

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 83556 / June 28, 2018**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3- 18558**

**In the Matter of**

**BAYES CAPITAL, LLC,**

**Respondent.**

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

**I.**

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

**II.**

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

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### **Summary**

1. These proceedings concern Bayes Capital's violations of Regulation SHO ("Reg SHO") of the Exchange Act, in connection with its principal trading practices. As described more fully below, from August 2016 through December 2017, Bayes Capital repeatedly failed to satisfy Reg SHO's order-marking, locate, and circuit breaker requirements for millions of short sales.

#### **Respondent**

2. Bayes Capital, headquartered in Tappan, New Jersey, is a registered broker-dealer. During the relevant period, Bayes Capital provided sponsored access and routing execution services to broker-dealer and institutional customers, and had an annual net income under \$1 million. On May 7, 2018, Bayes Capital filed a Form BDW to withdraw its registration as a broker-dealer.

#### **Background**

##### **A. Regulation SHO**

3. Reg SHO of the Exchange Act governs short sales. Under Rule 200(g) of Reg SHO, a broker or dealer must mark all sell orders of any equity security as long, short, or short exempt. Under Rule 200(g)(1), an order to sell shall be marked long only if the seller is deemed to own the security being sold pursuant to Rule 200(a) through (f), and either the security to be delivered is in the physical possession or control of the broker or dealer, or it is reasonably expected that the security will be in the physical possession or control of the broker or dealer no later than the settlement of the transaction. Rule 200(c) provides that a person shall be deemed to own securities only to the extent that he has a net long position in such securities.

4. Under Rule 201(b) of Reg SHO, trading centers must establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the execution or display of a short sale order at a price that is less than or equal to the current national best bid if the price of the covered security decreases 10% or more from the prior day's closing price as determined by the listing market (the "circuit breaker requirement").

5. Rule 203(b)(1) of Reg SHO prohibits a broker or dealer from accepting a short sale order in an equity security from another person or effecting a short sale in an equity security for its own account unless the broker or dealer has borrowed the security, entered into a bona-fide arrangement to borrow the security, or has "reasonable grounds" to believe that the security can be

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

borrowed so that it can be delivered on the delivery date (the “locate requirement”). Rule 203(b)(1) also requires the broker or dealer to document its compliance with the locate requirement.

## **B. Bayes Capital’s Reg SHO Failures**

6. In August 2016, Bayes Capital changed its approach to executing customer transactions from exclusively agency trading to a mixture of principal and agency trading. When a customer sent Bayes Capital a sell or sell short order, Bayes Capital mirrored its customer’s order in its own account with the objective of obtaining an execution between the quoted bid and ask.

7. If Bayes Capital obtained an execution between the bid and ask, Bayes Capital bought its customer’s shares to fulfill the execution from its principal account. Bayes Capital paid its customer the quoted bid and kept as profit the spread between the bid and the midpoint. If Bayes Capital was not successful in executing a trade at the midpoint, it executed the trade on an agency basis and was paid a commission by its customer.

8. Bayes Capital’s mismarking of sell orders occurred in two time periods. First, between August 2016 and August 2017, Bayes Capital mirrored its customers’ sell long orders in its principal account as sell long orders. Bayes Capital incorrectly marked the orders in its principal account as sell long, even though it did not own shares in the relevant securities and did not have a net long position in such securities at the time of order entry.

9. Second, starting on August 29, 2017, and continuing through December 2017, Bayes Capital incorrectly mirrored *both* its customers’ sell long orders and their sell short orders in its principal account, marking them as sell long, even though it didn’t own shares in the relevant securities and did not have a net long position in such securities at the time of order entry.

10. In all, between August 2016 and December 2017, Bayes Capital mismarked approximately one million orders in its principal account as sell long instead of sell short.

11. Additionally, in violation of the circuit breaker requirements of Rule 201(b) of Reg SHO, Bayes Capital did not establish, maintain and enforce any written policies and procedures, rule-based logic or otherwise, reasonably designed to prevent the execution or display of a short sale order of a covered security at a price that is less than or equal to the current national best bid when the price of the covered security had declined by 10% or more from the prior day’s closing price as determined by the listing market.

12. Finally, prior to executing short sale orders as principal, Bayes Capital did not comply with the locate requirement in Rule 203(b)(1) of Reg SHO. From August 2016 through December 2017, Bayes Capital entered over two million principal sell short orders and failed to borrow, arrange to borrow, or have reasonable grounds to believe that the securities could be borrowed so that they could be delivered on the date delivery is due. This includes the over one million orders that Bayes correctly marked as sell short (between August 2016 and August 2017) and the over one million mismarked sell orders, described above.

## Violations

13. As a result of the conduct described above, Bayes Capital willfully<sup>2</sup> violated Rules 200(g)(1), 201(b), and 203(b)(1) of Reg SHO promulgated under the Exchange Act.

### IV.

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

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

A. Respondent Bayes Capital cease and desist from committing or causing any violations and any future violations of Rules 200(g)(1), 201(b) and 203(b)(1) of Regulation SHO promulgated under the Exchange Act.

B. Respondent Bayes Capital is censured.

C. Bayes Capital shall, within fourteen (14) days of the entry of this Order, pay a civil money penalty in the amount of \$300,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. 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

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<sup>2</sup> 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)).

Payment by check or money order must be accompanied by a cover letter identifying Bayes Capital, LLC as 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 Lara Shalov Mehraban, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, Suite 400, New York, NY 10281-1022.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent Bayes Capital 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 Bayes Capital 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 Bayes Capital 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