

**NASDAQ PHLX LLC
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2017055657513**

TO: Nasdaq Phlx LLC
c/o Department of Enforcement
Financial Industry Regulatory Authority (FINRA)

RE: Electronic Transaction Clearing, Inc., Respondent
Member Firm
CRD No. 146122

Pursuant to Rule 9216 of Nasdaq PHLX LLC (Phlx) Code of Procedure,¹ Electronic Transaction Clearing, Inc. (the firm or Respondent) submits this Letter of Acceptance, Waiver and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, Phlx will not bring any future actions against the Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of Phlx, or to which Phlx is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by Phlx:

BACKGROUND

The firm became a member of FINRA in July 2009 and a member of Phlx in October 2010. The firm ceased its registration with Phlx on March 6, 2023. Phlx retains jurisdiction over the firm pursuant to Phlx Rule General 5, Section 1(c). The firm is headquartered in Dallas, Texas and employs fewer than 25 registered representatives across four branches. During the relevant period, ETC provided execution, clearing and stock lending services to broker-dealers and institutional customers.

RELEVANT PRIOR DISCIPLINARY HISTORY

In early 2016, ETC consented to a censure and an aggregate fine of \$875,000 imposed by The Nasdaq Stock Market LLC (Nasdaq), NYSE Arca, Inc. (NYSE Arca), Cboe BZX Exchange, Inc. (BZX), and FINRA for failing to reasonably supervise for potentially manipulative trading by customers and other deficiencies associated with the firm's risk management controls and supervisory procedures related to the provision of market access to customers from November 2009 through March 2015, in violation of

¹ Series 9000 of The Nasdaq Stock Market LLC Rules are incorporated by reference into Phlx Rule General 5, Section 3, and are thus Phlx Rules and thereby applicable to Phlx members, member organizations, persons associated with member organizations, and other persons subject to the Exchange's jurisdiction.

Section 15(c)(3) of the Securities Exchange Act of 1934 (Exchange Act); Exchange Act Rule 15c3-5; and the supervision rules of FINRA and the above exchanges.² ETC also was required to review its policies, systems, procedures, and training for compliance with market access requirements and supervision of its market access customers and to submit three written reports certified by the firm's CEO about the review performed, resulting recommendations for enhancements, and steps taken to remediate the findings. ETC completed the review and submitted the final reports by April 2017.

SUMMARY

From May 2017 through December 2020, ETC failed to reasonably supervise for potentially manipulative trading. Throughout the relevant period, ETC provided sponsored access to foreign and domestic broker dealers and institutional customers, including several institutional customers that were comprised of hundreds of individual foreign-based day traders. The firm did not reasonably surveil for potential manipulation such as marking the open or close, prearranged trading, and wash sales. In addition, the firm's review of surveillance alerts was unreasonable. ETC had limited staff and other resources to sufficiently review and resolve alerts for potentially manipulative trading, which, by 2018, totaled more than one million alerts per year. The firm also did not reasonably respond to red flags of potentially manipulative trading. As a result, the firm violated Phlx Rules 748 and 707, Phlx Rule General 9, Section 20(h) and PSX Rule 3503.

FACTS AND VIOLATIVE CONDUCT

1. This matter originated from surveillance conducted by FINRA.

ETC's Business and Surveillance Model

2. At all relevant times, ETC provided sponsored access to foreign and domestic broker dealers, and algorithmic and day trading entities, including several entities that were comprised of hundreds of individual foreign-based day traders, such as Client A and Client B, described below.³ The firm's customers used ETC's market participant identifiers (MPIDs) to route orders to other broker-dealers, alternative trading systems, and exchanges, including Phlx, for execution.

² Disciplinary Proceeding Nos. 20100254756-01 (FINRA), 20100254756-02 (Nasdaq), 20100254756-03 (NYSE Arca), and 20100254756-04 (BZX).

³ Broker-dealers provide access to the trading markets in a number of ways. One way is through "sponsored" access whereby a broker-dealer permits customers to enter orders in a manner that bypasses the broker-dealer's trading system and routes orders directly to a trading center. Another way is through "direct market" access whereby customer orders flow through the broker-dealer's trading systems prior to reaching the trading center.

3. ETC used a vendor-provided system (System 1) and an in-house system (System 2) in conjunction to surveil for potentially manipulative trading by customers using its MPIDs. All order flow fed into both systems. There was some overlap in surveillance but each system also surveilled for different types of potentially manipulative activity. For System 1, the firm used an automated scoring feature to exclude from the firm's review alerts that it believed were likely to be "false positives" for manipulation. System 2 did not include a scoring feature. Instead, reviewers were expected to review all the post-trade alerts for potentially manipulative trading generated by the system.

ETC Failed to Reasonably Supervise for Potentially Manipulative Trading

4. Phlx Rule General 9, Section 20(h), and its predecessor Phlx Rule 748, require each member to "establish, maintain, and enforce written supervisory procedures [WSPs], and a system for applying such procedures, to supervise the types of business(es) in which the member or member organization engages in and to supervise the activities of all registered representatives, employees, and associated persons. The [WSPs] and the system for applying such procedures shall reasonably be designed to prevent and detect, insofar as practicable, violations of the applicable securities laws and regulations, including the By-Laws and Rules of the Exchange."⁴
5. The duty to supervise imposed by Phlx Rule General 9, Section 20(h) and Phlx Rule 748 requires member organizations to reasonably investigate red flags that suggest misconduct may be occurring and to act upon the results of such investigation.
6. PSX Rule 3503, and its predecessor Phlx Rule 707,⁵ provided that "[a] member, member organization, or person associated with or employed by a member or member organization shall not engage in conduct inconsistent with just and equitable principles of trade." A violation of Phlx Rule General 9, Section 20(h) or Phlx Rule 748 also constitutes a violation of PSX Rule 3503 and Phlx Rule 707, respectively.
7. ETC's supervisory system for potentially manipulative trading through the firm was not reasonable in several respects from May 2017 through December 2020.

ETC Did Not Reasonably Surveil for Certain Forms of Manipulation

8. During the relevant period, the surveillance systems used by the firm were not reasonably designed to supervise for potential manipulative trading.

⁴ Phlx Rule General 9, Section 20(h) superseded Phlx Rule 748, effective February 3, 2020.

⁵ PSX Rule 3503 superseded Phlx Rule 707 on February 3, 2020. After the relevant period, on January 22, 2021, the rule was again renumbered to Phlx Rule General 9, Section 1(c). Because PSX Rule 3503 and Phlx Rule 707 were the rules in effect during the relevant period, those rules apply to the subject conduct.

9. *First*, the firm did not have a review specific to marking the open until the end of October 2019. Although the firm implemented a review to detect ramping in February 2018, that review was unreasonable for detecting marking the open because it required a series of orders and a cancellation to trigger an alert. After October 2019, ETC's marking the open surveillance was not reasonably designed because its parameters excluded orders with notional values less than \$25,000.
10. *Second*, ETC's surveillance for marking the close was unreasonable. System 1 only generated alerts for potential marking the close activity if the activity occurred within the last minute of the close. In November 2019, ETC further narrowed the parameters to consider only the last 15 seconds of the close and, by mid-November 2019, the last 2.5 seconds of the close. The firm's System 2 surveillance also was unreasonable. Although System 2 considered a longer time period — the last four minutes prior to the close — it did not generate alerts unless there had been at least three prior instances of potential marking in the same symbol in the last 20 days. As a result, System 2 would fail to identify instances where potential marking occurred on only one or two days during the preceding 20-day trading period and where potential marking occurred more than four minutes prior to the close.
11. *Third*, System 2 also was not reasonably designed to detect a client's use of multiple MPIDs to manipulate the market. Although ETC clients could enter orders through multiple MPIDs, only two of twelve of the firm's surveillance reports accounted for trading by clients using more than one MPID.⁶ As a result, potentially manipulative trading, such as wash sales, could go undetected if a client's traders used different MPIDs.
12. *Fourth*, ETC relied on System 2 to surveil for prearranged trading. Due to a coding issue, one algorithmic trading client was excluded from the firm's surveillance for potential pre-arranged trading from late November 2017 through December 2020. During this time, that client executed hundreds of millions of shares through ETC, including more than 472 million shares from 2018 through 2019. This client, along with Client A, Client B, and other clients, were the subject of warnings from two self-regulatory organizations (SROs), as described below.

ETC Failed to Reasonably Review Alerts

13. ETC's review of its surveillance alerts also was not reasonable. The firm's staff was too limited to reasonably conduct the initial review and analysis of alerts. As a result, from May 2017 through December 2019, the firm failed to review more than one million of 2.3 million alerts that exceeded System 1's scoring threshold for potential manipulative trading and, therefore, required review. There were also significant delays in reviews of System 2's surveillance alerts. For example, firm records reflect delays of 98 days or more for reviews of alerts for potentially manipulative trading such as wash sales, prearranged trading, use of non-bona-fide

⁶ The two surveillance reports were for prearranged trading and clients having stock in excess of 5 percent of the symbol's market capitalization.

orders, use of small orders to deceptively move prices, and manipulation of OTC small cap securities, and delays of six months in the review of alerts for potential unauthorized log-in attempts to trading systems in the above timeframe.

14. Further, first-level reviewers were permitted to close surveillance alerts for potentially manipulative trading without any oversight or supervision by a firm principal. During the relevant period, the persons responsible for reviewing all the alerts from System 2 since the spring of 2018 had no prior experience in identifying potentially manipulative trading.
15. The firm's reviewers used a central repository called the Service Bureau to access the identity of clients' individual traders when conducting supervisory reviews for potentially manipulative trading. The firm's reliance on the Service Bureau was unreasonable because the firm knew that traders had been inadvertently omitted from the repository. For example, at least 150 traders from the firm's largest client (Client A) were not captured in the firm's Service Bureau records related to the client.
16. The firm also failed to have reasonably designed WSPs concerning how to review for potentially manipulative trading. The firm's WSPs required alerts that evidenced patterns of potentially manipulative trading to be escalated to the Vice President of Compliance. The WSPs, however, did not provide guidance about what constituted a pattern of potential manipulation or how to reach those determinations.

ETC Did Not Reasonably Respond to Red Flags of Customers' Potentially Manipulative Trading

17. ETC also did not reasonably respond to "red flags" concerning its customers' potentially manipulative trading. One client, an algorithmic trader, generated more than 1.3 million alerts, which comprised more than half of the System 1 alerts requiring review from May 2017 through 2019. The firm, however, did not implement any reasonably enhanced surveillance or additional reviews of that client's trading activity.
18. In addition, in May 2019 and July 2019, an SRO issued written warnings to the firm detailing concerns that at least six ETC clients may have engaged in potentially manipulative trading. In August 2019, the firm initiated the termination of one of the six clients and instituted heightened surveillance for Client A and Client B. The clients identified in the warnings, however, continued to generate firm surveillance alerts for potentially manipulative trading, including Client A and Client B, which triggered trading alerts in over 85% of the inquiries from FINRA and other regulators. From May 2019 through December 2019, Client A, and its affiliate, Client B, generated more than 22,400 System 1 alerts for potentially manipulative trading that exceeded the firm's scoring thresholds. Although the firm terminated some individual traders from Client A and Client B, the continuing alerts often were either not reviewed or untimely reviewed. In January 2020, the firm terminated

Client A and Client B after Nasdaq Regulation and another SRO issued additional written warnings to ETC regarding serious concerns that the clients were sending manipulative orders to the markets through ETC.

19. For these reasons, ETC violated Phlx Rules 748 and 707, Phlx Rule General 9, Section 20(h) and PSX Rule 3503.

B. Respondent also consents to the imposition of the following sanctions:

1. a censure; and
2. a \$3 million fine, of which \$168,418.80 shall be paid to Phlx.⁷

Acceptance of this AWC is conditioned upon acceptance of parallel settlement agreements in related matters between the firm and Nasdaq, BX, BYX, BZX, EDGA, EDGX, FINRA, IEX, NYSE American, NYSE Arca, NYSE, and NYSE National.

Respondent agrees to pay the monetary sanction in accordance with its executed payment form.

Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under Phlx's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against the firm;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

⁷ The remainder will be paid to Nasdaq; Nasdaq BX, Inc. (BX); Cboe BYX Exchange, Inc. (BYX); BZX; Cboe EDGA Exchange, Inc. (EDGA); Cboe EDGX Exchange, Inc. (EDGX); FINRA; Investors Exchange LLC (IEX); NYSE American LLC (NYSE American); NYSE Arca; the New York Stock Exchange (NYSE); and NYSE National, Inc. (NYSE National).

- D. To appeal any such decision to the Exchange Review Council and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Regulatory Officer, the Exchange Review Council, or any member of the Exchange Review Council, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by FINRA's Department of Enforcement and the Exchange Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs (ODA), pursuant to Phlx Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Respondent; and
- C. If accepted:
 - 1. This AWC will become part of the Respondent's permanent disciplinary record and may be considered in any future actions brought by Phlx or any other regulator against the Respondent;
 - 2. Phlx may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Phlx Rule 8310 and IM-8310-3; and
 - 3. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of Phlx, or to which Phlx is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Respondent's right to take legal or factual positions in litigation or other legal proceedings in which Phlx is not a party.

- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by Phlx, nor does it reflect the views of Phlx or its staff.

The undersigned, on behalf of the firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the firm has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the firm to submit it.

August 10, 2023

Date

Electronic Transaction Clearing, Inc.
Respondent

By: William Brennan

Print Name: William Brennan

Title: CEO

Reviewed by:

Susan Light

Susan Light
Counsel for Respondent
Katten Muchin Rosenman LLP
50 Rockefeller Plaza
New York, NY 10020-1605

Accepted by Phlx:

Date September 8, 2023

Dawn Faris

Dawn E. Faris
Senior Counsel
Department of Enforcement

Signed on behalf of Phlx, by delegated
authority from the Director of ODA