Recent regulatory developments provide some clarifications regarding the market access rule for broker-dealers

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Abstract

Purpose – *To provide an overview of recent developments relating to the Securities and Exchange Commission (SEC)'s Market Access Rule, Rule 15c3-5 promulgated under the Securities Exchange Act of 1934.*

Design/methodology/approach – *Provides a brief overview of the Rule's requirements; highlights key points of guidance from the Frequently Asked Questions released by the Staff of the SEC's Division of Trading and Markets in April 2014; and discusses the SEC's first enforcement actions for alleged violations of the Rule, which include a settlement with Knight Capital Americas, LLC and administrative and cease-and-desist proceedings instituted against Wedbush Securities, Inc.*

Findings – *The SEC has prioritized its focus on Rule 15c3-5, which has resulted in the issuance of FAQs and enforcement actions against broker-dealers for violations of the Rule. While the FAQs and the Knight Capital settlement provide some insight into the Enforcement Staff's view of what the Rule requires, there are still areas where the substantive requirements are not entirely clear.*

Originality/value – *Practical guidance from experienced securities lawyers that consolidates several recent developments in one piece.*

Keywords *USA, Securities and Exchange Commission (SEC), Broker-dealer, High frequency trading, Market access, Rule 15c3-5*

Paper type *Technical paper*

1. Introduction

In the wake of the May 6, 2010 "flash crash" that caused the Dow Jones Industrial Average to plunge more than 600 points in a matter of minutes, the Securities and Exchange Commission ("SEC" or the "Commission") adopted Rule 15c3-5 under the Securities Exchange Act of 1934 ("Rule 15c3-5", the "Rule", or the "Market Access Rule"), which imposes requirements on broker-dealers that have or provide market access[1]. In the joint report issued in September 2010, the Staffs of the SEC and the Commodity Futures Trading Commission ("CFTC") determined that the flash crash was caused primarily by the placement of an order using an algorithm to sell $4.1 billion of futures contracts in an unusually turbulent market[2]. The algorithm in question was programmed to execute the trade based on a target rate of 9% of the trading volume calculated over the previous minute, but without regard to price or time, which meant it continued to sell even as prices dropped sharply[3]. Many of the contracts likely were purchased by high-frequency traders and intermediaries, which accumulated excessive "long" positions and, accordingly, began to sell the contracts aggressively[4]. This in turn caused the algorithm to accelerate its selling, creating a "hot-potato" effect as the contracts changed hands 27,000 times in 14 seconds[5]. The joint report cautioned that the "interaction between automated execution

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programs and algorithmic trading strategies can quickly erode liquidity and result in disorderly markets"[6].

The SEC adopted Rule 15c3-5 in November 2010, in part, to address the risks associated with high-frequency and other algorithmic trading. In particular, the Adopting Release emphasized that,

> [a]s trading in the USA securities markets has become more automated and high-speed trading more prevalent, the potential impact of a trading error or a rapid series of errors, caused by a computer or human error, or a malicious act, has become more severe[7].

Rule 15c3-5 requires broker-dealers that have or provide market access to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity[8]. "Market access" is defined in the Rule as access to trading in securities on an exchange or alternative trading system ("ATS") as a result of being a member of the exchange or a subscriber to the ATS[9]. The SEC emphasized that the Rule, which sets forth broad goals to be attained by broker-dealers providing market access but does not mandate specific controls and procedures, afforded broker-dealers flexibility in crafting the required controls and procedures, so long as they are "reasonably designed to achieve the stated goal"[10]. Practical implementation issues, however, arise from this flexible approach and the Rule's lack of specific guidance.

Since its adoption, regulators have viewed Rule 15c3-5 compliance as a high priority, which is not surprising given the numerous high-profile trading malfunctions in recent years. The SEC's Director of the Division of Enforcement emphasized in May 2014 that there would be "continued scrutiny relating to compliance with the Market Access Rule"[11]. Similarly, the Financial Industry Regulatory Authority's ("FINRA") regulatory and examination priorities for 2014 include continuing to assess "whether firms' testing and controls related to high-frequency trading (HFT) and other algorithmic trading strategies and trading systems are adequate in light of the Market Access Rule . . ."[12].

Following a brief overview of the Rule's requirements in Part II, this article highlights and discusses two important SEC developments with respect to the Rule:

1. the first set of Frequently Asked Questions ("FAQs") regarding the Rule, which were issued by the SEC's Division of Trading and Markets in April 2014 (discussed in Part III); and
2. the SEC's first enforcement actions for alleged violations of the Rule, which include a settlement with Knight Capital Americas, LLC ("Knight Capital") in October 2013 and administrative and cease-and-desist proceedings instituted against Wedbush Securities, Inc. ("Wedbush") in June 2014, which have not been concluded (discussed in Part IV)[13].

2. Requirements of rule 15c3-5

Rule 15c3-5 requires broker-dealers with or providing access to trading on an exchange or ATS to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the associated risks[14]. Specifically, these controls and procedures must be reasonably designed to

- systematically limit the financial exposure of the broker-dealer that could arise as a result of market access (the "Financial Risk Management Controls and Procedures"), and
- ensure compliance with all regulatory requirements (the "Regulatory Controls and Procedures").

With respect to the Financial Risk Management Controls and Procedures, the Rule requires that firms' systems, among other things, be reasonably designed to prevent the entry of

orders that would exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker-dealer by rejecting orders if such orders exceed the applicable credit or capital thresholds[15]. The broker-dealer must also implement controls and procedures reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders[16]. The financial controls must be applied on an automated, pre-trade basis[17].

With respect to the Regulatory Controls and Procedures, broker-dealers must implement controls and supervisory procedures reasonably designed to, among other things:

- prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis;
- prevent the entry of orders for securities if the trader is restricted from trading the securities;
- restrict access to trading systems and technology that provide market access to accounts pre-approved and authorized by the broker-dealer; and
- assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access[18].

A broker-dealer with, or that provides, market access may, after a thorough due diligence review, allocate by written contract specific Regulatory Controls and Procedures to a customer that is a registered broker-dealer, after reasonably determining that the broker-dealer to which the responsibility is delegated has better access to the ultimate customer and its trading information, such that the other broker-dealer can more effectively implement the Regulatory Controls and Procedures[19].

Finally, Rule 15c3-5 requires a broker-dealer to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures and promptly addressing any issues. On an annual basis, the Chief Executive Officer must certify that the broker-dealer's controls and supervisory procedures comply with the Rule and that the broker-dealer conducted the regular review[20].

3. Frequently asked questions regarding rule 15c3-5

While much of the guidance offered in the April 2014 FAQs reiterates points made in the Adopting Release, the FAQs are an important step in clarifying the applicability of the Rule to certain order types and entities, and providing guidance on the requirement that broker-dealers maintain "direct and exclusive control" over their risk management controls. These and other topics are addressed below.

3.1 Applicability of the rule

3.1.1 Applicability to orders (including quotes). The Staff clarified that the definition of "order", as used in Rule 15c3-5, is the same as in Regulation ATS[21], *i.e.*

> any firm indication of a willingness to buy or sell a security, as either principal or agent, including any bid or offer quotation, market order, limit order, or other priced order"[22].

Accordingly, the Rule applies to quotes, and the Staff advised that a broker-dealer's risk management controls should be reasonably designed to prevent a market maker's electronic quoting system from inadvertently entering "excessive quotes" into the market[23]. The FAQs also clarify that Rule 15c3-5 applies to security futures products traded on an exchange or ATS, but it does not apply to futures contracts or options on futures contracts[24]. Additionally, the Rule only applies to broker-dealers subject to Section 15(c)(3) of the Exchange Act; therefore, notice-registered security futures

broker-dealers that trade security futures are not subject to Rule 15c3-5, as they are exempt from Section 15(c)(3) of the Exchange Act[25].

3.1.2 Applicability solely to broker-dealers that have or provide market access. The Staff clarified that the Rule does not apply to a broker-dealer that provides only clearing services, not market access, to another broker-dealer[26]. Additionally, a broker-dealer that enters orders on an exchange or ATS solely through another broker-dealer providing the market access is not subject to the Rule[27]. This is because Rule 15c3-5 applies only to the broker-dealer with access, or providing access, to an exchange or ATS, as a result of being a member or subscriber thereof[28].

3.2 Financial risk management controls and procedures: Credit and capital thresholds

3.2.1 Capital and credit limits. The Staff explained the distinction between credit and capital thresholds, noting that

> [u]nder Rule 15c3-5, a broker-dealer is required to set appropriate pre-trade credit thresholds for each customer for which it provides market access, including broker-dealer customers, *and* an appropriate capital threshold for trading by the broker-dealer for its own account[29].

As used in Rule 15c3-5, the term "credit" refers to a broker-dealer's customer activity, and the term "capital" refers to a broker-dealer's activity for its own account[30].

3.2.2 Determining and monitoring the limits. The Staff also noted that the selection of a particular threshold amount will require the "exercise of reasonable business judgment" by the broker-dealer[31]. Accordingly, while broker-dealers will have flexibility in making this determination, a broker-dealer should be prepared to show

- why it selected a particular threshold;
- how that threshold meaningfully limits the financial exposure potentially generated by the customer or its own trading activity; and
- the process by which it monitors the continued appropriateness of those thresholds on an ongoing basis[32].

According to the Adopting Release, the Commission expects that broker-dealers will make such determinations based on appropriate due diligence as to a customer's business, financial condition, trading patterns, and other matters[33]. The specific amount selected for a credit or capital threshold must reflect an appropriate level of potential exposure for the customer or broker-dealer generated through market access, *i.e.*, through the submission of orders in securities to exchanges or ATSs, not to other trading centers (*e.g.* OTC market makers) or for orders that are not securities[34]. Additionally, the broker-dealer only needs to decrement the credit or capital exposure as orders in securities are submitted to exchanges or ATSs[35].

3.2.3 Modifications to the limits. The Commission expects that broker-dealers will monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and their controls and procedures, as necessary[36]. Furthermore, the Staff clarified that in appropriate circumstances, credit or capital thresholds may be adjusted after they are triggered[37]. If a threshold is reached, and as a result subsequent orders are rejected, the broker-dealer may evaluate whether it is appropriate to increase the relevant threshold, and, if appropriate, do so in accordance with supervisory procedures[38]. The reasons for such modifications should be documented and retained as part of the broker-dealer's books and records[39.]

3.3 "Direct and Exclusive Control" requirement

3.3.1 Market access provided to affiliates. Rule 15c3-5 requires that a broker-dealer's risk management controls and supervisory procedures be under the direct and exclusive control of the broker-dealer providing market access, subject to certain limited exceptions[40]. The Staff clarified that a broker-dealer that provides market access to an

affiliated broker-dealer may not permit the affiliate to have control over its risk management controls and supervisory procedures[41].

3.3.2 Integrating controls provided by multiple third parties. While a broker-dealer may use risk management tools or technology provided by third parties, including exchanges and ATSs, the Staff noted that if a broker-dealer has or provides market access to multiple exchanges and ATSs, and it uses multiple, stand-alone risk management control systems, these separate controls would have to be coordinated to comply with relevant regulatory and financial risk management requirements in the Rule[42]. For example, a broker-dealer that imposes a credit limit for a client by setting sub-limits at each exchange or ATS must ensure that, together, such individual limits do not exceed the aggregate credit limit[43].

3.3.3 Due diligence requirements when using third-party controls. The Adopting Release states that

> a broker-dealer providing market access can use risk management tools or technology provided by a third party that is independent of the customer, so long as it has direct and exclusive control over those tools or technology and performs appropriate due diligence . . .[44].

A broker-dealer relying on third-party technology or software must perform appropriate due diligence to assure that the developer is independent from the market access customer or its affiliates[45]. While noting that the efforts required for this due diligence will depend on the individual facts or circumstances, the Staff provided the following specific examples of what such due diligence might include:

- reviewing publicly available information about the ownership and material business relationships of the developer and the customer;
- following up on information that may indicate a lack of independence; and
- requesting that the developer and customer certify their independence from each other[46].

The Staff noted, however, that "mere reliance on representations of the third-party technology developer – even if an exchange or other regulated entity – would be insufficient to meet the due diligence standard"[47].

3.3.4 Controls at the customer's premises. The Staff cautioned against a broker-dealer maintaining its risk management controls at its customer's premises[48]. While not necessarily inconsistent with the Rule's "direct and exclusive control" requirement, the Staff noted that it would require rigorous assessment and ongoing monitoring of the integrity and security of the controls to assure that the broker-dealer retains exclusive control over them, and could complicate compliance[49].

3.4 Requirement that controls systematically reject orders

The Staff clarified that if an order is handled manually and results in a manual execution, with no involvement of electronic systems prior to execution, the requirements of Rule 15c3-5 can be satisfied by implementing manual pre-trade controls[50]. This exception to the requirement that pre-trade controls be automated is fairly narrow because, as noted in the FAQs, if an electronic system is involved in *any* part of the execution of an order, then the broker-dealer must use automated pre-trade controls[51]. For example, if a trade is negotiated manually on an exchange floor, but the orders are entered into a trading system to be executed, automated pre-trade controls should be used when the orders are entered into the trading system. By contrast, manual pre-trade controls could be used for an order that a floor broker receives by telephone, writes on a paper ticket, and trades manually[52].

3.5 Controls designed to prevent the Entry *of orders*

Finally, the Staff noted that controls and procedures that permit malformed (scrambled) orders to be entered on an exchange or ATS, or that allow orders to be entered with an

attempt to quickly cancel ("chase and cancel" functionality), are not reasonably designed to prevent the *entry* of orders that exceed the relevant limits or parameters set by the broker-dealer with or providing market access, as required by the Rule[53]. According to the Staff, these types of controls not only could create a risk of execution, but also could cause operational difficulties for the exchange or ATS[54].

* * *

The FAQs issued by the Staff provide some useful guidance concerning the Rule, but there are still many unanswered questions.

4. SEC enforcement actions

To date, the SEC has brought two actions against broker-dealers for violations of Rule 15c3-5. On October 16, 2013, Knight Capital agreed to pay $12 million to settle charges brought by the SEC alleging that the firm violated Rule 15c3-5[55]. On June 6, 2014, the SEC brought formal charges against Wedbush and two of its officers for violations of Rule 15c3-5[56]. These matters focus on different aspects of the Rule. Knight Capital was alleged to have insufficient financial controls, while Wedbush is charged with having inadequate regulatory controls.

4.1 Settlement with Knight Capital

The *Knight Capital* Order involved a settled matter and represented the first Market Access Rule-based enforcement action brought by the SEC. The settlement order provides some insight into the SEC Enforcement Staff's view of what the Rule requires and the pitfalls to be avoided.

The *Knight Capital* Order followed from the entry of millions of erroneous orders by the firm on August 1, 2012, as a result of technology errors in Knight Capital's systems. Specifically, Knight Capital sent over 4 million orders to the market in an effort to execute 212 small retail orders[57]. Knight Capital ultimately traded over 397 million shares, thereby accumulating billions of dollars in unwanted positions and suffering a loss of over $460 million[58].

The SEC charged Knight Capital with violating the Rule by failing to have controls reasonably designed to prevent the entry of erroneous orders at a point immediately prior to the submission of orders to the market, such as a control to compare orders leaving the router with those that entered it[59]. The SEC also alleged that Knight Capital failed to have controls reasonably designed to prevent the entry of orders for equity securities that exceeded pre-set aggregate capital thresholds for the firm and failed to link accounts to firm-wide capital thresholds, and instead relied on financial risk controls that were not capable of preventing the entry of orders[60]. The charges highlighted Knight Capital's failure to generate automated alerts, instead relying on human monitoring of the firm's financial exposure, and failure to have controls and supervisory procedures to guide employees' responses to significant technological and compliance incidents[61].

Additional allegations included:

- not having technology controls and supervisory procedures in place to ensure the orderly deployment of new code or to prevent the activation of code no longer intended for use but left on its servers;
- failing to retest code not intended for use but left on servers to determine whether it would still operate correctly if called upon; and
- not requiring a second technician to review new code deployment or maintain written procedures that require such a review[62].

Furthermore, the SEC alleged that Knight Capital's annual CEO certification was defective because it did not expressly state that the controls and supervisory procedures complied with the Rule, that Knight Capital failed to adequately review its business activity in

connection with its market access to assure overall effectiveness of risk management and supervisory procedures, and that Knight Capital did not have a sufficient written description of its risk management controls, as part of its books and records[63].

4.2 Wedbush complaint

The SEC's complaint is focused on Wedbush's provision of sponsored access to numerous customers and the market access controls applicable to that order flow[64]. Specifically, the SEC alleges that Wedbush did not directly set or monitor regulatory risk settings in third-party sponsored access platforms, but rather allowed its customers to determine and to make changes to those settings[65].

It is further alleged that Wedbush's customers, rather than Wedbush, leased the trading platforms from third parties and that Wedbush had no contractual relationship with the platform providers[66]. Finally, the SEC alleges that Wedbush did not conduct the required "thorough due diligence review" when purporting to allocate responsibility for regulatory risk management controls and supervisory procedures for many of its customers to other broker-dealers and continued to rely only on the attestations of these broker-dealers that they had implemented appropriate controls and procedures[67].

Accordingly, the SEC's complaint alleges that Wedbush violated Rule 15c3-5 because it did not

- maintain exclusive control over risk management controls in sponsored access trading platforms;
- have a system of risk management controls and supervisory procedures that was reasonably designed to ensure compliance with all regulatory requirements, including those that must be satisfied on a pre-order entry basis;
- have controls and procedures reasonably designed to restrict access to market access trading systems to persons and accounts pre-approved and authorized by Wedbush;
- establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access; or
- conduct an adequate review of its market access controls and procedures during the relevant period[68].

Subsequent to the filing of the SEC complaint, Wedbush released a statement and previewed its possible defenses[69]. In particular, Wedbush asserted that its risk management controls and procedures were reasonably designed to achieve compliance with applicable regulatory requirements and were "consistent with the rules and guidance given by the SEC and its staff beginning in 2011"[70]. Wedbush then noted that, as the case against it demonstrates, the Rule continues to evolve and cited, by way of example, the fact that the FAQs were not issued until April 2014[71]. After referring to the notice and comment period in advance of the Rule's adoption, Wedbush commented that "the SEC now seeks to impose additional regulatory requirements retroactively, through enforcement proceedings, without giving fair notice of its expectations in advance"[72].

The upcoming public administrative hearing will be closely followed to see how the SEC's Division of Enforcement will seek to prove that Wedbush's controls and supervisory procedures were not reasonably-designed.

5. Conclusion

While the FAQs and the Knight Capital settlement provide some insight into the Commission's interpretation of the Rule, there are still areas where the substantive requirements are not entirely fleshed out. The recent developments emphasize that broker-dealers must have controls and supervisory procedures that are under the direct

and exclusive control of the broker-dealer or allocated pursuant to a legally enforceable contract (as applicable for Regulatory Controls and Procedures in certain instances). The Financial Risk Management Controls must be executed on an automated, pre-trade basis and prevent the entry of orders that exceed the relevant limits or parameters. Broker-dealers may use "reasonable business judgment" to select credit and capital thresholds but must be prepared to explain the rationale and show how the thresholds meaningfully limit the financial exposure of the customer or firm, in addition to having a process by which it monitors the continued appropriateness of those thresholds. Finally, broker-dealers should have technology controls and supervisory procedures in place to ensure the orderly deployment of new code or to prevent the activation of code no longer intended for use but left on its servers, among other things.

Because Rule 15c3-5 continues to be a priority for the SEC, broker-dealers and their legal counsel should continue to follow further developments relating to the Rule.

Notes

1. 17 C.F.R. § 240.15c3-5.
2. *Findings Regarding the Market Events of May 6, 2010*, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, at 1-2 (Sept. 30, 2010), available at: www.sec.gov/news/studies/2010/marketevents-report.pdf.
3. *Id.* at 2.
4. *Id.* at 3.
5. *Id.*
6. *Id.* at 6.
7. Risk Management Controls for Brokers or Dealers With Market Access, Final Rule, 75 Fed. Reg. 69792, 69794 (Nov. 15, 2010) ("Adopting Release" or "Rule 15c3-5 Adopting Release").
8. 17 C.F.R. § 240.15c3-5(b).
9. *Id.* § 240.15c3-5(a)(1).
10. Rule 15c3-5 Adopting Release at 69801.
11. Andrew Ceresney, Director of the Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Keynote Address at Compliance Week 2014, Washington, D.C. (May 20, 2014), available at: www.sec.gov/News/Speech/Detail/Speech/1370541872207#.U8ZyjvlWrTA
12. Financial Industry Regulatory Authority, 2014 Regulatory and Examination Priorities Letter 9 (Jan. 2, 2014), available at: www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p419710.pdf
13. *In re Knight Capital Americas, LLC,* Exchange Act Release No. 70694, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (October 16, 2013) ("*Knight Capital* Order"); *In the Matter of Wedbush Securities Inc.*, Exch. Act Release No. 72340, Investment Advisers Act Release No. 3845, Admin. Proceeding File No. 3-15913, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940 (June 6, 2014) ("*Wedbush* Complaint"). FINRA is also active in enforcing compliance with Rule 15c3-5.
14. 17 C.F.R. § 240.15c3-5(b).
15. *Id.* § 240.15c3-5(c)(1)(i). According to the Adopting Release, a broker-dealer should assess its business and its customers to determine if it is appropriate to establish more tailored credit or capital limits by sector, security, or otherwise. Rule 15c3-5 Adopting Release at 69801.
16. 17 C.F.R. § 240.15c3-5(c)(1)(ii).

17. Rule 15c3-5 Adopting Release at 69802.

18. 17 C.F.R. § 240.15c3-5(c)(2)(i)-(iv).

19. *Id.* § 240.15c3-5(d)(1). Financial Risk Management Controls and Procedures may not be allocated under the Rule.

20. *Id.* § 240.15c3-5(e)(1) & (2).

21. Rule 300(e) of Regulation ATS, 17 CFR 242.300(e).

22. Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access, U.S. Sec. & Exch. Comm'n, Division of Trading and Markets, FAQ No. 1 (April 15, 2014) ("Rule 15c3-5 FAQs"), available at: www.sec.gov/divisions/marketreg/faq-15c-5-risk-management-controlsbd.htm

23. *Id.*

24. *Id.* FAQ No. 4.

25. *Id.* Section 15(c)(3) of the Exchange Act applies to a "broker or dealer (other than a government securities broker or government securities dealers, except a registered broker or dealer) . . .." 15 U.S.C. § 78o(c)(3). *See also id.* § 78o(b)(11)(B)(iii).

26. *Id.* FAQ No. 2.

27. *Id.* FAQ No. 3.

28. *Id.*

29. Rule 15c3-5 FAQs, FAQ No. 7 (emphasis added).

30. *Id.* FAQ No. 8.

31. *Id.*

32. *Id.*

33. Rule 15c3-5 Adopting Release at 69802. If a firm provides market access to a broker-dealer client that may trade on an agency basis for its customers, the firm's "customer" for purposes of establishing credit thresholds is the firm's broker-dealer client to which it provides market access, not the customer of such broker-dealer client. Rule 15c3-5 FAQs, FAQ No. 7.

34. *Id.* FAQ No. 15.

35. *Id.*

36. *Id.* FAQ No. 8 (citing Rule 15c3-5 Adopting Release at 69802).

37. *Id.* FAQ No. 18.

38. *Id.*

39. *Id.*

40. 17 C.F.R. § 240.15c3-5(d).

41. Rule 15c3-5 FAQs, FAQ No. 10.

42. *Id.* FAQ No. 5.

43. *Id.*, n.10 (citing Rule 15c3-5 Adopting Release at 69800).

44. Rule 15c3-5 Adopting Release at 69810.

45. *Id.* at 69810.

46. Rule 15c3-5 FAQs, FAQ No. 14.

47. *Id.* (citing Rule 15c3-5 Adopting Release at 69810).

48. *Id.* FAQ No. 17.

49. *Id.*

50. *Id.* FAQ No. 6.

51. *Id.* (citing Rule 15c3-5 Adopting Release at 69802)..

52. *Id.*

53. *Id.* FAQ No. 16.

54. *Id.*

55. *Knight Capital* Order, *supra* note 13.

56. *Wedbush* Complaint, *supra* note 13.

57. *Knight Capital* Order, *supra* note 13, at 2.

58. *Id.*

59. *Id.* at 4, 7.

60. *Id.* at 4. Knight Capital had an account with a position limit that was exceeded as a result of the aforementioned activity, but this account was not linked to an automated control to prevent the entry of orders that exceeded firm-wide pre-set capital thresholds. *Id.* at 7.

61. *Id.* at 4, 8.

62. *Id.* at 8.

63. *Id.* at 4.

64. *See Wedbush* Complaint, *supra* note 13.

65. *Id.* at 5.

66. *Id.* at 6. According to the complaint, Wedbush obtained email statements from many of the trading platform providers that the risk management settings in the platforms were under the direct and exclusive control of Wedbush, however, these statements also were not part of any legally enforceable contract as Wedbush had no contractual relationship with the platform providers. *Id.*

67. *Id.* at 7.

68. *Id.* at 15. Notably, unlike in *Knight Capital*, the SEC brought charges against two officers of Wedbush under Section 21C(a) of the Exchange Act. Specifically, each officer is alleged to have been "a cause of Wedbush's violation of Rule 15c3-5 because their acts and omissions contributed to Wedbush's violation and they knew or should have known that their conduct would contribute to the violation." *Id.*

69. Statement by Wedbush Regarding the Securities and Exchange Commission Proceeding, News Release (June 6, 2014), available at: www.wedbush.com/media/news-release/1459

70. *Id.*

71. *Id.*

72. *Id.*

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