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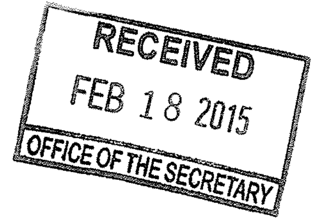

February 17, 2015

VIA FACSIMILE AND FEDEX

Brent J. Fields, Secretary
Jill M, Peterson, Assistant Secretary
Melissa Kimps
Office of the Secretary
United States Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549

Re: In the Matter of Application of Electronic Transaction Clearing, Inc., Kevin Murphy and Harvey C. Cloyd, Jr.; Admin. Proc. File No. 3-16285

Dear Mr. Field, Ms. Peterson and Ms. Kimps:

On behalf of the Chicago Board Options Exchange, Incorporated ("CBOE"), and pursuant to the Commission's December 17, 2014 Order Scheduling Briefs, enclosed please find CBOE's Response in Opposition to Application for Review concerning the above-referenced matter. A facsimile copy of this Opposition Brief was also transmitted to the Commission's Office of the Secretary on this date to (202) 772-9324.

Very truly yours,

Andrew D. Spiwak

cc: Ivan Harris, Esq. (Via Fedex and email)
Joanne Moffic-Silver, Esq. CBOE (via email)
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Admin. Proc. File No. 3-16285

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 Chicago Board Options Exchange, Incorporated.

CBOE'S RESPONSE IN OPPOSITION TO APPLICATION FOR REVIEW

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INTRODUCTION

In its 81-page Amended Decision and Order (the "Order"), CBOE's Business Conduct Committee ("BCC") carefully considered all of the evidence and arguments offered by the parties.[1] After considering the record, the BCC found that Electronic Transaction Clearing, Inc. ("ETC"), Harvey Cloyd ("Cloyd") and Kevin Murphy ("Murphy") (collectively, the "Applicants") "attempted to circumvent numerous regulatory obligations," that ETC "lacked a culture of compliance" and that ETC "consistently followed the regulatory path of least resistance."[2] (Order at 79.) The BCC also found that ETC, Cloyd (ETC's founder and Chief Executive Officer) and Murphy (who joined ETC one month after its founding and assumed the titles of President, Chief Operating Officer, Chief Compliance Officer and Anti-Money Laundering ("AML") Compliance Officer) ignored the evidence in their possession that strongly suggested that ETC's non-broker-dealer clients were operating as unregistered broker-dealers. (*Id.*) The BCC also held that:

> ETC's failure to implement an adequate compliance program was *not a result of negligence*, but rather, as the evidence revealed, ETC knew or should have known that it had serious problems and *it chose to cut corners and disregard certain rules* either to save money, or merely because it was more expedient or convenient for ETC's business and there were business incentives to do so.

(*Id.* at 80 (emphasis added).)

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[1] In this Response, testimony will be cited by referring to the name of the witness and the page of the hearing transcript (*e.g.*, Miller-Brouwer at ___.) Portions of the transcript consisting of arguments by counsel or comments by the Hearing Panel will be cited by referring to the pages of the hearing transcript (*e.g.*, Hearing Tr. at ____.) Exhibits entered into evidence during the hearing will be cited by referring to the party sponsoring the exhibit and the exhibit number (*e.g.*, Exch. Ex. ___.) The Applicants' Brief in Support of Application for Review will be cited to as "Apps.' Br."

[2] The BCC dismissed several of the charges, including all of the charges against David DiCenso ("DiCenso").

After reviewing the sanctions arguments presented by the parties, the BCC concluded that:

> In light of the *serious and willful violations* that ETC, Cloyd and Murphy committed in this matter, it is appropriate to assess a level of remedial sanctions in this case that recognizes the potential that ETC, Cloyd and Murphy, having exhibited a propensity to ignore regulatory requirements, may commit future rule violations, including those that may directly impact the public interest.

(*Id.* at 81 (emphasis added).) The BCC then unanimously voted to impose the following sanctions: (1) a censure for ETC, Cloyd and Murphy, (2) a $1,000,000 joint and several fine to be paid by ETC, Cloyd and Murphy, and (3) a six month suspension prohibiting Cloyd and Murphy from acting in any capacity with an Exchange Trading Permit Holder. (*Id.*)

On October 29, 2014, CBOE's Board issued a 13-page Decision (the "Board Decision") affirming the Order in its entirety. In particular, the Board affirmed each of the disciplinary violations found by the BCC, affirmed evidentiary rulings made by the BCC, rejected the Applicants' new claims that CBOE's disciplinary process is unfair, and affirmed the sanctions.

In this appeal, Applicants again raise many of the arguments that were rejected by both the BCC and the Board, along with several new arguments that were not raised below. Applicants' arguments about the sufficiency of the evidence and the legal underpinnings supporting the BCC's findings, however, are fundamentally flawed because they either ignore the contrary evidence and authorities or consist of conclusory statements made without citation to the record.

Applicants then make a series of claims attacking CBOE's disciplinary process. First, Applicants argue that the BCC abused its discretion when making evidentiary rulings – without discussing the BCC's discretion when considering such issues or the rationale articulated by the BCC for its decisions. Second, Applicants' claim that CBOE's procedures are unfair and that the

was the product of bias, while ignoring the fact that the Commission has approved CBOE's disciplinary procedures and without providing any evidence of bias in this case.

Finally, none of Applicants' complaints about the sanctions imposed – some of which are raised for the first time on appeal – have any merit. In the end, the record supports the findings of disciplinary violations by CBOE and the sanctions imposed fall within the range of reasonableness given the findings that the Applicants knowingly and willfully engaged in misconduct. As a result, the Order and the Board Decision should be affirmed in their entirety.

STANDARD OF REVIEW

When considering an appeal from a disciplinary decision issued by a self-regulatory organization, the Commission conducts an independent review of the record and applies a preponderance of the evidence standard. *See, e.g., In the Matter of Gregory E. Goldstein*, Exchange Act Release No. 71970 (April 17, 2014) at 5. It also is well established that "the credibility determination of the initial decisionmaker is entitled to considerable weight and deference, since it is based on hearing the witnesses' testimony and observing their demeanor" and that "without substantial evidence in the record to the contrary, [the Commission] cannot depart from the fact finder's determination of credibility." *See, e.g., In the Matter of Wanda P. Sears*, Exchange Act Release No. 58075 (July 1, 2008) at 4.

ARGUMENT

I. ETC LACKED A CULTURE OF COMPLIANCE.

While Applicants repeatedly refer to their "spotlessly clean disciplinary records" (*see* Apps.' Br. at 1-2.), the Commission has repeatedly held that a lack of prior disciplinary history is not mitigating because firms and associated persons *are expected* to comply with their regulatory

duties.[3] *See, e.g., In the Matter of Edward S. Brokaw*, Exchange Act Release No. 70883 (Nov. 15, 2013) at 31 (holding that a "lack of disciplinary history is not mitigating for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional") (internal quotation marks and citation omitted); *see also Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) (lack of a disciplinary history is not mitigating because registered representative was required to comply with NASD's standards of conduct at all times).

When referring to their records, Applicants also ignore the evidence in this case establishing that ETC, Cloyd and Murphy failed to take their compliance responsibilities seriously until after they faced regulatory scrutiny. While ETC was founded in 2007, the CBOE found that "that ETC effectively had *no* compliance program in place before 2010, even though ETC was clearing trades for both broker-dealer and non-broker-dealer clients. (Order at 10 (emphasis in original, citations to the record omitted).) Rather than ensuring that a compliance program was in place *before* clearing trades, ETC (acting through Cloyd and Murphy) relied on a "system" where three individuals (including Murphy) – none of whom were qualified to act as compliance professionals or to conduct surveillance – would merely "watch" trading activity to look for things that would "kind of bother ETC." (*Id.*)

Prior to December 2009, when David DiCenso joined ETC to become its Chief Compliance Officer, ETC had only one automated compliance program, which was intended to surveil for short sales. (Order at 10.) Indeed, DiCenso admitted that he had to start from "scratch" when attempting to build automated surveillance programs for ETC. (*Id.*)

[3] ETC no longer has a "spotless" disciplinary record. In addition to the violations found in this case, a review of the firm's disciplinary history reveals that ETC has resolved seven other formal disciplinary matters during the period from 2012 through 2014.

A series of comments made to CBOE staff during their investigation also demonstrate that ETC did not take its compliance obligations seriously. For example, Murphy characterized compliance programs as a "necessary evil." (Order at 11.) Murphy also stated that ETC's compliance philosophy was limited to protecting "the four walls" of ETC and that ETC did not believe that it had any responsibility to assess the operations of its clients or to assess the "legality of [its] customers' business." (*Id.*) Cloyd echoed that philosophy. (*Id.* at 11 n.13.)

The BCC also found that DiCenso and Murphy disagreed about what ETC needed to do in order to have adequate AML and Customer Identification Programs ("CIP"). While DiCenso wanted to investigate the backgrounds of a client's individual traders if the circumstances warranted, Murphy argued that ETC need only look at the principals of ETC's clients and that ETC could simply take the client's representations regarding their operations at face value. (*Id.* at 11.) DiCenso also told CBOE investigators that he was overwhelmed as he attempted to fulfill his compliance responsibilities and that Murphy and Cloyd yelled at him when he attempted to run background checks on the individuals who were trading through ETC's non-broker-dealer clients. (*Id.* at 12.)

While DiCenso denied during the hearing that he made many of the comments attributed to him by CBOE's witnesses, several of those comments were corroborated by a series of emails that he sent to an attorney representing ETC before CBOE began its on-site investigation.[4] (*Id.* 13-14 (discussing the testimony of DiCenso, Murphy and the text of Exch. Ex. 24).) In his emails, DiCenso questioned whether ETC should be doing more with respect to AML compliance in light of the fact that ETC knew that its non-broker-dealer clients had "1,000's of

[4] Beth Kiesewetter is the attorney who corresponded with DiCenso. She is with the firm of Morgan Lewis & Bockius LLP, the firm that is representing Applicants during these proceedings.

foreign traders" that were provided with "direct access" to "all exchanges" by ETC.[5] (*See* Exch. Ex. 24 (Dicenso's May 5, 2010 email and his June 8, 2010 email).) DiCenso told ETC's counsel that he was concerned about "wash and prearranged trading to move the money." (Exch. Ex. 24 (DiCenso's June 8, 2010 email).) Finally, DiCenso told ETC's counsel that his "boss" – Murphy – was concerned because if ETC learned more about the activities of the foreign traders, "the more [ETC] should do, i.e. background checks which would be very costly (our clients have 1000's of foreign traders)." (*Id.*)

II. ETC DID NOT HAVE ADEQUATE SURVEILLANCE PROCEDURES IN PLACE TO SURVEIL FOR WASH TRADES.

The BCC exhaustively reviewed the evidence related to ETC's wash trade surveillance program during 2010. (*See* Order at 14-31.) The BCC then concluded that ETC violated CBOE Rules 4.1 and 4.2 because, during 2010, ETC failed to implement effective risk procedures and surveillance tools for detecting suspicious trading activities by its clients. (Order at 28.)

In particular, the BCC held that ETC did not have an adequate program in place to surveil for wash trades during 2010 because its only functioning wash trade surveillance program – referred to as its "Wash Sale Report" ("WSR") – examined the activity of a single trader at a time and asked whether that trader had executed a trade with himself. (Order at 17.) Critically, while ETC's WSR looked at trading activity only at the individual trader level, ETC was

[5] The evidence established that ETC had actual knowledge that at least one of its non-broker-dealer clients had *thousands* of supposedly "proprietary" traders located in China. (*See, e.g.*, Order at 15 (noting that Exch. Exs. 39, 43 and 44 demonstrate that DiCenso and ETC knew that Vantage Point, a non-broker-dealer client, had thousands of traders located in China).) As discussed below in Section III.B., the BCC found that, in light of the suspicious circumstances regarding the nature of the relationship between Vantage Point and its Chinese traders, ETC should have recognized the existence of "red flags" and done more to determine the true nature of the relationship between Vantage Point and its traders, including whether those traders were actually proprietary traders or whether Vantage Point was operating as an unregistered broker-dealer. (Order at 16, 33-37, 42-44, 79.)

simultaneously taking the position that its customers were only the non-broker-dealer clients as a whole that sent orders to ETC. (Order at 17.) If ETC's customers were truly the non-broker-dealer clients that were submitting orders, ETC's wash trade surveillance should have been set up to review the activity across the entire client firm – meaning that surveillance should have been conducted across all of the firm's alleged proprietary traders (and their various user IDs). (Order at 17.) As the BCC recognized, the evidence concerning ETC's WSR alone "establish[es] that ETC's wash trade surveillance program was critically deficient." (Order at 18.)[6]

A. APPLICANTS' FACTUAL SUMMARY RELATED TO THE WASH TRADE SURVEILLANCE ISSUES IS NOT ACCURATE.

Applicants engage in a slight of hand and use the present tense when asserting that "ETC *has* a state-of-the-art monitoring system that tracks all potential wash trading activity." (Apps.' Br. at 5 (emphasis added).) The issue, however, is not what ETC's *current* surveillance system does. Instead, the issue before the BCC was whether ETC had an effective wash trade surveillance tool *before and during 2010.* Moreover, ETC's representation that it "maintained a robust wash trade prevention and surveillance program throughout the relevant time frame" is false.

1. ETC's Trade Participation Report Was Not Functioning During Most Of 2010.

Echoing its arguments before the BCC, ETC argues that the void in its automated wash trade surveillance program arising from the faulty design of the WSR was filled by a second program, its Trade Participation Report ("TPR"). In particular, ETC claims that the TPR "was

[6] The Board affirmed the findings of the BCC. (Order at 4-5.) In so ruling, the Board recognized that "[t]he BCC Decision reflects that the BCC heard substantial evidence and testimony that ETC's procedures for monitoring wash trades were deficient." (*Id.* at 4.)

introduced in February 2010," and that the TPR program thereafter worked "together" with the WSR to "enable[] ETC to monitor for potential wash trading between any combination of traders, customers and market participant identifiers."[7] (Apps.' Br. at 6.)

The BCC carefully examined all of the evidence regarding the TPR and concluded that the TPR "*did not cure the deficiencies in ETC's wash trade surveillance program.*" (*See* Order at 22-28 (emphasis added).) In fact, the TPR could not cure the deficiencies arising from the flaws in the design of the WSR because "the evidence is undisputed that the TPR *was not functioning* during the majority of 2010 which included the time period when CBOE was conducting its on-site examination." (Order at 28 (emphasis added); *see also Id.* at 27 (discussing the undisputed evidence that the TPR was not working until at least September 10, 2010 and DiCenso's admission that the first version of TPR was not an "effective tool"), 23 (BCC's discussion of the testimony by ETC's Barnaby Hatchman "confirm[ing] that when the TPR was being run prior to September 9, 2010, that the TPR was inadequate as a surveillance tool to detect wash trade activity"). In sum, the BCC concluded that:

> ETC's claim that the TPR was an adequate tool to surveil for wash trades is nothing more than a *post-facto* attempt to avoid liability for the fact that ETC's WSR was fundamentally flawed and did not capture all of the wash trades that that were being executed by ETC's clients. During the relevant period, the TPR was inadequate and out of service for at least three months and therefore . . . the TPR was an inadequate tool to surveil for wash trades.

(Order at 27.)

[7] ETC's claim that the WSR and the TPR were intended to work together cannot be reconciled with the admission by one of ETC's witnesses that ETC no longer runs the WSR. (*See* Hatchman Tr. at 943-44.)

2. CBOE's Investigator Did Not Testify That ETC Properly Surveiled For Wash Trading During 2010.

Applicants misrepresent the record when they claim that a CBOE investigator "acknowledged" that the TPR and the WSR "worked together to surveil for all potential forms of wash trading." (Apps.' Br. at 39; *id.* at 6 (claiming that the CBOE investigator "conceded" that the WSR and TPR "monitored for all potential forms of wash trading").) The CBOE investigator actually testified that, *once the TPR actually became functional*, ETC "may have" had an adequate wash trading surveillance program at that time. (*See* Miller-Brouwer at 1621-22, 1624.) The CBOE investigator also made those remarks immediately after noting that *the TPR was not working* when CBOE was on site at ETC in August and early September 2010 and that, during the period before the modified TPR was put back into service, *ETC was not adequately surveilling for wash trades.* (Miller-Brouwer at 1621.) While ETC may have corrected the deficiencies in its wash trade surveillance program in late 2010, the BCC correctly concluded that the TPR was not working during most of 2010 (*see* Order at 27-28) and the evidence is that the surveillance program ETC actually ran during most of 2010 (its WSR) was fatally flawed.

3. ETC Did Not Comply With CBOE's Regulatory Guidance.

In 2009, CBOE issued a Regulatory Circular describing how it would interpret Rules 4.1 and 4.2 in situations where the member, like ETC here, was "providing client access to Exchange systems." (*See* Exch. Ex. 54, CBOE Regulatory Circular RG09-118, dated October 26, 2009.) Rather than merely "recommending" that ETC have a compliance program (*Cf.* Apps.' Br. at 41), Regulatory Circular RG09-118 ("RG09-118") states that its purpose is "to highlight certain supervisory obligations of members when providing client access to Exchange systems." (Exch. Ex. 54, at 1.) While CBOE did not mandate that members have a particular supervisory procedure, RG09-118 states that "[e]ach system of supervision must be tailored to meet the

particular business type of the member" and that each member must have "adequate procedures and controls in place to monitor and supervise the entry of orders to minimize the potential for . . . misuse of Exchange systems." (*Id.*)

RG09-118 also includes specific recommendations for firms like ETC:

> <u>Reviewing Client Activity for Manipulative or Improper Trading Practices</u>
>
> To minimize the potential for misuse of Exchange systems, the Exchange 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.* These procedures may be implemented on a post-trade basis. Supervisory reviews for manipulative and improper trading practices can be conducted via exception reports and other post-trade reviews of documents showing trade activity. *These procedures should be designed to alert a member to potentially abusive or improper client trading patterns or practices.*

(*Id.* at 2 (emphasis added).) In other words, CBOE advised ETC that it was required to have an adequate system in place to monitor its clients for "potentially manipulative" conduct, like wash trades.[8]

As evidence of its alleged compliance with CBOE's Regulatory Circular, ETC again points to the implementation of its WSR and its TPR report. (Apps.' Br. at 41.) As

[8] Applicants state that it is "remarkable" that the BCC's Order did not discuss RG09-118. (Apps.' Br. at 41.) Given the overwhelming evidence that ETC did not have an adequate wash trade surveillance program in place during 2009 and most of 2010, there was no need for the BCC to discuss that Regulatory Circular.

Applicants also assert that CBOE's Board cited to RG09-118 "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'." (Apps.' Br. at 41-42.) That statement is based on a misreading of the Decision and the Board instead cited to RG09-118 to rebut the new argument made by the Applicants during that appeal that ETC was not required to have any trade surveillance program at all. (*See* Board Decision at 5.)

demonstrated above, however, the WSR was fundamentally flawed and the TPR was not functioning during most of 2010. (*See* Section II.A.1.)

Without citation to the record, Applicants claim that "even before the issuance of the Regulatory Circular [in 2009], ETC personnel reviewed trading activity in real time to detect potentially wash trading and any other improprieties." (Apps.' Br. at 41.) Because RG09-118 was issued in October 2009, it appears that Applicants are arguing that the *ad hoc* "watching" of activity done by Murphy and two other ETC employees during 2009 constituted a meaningful "real time" surveillance for potential wash trading and other potentially manipulative conduct. (*See* Apps.' Br. at 41 n.21 (citing to page 10 of the Order, where the BCC discusses watching activities).) Nothing could be further from the truth.

Murphy did not even specifically testify that ETC's "watching" group actually looked for wash trading activity. Instead, he referred generally to watching unspecified individual traders for unspecified activity "that kind of bothered us" and there was no evidence that ETC had any criteria in terms of the activity that would "kind of bother" ETC.[9] (*See* Order at 10 (quoting Murphy Tr. at 1481).)

Moreover, Applicants' suggestion (again made without citation to the record) that the three ETC employees who supposedly were part of the "watching" process were qualified to conduct real time monitoring for suspicious activity is frivolous. (*Cf.* Apps.' Br. at 41 n.21.) Instead, the undisputed evidence is that (1) Murphy had no hands on compliance experience before he joined ETC, (2) the second ETC employee (Barnaby Hatchman) admitted "that he is

[9] A practice of "looking" at the activity of certain traders would suffer from the same fundamental flaw that plagued ETC's WSR – if ETC's customers were its client firms, ETC should have been conducting surveillance across all of the orders entered by traders affiliated with a particular client. (*See* Section II.)

not a registered person at ETC and therefore is not qualified to supervise any activities at the Firm" and (3) the third employee (Pat Kelly) stated in his Wells response that he had no responsibility for monitoring and surveillance of customer trading for instances of suspicious activity or manipulative trading. (*See* Order at 10 (and the testimony and exhibits discussed therein).)

B. CBOE'S FINDINGS THAT ETC FAILED TO ADEQUATELY MONITOR FOR WASH TRADES ARE SUPPORTED BY THE EVIDENCE.

In addition to misrepresenting the evidence concerning the surveillance program that ETC was actually running during 2009 and most of 2010, Applicants also claim that CBOE's findings are "illogical" or "inconsistent." Those arguments are without merit.

1. Implementing Anti-Wash Settings Does Not Cure ETC's Violations.

Without referring to the record, Applicants claim that their failure to have an adequate wash trade surveillance program should be excused because "ETC implemented anti-wash settings at every exchange that provided them" and because it supposedly required "its order-entry vendors" to implement tools to prevent a single trader's orders from executing with that trader's other orders. (Apps.' Br. at 37-38.)

Those unsupported claims are contradicted by the record. With regard to the timing of ETC's actions, the evidence revealed that ETC only enacted the "anti wash settings" offered by one of its vendors (Sterling) with respect to the trades entered by certain traders from one ETC client (Vantage Point Securities, LLC, hereinafter "Vantage Point") after those traders generated dozens of wash trade exceptions from ETC's flawed WSR over a period of several months. (Order at 19-20.) Moreover, Sterling's anti-wash settings and an ARCA block prohibiting certain Vantage Point traders from entering two sided markets were activated only *after* ETC's

repeated requests to Vantage Point to stop its wash trade activity were ignored.[10] (Order at 20.) As a CBOE investigator recognized, ETC cannot avoid its duty to have an adequate program in place to surveil for and investigate possible wash trades by activating a "fix" provided by certain vendors and applied to selected traders of a client. (*See* Order at 20 n. 29 (discussing the testimony of Chief Investigator Ellen Miller-Brouwer).)

2. ETC's Regulatory Bulletin Does Not Excuse Its Violations.

Applicants argue that ETC's issuance of a "Regulatory Information Bulletin," "in or about April 2010," demonstrates its "commitment" to preventing wash trades. (Apps.' Br. at 38.) What the Applicants fail to mention is that ETC previously represented that the Information Bulletin was issued on May 5, 2010 – the same day that DiCenso began his email string with ETC's outside counsel where he admitted that he was concerned about ETC's existing wash trading issues. (*See* Order at 13 n.17 (citing to DiCenso at 1086-88, 1221-22).) Given the timing of those events, the BCC did not consider the Information Bulletin to be evidence that ETC was committed to stopping wash trading, but instead found that the issuance of the bulletin "clearly demonstrates that DiCenso had a concern about an *existing* wash trade problem at ETC." (Order at 13 n.17 (emphasis added).) In other words, the evidence is that ETC only issued its Bulletin after DiCenso knew that ETC had an existing wash trade problem and the Bulletin did nothing to cure the deficiencies in ETC's surveillance program.

3. ETC's New Case Does Not Undermine CBOE's Holdings.

Citing for the first time to a 2010 FINRA decision, *Department of Enforcement v. Sterne, Agee & Leach, Inc.*, Disciplinary Proceeding No. E052005007501, 2010 FINRA Discip. LEXIS

[10] DiCenso also testified that ETC put some form of "self-trade prevention modifiers" in place at other exchanges, but he was not able to pinpoint when ETC took that action and the evidence is not clear as to whether they were effective. (DiCenso at 1162-72.)

18 (Mar. 5, 2010), Applicants argue that the holding in that case requires the reversal of CBOE's decisions.[11] (Apps.' Br. at 42-43.) Applicants are wrong.

In *Sterne*, a hearing panel considered the unique facts of that case and rejected the contention that the respondent's AML policies and procedures should have been automated to a greater degree, instead holding that the procedures were reasonable during the time frame at issue. *Sterne* at 24-27. The FINRA panel also found that the opinions of the respondent's expert concerning the reasonableness of the procedures were "more reasonable" than the opinions offered by Enforcement's expert. *Id.* at 24. Overall, the panel found that the respondent's use of *extensive* manual monitoring, coupled with its automated process, resulted in a program that "was reasonably designed to detect potential money laundering transactions." *Id.* at 27.

The rationale and the fact-specific findings made by the *Sterne* panel do not apply here. In this case, the BCC found that ETC's automated surveillance program was wholly ineffective because the WSR did not monitor for wash trades on a client-wide basis and because the TPR was ineffective until at least September 2010. As a result, contrary to Applicants' arguments, suspicious activity *did* go undetected on a real time basis before and during 2010. (*See* Order at 17-18 (finding that ETC's WSR "significantly underreported" the number of potential wash trades that were attributable to ETC's clients and discussing the evidence of situations when potential wash trades would not have been captured by ETC's surveillance).)

While the FINRA panel did note that the respondent conducted a retrospective review of certain activity, it did so in the context of a situation where the firm first implemented

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[11] A copy of the *Sterne* decision can be found at http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/ohodecisions/p122075.pdf. Applicants do not explain why they failed to cite the *Sterne* decision (which was issued more than *two years* before the hearing in this matter) in their submissions to either the BCC or the Board.

surveillance software, only to discover later that the outside vendor of that software misrepresented the scope of the activity that the software would monitor. *Sterne* at 10-11. This case does not involve either an outside software vendor or a situation where a firm reasonably relied on the representations made by an outside vendor. Here, ETC designed and implemented its flawed surveillance programs. Most importantly, *Sterne* certainly does not announce a blanket rule that a firm's failure to have an adequate surveillance program in place will be excused if the firm later conducts a retrospective analysis of the activity in question. In sum, *Sterne* was decided on a markedly different record and the holding in that case does not apply here.

4. The Dismissal Of The Charges Against DiCenso Does Not Require The Dismissal Of The Charges Against ETC.

Applicants argue that CBOE's determinations are "internally inconsistent" because the BCC dismissed certain charges against DiCenso. (Apps.' Br. at 37.) There are, however, several reasons why the BCC may have differentiated between ETC's liability and its decision that DiCenso should not be held personally responsible for ETC's supervisory failures. For example, DiCenso was relatively new to ETC (arriving in December 2009) and, while DiCenso started from a blank slate in terms of developing surveillance programs at ETC, there is evidence that he attempted to build a program.

With regard to the dismissal of the charge that DiCenso did not adequately investigate even the exceptions generated by ETC's faulty WSR, the Panel found that, while "DiCenso could have taken further action to investigate each exception noted on the Wash Sale Activity Report," and he violated ETC's written supervisory procedures by failing to investigate each and every exception generated by ETC's WSR (Order at 18-19), DiCenso's review of the exceptions generated by ETC's flawed WSR was adequate. (Order at 22.)

Thus, it may be that the BCC concluded that DiCenso was doing the best that he could under difficult circumstances and therefore exercised its discretion to decide not to impose personal liability on him. That determination, however, is not inconsistent with the BCC's findings that ETC, as a firm, should be held liable for the fact that its surveillance procedures were inadequate both before and after DiCenso's arrival.

5. The BCC's Findings Are Not Dependent On A Showing That ETC's Clients Actually Engaged In Manipulative Wash Trading.

Next, Applicants claim that ETC's supervisory failures should be excused because CBOE "could not find a single instance of manipulative or improper wash trading." (Apps.' Br. at 8.) In support of that statement, Applicants cite to a few carefully selected lines of the testimony provided by a CBOE investigator. (*Id.*)

Applicants mischaracterize the testimony provided by that investigator. Instead of testifying that CBOE was able to fully analyze the activity of ETC's clients and that it affirmatively reached the conclusion that there was no manipulative behavior, the investigator actually testified that CBOE was "unable to conclude with certainty if [certain trades] were indeed manipulative or not manipulative," that she was "uncomfortable" commenting as to whether specific trades were improper, and that her investigation did not involve allegations of actual manipulation. (*See* Miller-Brouwer at 194-99.) Later, the investigator noted the reason CBOE was unable to reach a conclusion as to whether certain trades were improper or manipulative – it lacked jurisdiction over ETC's client and therefore could not compel that client to produce information. (Miller-Brouwer at 291.)

Significantly, the CBOE investigator also testified that she expected *ETC* to conduct an investigation as to whether the trades were improper and noted that ETC *would have the ability to request the necessary documentation from its client.* (*Id.*) In the end, Applicants' argument

fails for a fundamental reason: a failure to adequately supervise is not excused by the fact that, perhaps fortuitously for the broker-dealer, the broker-dealer's clients may not have actually engaged in illegal conduct. (*See* Miller-Brouwer at 229-230.)

III. ETC FAILED TO HAVE AN ADEQUATE ANTI-MONEY LAUNDERING PROGRAM.

The BCC carefully considered the governing legal standards and facts that were available to ETC concerning the activities of its clients before reaching its conclusion that ETC failed to have an adequate AML program in 2010 and that ETC violated Exchange Rules 4.1, 4.2 and 4.20 when ETC "failed to implement an AML program that was sufficient to reasonably detect and prevent money laundering and manipulative trading risks." (Order at 31-37.) Those findings are supported by the evidence and should be affirmed.

A. THE STANDARDS GOVERNING AML/CIP PROGRAMS.

The lynchpin of Applicants' arguments concerning the AML and CIP issues is that the default definition of "customer" and the minimum requirements for identifying a customer control in this case. (Apps.' Br. at 15-16.) In other words, despite ETC's acknowledgement in its written supervisory procedures that its AML program "require[d] that the identification go beyond the customer" for "certain customers identified as having heightened risk" and require the "[i]dentification of . . . individuals given trading authority" (Exch. Ex. 18 at 21), ETC claims that it was justified in limiting its inquiries to examining information at the corporate client level and that the facts of this case did not compel it to do more.[12] ETC is wrong and adopting its

[12] Applicants argue that a mere review of the definition of "customer" "should have been the end of the matter" because the traders who traded through the accounts of ETC's clients "did not open those accounts or control them." (Apps.' Br. at 17.) As discussed herein, however, a key issue is whether there were sufficient facts to put ETC on notice that there were serious questions as to whether the thousands of traders who traded through ETC's clients were controlling those accounts.

approach, under the facts of this case, would eliminate the requirement that an AML/CIP program be "risk based" and the requirement that a broker-dealer undertake more extensive CIP review when there are reasons to doubt the representations made by a client.

As the BCC and the Board both recognized, CBOE Rule 4.20 requires that Trading Permit Holders, like ETC, "develop and implement a written anti-money laundering program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, et seq.) . . . ." (Order at 31-32; Board Decision at 6.) The CIP regulations, in turn, mandate that a broker-dealer's CIP program include

> *risk-based procedures* for verifying the identify of each customer to the extent reasonable and practicable. The procedures *must enable the broker-dealer to form a reasonable belief that it knows the true identity of each customer.*

31 C.F.R. § 1023.220(a)(2) (emphasis added).

While ETC argues that the individuals who were executing trades through the accounts of its clients do not fall within the definition of "customer" found in 31 C.F.R. § 1023.100(d), the CIP regulations also provide that:

> *Additional verification for certain customers.* The CIP must address situations where, based on the broker-dealer's risk assessment of a new account opened by a customer that is not an individual, the broker-dealer will obtain information about individuals with authority or control over such account. This verification method applies only *when the broker-dealer cannot verify the customer's true identity* using the verification methods described in paragraphs (a)(2)(ii)(A) and (B) of this section.

31 C.F.R. § 1023.220(a)(2)(ii)(C) (emphasis in original title, emphasis added to the final sentence). Thus, when the regulations are read together, they contemplate that there may be situations where a broker-dealer is required to engage in a deeper inquiry because the default customer verification procedures are not sufficient to "verify a customer's true identity" such

that the broker-dealer is able "to form a reasonable belief that it knows the true identity of each customer."[13]

ETC's claim that it was required to go no further than the standard verification procedures with respect to its clients also is contradicted by ETC's own CIP, which provides:

> Risk-Based Identity Verification Requirements: Due to our commitment to having an effective AML Program, our AML-CO, in conjunction with other senior management and compliance personnel, has created a risk-based customer verification program.
>
> While we believe that we will be able to verify the majority of our customer's[sic] adequately through documentary and non-documentary means, and by adhering to the minimal requirements set forth in The USA PATRIOT ACT, *there will be instances where the risk of not knowing the customer sufficiently may be heightened for certain accounts*.
>
> For certain customers identified as having heightened risk, *we require that the identification go beyond the customer.* Identification of beneficial owners, control individuals, *individuals given trading authority*, etc. may be required identification in certain instances.

(*See* Exch. Ex. 18 at 21 (ETC's July 2010 Broker-Dealer Written Supervisory Policies and Procedures Manual).) Thus, ETC's CIP explicitly recognizes that its CIP efforts cannot simply stop at the initial customer identification level and that, when circumstances warrant, ETC was required to "go beyond the customer" and explore the "individuals given trading authority."

B. THE FACTS IN ETC'S POSSESSION SHOULD HAVE TRIGGERED AN EXPANDED CIP REVIEW OF ITS CLIENTS.

The BCC recognized that there were numerous facts – often referred to as "red flags" – that should have sounded a risk-based alarm at ETC and triggered an inquiry by ETC into the

[13] David Paulukaitis, a witness for ETC, acknowledged that the AML rules are intended to be risk-based and admitted that, if risk factors are present, a broker-dealer must inquire further and determine who is running the account and who really is the beneficial owner of the account. (*See* Order at 35 n.50.)

true nature of ETC's clients' relationships with the thousands of supposedly proprietary traders that were entering orders through those clients' accounts. (Order at 16, 34-37, 42-46, 79 (and the evidence cited therein).) For example, two ETC's clients, Vantage Point and Esurge Trading Group Ltd. (hereinafter, "Esurge"), had (1) hundreds or thousands of supposedly proprietary traders located in China, (2) strikingly low initial trading deposits to support the supposedly proprietary trading by those traders ($500,000 for each client) and (3) a conspicuously high level of expected trading activity (ranging from hundreds of thousands to billions of shares per month).[14] (Order at 33, 35.) ETC also knew that, based on documents provided by Vantage Point, that many of those traders had what appeared to be personal email accounts and those email addresses did not indicate that the traders were employees of Vantage Point. (Order at 34.)

In addition, as discussed above, DiCenso wrote emails to ETC's outside counsel voicing his concern about the large numbers of foreign traders associated with ETC's clients. (Order at 34; Exch. Ex. 24.) In his emails, DiCenso (who was then ETC's AML compliance officer) specifically questioned whether ETC should be implementing CIP procedures with respect to those traders. (*Id.*)

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[14] The witnesses from CBOE, ETC and ETC's experts all agreed on one point – none of them had ever encountered a comparable firm that had anywhere near as many proprietary traders as Vantage Point or Esurge claimed to have. (Order at 35 n.49 (citing the testimony from two CBOE investigators, ETC's expert witness and Murphy).)

The fact that Vantage Point had more than 1,000 traders located in China alone was an AML red flag. (*See, e.g.*, Order at 72 n.99.) In 2009 and 2010, according to the International Narcotics Control Strategy Report, issued by the U.S. Department of State, China was classified as a "Jurisdiction of Primary Concern." (*See 2009 INCSR: Major Money Laundering Countries*, available at: http://www.state.gov/j/inl/rls/nrcrpt/2009/vol2/116550.htm; *2010 INCSR: Major Money Laundering Countries*, available at: http://www.state.gov/j/inl/rls/nrcrpt/2010/vol2/137209.htm.)

As the BCC recognized, there also were many additional facts that put ETC on notice that its clients were probably not proprietary trading firms and appeared to be acting as non-registered broker-dealers that were engaged in the business of facilitating day trading.[15] (Order at 35.) In particular, the BCC pointed to the evidence establishing that (1) ETC possessed records that assigned both a day and night buying power to each individual trader, (2) the trading records demonstrated that the traders were engaged in day trading and ETC should have been aware of that fact, and (3) ETC treated the individual traders as separate account holders when it monitored for both risk management and compliance purposes. (Order at 35.)

After considering all of the evidence related to the "numerous" red flags present in this case and considering the fact that AML/CIP programs must be risk-based, the BCC held that "ETC had an obligation to investigate whether its customers' representations about who actually owned the accounts carried on ETC's books were truthful." (Order at 35.) CBOE's conclusion that ETC violated its AML/CIP obligations by not conducting a further inquiry is supported by the record and should be affirmed. *See In the Matter of Pinnacle Capital Markets, L.L.C.*, U.S. Department of the Treasury Financial Crimes Enforcement Network, Number 2010-4 (August 26, 2010) at 3, 5 (finding that a broker-dealer "failed to implement an adequate risk-rating methodology that evaluated correspondent accounts, based on specific customer information, with balanced consideration of all relevant factors including country/jurisdictional risks, products and services provided, nature of the customer's business, and volume of transactions" and that the broker-dealer's AML program was deficient when its risk assessment did not take into

[15] The BCC also noted that internet searches conducted during CBOE's investigation revealed that some of ETC's clients marketed themselves to day traders. (Order at 34 n.47 (citing to Santos at 509-10).) CBOE also referred the issue of ETC's unregistered broker-dealer clients to the SEC because it lacked jurisdiction to pursue that issue. (*Id.* at 33 n.44 (citing Santos at 359, 510).)

account activities occurring in jurisdictions that were known for a heightened money laundering risk, including those jurisdictions identified by as "Jurisdictions of Primary Concern" by the U.S. Department of State).

C. CBOE WAS NOT REQUIRED TO PROVE THE NATURE OF THE RELATIONSHIP BETWEEN ETC'S CLIENTS AND THEIR TRADERS.

Applicants take liberties with the record when they suggest that CBOE conceded that there was no evidence that the traders trading through ETC's clients had no beneficial ownership interest those clients' accounts at ETC. (Apps.' Br. at 20, 23-24.) What CBOE's witnesses consistently expressed was, while they strongly suspected that the traders had an ownership in the accounts and concluded that the traders were engaged in day trading, CBOE was unable to fully investigate that issue because CBOE lacks jurisdiction over ETC's clients. (Order at 36 n. 52 (noting that Applicants' attempt to weave snippets of testimony into a concession by CBOE's witnesses "miss the salient point that the Hearing Panel heard the Exchange's witnesses consistently make, *i.e.*, the abundance of 'red flags' in this case required that ETC either investigate what was actually occurring with its customers and the traders (rather than taken those customers' representations at face value) or refuse the business" and recognizing that CBOE lacks jurisdiction to investigate non-broker-dealer entities); *see also Id.* at 15 n.24 and 16 (citing to Miller-Brouwer's testimony that CBOE lacked jurisdiction to investigate Vantage Point), 33 (citing to Santos' testimony that CBOE lacked jurisdiction to investigate ETC's non-broker dealer clients, 36 n.52 (citing Adams' testimony that CBOE lacked jurisdiction to investigate ETC's non-broker dealer clients).)

Moreover, Applicants' argument again misses the mark. The issue with respect to the AML/CIP charges is not whether CBOE proved that the traders executing orders in the accounts of ETC's clients actually had a beneficial interest those accounts. Instead, the issue is whether

ETC – in light of all of the facts suggesting that those traders had a beneficial interest – had a duty under the CIP regulations to investigate further into the true nature of the relationship between the clients and their supposedly thousands of proprietary traders. The answer to that question is an unequivocal "yes."

D. THE TESTIMONY OF ETC'S EXPERT WITNESSES WAS NOT CREDIBLE.

Applicants claim that the testimony of their expert witnesses proves that they did not violate their AML/CIP obligations and that the red flags found to exist by CBOE are irrelevant. (Apps.' Br. at 20-22, 24.) In contrast, the BCC found that the testimony of ETC's witnesses was not credible. (Order at 36.)

In so ruling, the BCC criticized ETC's experts for dismissing all of the "red flags" by considering each factor in isolation, rather than examining the total mix of the facts available to ETC. (*Id.*) The BCC also criticized the superficial investigations conducted by ETC's experts before rendering their opinions, noted that they took facts supplied to them by ETC at face value and that they did not consider many of the facts that were known to ETC. (*Id.*)

Finally, the BCC recognized ETC's experts were engaged in an exercise of exalting form over substance when they essentially opined that ETC could have no AML/CIP liability so long as ETC avoided formally carrying sub-accounts on its books, made sure that the accounts were carried in the name of a client and all transactions other than trades were nominally carried out between the client and ETC. (Order at 36.) The BCC properly rejected the approach advocated by ETC's witnesses because adopting that approach would effectively eliminate the requirement that AML and CIP programs be risk-based and would provide broker-dealers with "an incentive

not to ask questions even in situations where "red flags" raise significant concerns about the true facts related to a customer's business and the ownership of accounts."[16] (Order at 36.)

E. FINCEN'S PROPOSED RULE FILING DOES NOT UNDERMINE CBOE'S FINDINGS.

Applicants argue that a recent Financial Crimes Enforcement Network proposed rule filing supports their position that a ETC did not have to look beyond its clients' representations in this case. (Apps.' Br. at 26, citing *Customer Due Diligence Requirements for Financial Institutions*, 79 Fed. Reg. 4515 (August 4, 2014) (the "Proposed Rule Filing").) Two months after its publication, Applicants requested that the Board consider the Proposed Rule Filing and the Board declined to do so because (1) Applicants' submission was untimely, (2) the Proposed Rule Filing is not a final rule and (3) the proposed rule would not be applicable to conduct that occurred in 2009 and 2010. (Board Decision at 3.)

Turning to the substance of the Proposed Rule Filing, it does not support the sweeping proposition that ETC can simply rely on the beneficial ownership information provided by a customer and that it never has a duty to inquire further. (*Cf.* Apps.' Br. at 26.) Instead, the proposed rule would impose "a new requirement that financial institutions identify the natural persons who are beneficial owners of legal entity customers," sets forth in an exhibit the information that the financial institution must obtain in a standard certification form directly from the individual opening the new account on behalf of the legal entity customer and states that, as a minimum standard, in the first instance financial institutions "may rely on the

[16] The approach taken by the BCC in its Order is consistent with the guidance provided by the SEC's Office of Compliance Inspections and Examinations in a National Exam Risk Alert entitled "Master/Sub-accounts," issued September 29, 2011. That Risk Alert is available at: https://www.sec.gov/about/offices/ocie/riskalert-mastersubaccounts.pdf.

beneficial ownership information provided on the standard certification form." *See Proposed Rule Filing*, 79 Fed. Reg. at 45156, 41162.

The Proposed Rule Filing, however, also repeatedly emphasizes the fact that CIP programs must be risk-based and that, when "suspicious activity" or "other red flags" are present, financial institutions may be required to investigate further in order to verify the identity of each beneficial owner. *See, e.g., Id.*, 79 Fed. Reg. at 45162 ("FinCen proposes that financial institutions verify the identity using existing risk-based CIP practices," noting that institutions must update beneficial ownership information "as appropriate on a risk-basis" and that "updating beneficial ownership information is appropriate after a customer has been identified as engaging in suspicious activity or exhibits other red flags, which FinCEN believes is generally consistent with existing practice for updating other customer information" and stating that "[e]ach institution's policies and procedures should be based on its assessment of risk and tailored to, among other things, its customer base and products and services offered"), 45163-64 and n.59 (noting that financial institutions must conduct ongoing monitoring for the purpose of updating customer information and that if a "financial institution becomes aware of information relevant to assessing the risk posed by a customer, it is expected to update the customer's relevant information accordingly" and determine whether there are substantive changes to the original information provided by a customer), 45165 (recognizing that ongoing monitoring has "been understood as necessary facets of other regulatory requirements, [and is] now being explicitly included in the applicable AML program rules" and that financial institutions are expected to apply monitoring procedures on a "risk-based approach").

In other words, the Proposed Rule Filing merely would clarify the types of information that financial institutions must gather when opening a new account and FinCEN repeatedly

recognized that institutions are required to do more under a risk-based approach if, as in this case, facts arise which should cause the institution to question the truthfulness of the information provided by a client.

F. THE EVIDENCE SUPPORTS CBOE'S HOLDING THAT KEVIN MURPHY WAS LIABLE FOR FAILING TO SUPERVISE AND IMPLEMENT AN ADEQUATE AML/CIP PROGRAM.

Focusing only on a summation paragraph in the Order, Applicants claim that the finding that Murphy failed to supervise and implement a satisfactory AML program is "illogical and inconsistent with the undisputed evidence." (Apps.' Br. at 27.) The evidence actually demonstrates that Murphy's fingerprints are all over the actions that resulted in the failure of ETC's AMP/CIP program.

Murphy was ETC's AML Compliance Officer ("AML-CO") from the time that he joined ETC in December 2007 through January 2010, when DiCenso assumed that title. (*See* Order at 9, 38 (referring to Murphy's testimony that he would "remain AML officer through January" 2010).) While he was AML-CO, Murphy signed the Client Approval Sheets for Vantage Point and Esurge – forms that include several of the red flags that the BCC found should have triggered a deeper CIP inquiry. (Order at 33-35 (discussing the Client Approval Sheets for Vantage Point and Esurge and finding that "Vantage Point's Client Approval Sheet (signed by Kevin Murphy) should have prompted further AML and CIP inquiries into the identities of the traders and the nature of their relationship with Vantage Point"); *see also* Exch. Exs. 19 (Vantage Point's Client Approval Sheet signed by Murphy and dated September 14, 2009), 20 (Esurge Trading Group's Client Approval Sheet signed by Murphy and dated January 14, 2010).) Despite the existence of the red flags on the face of those Client Approval Sheets, Murphy took no action to conduct a proper CIP inquiry.

While DiCenso assumed the title of AML-CO in February 2010, Murphy was his boss and the evidence is that Murphy hampered DiCenso's efforts to undertake additional CIP efforts regarding ETC's clients. (Order at 14 (DiCenso admitting that he was referring to Murphy as his "boss" who expressed concern that doing more to learn about the identities of the foreign traders executing trades might open ETC to more risk and force it to incur additional expenses); Murphy at 1529 (testifying that, during 2010, after he had given up his "chief compliance officer title," he was still DiCenso's supervisor).)

Murphy also espoused ETC's "protect the four walls" compliance philosophy, whereby ETC decided that it had no duty to assess "the legality of their customers' business" or to look beyond the principals of its clients. (*See, e.g.*, Order at 11-12 (noting the testimony that DiCenso expressed his disagreement with "Murphy's view that ETC need not concern itself with obtaining information about the traders of ETC's non-broker dealer clients"), 16 (quoting testimony that Murphy expressed the view that ETC "did not have to look through the customer account to all the [client's] individual traders"); Murphy at 1545 (testifying that ETC's AML/CIP responsibilities were limited to looking at "the account that's on the books of ETC").) Indeed, the evidence is that Murphy (and Cloyd) actually yelled at DiCenso and demanded that he stop when DiCenso began running U.S. Office of Foreign Assets Control ("OFAC") checks on the individual traders of ETC's clients because ETC's philosophy was "the more you know, the more liable you are, and the more you have to do, and the more work you do." (Order at 12-13 (noting that DiCenso did not deny that Cloyd and Murphy yelled at him for running OFAC checks and admitting that he stopped running checks on Vantage Point's traders after talking with Cloyd and Murphy).)

Murphy also injected himself into the process when DiCenso contacted ETC's outside counsel in an attempt to get AML/CIP guidance during May and June 2010. (Order at 13-14.) In particular, DiCenso wrote that *Murphy's* "concern is if we ask for the names of these foreign traders, we open ourselves to more risk, the more we know the more we should do, *i.e.* background checks which would be very costly (our clients have 1000's of foreign traders)".) Murphy also told DiCenso that he would "like to be in on that conversation" if DiCenso was able to arrange a call with ETC's counsel. (Order at 14 (citing Exch. Ex. 134).)

Thus, while the BCC did not restate all of the evidence against Murphy in the paragraph where it announced the holding that Murphy "failed to supervise and implement a satisfactory AML program that prevents money laundering and manipulative trading risks" (Order at 37), the evidence supports that finding.[17]

G. ETC DID NOT CONDUCT AN INDEPENDENT AML AUDIT IN ACCORDANCE WITH CBOE'S RULES.

It is undisputed that the BCC correctly held that "ETC violated Rules 4.1, 4.2 and 4.20 in that ETC failed to have the independent audit of its AML program conducted by an independent individual" and that Murphy is liable for those violations "because he was ETC's AML-CO at the time of the 2009 AML Audit and as such he failed to ensure that ETC's independent audit was conducted by an independent individual." (Order at 39.) Those violations occurred

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[17] The Board did not rely on "mere conjecture" when it affirmed the BCC's findings regarding Murphy. (*Cf.* Apps.' Br. at 28.) Instead, the Board *relied on the evidence* that "Murphy was responsible for the implementation of [ETC's] deficient AML program" because "Murphy continued to play a significant supervisory role in the AML process" by supervising DiCenso, yelling at DiCenso to stop the OFAC checks, rejecting DiCenso's requests for additional resources, and expressing his concern that running OFAC checks would open ETC up to risk and require it to do more. (Board Decision at 7.)

because, instead of ensuring that an independent individual conducted the AML Audit, Murphy improperly assigned the task to his subordinate, DiCenso. (Order at 39.)

Applicants do not, and cannot, challenge those findings. Instead, Applicants recycle variations of their prior arguments that the violations were technical because ETC complied with FINRA's rule and that CBOE should be blamed for not catching ETC's misconduct. Those arguments are meritless – as a CBOE Trading Permit Holder, ETC was required to comply with CBOE's rules and ETC's violation cannot be excused because CBOE did not uncover the violation sooner. (Order at 37-39.) Indeed, rather than demonstrate ETC's "good faith" (Apps.' Br. at 44), the AML Audit violations are another example of ETC's lax approach to compliance and its pattern of skirting the rules when it found it convenient or financially beneficial to do so. (Order at 79-80 (finding that "ETC consistently followed the regulatory path of least resistance" and that ETC "chose to cut corners and disregard certain rules either to save money, or merely because it was more expedient or convenient for ETCs' business").)

IV. ETC VIOLATED CBOE'S RULES BY FAILING TO PROPERLY IMPOSE MARGIN REQUIREMENTS.

The record reveals that, once again, the BCC carefully analyzed the evidence and the parties' arguments before it concluded that ETC violated CBOE's day trading and portfolio margin requirements and that Cloyd and Murphy committed related supervisory violations. (Order at 39-57.) The key issue underlying BCC's findings on the margin charges, as is the case with the AML/CIP charges, is whether ETC should have recognized that the thousands of foreign traders of its non-broker dealers were the actual "customers" for margin purposes.

To resolve that issue, the BCC considered all of the evidence that put ETC on notice that its non-broker dealer clients were facilitating day trading by individual traders and that, as a result, ETC should have treated those individual traders as its customers and imposed the day

trading margin requirements to each of those traders.[18] In particular, the BCC pointed to the facts that the Client Approval Sheets for Vantage Point and Esurge should have raised a red flag that those entities were facilitating day trading because they had an abnormally large number of supposed proprietary traders, with a relatively small amount of capital to support the activity of those traders and a large amount of anticipated activity. (Order at 42-43.) ETC also maintained records where each trader was individually named, had a separate ID number under a column with the heading "Account," listed the Market Participant Identification Number for each trader and assigned a separate day and night buying power figure for each trader. (Order at 43-44.)

The BCC also credited CBOE's analysis of a sample of the actual trading activity of several of Vantage Point's traders, which demonstrated that those traders were engaged in pattern day trading. (Order at 44.) Finally, the BCC found that ETC was on actual notice that it could not ignore the true nature of the day trading activity that was being undertaken by the alleged proprietary traders because FINRA issued a Regulatory Notice in April 2010, which listed a number of red flags – three of which were present in this case – that "should have indicated to ETC that its clients' traders were individual customers engaged in day trading and not proprietary traders."[19] (Order at 45 (agreeing with the analysis of CBOE's margin expert).)

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[18] Because ETC should have been applying the day trading margin requirements to the individual traders of its non-broker dealer clients, it also violated CBOE's portfolio margin requirements when it approved three of those non-broker dealer entities – Vantage Point, Esurge and Epiphany Trading, LLC – for portfolio margining treatment. (Order at 52-57.)

The day trading margin violations provided improper benefits to both the individual day traders (who did not have to meet the margin requirements) and to ETC's non-broker dealer clients (who were permitted by ETC to facilitate a customer day-trading business without having to register as a broker-dealer and thereby avoided the duty to comply with the rules and regulations applicable to broker-dealers).

[19] FINRA Regulatory Notice 10-18, entitled "Master and Sub-Accounts," dated April 2010, was admitted into evidence as Exchange Exhibit 31.

A. CBOE'S FINDINGS OF MARGIN VIOLATIONS ARE CONSISTENT WITH THE DEFINITIONS OF "CUSTOMER" IN REGULATION T AND IN FINRA'S RULES.

Citing to the definition of "customer" in Regulation T and in FINRA's margin rules, Applicants argue that CBOE's findings are incompatible with those definitions because they require that the "customer" be the person to whom credit is extended or the person for who securities are held or carried by a broker-dealer. (Apps.' Br. at 29-30.) That argument overlooks the fact that the BCC found, under the unique facts of this case, that ETC was extending a form of credit to the day traders by virtue of the fact that it was not properly imposing the margin requirements on them. (Order at 46 (the pattern day-traders were allowed to trade by ETC without posting the minimum equity requirement that should have been required for them and were allowed to exceed the day trading buying power limits that otherwise would have applied to them), 80 (the actions of ETC, Cloyd and Murphy resulted in an "egregious situation" where individual day traders were given access to the U.S. securities markets without meeting the minimum equity requirements and were allowed to avoid the day-trading buying power limits that should have been applied to them).)[20]

Applicants also attempt to manufacture an issue by citing to the answer provided by CBOE's expert in response to a question from a Panel member and claiming that the answer is evidence of ambiguity regarding the definition of "customer." (Apps.' Br. at 31.) Referring to Vantage Point, the Panel member asked CBOE's expert if there would be margin violations if the

[20] As the Board also noted, CBOE is vested with considerable discretion to determine the meaning of their rules and that principle also applies to how CBOE defines "customer" for purposes of its margin rules. (Board Decision at 9 (citing *Shultz v. Securities and Exchange Commission*, 614 F.2d 561, 571 (7th Cir. 1980).)

BCC concluded that "these 1,400 were prop traders and not accounts of ETC." (Hearing Tr. at 1605.) CBOE's expert answered:

> If [CBOE] 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.

(Hearing Tr. at 1605-06.) In sum, after giving a direct answer to the question posed based on the facts of this case, CBOE's expert merely indicated that another portfolio margining problem might arise under different facts and circumstances. Moreover, the response by CBOE's expert does not undermine any of the BCC's findings in this case because the BCC unanimously concluded that the traders in question *were not proprietary traders* and that ETC's clients *were not legitimate proprietary trading firms*. (*See, e.g.*, Order at 42 (agreeing with CBOE's witness that ETC's clients "were actually facilitating day trading by numerous separate individuals and that those individuals were not proprietary traders), 80 (criticizing Applicants for taking "at face value" the "dubious representations" by ETC's clients that their thousands of traders were proprietary traders and holding that the evidence "established that those traders were actually day traders rather than proprietary traders").)

B. APPLICANTS WERE ON NOTICE THAT THEIR ACTIONS COULD VIOLATE THE CIP AND MARGIN RULES.

In an argument that was not raised before the BCC or the Board, Applicants now claim that the BCC's findings of AML/CIP violations and violations of CBOE's margin rules violate the "fundamental principles of fair notice." (Apps.' Br. at 34-36.) Applicants' argument should be rejected.

As the Courts of Appeals and the Commission have repeatedly recognized, due process is satisfied when a reasonable securities professional would recognize that his conduct was sanctionable. *See, e.g., Heath v. SEC*, 586 F.3d 122, 140-141 (2d Cir. 2009) (rules must provide sufficient clarity to tell a reasonable securities professional what is prohibited); *Rooms*, 444 F.3d at 1214 (a rule is not impermissibly vague if a reasonable person should know that his conduct was contrary to the rules). Exchanges also are allowed discretion in determining the meaning of their rules and a rule need not specifically spell out each way that it could be violated. *Shultz*, 614 F.2d at 570-571.

In light of the requirement that AML/CIP compliance programs be risk-based and the existence of the many red flags discussed above, a reasonable securities professional should have recognized that ETC was at risk of violating the AML/CIP regulations and CBOE's margin rules. In addition, by means of the regulatory guidance discussed above – including CBOE's 2009 Regulatory Circular (Exch. Ex. 54) advising members that heightened supervision is required when providing clients with direct access to the market and FINRA's April 2010 Regulatory Notice (Exch. Ex. 31) advising firms that careful scrutiny should take place with respect to clients that have sub-accounts (which the BCC concluded actually existed here) – ETC was on specific notice that it should have carefully examined the relationships between its non-broker dealer clients and their supposedly thousands of foreign proprietary traders. Furthermore, ETC's own risk-based AML/CIP written supervisory procedures, the emails that DiCenso wrote to ETC's outside counsel and his act of starting to run OFAC checks (until Cloyd and Murphy demanded that he stop) also demonstrate that ETC knew that its conduct might violate the applicable rules. In fact, after considering all of the evidence, the BCC specifically held that "ETC knew or should have known that it has serious [compliance] problems" and that ETC,

Cloyd and Murphy committed "willful violations." (Order at 80-81.) The evidence demonstrate that Applicants' fair notice argument is without merit.[21]

V. ETC VIOLATED THE SHORT SALE REGULATIONS.

There is no dispute that Regulation SHO is a strict liability provision and that ETC violated Rule 204 when it failed "to close out an open short position in China North East Petroleum ("NEP") on the morning of T+4." (Order at 58.) Moreover, an attempt to borrow stock to cover a short position does not cure a violation and instead a firm must actually either purchase and deliver stock or actually borrow and deliver stock to properly close out a position. (Order at 59.) Thus, the violation of Regulation SHO found by the BCC is supported by the record.

VI. APPLICANTS' PROCEDURAL ARGUMENTS ARE FRIVOLOUS.

In their appeal to CBOE's Board, Applicants raised a host of new arguments claiming that CBOE's disciplinary procedure is unfair and also argued that several BCC evidentiary rulings were erroneous. As demonstrated below, none of those arguments have merit.

[21] The decision in *In The Matter of American Funds Distributors, Inc.*, Exchange Act Release No. 64747, 2011 WL 2515376 (June 24, 2011) is not on point. In that case, after recognizing that regulatory language does not have to precisely delineate each course of conduct that is covered, the Commission held that the text of the rule at issue was ambiguous on its face and susceptible to competing interpretations. *Id.* at *5-6 and n.23.

Applicants' attempt to draw a parallel to the *American Funds* case by citing to one question by a Panel member fails. (Apps.' Br. at 36.) The question at issue was posed during closing arguments and addressed how the Panel could reconcile the default definition of "customer" in the AML regulations with the requirement that AML compliance programs be risk-based. (Hearing Tr. at 1720-26.) The Panel member did not say that he found an irreconcilable ambiguity and he ultimately voted in favor of finding that the Applicants violated both the AML/CIP rules and the margin rules.

A. THE BCC HEARING PANEL PROPERLY EXERCISED ITS DISCRETION WHEN RULING ON EVIDENTARY ISSUES.

Applicants' make a series of arguments that the Hearing Panel erred when it ruled against them on certain evidentiary issues, without disclosing the rationale articulated by the Hearing Panel in support of its decisions.[22] The rationale for those decisions not only demonstrates that Hearing Panel acted within its discretion under CBOE Rule 17.6, but also that the Hearing Panel's decisions were correct. *See* CBOE Rule 17.6(c) and (d) (providing that the formal rules of evidence do not apply, that the panel shall determine all questions concerning the admissibility of evidence and has discretion to determine whether to order the production of documents after considering the probative value of the evidence against other considerations such as undue delay, waste of time, confusion, unfair prejudice or needless presentation of cumulative evidence).

First, Applicants claim that the Hearing Panel improperly allowed CBOE to introduce a "clearly privileged email between ETC and its outside counsel" that had been "produced inadvertently." (Apps.' Br. at 48-49.) The record reveals, however, that the Panel considered the parties' submissions and heard argument before ruling that ETC *waived* any claim of privilege because it intentionally produced the email string without taking any steps to review its production for privileged material. (Board Decision at 10.)

Second, while complaining that the BCC refused to require a CBOE investigator to produce her notes (Apps.' Br. at 49), Applicants fail to mention that the Hearing Panel heard

[22] Each of the evidentiary issues were discussed in detail in CBOE's Response to Applicants' appeal to CBOE's Board. *See Response of CBOE, Incorporated to Petition by Electronic Transaction Clearing, Inc., Kevin Murphy and Harvey Cloyd for Review of March 4, 2014 Amended Decision and Order*, at 31-43. While space does not permit CBOE to repeat those discussions here, the Board cited to the record and to the exhibits attached to CBOE's response brief when affirming the evidentiary rulings. (*See* Board Decision at 9-10.)

extensive argument as to whether the notes should be produced, reviewed the notes *in camera* and ruled that the notes were either subject to the investigative privilege, were work product or were irrelevant to the issues in the case. (Board Decision at 10.)

Third, Applicants complain that the BCC erroneously denied their request for documents concerning an unrelated investigation of CBOE by the SEC. (Apps.' Br. at 49.) Once again, the record reveals that the BCC considered the parties' written submissions before issuing a detailed order explaining why the requested documents were irrelevant to the charges in this case and that the requests were overbroad, burdensome and vague. (Board Decision at 10; BCC's Order Denying Respondents' Motion to Compel the Production of Documents, issued August 3, 2012.)

B. THE SEC HAS HELD THAT CBOE'S DISCIPLINARY PROCEDURE IS FAIR.

While Applicants claim that CBOE's disciplinary rules and procedures "deprive parties of the fair process required by Section 6(b)(7) of the Exchange Act," 15 U.S.C. § 78f(b)(7) (Apps.' Br. at 45), the SEC previously approved CBOE's rules and found that those rules provide the "fair procedure" required by Section 6(b)(7). *See, e.g., In the Matter of David C. Ho*, Exchange Act Release No. 54481 (Sept. 22, 2006) at 8 (noting that "CBOE's rules were approved by the Commission as providing 'a fair procedure for the disciplining of members and persons associated with members,' the standard to which we hold all disciplinary rules promulgated by self-regulatory organizations"). Moreover, CBOE is obligated under Section 19(g)(1) of the Exchange Act to continue to follow its existing rules.[23] *See* 15 U.S.C. § 78s(g)(1) ("[e]very self-regulatory organization shall comply with . . . its own rules").

[23] While Petitioners might prefer that CBOE's disciplinary rules contain different procedures, ETC *agreed to abide by CBOE's rules* when it became a member and that agreement also binds persons, like Cloyd and Murphy, who are associated with ETC. *See Ho*, Exchange Act Release No. 54481 at 8.

While Applicants point to the fact that CBOE does not employ professional hearing officers, there is no requirement that it do so or any evidence that the existence of hearing officers necessarily results in a better disciplinary process.[24] There also is no evidence of bias against Applicants arising from the composition of the Hearing Panel, the identity or tenure of counsel to the BCC or the tenure of certain members of CBOE's enforcement staff. (*See* Board Decision at 11 (citing *Ho*, Exchange Act Release No. 54481, at 8 (rejecting a respondent's claim that BCC members were biased in the absence of any evidence that a member was "specifically biased against him due to any adverse economic or personal interest").)

Applicants also claim that "CBOE's win/loss record . . . speaks volumes about the fairness" of its system. (Apps.' Br. at 45.) As the Board recognized, the fact that the BCC found against staff on many of the charges in this case alone belies any claim of bias against the Applicants. (Board Decision at 11.) Moreover, Applicants offer no evidence that any prior CBOE case was wrongly decided or that bias infected the decisions in those cases.[25] (*Id.*)

While Applicants cite to the *ex parte* rules of the SEC and FINRA and claim that the Hearing Panel Chairman, BCC counsel and CBOE's Chief Enforcement Attorney have an "ability to engage in *ex parte* communications," they provide *no evidence* that any improper *ex parte* communications actually took place in this case. (Board Decision at 11.)

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[24] Contrary to their theory in this case, the law review article cited by Applicants hypothesizes that *hearing officers may be biased* against respondents because regulatory staff and hearing officers are supposedly members of the same "club." *See* Brian L. Rubin and 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).

[25] The law review article cited by Applicants does not mention CBOE and, while the article attempts to quantify the success rates of respondents in SEC and FINRA proceedings, it offers no evidence that the results in those proceedings are the result of bias. *See* Rubin and Yoon, *Stepping into the Ring, supra* n.22.

Finally, Applicants complain that CBOE rules do not allow for a summary disposition or dismissal of charges "before, during or after a hearing." (Apps.' Br. at 47.) But, there is no requirement that CBOE's rules include a procedure for summary disposition of cases and, in any event, the *Wells* process provides investigative subjects with the ability to argue that charges should not be brought against them. (*See* Board Decision at 11; CBOE Rule 17.2(d) (CBOE's *Wells* process).) Because none of Applicants' undeveloped and unsupported procedural arguments have any merit, they should be rejected.

VII. THE SANCTIONS ARE SUPPORTED BY THE RECORD AND SHOULD BE AFFIRMED.

The Commission should sustain the sanctions imposed by CBOE unless those sanctions are excessive, oppressive or impose an unnecessary or inappropriate burden on competition. *See, e.g., In the Matter of Kent M. Houston*, Exchange Act Release No. 71589A (Feb. 20, 2014) at 5; *Brokaw*, Exchange Act Release No. 70883 at 26. The record in this case reflects that the BCC carefully considered all of the sanction arguments and the authorities presented by the parties before censuring each Applicant, imposing a joint and several fine of $1,000,000 on the Applicants and imposing six month suspensions for Cloyd and Murphy. (Order at 71-81.) On appeal, the Board concluded that the sanctions imposed were consistent with the discretion granted to the BCC under CBOE's rules and in accord with the sanction considerations found in CBOE's rules. (Board Decision at 12-13.) Applicants present no legitimate basis for overturning the sanctions.

A. THE SANCTIONS ARE SUPPORTED BY THE EVIDENCE.

First, Applicants claim that they had no notice that additional regulatory scrutiny was required for their non-registered clients. (Apps.' Br. at 51.) That argument overlooks the facts that, as demonstrated above, (1) ETC had notice that AML/CIP programs had to be risk-based

and required additional verification for certain customers (*see* Section III.A.), (2) CBOE's October 2009 Regulatory Circular put ETC on notice that it was required to have surveillance programs that were designed to review for manipulative conduct (*see* Section II.A.3.), (3) FINRA April 2010 Regulatory Notice put ETC on notice that it should look for red flags indicating its clients' traders were not proprietary traders and instead were individual customers engaged in day trading (*see* Section IV.) and (4) perhaps most importantly, the actions of ETC employees illustrate that they actually knew ETC had serious problems with its AML/CIP program (*see* Section IV.B.).[26]

Applicants claim that they were not on notice because none of CBOE's prior examinations warned them of their regulatory deficiencies is specious. As the BCC recognized, ETC "cannot escape liability in this proceeding simply because a regulator did not detect the misconduct at an earlier time." (*See* Order at 77 n.113 (citing authorities).) Thus, the record contains ample support for the conclusion that ETC was on notice that it had serious regulatory problems and that it chose not to address them. (Order at 79-81.)

Second, Applicants take issue with the fact that the BCC criticized it for failing to develop a surveillance program until 2010 because it now claims, without citation to the record, that it only started clearing trades for customers in the Fall of 2009. (Apps.' Br. at 52.) ETC's argument misses the larger point – ETC should have had surveillance programs in place *before* it

[26] While Applicants suggest that the timing of the issuance of the April 2010 FINRA Regulatory Notice did not give them time to change their conduct and that CBOE's October 2010 Regulatory Circular entitled "Master Accounts and Sub-Accounts" should not be considered because it was issued after CBOE conducted its investigation, the evidence is that Applicants did nothing to change their conduct in response to that regulatory guidance. (*See* Order at 45 n.67 (noting that there is no evidence that ETC modified its conduct even after the issuance of CBOE's October 2010 Regulatory Circular).) Instead, Applicants continue to assert in this appeal that their conduct was proper and did not need to be modified as a result of any regulatory guidance.

started clearing customer trades. (*See* Order at 10 (finding that ETC had no compliance program in place before 2010).) Nor did ETC "immediately follow[]" RG09-118 after it was issued in 2009 – instead, the evidence is undisputed that ETC did not have an effective wash trade surveillance program until, at the earliest, September 2010 (*see* Section II.A.1.).

Third, Applicants claim that the sanctions should be reversed because the FinCEN CIP rule proposal justifies their conduct. (Apps.' Br. at 52-53.) As discussed above in Section III.E., Applicants mischaracterize the nature of that rule proposal and it does not support ETC's claim that it can simply rely on the CIP information provided by a client.

Fourth, Applicants argue that the BCC failed to consider Lisa Roth's "Initial Report of Independent Consultant" (Resp. Ex. 54) as a "key mitigating factor." The BCC, however, not only mentioned that Roth's report in its sanctions discussion (*see* Order at 77-78), it also held that Roth's testimony on the CIP issues was entitled to no weight because she (1) did not consider all of the available evidence, (2) dismissed the red flags, (3) relied on form over substance when testifying that the existence of formal sub-accounts is determinative, and (4) was unaware that the SEC also had expressed its concern that ETC's non-broker dealer clients were apparently facilitating day trading. (Order at 36 and n.51 (citing to Resp. Ex. 22).) Roth's statement that "the combination of the [WSR] and the [TPR] effectively monitored for wash trade activity" also reflects a conclusion that she apparently reached when she issued her report in 2011 – *i.e.* at a time when, unlike the situation during most of 2010, both the WSR and the TPR were apparently functioning.

B. THE SANCTIONS ARE NOT EXCESSIVE, OPPRESSIVE OR PUNITIVE.

Applicants also argue that the fine and the suspensions are "impermissibly punitive, excessive, and oppressive." None of the points Applicants offer in support of that argument withstand scrutiny.

First, Applicants argue that the sanctions are impermissibly punitive because they are innocent of all of the charges. (Apps.' Br. at 54-55.) The BCC disagreed and its holdings are supported by the record. Indeed, rather than holding that the Applicants were innocent, the BCC found that (1) Applicants "made a choice to increase ETC's business by clearing transactions for nonregistered entities and they attempted to circumvent the numerous regulatory obligations that are required for clearing this kind of business," (2) ETC lacked a culture of compliance, (3) Applicants cherry-picked how they viewed their clients in order to avoid regulatory requirements, (4) "ETC knew or should have known that it had serious problems and it chose to cut corners and disregard certain rules either to save money, or merely because it was more expedient or convenient for ETC's business and there were business incentives for them to do so," (5) Applicants committed "serious and willful" regulatory violations, (6) Applicants had "exhibited a propensity to ignore regulatory requirements [and] may commit future rule violations, including those that may directly impact the public interest," and (7) the sanctions will "directly serve the public interest by making it clear to [Applicants] that the rules requiring the implementation of an adequate compliance program and the imposition of margin requirements are not to be ignored and that there are significant repercussions to doing so." (Order at 79-81.) Finally, as noted above, the Applicants' previously "spotless records" are not mitigating because it is expected that securities firms and professionals will comply with the applicable rules. (*See* Section I.)

Second, Applicants claim that the fine is excessive by comparing the fine to ETC's alleged net capital and to the fines imposed in a few other CBOE cases. (Apps.' Br. at 55-56.) Applicants' net capital argument ignores the fact that Cloyd and Murphy are jointly and severally liable for the fine and Applicants offer no evidence establishing that ETC, Cloyd or Murphy actually are unable to pay the fine. *Cf. Houston*, Exchange Act Release No. 71589A at 5 (rejecting an inability-to-pay defense raised without supporting evidence). Moreover, the BCC specifically considered the settled cases cited in Applicants' footnote (*see* Order at 78 and n.116) and, based on the record in this case, decided that stronger sanctions are warranted. *Cf. Houston,* Exchange Act Release No. 71589A at 12-13 (recognizing that it is not appropriate to compare sanctions in settled cases to cases that have gone to hearing, that the sanctions in each case necessarily depend on the particular facts and circumstances presented and that litigated cases result in more developed factual records that may support increased sanctions).

Third, Applicants' claims that the suspensions of Cloyd and Murphy are excessive, however, gloss over the facts that Cloyd (ETC's CEO and Chairman) and Murphy (ETC's President, Chief Operating Officer and, until the end of January 2010, its AML-CO) are the two senior officers of the firm and that their actions and attitudes set the tone that resulted in ETC's lax culture of compliance and to the regulatory violations found by the BCC. Under those circumstances, it was appropriate for the BCC to impose suspensions as a means of deterring Cloyd and Murphy from committing future violations and to impress upon them the need to ensure that they comply with their regulatory responsibilities in the future. (Order at 81.)

C. NO AUTHORITY PROHIBITS THE IMPOSITION OF A JOINT AND SEVERAL FINE.

CBOE Rule 17.11(a) provides the BCC with broad discretion to craft an appropriate sanction, including imposing fines or "any other fitting sanction." As the Commission is well

aware, regulators often impose joint and several fines and there is no authority prohibiting that practice. *See, e.g.,* Morgan Lewis & Bockius LLP, *Select Broker-Dealer, Investment Advisor, and Investment Company Enforcement Cases and Developments: 2013 Year in Review*, at 61, 98-99, 122-23, 128-29 (identifying several recent disciplinary cases where the SEC and FINRA have imposed joint and several fines).[27]

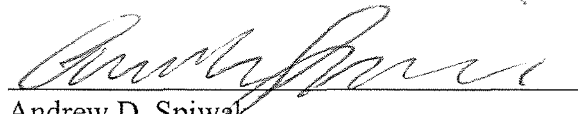
Contrary to Applicants' argument, the opinion in *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279 (2d Cir. 2013) does not call into question whether CBOE has the authority to impose a joint and several fine. In fact, *Pentagon Capital* did not involve an exchange disciplinary proceeding and the court held only that a specific Exchange Act provision did not permit the imposition of "joint and several liability for the amount of [a] civil penalty" because the statute required that the penalty be based on the "gross amount of pecuniary gain *to such defendant*." 725 F.3d at 287-88 (quoting 15 U.S.C. § 77t(d)(2)) (emphasis in original). In contrast to the statutory language at issue in *Pentagon Capital*, CBOE's Rules contain no prohibition on joint and several liability and CBOE has properly exercised its discretion to interpret its rule as allowing it to impose such liability. *Cf. Shultz*, 614 F.2d at 571 (recognizing that Exchanges "should be allowed discretion in determining [the] meaning" of their rules).

CONCLUSION

For the foregoing reasons, and for the reasons stated in the BCC's Amended Decision and Order and in the Board's Decision, CBOE respectfully requests that the Commission affirm the findings made, and the sanctions imposed, in the Amended Decision and Order in their entirety.

[27] Available at: http://www.morganlewis.com/pubs/LIT_2013YearInReview.pdf.

Dated: February 17, 2015



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CERTIFICATE OF COMPLIANCE WITHRULE 450(D)

I, Andrew D. Spiwak, certify that this brief complies with the word limitation set forth in Commission Rule of Practice 450(d), as it contains 13,758 words, excluding the parts of the brief exempted by the Rule. 17 C.F.R. § 201.450(d).

Dated: February 17, 2015

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