

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2014041809401**

TO: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)

RE: Interactive Brokers LLC (Respondent)
Member Firm
CRD No. 36418

Pursuant to FINRA Rule 9216, Respondent Interactive Brokers LLC (Interactive) submits this Letter of Acceptance, Waiver, and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described in this AWC.

I.

ACCEPTANCE AND CONSENT

A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

Interactive has been a FINRA member since January 1995. The firm is headquartered in Greenwich, Connecticut and employs approximately 350 registered persons operating out of seven branch locations. The firm provides online trading in equities and options to retail and institutional customers through self-directed accounts and provides clearing services.¹

OVERVIEW

From at least January 2014 to February 2023, Interactive failed to comply with its best execution and related supervision obligations. Prior to November 2016, the firm's reviews of execution quality were *ad hoc*, not adequately documented, and did not consistently include all relevant execution quality factors or regularly assess competing venues. Additionally, when the firm's own Alternative Trading System (IBKR ATS) or, starting in October 2019, two other market centers, disseminated priced indications of interest (IOIs) at least \$0.01 better than the National Best Bid or Offer (NBBO), the firm routed its customers' marketable orders to such venues before routing to venues that did not disseminate IOIs (non-IOI venues). Prior to February 2023, the firm did so without reasonably evaluating the likelihood of obtaining greater price improvement from non-IOI venues.

¹ For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

Interactive also failed to reasonably assess whether its practice, which it ceased during the relevant period, of adjusting its routing of non-marketable equity and options orders at the end of certain months to receive volume-based rebate payments affected its customers' execution quality. As a result of the foregoing, Interactive violated FINRA Rule 5310(a)(1), FINRA Rule 5310 Supplemental Material .09 (FINRA Rule 5310.09), and FINRA Rule 2010.

Further, from January 2014 through March 2018, Interactive effected approximately 10.4 million customer transactions through two other broker-dealers, which engaged in net trading activity.² As such, the firm interjected these two broker-dealers between itself and the best market for the subject security. As a result, the firm violated FINRA Rules 5310(a)(2) and 2010. By failing to reasonably review this net trading activity to ensure it did not interfere with the firm's best execution obligations, Interactive separately violated FINRA Rules 5310(a)(1), 5310.09, and 2010.

From at least January 2014 through February 2023, Interactive also violated FINRA Rules 3110 and 2010 and NASD Rule 3010³ by failing to establish, maintain, and enforce a supervisory system, including written supervisory procedures (WSPs), reasonably designed to achieve compliance with its best execution obligations.

Separately, from January 2014 through March 2017, Interactive violated Rule 606 under the Securities Exchange Act of 1934 and FINRA Rule 2010 by failing to disclose material aspects of its relationship with markets to which it routed orders in its quarterly reports made available pursuant to Exchange Act Rule 606.

FACTS AND VIOLATIVE CONDUCT

1. FINRA's Best Execution Rule

Broker-dealers have a longstanding and fundamental obligation to seek "best execution" of their customers' orders—that is, to seek the most favorable terms for their customers' orders that are reasonably available under the circumstances.

FINRA codified this best execution obligation in FINRA Rule 5310 and its Supplementary Material. FINRA Rule 5310(a) provides that, "[i]n any transaction for or with a customer or a customer of another broker-dealer, a member . . . shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions." Under FINRA Rule 5310.09(a), if a member does not conduct an "order-by-order" review of execution quality, it must conduct "regular and rigorous" reviews of the execution quality of customer orders.

² The term "net" trading generally refers to contemporaneous principal transactions where the initial and offsetting transactions are at different prices. For example, a firm trades on a "net" basis when it accumulates a position at one price and executes the offsetting trade with its customer or broker-dealer client at another price. As FINRA stated in *Regulatory Notice 18-29*, FINRA rules do not prohibit net trading, but if a firm chooses to trade on a net basis, it must comply with all applicable rules, including FINRA Rule 5310 (Best Execution and Interpositioning).

³ FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014.

FINRA Rule 5310.09(a) requires that, at minimum, the member conduct such regular and rigorous reviews on a quarterly basis and that firms consider whether, based on their business, more frequent reviews are needed. FINRA Rule 5310.09(b) provides that, “[i]n conducting its regular and rigorous review, a member must determine whether any material differences in execution quality exist among the markets trading the security and, if so, modify the member’s routing arrangements or justify why it is not modifying its routing arrangements.” Each member must “compare, among other things, the quality of the executions the member is obtaining via current order routing and execution arrangements . . . to the quality of the executions that the member could obtain from competing markets.”

FINRA Rule 5310.09(b) also identifies certain factors that should be considered in reviewing and comparing the execution quality of the member’s current order routing and execution arrangements to the execution quality of competing markets, including: (1) price improvement opportunities (i.e., the difference between the execution price and the best quotes prevailing at the time the order is received by the market); (2) differences in price disimprovement (i.e., situations in which a customer receives a worse price at execution than the best quotes prevailing at the time the order is received by the market); (3) the likelihood of execution of limit orders; (4) the speed of execution; (5) the size of execution; (6) transaction costs; (7) customer needs and expectations; and (8) the existence of internalization or payment for order flow arrangements.

A violation of FINRA Rule 5310 also constitutes a violation of FINRA Rule 2010, which requires members to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

2. Interactive’s routing practices for marketable and non-marketable customer orders

a. Marketable customer orders

Throughout the relevant period, Interactive used its Smart Order Router (SOR) to route marketable customer orders to each national securities exchange, certain fully dark venues, such as single-dealer platforms and alternative trading systems (ATs), certain third-party market centers, and certain venues that provided priced indications of interest (IOIs), including Interactive’s IBKR ATS. Prior to October 2019, only the IBKR ATS disseminated priced IOIs to the SOR. Starting in October 2019, Interactive’s SOR also began receiving priced IOIs from two additional market centers.

In determining where to route marketable orders, the SOR compared disseminated priced IOIs to the firm’s estimate of price improvement available from other market centers (based upon historically observed amount of net price improvement multiplied by fill rates).⁴ In instances in which a priced IOI venue, including the IBKR ATS, indicated a price that was better than the NBBO by at least \$0.01 (an amount which exceeded Interactive’s estimate of price improvement available from non-IOI venues during the relevant period), Interactive would route to the IOI

⁴ The routing logic varied depending on customer preferences to maximize price improvement, fill rates or minimize fees and also varied depending on whether the relevant customer had elected pricing whereby Interactive passed through to the customer a portion of the venue fee or rebate assessed by the market center.

venue, including the IBKR ATS, disseminating the better price before routing to non-IOI venues. In all other instances Interactive would route to non-IOI venues first.

However, prior to February 2023, Interactive did not reasonably assess whether, in instances where a priced IOI venue was indicating \$0.01, or more, of available price improvement, one or more non-IOI venues might offer greater price improvement than the IBKR ATS or starting in 2019, the two market centers that also disseminated priced IOIs to the firm.

Since January 2014, Interactive has executed approximately ten percent of its total share volume (or approximately 2.4 billion shares per month) of customers' marketable orders in the IBKR ATS, where the IBKR ATS has indicated available liquidity priced at least \$0.01 better than the NBBO.

From January 2014 through March 2018, Interactive effected approximately 10.4 million customer transactions through two broker-dealers that traded the customers' marketable orders on a net basis.

b. Non-marketable customer orders

During the relevant period, Interactive routed non-marketable equity and options orders to the national securities exchanges for execution. Interactive, pursuant to the national securities exchanges' published fee schedules, obtained monthly per-share, volume-based rebates from certain exchanges. Where the firm achieved a higher volume-based rebate tier at a given exchange, it did not share such additional rebates with its customers.

Interactive programmed its SOR to route non-marketable customer orders to those national securities exchanges that would likely provide the best fill rates based upon a statistical analysis of the exchanges' historical performance. If, according to this analysis, there was not a material statistical difference among the likely fill rates of two or more exchanges, the SOR would route the non-marketable orders to those exchanges on a randomized basis. Toward the end of certain months, however, Interactive would adjust its routing of non-marketable orders to achieve exchange volume thresholds that would increase the amount of the exchange rebate payable to Interactive. Interactive ceased this practice during the relevant period.

3. Interactive failed to conduct reasonable regular and rigorous reviews.

From January 2014 through February 2023, Interactive's reviews of customer execution quality failed to meet the reasonable diligence standard of FINRA Rule 5310 and the regular-and-rigorous review requirements of FINRA Rule 5310.09.

From at least January 2014 until November 2016, when the firm formed a best execution committee,⁵ Interactive's reviews of customer execution quality were *ad hoc*, not adequately documented, did not consistently include all relevant execution factors set forth in FINRA Rule

⁵ Beginning in November 2016, the firm's best execution committee met quarterly and reviewed data that included the factors set forth in FINRA Rule 5310.09.

5310.09, and did not regularly consider the execution quality that might have been available at competing venues.

In addition, from January 2014 through February 2023, Interactive failed to conduct reasonable reviews for price improvement opportunities. Specifically, when a priced IOI venue, including the IBKR ATS, indicated a price that was at least \$0.01 better than the NBBO, Interactive would route to such venue before routing to non-IOI venues. Interactive, however, did not reasonably assess whether, in instances where a priced IOI venue was indicating \$0.01/share or more of available price improvement, one or more non-IOI venues might offer greater price improvement.

Interactive also did not reasonably review whether the firm's end of month adjustments to its routing of customers' non-marketable equity and options orders to achieve exchange volume-based rebates affected the execution quality of customers' orders. Interactive ceased this practice during the relevant period.

Furthermore, from January 2014 through March 2018, the firm failed to reasonably review the impact its routing to two broker-dealers that traded on a net basis had on its customers' execution quality, including price improvement, transaction costs, speed of execution, and whether customers' orders would have received better execution quality had Interactive routed the orders directly for execution.

Therefore, Interactive violated FINRA Rules 5310(a)(1), 5310.09, and 2010.

4. By allowing two destination broker-dealers to effect trades on a net basis, Interactive interjected third parties between it and the best markets.

FINRA Rule 5310(a)(2) provides that, "[i]n any transaction for or with a customer or a customer of another broker-dealer, no member or person associated with a member shall interject a third party between the member and the best market for the subject security in a manner inconsistent with paragraph (a)(1) of this Rule."

Between January 2014 and March 2018, Interactive effected approximately 10.4 million customer transactions through two broker-dealers that traded on a "net" basis.⁶ The firm's practice of routing marketable orders to these two broker-dealers resulted in the firm interjecting these two broker-dealers between itself and the best market for the subject securities.

For example, on May 10, 2017, Interactive routed 7,700 shares of a customer's limit buy order to another broker-dealer (Broker A). Broker A routed a representative order to an affiliated ATS, which in turn routed the order to an exchange that executed the order at \$2.815. Broker A then executed Interactive's customer buy order at \$2.8192, which was \$0.0042 worse than the execution price provided by the exchange. In this example, Interactive received a \$0.0021 per share rebate for this transaction, approximately half of which Interactive shared with the customer in the form of a commission reduction.

⁶ The two broker-dealers, like most broker-dealers to which Interactive routed customer orders during the relevant period, provided rebates to Interactive.

Therefore, Interactive violated FINRA Rules 5310(a)(2) and 2010.

5. Interactive did not reasonably supervise for best execution.

FINRA Rule 3110(a) and its predecessor, NASD Rule 3010(a), require each member to “establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and applicable FINRA rules.”

FINRA Rule 3110(b) and its predecessor, NASD Rule 3010(b), require each member to “establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations” and FINRA rules. A violation of FINRA Rule 3110 or NASD Rule 3010 also constitutes a violation of FINRA Rule 2010.

From at least January 2014 through February 2023, Interactive’s supervisory system was not reasonably designed to achieve compliance with its best execution obligations. From at least January 2014 through November 2016, the firm’s reviews were *ad hoc*, not adequately documented, and did not consistently consider all relevant execution quality factors for existing order routing arrangements or regularly assess competing markets.

From at least January 2014 until February 2023, Interactive failed to conduct reasonable reviews for price improvement opportunities as described above.⁷

In addition, Interactive did not have in place a supervisory system to review whether the firm’s periodic end-of-month adjustments to its routing of customer non-marketable equity and options orders to achieve exchange volume-based rebates affected the execution quality of customers’ orders. Interactive ceased this practice during the relevant period.

Furthermore, from at least January 2014 until March 2018, Interactive did not have in place a supervisory system reasonably designed to review whether its routing to third parties for net trading impacted execution quality.

From at least January 2014 until July 2017, Interactive’s WSPs failed to reasonably describe the supervisory system in place for performing regular and rigorous reviews of execution quality. For example, the firm’s procedures failed to describe how best execution reviews should be conducted, including what execution quality statistics should be reviewed and how the firm’s supervisory reviews should be documented. The WSPs were similarly devoid of any guidance for determining the circumstances in which the firm should modify order routing arrangements.

Therefore, Interactive violated FINRA Rules 3110 and 2010 and NASD Rule 3010.

⁷ By February 2023 the firm remediated the regular and rigorous review and related supervisory deficiencies described above.

6. Interactive failed to disclose material aspects of its relationships with venues.

Exchange Act Rule 606 is designed to foster greater transparency in connection with a broker-dealer's best execution responsibilities. Specifically, Exchange Act Rule 606 requires that a broker-dealer disclose to the public in quarterly reports, among other things, a discussion of the material aspects of its relationship with the venues to which it routes its orders, including a description of any arrangement for payment for order flow and any profit-sharing relationship. Such material aspects would include amounts per share or per order that a broker-dealer receives and transaction rebates. A violation of Exchange Act Rule 606 also is a violation of FINRA Rule 2010.

From January 2014 through March 2017, Interactive's quarterly reports under Exchange Act Rule 606 did not disclose per share or per order amounts that the firm received as trading rebates from exchanges. Instead, the reports contained general disclosures that the firm received trading rebates without specifically noting the amount per share received during the quarter.

Therefore, Interactive violated Exchange Act Rule 606 and FINRA Rule 2010.

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

- a censure; and
- a \$3.5 million fine.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a complaint issued specifying the allegations against it;
- B. To be notified of the complaint and have the opportunity to answer the allegations in writing;

- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made, and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

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

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

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and
 - 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying,

directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.

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

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

December 20, 2023

Date

Elaine Mandelbaum

Interactive Brokers LLC
Respondent

Print Name: Elaine Mandelbaum

Title: General Counsel

Reviewed by:

Julian Rainero, Esq.
Julian Rainero, Esq.
Counsel for Respondent
Schulte Roth & Zabel LLP
919 Third Avenue
New York, New York 10022

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

December 22, 2023

Date

Gary E. Jackson

Gary E. Jackson

Senior Counsel

FINRA

Department of Enforcement

9509 Key West Avenue

Rockville, MD 20850

This Corrective Action Statement is submitted by the Respondent. It does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA, or its staff.

STATEMENT OF CORRECTIVE ACTION BY INTERACTIVE BROKERS LLC

Interactive Brokers LLC (“Interactive” or the “Firm”) submits this Statement of Corrective Action in connection with the foregoing Letter of Acceptance, Waiver, and Consent (“AWC”) describing the steps it has already taken to correct and substantially reduce the risk of recurrence of the issues addressed by the AWC. As set forth in detail below, Interactive has invested significant resources to provide best execution to its customers pursuant to FINRA Rule 5310, and those efforts continue to this day.

Enhancement of Interactive’s Supervisory Processes and Procedures. Interactive takes its supervisory obligations under FINRA Rule 5310 seriously and the Firm has always been dedicated to achieving best execution for its customers. The Firm’s supervisory processes and procedures are subject to ongoing reviews and enhancements, including, among other things, (i) continued enhancement of the Firm’s execution quality reviews, both during and after the period at issue in the AWC, through additional review and testing of the assumptions underlying the Firm’s order routing logic and (ii) updates and revisions to our Written Supervisory Procedures.

Interactive’s Routing of its Customers’ Marketable Orders Benefited its Customers

In instances in which a priced IOI venue, including the IBKR ATS, indicated a price that was better than the NBBO by at least \$0.01 (an amount which exceeded IBKR’s estimate of price improvement available from non-IOI venues during the relevant period), Interactive would route to the IOI venue disseminating the better price (including the IBKR ATS) before routing to non-IOI venues.

Interactive carried out A/B testing in February 2023, which demonstrated that IBKR customers received approximately 50% higher levels of price improvement when IBKR routed to IOI venues indicating at least \$0.01 of price improvement prior to routing to dark venues or lit venues displaying a worse price. The outcome of this testing led Interactive to maintain its existing smart order routing logic without change.

Interactive’s Routing of Non-marketable Orders

Interactive programmed its SOR to route non-marketable customer orders to those national securities exchanges that would likely provide the best fill rates based upon a statistical analysis of the exchanges’ historical performance. If, according to this analysis, there was not a material statistical difference (using the Student’s t-test) among the likely fill rates of two or more exchanges, the SOR would route the non-marketable orders to those exchanges on a randomized basis. Toward the end of certain months, Interactive would adjust its routing of non-marketable orders to achieve exchange volume thresholds that would increase the amount of the exchange rebate payable to Interactive, but with no expected effect on customer fill rates. Interactive has adopted a revised policy requiring post-change analysis in the event Interactive changes the pre-set weights in the future.