In October 2012, Latour implemented a post-trade surveillance tool to identify any instance in which Latour relied for longer than one second (later revised to 50 milliseconds) on a previously-sent ISO that had not been cancelled. Latour also implemented a tool to confirm that a previously-sent cancelled ISO was not relied upon for more than one-second after Latour received a message indicating that the ISO had been fully or partially cancelled. As discussed above, Latour did not fully address the problems involving executions against reserve and hidden orders until August 2014, when it stopped relying on fully executed previously-sent ISOs in subsequent ISO decisions.

## VIOLATIONS

45. As described above, Latour sent nearly 12.6 million non-compliant ISOs between October 2010 and August 2014. These non-compliant ISOs caused approximately 1.1 million trade-throughs and 1.7 million locked or crossed protected quotations. Latour received \$2,784,875 in gross trading profits and exchange rebates from its non-compliant ISOs.

### **A. Market Access Rule: Section 15(c)(3) and Rule 15c3-5**

#### **Section 15(c)(3)**

46. Section 15(c)(3) of the Exchange Act, among other things, prohibits a broker or dealer from effecting any securities transactions in contravention of the rules and regulations the Commission prescribes as necessary or appropriate in the public interest, or for the protection of investors, to provide safeguards with respect to the financial responsibility and related practices

of brokers or dealers. Latour violated this provision through its violations of Rule 15c3-5 described below.

#### **Rule 15c3-5(d)**

47. Rule 15c3-5(d) requires that the controls and supervisory procedures of a broker or dealer to manage the financial and regulatory risks of its market access (as required by Rule 15c3-5(c)) must be under the direct and exclusive control of the broker or dealer.

48. Latour violated Rule 15c3-5(d) because its financial and regulatory risk management controls and supervisory procedures were not under its direct and exclusive control. As explained above, Tower Research's Core Engineering department could (and did) make changes to the common code base Latour used to access the U.S. markets without Latour's knowledge or approval. As demonstrated by the translation error with directed ISOs, such changes could nullify the effectiveness of the ISO regulatory controls that Latour applied before such orders reached the common code base. Additionally, although the changes at issue here had no effect on Latour's financial risk management controls, changes to the common code base potentially could have impacted how those controls were applied. The steps that Latour took to guard against such changes to the common code base were inadequate to give it direct and exclusive control over its regulatory and financial risk management controls.

#### **Rule 15c3-5(b) and (c)(2)(i)**

49. Rule 15c3-5(b) requires that a broker or dealer with market access establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access activity.

50. Rule 15c3-5(c)(2)(i) requires that a broker or dealer's risk management controls and supervisory procedures be reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis. Rule 15c3-5(a)(2) defines "regulatory requirements" to mean all federal securities laws, rules and regulations, and rules of self-regulatory organizations, that are applicable in connection with market access.

51. Latour violated Rule 15c3-5(b) and (c)(2)(i) because its pre-trade ISO controls and procedures were not reasonably designed to prevent the entry of orders that did not comply with Rules 600(b)(30) and 611(c) of Reg NMS and exchange rules to prevent the display of locking and crossing quotes (adopted in response to Rule 610 of Reg NMS). As explained above, Latour's pre-order controls and procedures were not reasonably designed to ensure that the directed ISOs that Latour sent to BATS contained the instructions regarding the destination venue that were necessary for Latour to comply with Reg NMS. These controls and procedures also were not reasonably designed to prevent Latour's unwarranted reliance on previously-sent ISOs that had executed against non-displayed and reserve orders. As a result, Latour sent millions of ISOs to exchanges that did not comply with the requirements of Rules 600(b)(30) and 611(c) of Reg NMS and the rules adopted by exchanges pursuant to Rule 610 regarding the display of locking or crossing quotes. Further, changes made to the common code base without

Latour's knowledge or approval could – and did – render critical aspects of its ISO regulatory controls ineffective. Finally, Latour incorrectly implemented a failsafe control that could have prevented some of the non-compliant ISOs.

**B. Regulation NMS: Rule 611(c)**

52. Rule 611(c) requires that brokers or dealers take reasonable steps to establish that an ISO meets the requirements of Rule 600(b)(30).

53. Rule 600(b)(30) defines an ISO as a limit order that is identified as an ISO. In addition, simultaneously with the routing of the ISO, one or more additional orders, as necessary, must be routed to execute against the full displayed size of any protected bid (in the case of a limit order to sell) or protected offer (in the case of a limit order to buy) for the stock with a price that is superior to the limit price of the ISO. These additional routed orders also must be marked as ISOs.

54. Latour violated Rule 611(c) because it failed to take reasonable steps to establish that its ISOs met the requirements set forth in Rule 600(b)(30). Latour sent approximately 12.6 million non-compliant ISOs between October 2010 and August 2014. The majority of these non-compliant ISOs resulted from Latour's failure to include necessary destination instructions on its directed ISOs. Latour sent these non-compliant ISOs despite having information available indicating that the orders did not reach their intended destinations. Latour also relied on flawed ISO routing logic that failed to account for executions against hidden liquidity or reserve orders. Latour did so despite having information available indicating that its previously-sent ISOs had executed against hidden orders and not protected quotations. Additionally, as described above, Latour's post-trade surveillance steps were inadequate.

**REMEDIAL EFFORTS**

55. In determining to accept this offer, the Commission considered the remedial acts undertaken by Latour and cooperation afforded the Commission staff.

**IV.**

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

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Latour cease and desist from committing or causing any violations and any future violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder and Rule 611(c) of Regulation NMS.

B. Respondent Latour shall, within ten (10) days of the entry of this Order, pay disgorgement of \$2,784,875, which represents profits gained as a result of the conduct described herein, and prejudgment interest of \$268,564, for a total of \$3,053,439, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If a timely payment of disgorgement plus

prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Latour also shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$5,000,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment of the civil monetary penalty is not made, additional interest will accrue pursuant to 31 U.S.C. §3717. Payments 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 Latour 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 Robert A. Cohen, Co-Chief, Market Abuse Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549.

C. 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 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.

Brent J. Fields  
Secretary