UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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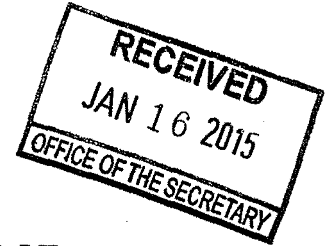

In the Matter of the Application of ELECTRONIC TRANSACTION CLEARING, INC., KEVIN MURPHY, and HARVEY C. CLOYD, JR., For Review of Disciplinary Action Taken by CBOE	**BRIEF IN SUPPORT OF APPLICATION FOR REVIEW**

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INTRODUCTION

Until now, Applicants had worked over 25 years in the securities industry with spotlessly clean disciplinary records. Each of them is now subject to a million-dollar fine—one of them based on a single violation—as a result of the CBOE's deeply flawed legal and factual determinations in this matter. To reach that result, the CBOE departed from the plain language of the applicable rules, ignored the key authorities that have long guided the interpretation and enforcement of those rules, and strayed from the most current regulatory guidance on those rules. What is more, the CBOE's determinations, flawed as they are from a legal perspective, cannot be supported factually, either, given the uncontroverted evidence presented in this matter—including the testimony of an expert that the CBOE staff itself approved—that no violations occurred. The decision should therefore be set aside.

Regrettably, the errors committed by the CBOE are not confined to this particular matter, but reflect more systemic problems with the fairness of the CBOE's disciplinary system, which lacks important safeguards that other regulators like FINRA and the Commission have adopted. As a result, Applicants did not receive the fair procedures guaranteed to them by the Securities Exchange Act of 1934 ("Exchange Act"), and therefore respectfully request that the entire proceeding be dismissed for that reason, too.

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BACKGROUND

This appeal involves multiple parties, numerous charges, and an extensive case history. For simplicity's sake, only the relevant parties, proceedings, and facts are set forth below.

I. Until This Action, Applicants Worked Decades In The Securities Industry With A Spotless Disciplinary Record.

Applicant Electronic Transaction Clearing, Inc. ("ETC") is a registered broker-dealer that provides high-volume equity execution and clearing services to other broker-dealers and non-broker-dealer proprietary trading firms. (Tr. 1394:2-12 (Cloyd).)[1] ETC was a CBOE member for five years (until April 2013) and has been a FINRA member since the fall of 2009.

Applicant Harvey Cloyd is ETC's former CEO. (Tr. 1363:9-17, 1366:10-12 (Cloyd).) He is now the CEO of ETC's parent company, ETC Global Holdings, Inc., and the Chairman of the Board of Directors of both ETC and its parent. Applicant Kevin Murphy is ETC's former President and Chief Operations Officer, and its current CEO. (Tr. 1474:2-6 (Murphy).) Cloyd and Murphy have each worked in the securities industry for over 25 years. (Tr. 1474:11-24 (Murphy).) ETC, Cloyd, and Murphy all had spotless disciplinary records until the CBOE

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[1] For ease of reference, citations to the Transcript of Proceedings are designated as "Tr." followed by the page and line number where the testimony can be located. The parenthetical indicates the identity of the witness who provided the testimony.

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brought this action against them. (CBOE Ex. 4; *see also* Tr. 1366:10-12 (Cloyd), 1475:22-1476:1 (Murphy).)[2]

II. The CBOE Brings This Action Alleging Numerous Violations And The BCC Holds A Hearing.

In June 2011, the CBOE charged ETC, Murphy, Cloyd, and ETC's Chief Compliance Officer, David DiCenso, with numerous violations allegedly occurring over a seven-month period between December 2009 and July 2010. (DiCenso was cleared of all charges and is not a party to this appeal.)

The alleged violations fall into three general categories. First, the CBOE brought charges concerning compliance with the Commission's anti-money-laundering ("AML") Customer Identification Program ("CIP") Rule (31 C.F.R. § 1023.220; CBOE Rules 4.1, 4.2, 4.20) and the CBOE's margin requirements (CBOE Rules 12.3(j), 12.4(i)) as applied to the traders for ETC's institutional customers (the "customer identification and margin charges"). Second, the CBOE brought charges under its Rules 4.1 and 4.2 concerning effective monitoring for wash trading, a form of stock manipulation where an investor simultaneously sells and buys the same financial instrument (the "monitoring charges").

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[2] References to exhibits introduced by the CBOE are designated as "CBOE Ex. __" followed by the exhibit number. References to exhibits introduced by the Applicants are designated as "Resp. Ex. __" followed by the applicable exhibit number.

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Third, the CBOE brought charges under its Rules 4.2 and 15.1, and Regulation SHO of the Exchange Act and Rule 204 promulgated thereunder, for a single instance of failing to close out a short position that was "failing to deliver," and under its Rules 4.1, 4.2, and 4.20 for failing one year to conduct an independent AML audit (the "remaining charges").

Between August and December 2012, CBOE's Business Conduct Committee ("BCC") held a seven-day hearing on all of the charges.

A. The Evidence On The Customer Identification And Margin Charges.

Most of the charges related to ETC's institutional customers and the traders who enter trades in those customers' accounts at ETC—so the majority of evidence presented at the hearing related to these customers and traders. Most notable was the absence of any evidence that the traders could affect the movement of money or securities into or out of any account at ETC. Specifically, undisputed evidence established:

- The traders do not have accounts or sub-accounts at ETC;[3]
- The traders cannot deposit or withdraw money or securities from any account at ETC;[4]

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[3] Tr. 475:20-476:11 (Santos), 1124:6-1125:3, 1414:7-19 (Cloyd), 1504:9-13 (Murphy).

[4] Tr. 1124:21-1125:3 (DiCenso), 1504:14-21 (Murphy).

- The traders cannot segregate monies or securities in any account at ETC;[5]
- ETC does not provide account statements or confirmations to traders;[6]
- ETC does not prepare tax information regarding the traders;[7]
- ETC does not lend money to traders;[8] and
- The traders are not parties to any margin agreements with ETC or between ETC and its customers.[9]

The CBOE's witnesses also conceded the absence of any evidence that the traders were separate beneficial owners of any accounts at ETC. (Tr. 187:11-13 (Miller-Brouwer), 478:13-21, 493:20-494:1 (Santos), 712:12-18 (Adams).)

B. The Evidence On The Monitoring Charges.

As the evidence presented at the hearing showed without contradiction, ETC has a state-of-the-art monitoring system that tracks all potential wash trading activity. DiCenso, who was cleared of all charges by the BCC—including the charge that he failed to supervise the trading activity by ETC's customers—began designing this state-of-the-art system in December 2009 using his nearly 30 years of experience as a regulator, surveillance expert, and compliance officer. (Tr. 1054:4-1060:20, 1063:9-20, 1075:21-1076:15 (DiCenso).)

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[5] Tr. 1131:24-1132:5 (DiCenso), 1415:16-1416:13, 1416:24-1417:3 (Cloyd).
[6] Tr. 1131:21-23 (DiCenso), 1417:4-6, 1510:22-24 (Murphy).
[7] Tr. 1132:9-11 (DiCenso).
[8] Tr. 1507:3-7 (Murphy).
[9] Tr. 1506:22-1507:2 (Murphy).

The first report DiCenso developed at ETC was the "Wash Sale Report," which came "online" in January 2010, just a few months after ETC became a FINRA member and began clearing trades for institutional customers. This report monitored for potential wash trading by the same individual trader for ETC's customers. DiCenso's second report—called the "Trade Participation Report"—was introduced in February 2010 and monitored for potentially improper wash and other manipulative trading activity between different traders for the same ETC customer, different customers, and different market participant identifiers ("MPIDs") used by the same customer. (Tr. 1078:14-1079:19 (DiCenso).)

Together, the reports enabled ETC to monitor for potential wash trading between any combination of traders, customers, and market participant identifiers. (Tr. 1148:23-1149:21 (DiCenso).) The CBOE's principal investigator for its wash sale investigation conceded at the hearing that these two reports monitored for all potential forms of wash trading. (Tr. 1621:17-1622:2 (Miller-Brouwer).)

Between the initiation of the Trade Participation Report in February 2010 and late May 2010, ETC ran the Report in an Excel-based format once every two weeks to analyze and detect patterns of potentially manipulative wash trading activity. (Resp. Ex. 18 at 224; Resp. Ex. 46; Tr. 905:10-906:17 (Hatchman), 1152:15-18 (DiCenso).) Because the report conducted such a comprehensive analysis of every trade executed at ETC, however, it consumed significant

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computer resources and interfered with running other programs. (Tr. 911:21-912:16 (Hatchman).) Accordingly, in late May 2010, ETC decided to redesign the Report to eliminate these technical issues. (Tr. 912:17-914:12 (Hatchman).) The new Report came "online" about three months later (Tr. 1152:23-1153:3 (DiCenso)), and ETC has run it regularly ever since (Tr. 1155:15-1156:1 (DiCenso)). (*See* Letter from Ivan P. Harris, Counsel for ETC et al., to Bruce Andrews, Chairman, CBOE Business Conduct Committee (Sept. 4, 2012).)[10] Moreover, when the Report came back "online," in September 2010, ETC ran all activity that occurred during the three months it was "offline" through the new Report and found no activity that warranted further review. (Tr. 1153:4-1155:5 (DiCenso).)

ETC also used other tools to prevent wash trading, such as activating a setting on a front-end trading system used by its customers that prevented individual traders from executing wash trades. (Tr. 1162:1-23 (DiCenso).) ETC further activated anti-wash or self-trade prevention "modifiers" at all securities exchanges used by its customers that offered such features, including NYSE ARCA, BATS, NASDAQ, and Direct Edge. (Tr. 1162:21-1163:3 (DiCenso).) These modifiers prevent wash trades by the same market participant identifiers on those exchanges. (Tr. 1163:4-7 (DiCenso); *see also* BATS, Participant Trade

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[10] This letter is identified in the CBOE Index to the Record at Line No. 1168.

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Prevention, *available at* http://cdn.batstrading.com/resources/participant_resources/BATSEuro_PTP.pdf (acknowledging that the modifiers help members "avoid unintentional trading with their own orders by preventing orders with the same unique identifier," such as an MPID, from executing against each other).)

This multi-layered approach of monitoring, program settings, and modifiers created a system so comprehensive that the CBOE conceded at the hearing that it could not find a single instance of manipulative or improper wash trading—or any other improper trading activity by ETC's customers or their traders. (Tr. 196:20-24, 199:13-18 (Miller-Brouwer).)

C. The Evidence On The Remaining Charges.

1. ETC cleared almost 60 million short sales involving over 20 billion shares in 2010. Out of all that activity, the examination disclosed a single customer short sale of 300 shares that ETC was unable to close out because trading in the security in question was halted after the short sale occurred. (Tr. 1495:19-1496:12, 1497:12-18 (Murphy).) Despite the trading halt, ETC complied with its written procedures by making every reasonable effort to attempt to borrow the stock. (Tr. 1495:16-1497:18 (Murphy).) But ETC could not close out the position because no stock lenders would loan the security—and that was the only way ETC could have closed out the position given the trading halt. (*Id.*)

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2. In 2009, ETC's annual independent AML test was conducted by DiCenso, who had recently joined ETC as its Chief Compliance Officer but not yet assumed the role of AML Compliance Officer. (Tr. 1497:19-1498:11 (Murphy), 1065:20-1066:5 (DiCenso).) FINRA's AML independent testing rule in existence at the time, NASD Rule 3011 and IM-3011-1, allowed for this review but, unbeknownst to ETC, the CBOE's companion AML rule did *not* permit a person who reported to the AML Compliance Officer (as DiCenso did at that time) to perform the independent test. *Compare* NASD Rule IM-3011-1 (which was effective for all independent tests conducted through the year ending December 31, 2009)[11] *with* CBOE Rule 4.20 and interpretation (.01)(c).

In early 2010, ETC sent the 2009 audit report to its designated examiner at the CBOE who, despite the inconsistency between the CBOE and FINRA rules, never objected or advised ETC that the report may not have complied with the CBOE rules. (Resp. Exs. 69, 70.)

III. The BCC Rules Against Applicants And The CBOE Affirms.

Notwithstanding the evidence (or lack thereof) at the hearing, the BCC ruled against Applicants on all of the above charges.

First, as to the customer identification and margin charges, the BCC acknowledged that ETC complied with the requirement that it maintain written

[11] NASD IM-3011-1 is available at http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=3720.

procedures that are risk-based, and that ETC's procedures satisfied the rule. (BCC Decision 32.) The BCC further acknowledged that the CIP Rule and the CBOE's margin regulations apply solely to "customers" who hold "accounts" at ETC. (*Id.* at 32, 41, 50-51.) Nonetheless, the BCC found that ETC violated the customer identification rules and the CBOE's margin regulations because it did not apply those rules and regulations to the individual traders who executed trades on behalf of ETC's institutional customers. (*Id.* at 37, 46-49, 54-56, 70.)

Second, as to the monitoring charges, despite all of ETC's trade surveillance reports and anti-wash trade measures, and even though the CBOE's own examiners admitted they uncovered no instance of improper wash trading during the relevant time period, the BCC found that ETC did not maintain effective surveillance tools for detecting wash trading, and that ETC therefore violated CBOE Rules 4.1 and 4.2. (*Id.* at 28, 70.)

Third, as to the remaining charges, the BCC found that ETC violated CBOE Rules 4.2 and 15.1 and Regulation SHO of the Exchange Act and Rule 204 thereunder, by failing to close out the single "fail-to-deliver" of 300 shares that occurred in 2010 (*id.* at 60, 70), and violated Rules 4.1, 4.2, and 4.20 by failing to conduct an "independent" AML audit in 2009 because at that time DiCenso reported to the AML Compliance Officer (*id.* at 37-39, 70).

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As to the individual Applicants—Murphy and Cloyd—the BCC found that Murphy failed to supervise ETC's compliance with the CIP Rule, margin regulations, and AML independent testing requirements (but not the trade monitoring or Regulation SHO requirements), and that Cloyd committed the single violation of failing to supervise ETC's compliance with the CBOE's margin regulations. (*Id.* at 70-71.)

In determining sanctions, the BCC lumped all of the alleged violations together and imposed a $1 million fine jointly and severally on ETC and the individual Applicants. (*Id.* at 81.) The BCC also suspended the individual Applicants from associating with any CBOE member for six months. (*Id.*)

Applicants filed a timely petition for review of the BCC decision to the CBOE Board of Directors ("Board"), which affirmed the decision in its entirety.[12] (Board Decision 13.)

STANDARD OF REVIEW

In reviewing a disciplinary proceeding by a self-regulatory organization like the CBOE, it is the Commission that determines whether a party engaged in the conduct at issue, whether the alleged conduct violated the rule(s) at issue, and

[12] In affirming the BCC's Decision, the Board incorrectly applied a "clearly erroneous" standard to the BCC's findings of liability and an "arbitrary, capricious or abuse of discretion" standard to the BCC's sanctions determination. (Board Decision 3.) The Board did not, as FINRA and the Commission do, apply a de novo standard.

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whether the rule(s) were applied in a manner consistent with the purposes of the Exchange Act. 15 U.S.C. § 78s(e). Accordingly, the Commission reviews CBOE decisions de novo. *Id.* § 78s(d)(2); *see also Shultz v. SEC*, 614 F.2d 561, 568 (7th Cir. 1980). Similarly, the Commission will set aside any sanction imposed by the CBOE if it is punitive, oppressive, or excessive. *See Saad v. SEC*, 718 F.3d 906, 912 (D.C. Cir. 2013).

SUMMARY OF ARGUMENT

I. ETC fully complied with the CIP Rule and margin requirements as properly interpreted and enforced. Indeed, until now no regulator has *ever* found that persons like the traders here are subject to the CIP Rule or the margin requirements—and for good reason. The CBOE's contrary interpretation impermissibly extends the rules' reach beyond their plain language, departs from their enforcement history, and defies common sense. Further, the uncontroverted evidence establishes that ETC fully complied with the rules as properly interpreted. As a result, the CBOE's contrary conclusion cannot stand.

II. ETC maintained a multi-layered surveillance system so effective that not even the CBOE's own examination could uncover *any* violation during the relevant time frame. And the CBOE found that the individual who designed that system (DiCenso) was entirely blameless. The CBOE reversibly erred in reaching the opposite conclusion about the system that he designed. Indeed, the CBOE's

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conclusion that ETC lacked an adequate trade surveillance program rests entirely on the erroneous premise that ETC did not monitor for potential wash trading between two different customer accounts, or between two different traders for a single customer account. The uncontroverted evidence conclusively refutes that premise, and the monitoring charges, like the customer identification and margin charges, cannot stand.

III. The remaining charges and findings are similarly erroneous. First, sanctioning ETC for an audit that fully complied with FINRA's rules—and that the CBOE did not indicate was flawed in any way despite the opportunity to do so—would be unfair and unduly punitive. Second, sanctioning ETC for not closing out a single short position when it was simply impossible under the circumstances for ETC to do so does not warrant disciplinary action, either.

IV. Regrettably, the lack of procedural fairness in this matter is not an isolated incident, but a function of systemic problems in the CBOE's disciplinary system as a whole. Most fundamentally, the CBOE has failed to adopt key safeguards used by other regulators—including the Commission—and its virtually perfect win/loss rate raises serious questions about the fairness of its procedures. If nothing else, the appearance of unfairness is deeply troubling. Because the CBOE's conduct in this particular disciplinary matter did not satisfy the procedural

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fairness requirements of the Exchange Act in a number of respects, the proceeding must be dismissed.

V. At a minimum, the sanctions imposed by the CBOE in this matter must be set aside because they are impermissibly punitive, excessive, and oppressive. For one thing, the CBOE relied upon a deeply flawed rationale for imposing the sanctions, failed to consider important mitigating factors, and erroneously relied on aggravating factors that cannot be supported by the evidence. For another thing, the CBOE lumped together the violations it found and assessed a million-dollar fine jointly and severally against ETC and the individual Applicants. Even assuming that the CBOE has the authority to impose sanctions on that basis, doing so here impermissibly results in excessive sanctions on individual defendants who have never before in their decades of work in the securities industry been accused of any violation. Accordingly, at the very least, the sanctions imposed in this case must be vacated.

ARGUMENT

I. The CBOE Committed Multiple Legal Errors That Require Reversal Of The Customer Identification And Margin Charges.

A. The CBOE's Interpretation Of The Commission's CIP Rule Is Unprecedented, Erroneous, And Unsupported By The Evidence.

The CBOE determined that ETC violated Rules 4.1, 4.2, and 4.20 by failing to comply with the CIP Rule because ETC "should have treated its clients' traders as separate sub-accounts and that the information ETC had concerning its clients

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should have triggered a CIP review of the individual traders." (Board Decision 6.) In reaching that conclusion, the CBOE determined that the Commission's CIP Rule extended not only to ETC's entity customers, but to their traders as well. The CBOE's determination that it does is both unprecedented and erroneous.

No regulator of which we are aware has *ever* found that persons like the traders here are subject to the CIP Rule—and for good reason, as it would extend the Rule's reach far beyond its plain language, depart radically from the Rule's enforcement history, and defy common sense. In this matter, the uncontroverted evidence established that ETC fully complied with the CIP Rule as properly interpreted. The CBOE's attempt to enforce a rule that simply does not exist raises serious concerns and should be rejected in no uncertain terms.

1. The CBOE's Interpretation Of The CIP Rule Sharply Conflicts With Its Text, History, And Enforcement.

The CIP Rule requires broker-dealers to adopt and implement a program that includes "risk-based procedures for verifying the identity of each *customer* to the extent reasonable and practicable." (BCC Decision 32 (citing 31 C.F.R. § 1023.220) (emphasis added).) The Rule limits the word "customer" to "[a] person that opens a new account" (31 C.F.R. § 1023.100(d)(1)(i)), and defines an "account" as "a formal relationship with a broker-dealer established to effect transactions in securities, including, but not limited to, the purchase or sale of

securities and securities loaned and borrowed activity, and to hold securities or other assets for safekeeping or as collateral" (*id.* § 1023.100(a)(1)).

When the Commission adopted the CIP Rule, it explicitly considered—but ultimately rejected—a more expansive definition of "customer" that perhaps would have included individuals like the traders here who have been "granted trading authority" in customer accounts. *See Proposed Rule: Customer Identification Programs for Broker-Dealers*, Exchange Act Release No. 34-46192, 2002 WL 31769244 , at *4 (July 15, 2002) (defining "customer" to include any person who "is granted trading authority with respect to an account at a broker-dealer"). When it adopted the final rule, the Commission dropped that requirement and made clear that traders are *not* "customers" for purposes of the rule:

> After revisiting this component of the "customer" definition, we have determined that requiring limited resources to be expended on verifying the identities of persons with authority over accounts could interfere with a broker-dealer's ability to focus on identifying customers and accounts that present a higher risk of not being properly identified. *Accordingly, the final rule does not include persons with authority over accounts in the definition of "customer."*

Customer Identification Programs for Broker-Dealers, 68 Fed. Reg. 25113, 25116 (May 9, 2003) (Resp. Ex. 61) (emphasis added). The Commission thus limited the definition of "customer" to those persons or entities who open a new account—*not* those who are merely "granted trading authority" in an existing account. *Id.* at 25129.

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There should have been no serious question, then, that the traders here are not "customers" for purposes of the CIP Rule because, even though they may effect trades in the accounts, they did not open those accounts or control them—ETC's entity customers did. That should have been the end of the matter. Instead, the CBOE embarked on convoluted analysis that departs from the language of the rule, conflicts with the guidance issued by the Commission and the Department of the Treasury when the CIP Rule was adopted, and strays from the enforcement history of the Rule.

First, the CBOE's interpretation cannot be squared with the plain language of the CIP Rule, which only applies to "customers." The evidence conclusively established that the traders do not have "accounts" at ETC and do not have formal relationships with ETC to purchase or sell securities, to engage in borrower activity, or to hold securities or other assets for safekeeping or as collateral. Indeed, the uncontested evidence established that the traders have no customer relationship with ETC at all—they do not have accounts or sub-accounts at ETC;[13] they cannot deposit money or securities into any account at ETC;[14] they cannot

[13] As CBOE examiner Noel Santos conceded, ETC does not offer sub-accounts and the traders cannot segregate monies or securities at ETC in any account resembling a sub-account. (Tr. 475:20-476:11 (Santos); *see also* Tr. 1124:6-1125:3 (DiCenso), 1414:13-19 (Cloyd), 1504:9-13 (Murphy).)

[14] *See* Tr. 1124:21-1125:3 (DiCenso), 1504:14-21 (Murphy).

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withdraw money or securities from any account at ETC;[15] and they cannot segregate monies or securities in any account at ETC.[16]

In sum, the traders have no ability to effect the movement of funds or securities into or out of any account at ETC, or otherwise to control the movement of assets. And there was no evidence whatsoever that the traders were trading their own funds or had any ownership interest in any customer account at ETC. Even the CBOE's own witnesses conceded these facts. (Tr. 187:11-13 (Miller-Brouwer), 475:20-476:11, 478:13-21, 493:20-494:1 (Santos).)

Accordingly, ETC properly applied its customer identification procedures to the institutional *customers* that established accounts at ETC (and even further to the individuals identified by those customers as their beneficial owners)—*not* to the traders who merely entered trades for those customers. ETC therefore acted in full compliance with both the CIP Rule and the Commission's guidance, and the CBOE's contrary conclusion cannot stand.

The CIP Rule's (sparse) enforcement history confirms that conclusion. *See In the Matter of Pinnacle Capital Markets LLC & Michael A. Paciorek*, Exchange Act Release No. 62811, 99 SEC Docket 779, 2010 WL 3437456 (Sept. 1, 2010). The broker-dealer in *Pinnacle* permitted certain foreign institutional customers to

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[15] *See* Tr. 1124:21-1125:3 (DiCenso), 1416:20-23 (Cloyd), 1504:14-21 (Murphy).
[16] *See* Tr. 1124:21-1125:3, 1131:24-1132:5 (DiCenso), 1415:16-1416:13, 1416:24-1417:3 (Cloyd).

establish omnibus master accounts, and permitted traders associated with those customers to open separate sub-accounts on the broker-dealer's own books. The traders, in turn, used the sub-accounts to conduct trading for their own accounts separate and apart from the master account holder, and to segregate their own funds and securities separate from those of the master account holder.

In determining that the CIP Rule applied to the traders who owned those sub-accounts, the Commission made three necessary findings: (1) the sub-account holders "effect transactions for their own accounts," (2) "do not act on behalf of the foreign entity," and (3) "are not proprietary accounts of the foreign entity." *Id.* ¶ 20. Based on these findings, the Commission concluded that the sub-account holders were "Pinnacle's customers for purposes of the CIP rule." *Id.*

Neither the BCC nor the Board reached the ultimate (and necessary) determination that the Commission made in *Pinnacle*: that the traders were ETC's "customers" for purposes of the CIP Rule. Nor could they have reached this conclusion, because the undisputed evidence here precludes *all* of the findings that were necessary to the Commission's decision in *Pinnacle*. The traders did not effect transactions for their own accounts—as opposed to the accounts of ETC's institutional customers—and the CBOE's own examiners conceded that the traders for each institutional customer made all of their trades in a single pooled account at

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ETC for that customer.[17] The CBOE also conceded that it had no evidence indicating that the traders had any beneficial ownership interest in the trading firms' accounts at ETC.[18]

Indeed, the CBOE did not—and could not given the evidence to the contrary—determine that the traders were ETC's customers because, as that evidence showed, the traders' only authority with respect to any accounts at ETC was to enter trades consistent with the institutional customers' trading strategies. In this respect, the traders are no different than any other trader for a broker-dealer's hedge fund or mutual fund customers. And under the CIP Rule's plain language, such "persons with authority over accounts" are not included in the Rule's definition of "customer." *Customer Identification Programs for Broker-Dealers*, 68 Fed. Reg. at 25116.

To further buttress that conclusion, Applicants presented the testimony of two highly credentialed expert witnesses. One (David Paulukaitis) is a former NASD senior examiner who has served as an AML consultant for numerous broker-dealers (and was retained as an independent consultant by Pinnacle Capital Markets after the Commission's 2010 enforcement action). (Resp. Ex. 138; Tr. 1262:12-1263:9 (Paulukaitis).) Thus, he was uniquely familiar with the particular

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[17] *See, e.g.*, Tr. 475:20-476:11 (Santos); *see also* Tr. 187:11-13 (Miller-Brouwer).

[18] *See, e.g.*, Tr. 712:12-18 (Adams) ("Q: Do you have any evidence that the individual traders are beneficial owners of these entity accounts at ETC? [] A: I don't."); *see also* Tr. 478:13-21, 493:20-494:1 (Santos).

CIP issues presented here. Applicants' other expert (Lisa Roth) is a veteran compliance consultant who was retained as an independent consultant by ETC at the insistence of the CBOE's staff following its 2010 examination. (Resp. Exs. 56, 139; Tr. 1262:12-1263:9 (Paulukaitis).) Both testified that the traders are not subject to the CIP Rule. (Tr. 1275:6-1278:5, 1323:15-1325:5 (Paulukaitis), 1567:17-1568:12 (Roth).)[19]

As Paulukaitis testified, the CIP Rule does not require a broker-dealer to apply customer identification procedures to an individual whose sole relationship with the broker-dealer is to effect transactions in a customer account. (Tr. 1270:4-12:72:16 (Paulukaitis).) So long as those individuals lack control over any account at the broker-dealer, the Rule does not extend to them. And control in the context of the CIP Rule means moving funds or securities, opening or closing an account, or other actions beyond entering trades. (Tr. 1272:2-16 (Paulukaitis).) The traders did not possess any element of control over any account at ETC, and therefore were not subject to the CIP Rule. (*Id.*; *see also* Tr. 1323:15-1325:5 (Paulukaitis).)

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[19] The CBOE did not present any expert testimony on the CIP Rule or its application to the traders. Rather, the CBOE's sole witness on the application of the CIP Rule was one of its own examiners, Noel Santos, who testified that although the traders could not segregate assets, did not trade for their own accounts, and did not have any beneficial ownership in the customers' accounts, he nonetheless believed that the traders were subject to the CIP Rule. (Tr. 475:20-476:11, 478:13-21, 493:20-494:1 (Santos).)

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Similarly, in both her testimony at the Hearing and in her independent consultant's report submitted to the CBOE's staff, Roth agreed that the CIP Rule does not extend to the traders in this case, because they do not have accounts at ETC or otherwise qualify as "customers" under the CIP Rule. (Resp. Ex. 56; Tr. 1563:8-1564:5, 1566:22-1569:22 (Roth).) As Roth's independent consultant report concluded:

> [T]he scope of ETC's CIP obligation rests at the institutional customer level, including the principals and control persons of the entity. We do not believe that individual traders are analogous to sub-accounts as addressed and discussed in recent regulatory guidance by FINRA . . . or the CBOE . . . Specifically, we found no evidence that the elements of control and/or beneficial ownership that are inherent to the regulators' guidance could be attributed to any individual trader.

(Resp. Ex. 56 at 6.) Thus, all of the expert analysis presented at the Hearing, as well as the conclusions reached by the independent consultant retained at the CBOE's insistence, confirmed that the CIP Rule did not apply to the traders.

2. The CBOE Improperly Relied On So-Called "Red Flags" That Are Irrelevant To The CIP Analysis.

Notably, the CBOE did not find at either the BCC or the Board level that the traders were "customers" of ETC for purposes of the CIP Rule. Instead, the CBOE claimed that so-called "red flags" should have caused ETC to "treat" the traders as having sub-accounts, thus implicating (in the CBOE's view) the CIP Rule. (Board Decision 6.) But those "red flags" are entirely irrelevant to determining whether a trader can properly be considered a "customer" for purposes of the CIP Rule.

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Moreover, the CBOE's analysis was incomplete, for by finding—erroneously—that the traders should have been treated as sub-accounts, the CBOE still left unanswered the critical question of whether those individual traders were "customers" with "accounts" at ETC for purposes of the CIP Rule.

The "red flags" (red herrings, really) cited by the CBOE included the number of traders who traded for one of ETC's customers, that many of those traders were located in China, the size of that customer's initial trading deposit, that a list of the customer's traders contained their personal email addresses, the level of activity that the traders were expected to trade, that the customer (but not ETC) assigned trading limits to the traders, and that ETC monitored the traders' activity for purposes of detecting potential wash trades. (BCC Decision 35.) Based on these "red flags," the CBOE concluded that "ETC should not have taken its customers' word on the issue of whether their traders had a beneficial ownership interest in the accounts used to enter their trades . . . ." (*Id.*)

None of these "red flags," however, is relevant to whether the traders are "customers" for purposes of the CIP Rule. The CBOE did not explain, for example, how the Rule requires a broker-dealer to "treat," in the CBOE's words, traders who have no ability to control any assets at the broker-dealer, otherwise segregate their funds or securities at the broker-dealer, or engage in any activities typically undertaken by an accountholder (such as withdrawing funds or securities

or opening or closing accounts) as "having sub-accounts." As *Pinnacle* instructs, it is the trader's ability to engage in these activities in his or her *own* proprietary account or sub-account that subjects the trader to the CIP Rule—not merely the ability to enter trades in an institutional customer's account.

Most fundamentally, the so-called "red flags" identified by the CBOE do not indicate the existence of any accounts belonging to the individual traders or even their control over any accounts at ETC. Persons with trading authority can, by definition, make trades, have limits assigned to them within the overall account, and have their activity monitored, but none of these things is a "red flag" or a fact that would render the traders anything more than persons "granted trading authority" who are excluded from the definition of "customer" in the CIP Rule. That is why Applicants' experts testified that the so-called "red flags" cited by the CBOE are utterly irrelevant to the proper analysis and cannot create any obligation to perform a CIP review on the traders. (Tr. 1271:24-1272:16, 1273:24-1275:3, 1277:16-1278:5, 1280:14-1280:24, 1323:23-1325:5, 1329:6-1330:3, 1332:12-1333:15 (Paulukaitis).)

The CBOE also erred in finding that because of these so-called "red flags," ETC could not verify its institutional customers' true identities and was therefore required to obtain identifying information about their traders. (Board Decision 6.) In so finding, the CBOE badly misinterpreted the CIP Rule, which provides that if

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a broker-dealer cannot verify an entity customer's "true identity using the verification methods described in paragraphs (a)(2)(ii)(A) and (B)" of the CIP Rule, it must obtain identifying information about "individuals with authority or control over such account." 31 C.F.R. § 1023.220(a)(2)(ii)(C).

The CBOE, however, never stated what the verification methods described in paragraphs (a)(2)(ii)(A) and (B) of the CIP Rule are. Had it considered those methods, the CBOE would have understood that ETC *did* verify its customers' true identities using precisely the verification methods set out in the Rule, including verifying that its institutional customers were duly incorporated, obtaining representations from those customers about the identities of their beneficial owners, and using public databases to conduct full background checks on the entities and the individuals they represented to be beneficial owners (and controlling shareholders). (31 C.F.R. § 1023.220(a)(2)(ii)(A)-(B); Resp. Exs. 54, 55; CBOE Exs. 70, 84.)

Instead, the CBOE simply disregarded this part of the Rule. It was plain error for the CBOE to conclude that ETC could not verify its customers' true identities using the verification methods described in the CIP Rule without even noting what those verification methods are, and ignoring that ETC in fact verified its entity customers' true identities using those prescribed methods. Indeed, there

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was no evidence that these methods prevented ETC from verifying its customers' "true" identities as contemplated by the Rule.

Further, ETC's reliance on the information it obtained from its customers about their beneficial owners was reasonable and consistent with the CIP Rule. That conclusion is confirmed by a recent rule proposal by the Financial Crimes Enforcement Network ("FinCEN"), which administers the Bank Secrecy Act. *See Customer Due Diligence Requirements for Financial Institutions*, 79 Fed. Reg. 45151 (Aug. 4, 2014). The proposed rule would extend the CIP Rule to individuals identified by an entity customer as its beneficial owners.

Critically, the proposal makes clear that "FinCEN is *not* proposing to require that financial institutions verify the status of a beneficial owner. Financial institutions *may rely on the beneficial ownership information provided by the customer*." *Id.* at 45162 (emphasis added). The proposed rule thus "focuses on verifying *the identity* of the beneficial owners, but does *not* require the verification of their *status* as beneficial owners." *Id.* at 45156 (emphasis added).

Here, consistent with and well in advance of both the Rule and FinCEN's proposal, ETC obtained information from its entity customers identifying their beneficial owners, and conducted a full review of those beneficial owners. There was no question about the customers' "true identities" and ETC was not required to apply any additional scrutiny to their accounts or obtain any additional information

beyond what its procedures required. ETC thus did precisely what the Rule required it to do.

In sum, the CBOE's determination that ETC should have doubted its customers' representations about their identities and that the CIP Rule covers persons whose sole authority is to enter trades in customer accounts conflicts with the Rule's plain text, with the Commission's and FinCEN's guidance on enforcing it, and with common sense. ETC acted in full compliance with the Rule, properly interpreted and applied, and as a result the CBOE's findings against ETC must be set aside.

3. In All Events, The CBOE's Determination As To Murphy Must Be Set Aside Because It Is Refuted By The Uncontroverted Evidence.

Even if the CBOE's findings on the CIP Rule could be upheld as to ETC, which they cannot be, its determinations as to Murphy cannot stand. The CBOE acknowledged that Murphy was not ETC's AML officer in July 2010, when the alleged violation occurred. (BCC Decision 9.) Nonetheless, and without providing any rationale, the CBOE found that in July 2010 Murphy "failed to supervise and implement a satisfactory AML program that prevents money laundering and manipulative trading risks." (*Id.* at 37.) That finding is illogical and inconsistent with the undisputed evidence.

Indeed, Murphy's name appears only once in the BCC's entire analysis of the CIP Rule violation—in a parenthetical noting that he signed one customer's Client Approval Sheet. But that passing reference provides no basis for holding Murphy liable under CBOE Rule 4.2. *See* CBOE Rule 17.9 (requiring the BCC's decision to "include a statement of findings and conclusions, with the reasons therefore").

The Board attempted to justify the BCC's flawed ruling by speculating that perhaps what the BCC meant in holding Murphy liable was that he was responsible for the "implementation of the deficient AML program that was then in place in or about July 2010." (Board Decision 7.) But there is no support for that hypothesis, because there is no evidence that Murphy implemented the CIP Program that existed in 2010. That lack of evidence cannot be overcome by mere conjecture. And while holding Murphy liable, the BCC absolved of all liability the person who was ETC's AML officer in July 2010. Because Murphy had no AML responsibilities in July 2010, and because the CBOE cannot point to any evidence supporting its finding of liability, the finding that Murphy violated Rule 4.2 must be set aside.

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B. The BCC Reversibly Erred In Stretching The CBOE's Margin Regulations To Reach Traders Who Are Not "Customers" Within The Meaning Of The Regulations.

Like the CIP Rule, the CBOE's margin regulations apply only to ETC's "customers" and their "accounts." CBOE Rule 12.3(j) governs margin limits on "pattern day traders," which are defined as "any *customer* who executes four (4) or more day trades within five (5) business days." Rule 12.3(j)(2) (emphasis added). The rule further states that "[t]he minimum equity required for the *accounts of customers* deemed to be pattern day traders shall be $25,000." Rule 12.3(j)(4) (emphasis added). The rules thus make clear that the margin requirements apply only to "customers" and "accounts of customers."

Without citing any authority, the CBOE expanded the term "customer" in the margin regulations to encompass the traders here. The lack of authority is not surprising because, as demonstrated next, the traders do not fall within any relevant definition of the word "customer" and the CBOE's contrary interpretation should be rejected.

1. The CBOE's Interpretation Of "Customer" Is A Radical, Unexplained Departure From Well-Settled Authority.

Although the CBOE's margin regulations do not define "customer" or "accounts of customers," the BCC acknowledged that the "'ultimate authority for margin requirements'" is Regulation T (BCC Decision 40 (quoting Tr. 633 (Adams))), and Regulation T defines "customer" as any person "(i) [t]o or for

whom a creditor extends, arranges, or maintains any credit; or (ii) [w]ho would be considered a customer of the creditor according to the ordinary usage of the trade." 12 C.F.R. § 220.2. Similarly, FINRA's margin rules define "customer" as "any person for whom securities are purchased or sold or to whom securities are purchased or sold whether on a regular way, when issued, delayed or future delivery basis. It will also include any person for whom securities are held or carried and to or for whom a member extends, arranges or maintains any credit." *See* FINRA Rule 4210(a)(3).

The BCC ignored these well-established definitions. Instead, it uncritically adopted the definition of "customer" put forth at the Hearing by CBOE employee James Adams, who stated that he defines the word expansively and "'in a generic sense . . . meaning an individual, a person, an entity, that engages in securities transactions . . . .'" (BCC Decision 41 (quoting Tr. 732 (Adams)).)

Adams's definition is sweepingly more expansive than the well-established definitions found in Regulation T and the other margin rules. Regulation T, for example, requires a "customer" subject to margin requirements to receive credit from a creditor such as ETC, but Adams's definition contains no such requirement. Further, although FINRA's margin rules state that a customer is a person for whom securities are held or carried by a broker-dealer, Adams's definition is hardly so limited.

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Adams's definition is not only a marked departure from Regulation T and the FINRA rule, it is also wrongheaded on its terms. This is shown in the following response Adams provided to a question from the Hearing Panel about whether a customer can have multiple traders who would not be subject to the margin rules:

> If we believed that the accounts carried by ETC were legitimate prop trading accounts and the individual traders were prop traders, I think generally, the margin requirements would be satisfied, *although I would object to more than a moderate number of individual traders on one portfolio margin account, depending on the facts and circumstances.*

(Tr. 1605:23-1606:6 (Adams) (emphasis added).) Adams's interpretation thus makes the application of the margin requirements dependent on whatever the CBOE deems "more than a moderate number of individual traders"—an interpretation that not only divorces the word "customer" from the requirement that the person or entity buy or sell securities to or from the broker-dealer or receive credit from the broker-dealer, but also leaves uncertain (and impermissibly vague) what the CBOE views a "moderate number" to be.

Perhaps recognizing as much, the Board ignored Adams's definition and his testimony completely. Instead, the Board gave lip service to the definition of "customer" in Regulation T and concluded—without any analysis—that the individuals who make trades for ETC's customers "were in fact receiving credit from ETC." (Board Decision 9.) The Board did not explain, however, how that

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could possibly be the case when ETC did not enter into any margin or lending arrangements with those traders, the traders were not liable to ETC for any debits in the entity customer's accounts, and, as the CBOE's own witnesses acknowledged, the traders were all "trading the same pool of money" and there was no evidence that the traders had any ownership interest in the customer accounts at ETC.

Just because an institutional customer receives credit from a broker-dealer like ETC does not mean that an individual who enters transactions in that customer's account also receives credit from the broker-dealer. Doing so would render every trader for a broker-dealer's mutual fund or hedge fund customers, and every person—whether an investment adviser, trustee, relative, or other person—with the ability to make trades in a customer's account subject to the CBOE's margin rules. The CBOE's interpretation thus produces an absurd result and should be rejected for that reason, too.

Because the CBOE's definition of "customer" is a radical, unexplained departure from Regulation T (and the FINRA rules) that leads to absurd results and would not even apply on its own terms to the uncontroverted evidence here, the Board's finding on the margin rule charges was seriously in error and must be set aside.

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2. FINRA Regulatory Notice 10-18 Is Not Dispositive, And In Any Event Supports Applicants, Not The CBOE.

In applying the margin rules to the traders, the CBOE also relied on FINRA Regulatory Notice 10-18, Master Accounts and Sub-Accounts. (CBOE Ex. 31.) The CBOE cited the notice for the proposition that ETC was purportedly on notice that the traders were individual "customers" engaged in day trading and were therefore subject to the CBOE's margin rules. (BCC Decision 45.) That is not so for at least two reasons.

First, the regulatory notice does not carry any authoritative weight, as it is not a rule and especially given that the statutes and regulations discussed above define "customer" *not* to apply to the traders here. Indeed, the regulatory notice does not even speak to FINRA's *own* margin rules, so it is unclear at best how it could possibly apply to the CBOE's margin rules.

Second, to the extent it is relevant at all, the notice makes clear that it applies only (i) to broker-dealers "that maintain master/sub-account arrangements," *and* where (ii) those sub-accounts have different beneficial owners than the master account. (CBOE Ex. 31 at 2). Here, there are no sub-accounts at ETC and the traders have nothing even resembling a sub-account at ETC. And even if there were sub-accounts, the CBOE has conceded that the traders were trading the entity customer's proprietary funds, not the traders' own proprietary funds. If anything, then, the regulatory notice supports Applicants—not the CBOE's erroneous

conclusion that the traders are somehow "customers" for purposes of the margin rules.

C. Alternatively, The CBOE's Novel Interpretations Of The CIP And Margin Rules Cannot Be Applied Here Without Violating Fundamental Principles Of Fair Notice.

Even if the CBOE's novel interpretations of the CIP and margin rules could be permitted to stand, those interpretations could not be applied to punish Applicants without violating basic fair notice standards. As the Commission has made clear, "[r]egulatory authorities have a fundamental obligation to give fair warning of prohibited conduct before a person may be disciplined for that conduct." *In re American Funds Distributors, Inc.*, Exchange Act Release No. 64747, 2011 WL 2515376, at *5 (June 24, 2011) (internal quotation marks omitted); *see also Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996) (Courts "cannot defer to the Commission's interpretation of its rules if doing so would penalize an individual who has not received fair notice of a regulatory violation") (internal citations omitted)). Because Applicants had no fair warning that their conduct could violate the CIP and margin rules as interpreted by the CBOE, they cannot be held liable for that conduct.

The Commission's decision in *American Funds* confirms that conclusion. *American Funds* involved an appeal from an NASD disciplinary action involving the NASD's rules prohibiting a mutual fund underwriter from "request[ing] or

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arrang[ing] for the direction to any member of a specific amount or percentage of brokerage commission *conditioned upon* that member's sales or promise of sales of shares of an investment company." 2011 WL 2515376, at *1 (emphasis in original). The NASD hearing panel found that the member firm's use of "targets tied to sales of the Funds triggered the Rule's prohibitions." *Id.* at *4 (internal quotation marks omitted).

On appeal, the Commission reversed. *Id.* at *10. Citing the serious fair notice concerns raised by the censure and sanctions, the Commission found that the member firm had "raised valid questions about the clarity of the [r]ule's language" and that the "[r]ule in place during the period at issue was ambiguous." *Id.* at *5-6. In so holding, the Commission noted the NASD hearing panel's own confusion about the rule. *Id.* (noting that the Hearing Panel chairperson observed "just reading the rule and part of the rule history . . . I read it one day I think well, it probably means this and then I read it again and I go well maybe it meant that.")

Fair notice concerns are even more serious here because Applicants had no notice whatsoever that the CBOE would depart so sharply from the clear text of the relevant statutes and rules to impose the unprecedented sanctions at issue. Nothing in those statutes, rules, or decisions enforcing them could have given fair notice to Applicants that a trader who does not maintain an account or sub-account at a broker-dealer, does not segregate assets at the broker-dealer, does not deposit funds

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or securities at the broker-dealer, does not borrow funds or securities or receive any credit from the broker-dealer, and for whom the broker-dealer does not hold or carry securities, would nevertheless be deemed a "customer" for purposes of the CIP and margin rules.

Moreover, as in *American Funds*, the Hearing Panel in this matter found it difficult to understand the applicable rules and whether they applied here. As one panel member put it: "[T]hat's the question I have, and that's what's sitting here . . . a customer is a person who opens an account, and you have to have some indication that these traders were customers. And so I don't want to belabor it, I understand the argument, but that's what I'm struggling with. (Tr. 1723:9-15 (Panel Member Stone).) In the absence of fair notice, the Commission should set aside the decision below just as it did in *American Funds*. *See also In the Matter of the Application of Husky Trading LLC.*, Admin. Proc. File No. 3-13096, 2009 WL 1834166, at *9 (June 26, 2009) (setting aside Philadelphia Stock Exchange, Inc. finding of liability where "some level of uncertainty may have existed . . . concerning the correct interpretation of PHLX's rules" and where questions existed whether "Applicants were properly on notice that their conduct was violative.").

II. Because The Evidence Conclusively Establishes That ETC Maintained An Effective, Multi-Layered Surveillance System, The Monitoring Charges Cannot Stand.

The CBOE's conclusion that ETC lacked an adequate trade surveillance program rests entirely on a single, erroneous premise: that ETC did not monitor for potential wash trading between two different customer accounts or between two different traders for a single customer account. That premise, however, is conclusively refuted by the uncontroverted evidence. It is also internally inconsistent, given that the CBOE found that the individual who designed ETC's surveillance program (DiCenso) was blameless, yet the program he designed was fatally flawed. As a result, the Board Decision cannot stand.

A. ETC's Controls Were So Robust That The CBOE's Own Examination Failed To Uncover A Single Instance Of Improper Wash Trading.

The evidence established without contradiction that ETC maintained a robust wash trade prevention and surveillance program throughout the relevant time frame. To prevent wash trades, ETC implemented anti-wash settings at every exchange that provided them to prevent buy-and-sell orders submitted by the same MPID from executing against each other. The CBOE's CBSX stock exchange did not have such tools at the time,[20] but ETC nevertheless was able to minimize, if not eliminate, the potential that wash trades occurred on the CBSX by requiring its

[20] *See* Tr. 1007:8-1009:14 (Harris) (explaining that the CBOE did not provide funding to the CBSX to develop such tools).

order-entry vendors to implement tools that prevent buy-and-sell orders submitted by the same trader for one of ETC's customers from executing against each other.

ETC further developed advanced surveillance reports that monitored for potential wash trading. ETC implemented a wash sale report to detect instances in which the same trader executed buy-and-sell orders against himself, and also implemented the Trade Participation Report to detect instances where different traders for the same customer (or even different customers) executed buy-and-sell orders against each other. ETC's commitment to preventing wash trades and other improper trading activity was also evidenced by its issuance of a compliance circular to its customers in or about April 2010 advising them that wash trading was prohibited. (Resp. Ex. 62; Tr. 1086:17-1088:21 (DiCenso).) Given these robust controls and preventive measures, it is not surprising that the CBOE's examination did not uncover a single instance of improper wash trading by any ETC customer or trader. (Tr. 196:20-24; 199:13-18 (Miller-Brouwer).)

Nonetheless, the CBOE concluded that ETC's controls were so insufficient that ETC should be sanctioned. As an initial matter, it is difficult to discern from the decisions what, exactly, was wrong with ETC's monitoring system, given that no wash trading occurred. And although the Board stated in conclusory fashion that the Trade Participation Report "was not functioning during the majority of 2010" and "did not cure the deficiencies in ETC's wash trade surveillance

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program" (Board Decision 5 (citing BCC Decision 22-28)), the evidence does not support those assertions.

ETC did take the Trade Participation Report offline in May 2010, but it is uncontroverted that ETC did so because the Report consumed an excessive amount of computer resources by conducting an analysis of every trade at ETC over a two week period—not because it was somehow failing to monitor for wash trading adequately. Indeed, the BCC's finding that the Report "was not functioning" is belied by the fact that the BCC accepted into evidence copies of Trade Participation Reports that had been reviewed by ETC's compliance department *during the very same period* that the Report supposedly "was not functioning." (Resp. Ex. 46.) The CBOE's finding on this score makes no sense.

It is also undisputed that when the redesigned system came online in September 2010, ETC's compliance department ran through that system all trades from the three months the previous system was offline. (Tr. 1153:4-1155:5 (DiCenso).) Thus, the Trade Participation Report in either its original or redesigned form monitored all trades effected by ETC's customers and their traders from February 2010 onward. The CBOE's own examiner further acknowledged that the Trade Participation Report monitored for activity that, in her view, the wash trade report did not, and that the two reports worked together to surveil for all potential forms of wash trading. (Tr. 1621:17-1622:2 (Miller-Bouwer).) The

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Board's affirmation of the BCC's finding that the Trade Participation Report "was not functioning during the majority of 2010" and that ETC's wash trade surveillance was ineffective makes no sense whatsoever in light of these uncontested facts.

In upholding the BCC's finding that ETC maintained an inadequate wash trade surveillance program notwithstanding all of this uncontroverted evidence, the Board emphasized that the BCC's "factual and credibility determinations are entitled to deference." *Id.* at 5 (citing *In the Matter of the Application of Wanda P. Sears*, Exchange Act Release No. 34-58075, 2008 WL 2597567, at *2 (July 1, 2008)). But the BCC's analysis did not involve any credibility determinations, and to the extent the BCC made any factual determinations, they are so illogical as to warrant no deference. *See Carradine v. Barnhart*, 360 F.3d 751, 756 (7th Cir. 2004) ("[A]n administrative agency's decision cannot be upheld when the reasoning process employed by the decision maker exhibits deep logical flaws").

B. ETC Fully Complied With The CBOE's Most Recent Guidance.

As further evidence of ETC's commitment to building a robust surveillance program, the uncontroverted evidence established that ETC promptly and fully complied with a regulatory circular issued by the CBOE in late 2009—CBOE's first regulatory guidance on the supervisory and trade-surveillance obligations of CBOE members. *See* CBOE Regulatory Circular 09-118, *Supervisory Obligations*

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of Members Providing Access to Exchange Systems, RC-09-118 (Oct. 26, 2009) (CBOE Ex. 54).

In the Regulatory Circular, the CBOE stated that it "recommends that members providing access to the Exchange systems have procedures in place designed to review any client trading activity on Exchange systems for potentially manipulative or otherwise improper trading practices." *Id.* The Regulatory Circular went on to state that if a member chooses to have such procedures in place to review client trading activity, those reviews "can be conducted via exception reports." *Id.*

ETC immediately and fully complied with the recommendations in the CBOE's October 2009 Regulatory Circular. Within two months, ETC implemented its wash trade surveillance report, and one month later it implemented its Trade Participation Report. Even before the issuance of the Regulatory Circular, ETC personnel reviewed trading activity in real time to detect potential wash trading and any other improprieties—an approach the Regulatory Circular agrees is permissible.[21]

Remarkably, despite repeated references to the Circular at the hearing and in the post-hearing briefs, the BCC Decision did not discuss the Circular at all. The

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[21] Although the CBOE criticized the real-time review and questioned the qualifications of the personnel who conducted it (BCC Decision 10), that criticism is completely unfounded. The CBOE's own examiners reviewed the same activity on a post-trade basis and did not find any violative wash trade activity, either.

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Board did take note of it, but only to make the conclusory finding that ETC failed to comply with the Circular because the Trade Participation Report "was not functioning during the majority of 2010." (Board Decision 5.) As already demonstrated above, however, that reasoning is deeply flawed and cannot support the Board Decision.

The flaws in CBOE's analysis are further evidenced by *Department of Enforcement v. Sterne, Agee & Leach, Inc.*, Disciplinary Proceeding No. E052005007501, 2010 FINRA Discip. LEXIS 18 (Mar. 5, 2010). In that matter, a FINRA hearing panel concluded that the member firm complied with its anti-money laundering surveillance obligations where the broker-dealer initially used a combination of manual and proprietary automated processes to review activity, and subsequently implemented software from an outside vendor to review activity. *Id.* at *19-20. After using the software for four months, the firm stopped because it was not reviewing certain activity. The firm's compliance department then used its own reports to conduct a "retrospective review" of activity during those months that the outside vendor report did not monitor. *Id.*

In rejecting FINRA's contention that the firm failed to maintain an adequate surveillance program, the hearing panel found that Enforcement "did not establish that [the firm's] mix of manual and automated monitoring missed suspicious transactions that an automated system would have caught." *Id.* at *43. The

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hearing panel further found that the firm's "compliance efforts were substantial" and that its compliance officer reviewed matters brought to his attention and conducted reviews of possible money-laundering activity. *Id.* at *45.

The parallels between that matter and this one are striking. In both matters, the firms used automated reports to monitor for suspicious activity; those reports were implemented shortly after new regulatory rules or guidance came into effect; the firms conducted retrospective reviews of activity during the short time period during which more immediate reviews could not be conducted; and the firms reviewed the exception reports at the compliance-officer level. And in both matters, no illegal or suspicious activity went undetected. FINRA found no violation, and the same result should obtain here.

III. The Remaining Charges Do Not Warrant Disciplinary Action.

A. Sanctioning ETC For An Audit Conducted In Full Compliance With The FINRA Rules Would Be Unduly Punitive.

The evidence at the Hearing was clear that in 2009, when ETC was a member of both FINRA and the CBOE, FINRA's rules permitted DiCenso to conduct ETC's annual AML test, and that ETC conducted its 2009 annual AML test in full compliance with FINRA's rule. The evidence was also uncontested that ETC sent DiCenso's AML audit report to its designated CBOE examiner in early 2010, the report stated that DiCenso conducted the audit under NASD Rule 3011 and IM-3011-1, and the CBOE did not even respond, much less object.

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Nonetheless, some eighteen months later, the CBOE charged ETC with violating CBOE Rule 4.20 because CBOE Rule 4.20 did not permit DiCenso to conduct the required annual audit. Although ETC conducted its 2009 audit in good faith and in compliance with the rules of the largest SRO to which it belonged, the CBOE nonetheless believed that discipline was still warranted. But the CBOE sanctioned ETC for little more than being subject to inconsistent rules adopted by different regulators. That finding is unduly punitive and should be reversed.

B. ETC's Inability To Close Out A Single Short Position Does Not Warrant Disciplinary Action.

The sole basis for the charges under CBOE Rules 4.2 and 15.1 and Regulation SHO Rule 204 was ETC's inability to close out a single short sale for 300 shares in a halted security—in a year where ETC successfully cleared and closed out almost 60 million short sales involving over 20 billion shares. It would be unduly punitive to permit the CBOE's determinations on those charges to stand.

As the BCC found, after trading in the security was halted, ETC complied with its Regulation SHO procedures by making every effort to borrow shares (Resp. Ex. 18 at 203), but could not borrow or purchase the stock because of the trading halt. (BCC Decision 59.) The CBOE concluded, however, that "[b]ecause Rule 204 imposes strict liability . . . a single failure to close out a position is still a violation of Rule 204." (BCC Decision 58.) Given the extenuating facts, however,

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and ETC's overwhelming record of compliance with Rule 204 during 2010, no finding of liability is warranted.

IV. The Errors Committed By The CBOE In This Matter Reflect Broader, Systemic Issues Of Unfairness.

Regrettably, the legal and factual errors made by the CBOE in this disciplinary matter are not confined to this case, but stem from broader problems with the CBOE's disciplinary system as a whole that deprive parties of the fair process required by Section 6(b)(7) of the Exchange Act. This disciplinary action should be set aside for that reason, too.

Most fundamentally, the CBOE has failed to put in place important safeguards used by other regulators like the Commission and FINRA to help ensure procedural fairness on a systemwide basis. The CBOE does not, for example, employ professional hearing officers, nor does it have any procedures requiring the rotation of BCC members or staff, which has resulted in the same BCC Chairman serving in that role (and on this Panel) and participating in cases with the same CBOE staff and counsel for over ten years. The CBOE's win/loss record in that decade and indeed since 1986 speaks volumes about the fairness—and the appearance thereof—of the resulting system. Since 1986, the CBOE has prevailed in every decision (26 in all) issued by the BCC and in every published decision (5 in all) issued by the Board. Neither the Commission nor FINRA can claim such a remarkable and uniform record of success. *See, e.g.*, Brian L. Rubin

& Jae C. Yoon, *Stepping Into the Ring Against the SEC and FINRA: Sometimes It Pays to Duke It Out Against the Regulators*, 2012 Sec. Reg. L.J. 485 (2012) (noting the success rate of litigants who contest cases before a Commission Administrative Law Judge or a FINRA Hearing Panel and in appeals to the Commission or FINRA's National Adjudicatory Council).

Further, the CBOE's disciplinary rules lack basic procedural safeguards that other regulators use to ensure fair hearings. Among other things, the CBOE's rules permit *ex parte* communications between adjudicators (in this case, the BCC and members of a hearing panel) and the CBOE staff before, during and after a hearing regarding the matters at issue. (The CBOE rules only prohibit *ex parte* communications between *respondents* and a hearing panel. *See* CBOE Rule 17.4(d).)

Unlike the CBOE, the Commission and FINRA prohibit both their staffs as well as respondents from engaging in *ex parte* communications with adjudicative bodies in disciplinary proceedings. *See* SEC Rule of Practice 120 (17 C.F.R. § 201.120); *see also* FINRA Rule 9143(a)(1). Indeed, the NASD first imposed its prohibition on *ex parte* communications in 1997, and in doing so noted that its rule would "ensure that Respondents in an Association disciplinary proceeding are protected from unfair ex parte communication." *Self-Regulatory Organizations*, File No. SR-NASD-97-28, SEC Release No. 34-38545, 64 S.E.C. Docket 862,

1997 WL 211525, at *45 (Apr. 24, 1997). At the time it adopted this rule, the NASD also noted that it was conforming to "comparable provisions in the Administrative Procedure Act, and the rules of various federal agencies, including the [Commission]."[22] Here—particularly given that the same BCC Chairman, counsel to the BCC, and Chief Enforcement Attorney have worked together for over 10 years on disciplinary matters and meet regularly to consider disciplinary actions—their ability to engage in *ex parte* communications is particularly concerning.

The CBOE is also alone among financial industry regulators in lacking a procedure for summary disposition or dismissal of charges at any time before, during or after a hearing. Notably, a respondent facing charges by the Commission can seek summary disposition of claims when, as here, there is no genuine issue of material fact with respect to those claims. *See* 17 C.F.R. § 201.250; *In the Matter of Leila C. Jenkins*, SEC Release No. 451, 2012 WL 681585 (ALJ Feb. 10, 2012). Similarly, FINRA, NASDAQ, and the NYSE allow a respondent to seek summary disposition of claims in the absence of material factual disputes. *See* FINRA Rule 9264; NASDAQ Equity Rule 9264; NYSE Rule 476(c).

[22] *See* FINRA, *Notice 95-102 Overview Of Planned Changes To Disciplinary And Enforcement Procedures*, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1854&print=1.

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This matter is a good example of the problem. Applicants here sought summary disposition of charges that even the CBOE staff recommended be dismissed at the start of the hearing, and on charges for which the CBOE presented no evidence at the hearing. DiCenso—who was ultimately cleared of all charges against him—also asked for summary disposition before and throughout the Hearing. But the Hearing Panel could not even consider summary disposition because the CBOE's rules do not provide for it. As a result, respondents can find themselves trapped in a lengthy, expensive, and uncertain disciplinary process on the basis of charges that even the CBOE staff recommends be dismissed—thereby giving the CBOE leverage to extract settlements regardless of the merits (or lack thereof) of the charges at issue. That is a troubling scenario, to say the least.

Applicants respectfully submit that these broader problems with the procedural fairness of the CBOE's disciplinary system, and in particular its lack of structural safeguards and procedures utilized by FINRA and the Commission, manifested themselves in specific ways in this matter. Most fundamentally, the BCC improperly ruled against Applicants on key evidentiary issues. For example, on privilege issues, the BCC ruled, and the Board affirmed, that the CBOE could use as evidence a clearly privileged email between ETC and its outside counsel that had been produced inadvertently during the examination. (*See* Letter from Ivan P. Harris, Counsel for ETC et al., to Bruce I. Andrews, Chairman of the

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COMMENTS

Enclosed please find Electronic Transaction Clearing's Brief in Support of Application for Review of Disciplinary Action Taken by CBOE.

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Business Conduct Committee, CBOE (Aug. 8, 2012);[23] *see also* Tr. 21:20-22:2 (Chairman Andrews).) Conversely, the BCC ruled, and the Board affirmed, that notes taken by a CBOE examiner (not an attorney) of separate interviews of ETC's customers and CBSX staff were protected from disclosure by the investigative privilege, even though the examiner consulted her notes immediately before she testified at the Hearing. (*See* (Tr. 270:6-24, 275:8-276:16 (Miller-Brouwer), Tr. 318:5-21 (Applicants' Counsel), Tr. 1295:15-21 (Panel Member Stone).)

The CBOE also erroneously denied Applicants' request for documents produced during an investigation of the CBOE by the Commission—documents that reflected, at the very least, on the credibility of the CBOE's key margin witness, James Adams—as "overly burdensome" and irrelevant. (*See* Order Denying Respondents' Motion to Compel the Production of Documents, at 10 (Aug. 3, 2012).)[24] That Commission investigation resulted in a finding that, among other things, CBOE staff "lacked a fundamental understanding of" Regulation SHO—which Applicants were charged with violating in this matter. *See In the Matter of CBOE, Inc. & C2 Options Exch. Inc.*, Admin. Proc. File No. 3-15353, at ¶¶ 6, 17, 2013 WL 2540903, at *4, 5 (June 11, 2013) (further finding that CBOE staff did not know what a failure to deliver was and did not know how to determine if a fail existed). These findings were directly relevant to the credibility of certain

[23] This letter is identified in the CBOE Index to the Record at Line No. 1244

[24] This Order is identified in the CBOE Index to the Record at Line No. 1235.

CBOE witnesses and other CBOE employees involved in this matter.[25] The CBOE's determination that the documents were somehow "irrelevant" is difficult to fathom.

In sum, the CBOE's conduct of this disciplinary proceeding did not satisfy the fundamental principles of fairness embodied by the Exchange Act's requirements, and also reflects the broader problems of unfairness inherent in the CBOE's system as a whole. The decision should be set aside for that reason, too.

V. The Sanctions Imposed By The CBOE Rest On Deeply Flawed Analysis And Are Impermissibly Punitive, Excessive, And Oppressive To Boot.

The Commission will set aside sanctions if they are excessive, oppressive, or serve a punitive, rather than a remedial, purpose. 15 U.S.C. § 78s(e)(2); *Saad*, 718 F.3d at 910. In making that determination, the Commission must consider both aggravating and mitigating factors. *Matter of the Application of Gregory Evan Goldstein*, Admin. Proc. File No. 3-15183, Exchange Act Release No. 71970, 2014 SEC LEXIS 4625, at *38 (Apr. 7, 2014). Here, the sanctions must be set aside because the CBOE relied upon a deeply flawed rationale and failed to consider important mitigating factors—resulting in sanctions that are excessive and impermissibly punitive.

[25] Three individuals involved in this matter during the investigation, hearing, or both were specifically listed by title in the Commission's Order against CBOE.

A. The CBOE's Deeply Flawed Sanctions Analysis Is Based On A Number Of Clearly Erroneous Findings That Run Directly Counter To The Evidence.

As demonstrated below, the aggravating factors relied upon by the CBOE run counter to the evidence—and the sanctions should be set aside for that reason alone. *See Saad*, 718 F.3d at 910-11 (reversal is required when an administrative agency has "'offered an explanation for its decision that runs counter to the evidence before the agency'") (quoting *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

First, the CBOE accused Applicants of disregarding "red flags" about its customer base "despite having been put on notice by the [CBOE] and FINRA, among others, that additional scrutiny was required for nonregistered entities." (BCC Decision 79.) But the record contains no such evidence. Indeed, before the examination that resulted in this action, *none* of ETC's prior examinations—including the CBOE's 2009 examination of ETC—elicited any such warnings. (Resp. Ex. 21.) Further, although the CBOE issued a regulatory circular on master-sub accounts, it did not do so until *after* the examination that resulted in this action began, so it could not have put ETC on notice of anything. *See* CBOE Regulatory Circular RG10-101, *Master Accounts and Sub-Accounts*, (Oct. 1, 2010) (CBOE Ex. 32). Similarly, FINRA issued Regulatory Notice 10-18 in April 2010,

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just four months before the CBOE's examination began. The CBOE's assertion that Applicants "disregarded" any regulatory warnings is thus unfounded.

Second, the CBOE criticized ETC for failing to develop internal surveillance reports until January 2010, "notwithstanding the fact that ETC had been a registered broker-dealer since June 2008." (BCC Decision 79.) But ETC did not begin clearing trades for customers until it became a FINRA member in the fall of 2009—and ETC indisputably began developing internal surveillance reports within months of that date. And the CBOE itself did not issue any relevant guidance on trade surveillance until it issued RC-09-118 in October 2009, which ETC immediately followed. (*See* CBOE Ex. 54.) Thus, like the CBOE's "red flags" criticism, the CBOE's accusation that ETC improperly delayed its development of internal surveillance reports is similarly unfounded.

Third, the CBOE accused Applicants of "cherry-picking" by considering ETC's entity clients as its only customers for purposes of the CIP Rule and margin regulations, but monitoring those same clients' individual traders when looking at wash trades. (BCC Decision 79.) The CBOE further chastised Applicants for "taking at face value ETC's clients' dubious representations" that their traders were proprietary traders. (*Id.* at 80.) Again, as already discussed, FinCEN's recent CIP rule proposal makes clear that firms "may rely on the beneficial ownership information provided by" their customers, and are not required, contrary to the

CBOE's unsupported finding, to doubt those customers' representations. *Customer Due Diligence Requirements for Financial Institutions*, 79 Fed. Reg. at 45162. FinCEN's rule proposal also notes that even though the CIP Rule may not apply to individuals with trading authority in a customer's account, a broker-dealer should nevertheless monitor those individuals' trading activity for purposes of detecting suspicious trading—and that is exactly what ETC did here. *Id.* at 45161. The CBOE thus considered conduct that complies with FinCEN's most recent thinking on the issue to be an aggravating factor in imposing sanctions. That cannot be right.

In addition to considering erroneous aggravating factors, the CBOE also failed to consider as a key mitigating factor the findings in Lisa Roth's Independent Consultant report. (Resp. Ex. 56.) ETC commissioned that report at the CBOE's insistence after the examination, and the CBOE did not object to Roth's selection. Roth then conducted a full investigation and, as CBOE's staff was aware, she concluded in no uncertain terms that (i) ETC fully complied with the CIP Rule; (ii) the Rule did not apply to the traders; and (iii) the combination of the Wash Sale Report and the Trade Participation Report effectively monitored for wash trade activity. (*Id.* at 6, 12.)

The CBOE thus chastised ETC for disregarding regulatory requirements—without any evidence that it did so—while ignoring that the independent consultant

retained at the CBOE's insistence concluded that the CBOE's examination findings were wrong and that ETC committed no violations at all. The CBOE's failure to consider that key mitigating factor, along with its consideration of aggravating factors unsupported by any evidence, require that the sanctions imposed on the basis of that deeply flawed analysis be set aside.

B. The Sanctions Are Impermissibly Punitive, Excessive, And Oppressive.

The $1 million joint-and-several fine imposed on Applicants—along with the suspensions of Cloyd and Murphy—not only rests on flawed legal and factual analysis, but is also impermissibly punitive, excessive, and oppressive—and must be set aside for that reason, too.

When considering sanctions, a regulator "must do more than say, in effect, petitioners are bad and must be punished." *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1113 (D.C. Cir. 1988). That is why the CBOE's own rules require it to impose sanctions that are remedial in nature (not punitive) and to consider relevant precedent. CBOE Rule 17.11. In this matter, however, the CBOE failed to adhere to those obligations, which perform a vital role not only in safeguarding the due process rights of defendants, but also in ensuring the appearance of fairness that is the cornerstone of good government.

First, the sanctions are impermissibly punitive. Although the CBOE was required to find that the sanctions were designed to "protect investors, not to

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penalize brokers," *SEC v. McCarthy*, 406 F.3d 179, 188 (2d Cir. 2005) (emphasis added), the CBOE failed to do so. Instead, the BCC relied on its flawed determination that Cloyd and Murphy "exhibited a propensity to ignore regulatory requirements" and thus "may commit future rule violations." (BCC Decision 81.) As already demonstrated, however, that determination lacks any evidentiary support. Not only did Applicants fully comply with the CIP Rule and their trade surveillance obligations, as the Independent Consultant and other experts found, they undoubtedly complied with NASD Rule 3011 and IM-3011-1 in conducting ETC's annual AML audit, made every effort to comply with Regulation SHO and Rule 204 thereunder, were absolved of charges that the CBOE did not pursue at the Hearing or on which the CBOE presented no evidence, and had spotless records for almost 30 years. On the basis of this record, the CBOE had no grounds to find that Applicants disregarded regulatory requirements and may commit future violations.

Second, the sanctions are excessive and oppressive. The $1 million fine—imposed for alleged conduct that took place over a 7-month period in a single year—amounts to 60 percent of ETC's total net capital as of December 31, 2010, and more than 40 percent of ETC's total net capital as reflected in its recent

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Commission filings.[26] That debilitating fine is exponentially higher than the $2,500 to $25,000 penalties imposed by the CBOE in far more egregious matters in similar cases.[27] This relevant precedent, which should have guided the CBOE's sanctions analysis, sharply underscores the excessiveness of the fine imposed on ETC.

Third, the suspension of Cloyd and Murphy is similarly excessive—and, if anything, even more inappropriate. Neither the BCC nor the Board found that the simultaneous suspensions of ETC's two most senior executives would serve any remedial purpose. And in suspending the individual Applicants, the CBOE did not focus on the limited number of violations found against them, but lumped together *all* of the alleged violations (including those concerning ETC). Cloyd, for

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[26] Pursuant to Rule 323 of the Commission's Rules of Practice, the Commission may take official notice of ETC's FOCUS Reports filed with the Commission on Form X-17A-5 for the periods ending December 31, 2010 and September 30, 2014. *See* 17 C.F.R. § 201.323.

[27] *See, e.g.*, *In the Matter of: Michael Lohman*, File No. 09-0040, *available at* https://www.cboe.org/publish/disdecision/09-0040.pdf (Nov. 10, 2009) (imposing $2,500 fine for failing to file its AML Compliance Program with the CBOE); *In the Matter of: Benchmarq Trading Partners, LLC*, File No. 10-0028, *available at* https://www.cboe.org/publish/disdecision/10-0028.pdf (Feb. 3, 2011) (imposing $10,000 fine for "fail[ing] to evidence senior management approval of its AML Program, fail[ing] to provide AML training for appropriate personnel[,] fail[ing] to obtain AML attestations for 10% of its associated persons" and "fail[ing] to maintain adequate AML procedures"); *In the Matter of: Blinkbox, Ltd.*, File No. 10-0036, *available at* https://www.cboe.org/publish/disdecision/10-0036.pdf (Dec. 22, 2010) (imposing $25,000 fine for failing to institute any kind of AML Program whatsoever, to designate an AML Compliance Officer, and to conduct any AML training).

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example, was found to have committed just one violation, and Murphy was found to have committed three. Lumping together all of the violations without regard to the individual or entity alleged to have committed them renders the suspensions of Cloyd and Murphy excessive for that reason alone.

C. The CBOE's Assessment Of The Fine Jointly And Severally Further Underscores The Excessiveness Of The Fine.

The CBOE's assessment of the $1 million fine jointly and severally against Applicants—particularly against the individual Applicants—further confirms that it is impermissibly excessive and oppressive.

For one thing, it is questionable whether the CBOE even has the authority to impose a fine on that basis, as nothing in the Exchange Act or the rules promulgated thereunder authorizes joint and several liability—and without that authority, the CBOE cannot act. *See* CBOE Rule 17.11 (stating that the CBOE can impose fines but omitting any reference to joint and several liability); *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 287-88 (2d Cir. 2013) (holding that the Exchange Act does not authorize joint and several liability and vacating penalty imposed on that basis).

For another thing, even if the CBOE could impose joint and several liability as a general matter, it could not do so in this particular matter without violating the prohibition against excessive, oppressive fines. Under joint and several liability, each Applicant—including the two individuals—is liable for the entire amount of

the million-dollar fine. *See Golden ex rel. Golden v. Golden*, 382 F.3d 348, 355 n.5 (3d Cir. 2004) (noting that "an assertion of joint and several liability is an assertion that each defendant is liable for the entire amount"), *superseded by statute on other ground by Smith v. Albert Einstein Med. Ctr.*, No. Civ.A. 08 05689, 2009 WL 1674715 (E.D. Pa. June 11, 2009).

Thus, although Cloyd was found liable for a single violation, he is responsible for the entire million-dollar amount. And although Murphy had no liability for the trade surveillance or Regulation SHO violations, he too is potentially on the hook for the full $1 million. That is plainly excessive and oppressive and underscores why the sanctions imposed against Cloyd and Murphy, in particular, cannot stand.

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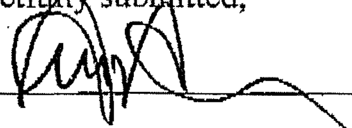
CONCLUSION

For the foregoing reasons, the Board Decision should be set aside.

Dated: January 16, 2015

Respectfully submitted,

By: 

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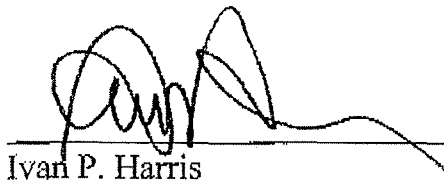
CERTIFICATE OF COMPLIANCE WITH RULE 450(D)

I, Ivan P. Harris, certify that this brief complies with the word limitation set forth in Commission Rule of Practice 450(d), as it contains 13,256 words, excluding the parts of the brief exempted by the Rule. 17 C.F.R. § 201.450(d).

Dated: January 16, 2015



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