U.S. Securities and Exchange Commission

SEC Charges 14 Specialist Firms for Improper Proprietary Trading

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Washington, D.C., March 4, 2009 — The Securities and Exchange Commission today brought enforcement actions against 14 specialist firms for unlawful proprietary trading on several regional and options exchanges. The firms agreed to settle the SEC's charges by collectively paying nearly $70 million in disgorgement and penalties.

The SEC charged the specialist firms for violating their fundamental obligation to serve public customer orders over their own proprietary interests by "trading ahead" of customer orders, or "interpositioning" the firms' proprietary accounts between customer orders.

"These firms violated the public trust by abusing the privileged position they had as specialists on the various exchanges," said James Clarkson, Acting Director of the SEC's New York Regional Office. "Today's enforcement action demonstrates that the SEC has no tolerance for unscrupulous trading practices, and will work vigorously to protect investors from improper trading conduct."

David Rosenfeld, Associate Director of the SEC's New York Regional Office, added, "Specialists who engage in unlawful proprietary trading hurt the investing public and undermine confidence in the fairness of our capital markets. We will aggressively pursue market professionals who engage in improper trading and hold them accountable for their actions."

The SEC's investigation into the improper trading began with a referral from the SEC's Office of Compliance Inspections and Examinations (OCIE). Lori Richards, Director of OCIE, said, "The SEC expects strict compliance with the trading rules governing market participants."

The Commission instituted settled administrative and cease-and-desist proceedings against eight specialist firms: Botta Capital Management L.L.C.; Equitec Proprietary Markets LLC; Group One Trading L.P.; Knight Financial Products LLC; Goldman Sachs Execution & Clearing L.P.; SLK-Hull Derivatives LLC; Susquehanna Investment Group; and TD Options LLC. According to the SEC's order, the firms engaged in improper proprietary trading on the American Stock Exchange, the Chicago Board Options Exchange, and the Philadelphia Stock Exchange.

Administrative Orders

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- Order in the Matter of Botta Capital Management, L.L.C.
- Order in the Matter of Equitec Proprietary Markets, LLC
- Order in the Matter of Group One Trading, L.P.
- Order in the Matter of Knight Financial Products, LLC
- Order in the Matter of Goldman Sachs Execution & Clearing L.P. and SLK-Hull Derivatives LLC
- Order in the Matter of Susquehanna Investment Group
- Order in the Matter of TD Options LLC

The Commission also filed settled civil injunctive actions in the U.S. District Court for the Southern District of New York against six specialist firms: Automated Trading Desk Specialists LLC; E*Trade Capital Markets LLC; Melvin Securities LLC; Melvin & Company LLC; Sydan LP; and TradeLink LLC. According to the SEC's complaints, these firms engaged in improper proprietary trading on the Chicago Stock Exchange.

SEC Complaints

- SEC Complaint v. Automated Trading Desk Specialists, LLC
- SEC Complaint v. E*Trade Capital Markets LLC
- SEC Complaint v. Melvin Securities, LLC and Melvin & Company, LLC
- SEC Complaint v. Sydan, LP
- SEC Complaint v. TradeLink, LLC

According to the SEC's orders and complaints, from 1999 through 2005, the firms violated their basic obligation as specialists to serve public customer orders over their own proprietary interests. As specialist member firms on one or more of the regional and options exchanges, the firms had a duty to match executable public customer or "agency" buy and sell orders and not to fill customer orders through trades from the firm's own accounts when those customer orders could be matched with other customer orders. However, the firms violated this obligation by filling orders through proprietary trades rather than through other customer orders, thereby causing millions of dollars of customer harm.

According to the SEC, the improper proprietary trading took three basic forms: trading ahead, interpositioning, and trading ahead of unexecuted open or cancelled orders. In certain instances, specialists filled one agency order through a proprietary trade for their firm's account while a matchable agency order was present on the opposite side of the market, thereby improperly "trading ahead" of such opposite-side executable agency order. The customer order that was traded ahead of was then disadvantaged when it was subsequently executed at a price that was inferior to the price received by the firm's proprietary account. In some instances, after trading ahead, specialists also traded proprietarily with the matchable opposite-side agency order that had been traded ahead of, thereby interpositioning themselves between the two agency orders that should have been paired off in the first instance. By participating on both sides of trades, the specialist captured the spread between the purchase and sale prices, thereby disadvantaging the other parties to the transactions. In some instances, after the specialists traded ahead, the opposite-side executable

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agency orders were left open until the end of the trading day, or were cancelled by the customer prior to the close of the trading day before receiving an execution.

In the orders against eight firms, the Commission found that by engaging in unlawful proprietary trading, the firms each violated Section 11(b) of the Securities Exchange Act of 1934 and Rule 11b-1 thereunder, as well as various rules in effect on each of the exchanges. The Commission ordered those firms to pay, in the aggregate, more than $22.7 million in disgorgement and more than $4.3 million in penalties. The Commission also ordered the firms to cease-and-desist from future violations, and censured each of the firms. The firms consented to the entry of the orders without admitting or denying the findings.

In its complaints filed against six firms, brought pursuant to Section 21(d) and (e) of the Exchange Act, the SEC alleges that by engaging in unlawful proprietary trading, each of the firms violated Chicago Stock Exchange Article 9, Rule 17. The complaints also allege that each of those firms failed to make or keep current records pertaining to certain types of orders, in violation of Section 17(a) of the Exchange Act and Rule 17a-3(a)(1) thereunder. Those firms have agreed to settle the SEC's charges by consenting to the entry of judgments enjoining them from future violations of the above provisions, and ordering them to pay, in the aggregate, more than $35.7 million in disgorgement and more than $6.7 million in penalties. The consent judgments are subject to approval by the court.

The SEC acknowledges the assistance and cooperation of the Financial Industry Regulatory Authority, the American Stock Exchange, the Chicago Board Options Exchange, the Chicago Stock Exchange, and the Philadelphia Stock Exchange.

The SEC's investigation is continuing.

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http://www.sec.gov/news/press/2009/2009-42.htm

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