

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014041812501**

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

RE: TradeStation Securities, Inc. (Respondent)
Member Firm
CRD No. 39473

Pursuant to FINRA Rule 9216, Respondent TradeStation Securities, Inc. 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 hereby accepts and consents, without admitting or denying the findings and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

TradeStation has been a FINRA member since January 1996. The Firm is headquartered in Florida, maintains three additional branch offices, and employs approximately 130 registered persons. TradeStation does not have any relevant disciplinary history. TradeStation currently offers commission-free equities and options trading to its retail customers.

OVERVIEW

Since January 2014, TradeStation has predominantly routed its customers' equity and option orders to several market-makers and certain exchanges that paid the Firm for that order flow. As described below, TradeStation did not exercise reasonable diligence to ascertain whether the venues where it routed certain equity and option customer orders provided the best market for the subject securities as compared to the execution quality that was being provided at competing markets. In addition, the Firm did not review the execution quality it was receiving for certain order types. TradeStation also failed to establish and maintain a supervisory system, including written supervisory procedures (WSPs), reasonably designed to achieve compliance with its best execution obligations under FINRA's rules. Finally, the Firm failed to disclose material aspects of its

relationship with the markets to which it routed most of its order flow.

By virtue of the foregoing, TradeStation violated NASD Rules 3010(a) and (b), FINRA Rules 5310(a), 5310.09, 3110(a) and (b),¹ Rule 606 of the Securities Exchange Act of 1934, and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

1. The Firm's Routing of Equity and Option Orders

TradeStation provides online trading to retail and institutional customers for equities and options. As a discount broker, TradeStation generally offered low commission trading from 2014 until October 2019, when it began offering commission-free trading. With respect to its low commission and commission-free trading, the Firm predominantly routed its customers' non-directed equity and option orders for execution to broker-dealers and exchanges that paid for that order flow.² This arrangement is known as "payment for order flow."³ Accordingly, although TradeStation provided discount and commission-free trading to its customers, it nevertheless received additional compensation for that trading through its payment for order flow model. This compensation has represented a significant source of revenue for the Firm. For example, in the first three quarters of 2020, payment for equity order flow accounted for approximately \$15 million in revenue while payment for option order flow accounted for approximately \$13 million in revenue.⁴

2. Best Execution Obligations

Best execution of customer orders is a key investor protection requirement that is codified in FINRA Rule 5310 and its Supplementary Material. This requirement echoes longstanding principles associated with the duty of best execution broker-dealers owe to customers that arises, in part, from common law agency duties of loyalty that predate the federal securities law.

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

² A non-directed order is an order where the customer does not provide instructions as to the market venue where the customer wants the order to be sent for execution (*i.e.*, the choice of execution venue is determined by the broker-dealer receiving the order).

³ Rule 10b-10(d)(8) of the Securities Exchange Act of 1934 defines payment for order flow as including any monetary payment, service, property, or other benefit that results in remuneration, compensation, or consideration to a broker/dealer from any broker/dealer, national securities exchange, registered securities association, or exchange member in return for the routing of customer orders to any such entities.

⁴ Since the second quarter of 2016, TradeStation has required uniform payment rates from its market-maker equities and options routing venues.

a. FINRA Rule 5310's Best Execution Requirements

FINRA Rule 5310(a) provides that, in any transaction for or with a customer or a customer of another broker-dealer, a member and persons associated with 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.

Where, as in this matter, customer orders are routed away for execution, member firms generally can satisfy their best execution obligations by conducting either an order-by-order review or a periodic “regular and rigorous review” of the quality of the executions of its customers’ orders.

On May 31, 2012, FINRA codified a firm’s obligations when it undertakes a “regular and rigorous review” in Rule 5310’s Supplementary Material .09. Supplementary Material .09(a) requires members that route customer orders to other broker-dealers for execution on an automated, non-discretionary basis to have procedures in place to ensure the member conducts regular and rigorous reviews of the quality of the executions of its customers’ orders, if it does not conduct an order-by-order review. The review must be conducted on a security-by-security and type-of-order basis (*e.g.*, limit order, market order, and market on open order) on at least a quarterly basis.⁵ The Supplementary Material also clarifies that firms should consider, based on their business, whether more frequent reviews are needed.

In conducting regular and rigorous reviews, Supplementary Material .09(b) states that 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. To assure that order flow is directed to markets providing the most beneficial terms for its customers’ orders, the member must compare, among other things, the quality of the executions the member is obtaining via current order routing and execution arrangements (including the internalization of order flow) to the quality of the executions that a member could obtain from competing markets.

Supplementary Material .09(b) also identifies certain factors (the 5310.09(b) 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 other markets. These factors include: (1) price improvement opportunities (*i.e.*, the difference between the execution price and the best quotes prevailing at the time the order is

⁵ For example, FINRA Regulatory Notice 15-46 (Nov. 2015) (NTM 15-46) states that, for non-marketable orders, “firms should regularly review their routing decisions as well as the policies and procedures in place regarding the monitoring of non-marketable orders to ensure their best execution obligations are met.” NTM 15-46 at 3.

received by the market);⁶ (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) likelihood of execution of limit orders; (4) speed of execution; (5) size of execution; (6) transaction costs; (7) customer needs and expectations; and (8) existence of internalization or payment for order flow.

b. Regulatory Guidance Surrounding Payment for Order Flow

The SEC has stated that, “a broker-dealer must not allow a payment or an inducement for order flow to interfere with its efforts to obtain best execution.”⁷ While noting that bulk order routing “based, in part, on the receipt of payment for order flow is not, in and of itself, a violation” of a broker-dealer’s duties of best execution, the SEC also has expressed its concern that “the availability of payments in return for order flow commitments may influence the evaluation by a broker-dealer of the most advantageous market or market-maker to whom to route its customer order.”⁸ Accordingly, FINRA also has emphasized that, “[g]iven the potential conflict between the receipt of payment for order flow . . . and the duty of best execution, a firm should carefully evaluate its receipt of payment for order flow and the impact of such practices on execution quality.”⁹ For example, NTM 15-46 reminds broker-dealers that, “the possibility of obtaining price improvement on an order is a heightened consideration when the broker-dealer is receiving payment for order flow.”¹⁰

3. TradeStation’s Reviews of Customer Executions Did Not Meet the Reasonable Diligence Standard Required by the Best Execution Rule

TradeStation conducted quarterly reviews of execution quality through its Best Execution Committee (BEC). In July 2016, the Firm’s Product Management Team (PMT), whose members were also part of the BEC, also began meeting monthly to review execution quality and to modify routing practices. As described below, the Firm failed to meet the reasonable diligence standard required by FINRA’s best execution rule for both its customers’ equity and option order flow. In particular, at various times, the Firm did not reasonably consider or perform underlying execution quality analysis of competing markets relative to the Firm’s current routing arrangements under Rule 5310.09(b) factors. In addition, at other times, the Firm did not conduct reviews of the execution quality provided by existing routing venues for specific order types.

⁶ Price improvement includes situations where an execution is available at a price that is better than existing quotations. For example, Rule 600(b)(29) of Regulation NMS defines the phrase “executed with price improvement” as meaning, “for buy orders, execution at a price lower than the national best offer at the time of order receipt and, for sell orders, execution at a price higher than the national best bid at the time of order receipt.” 17 C.F.R. § 242.600(b)(29).

⁷ Payment for Order Flow, Exchange Act Release No. 34902, 59 Fed. Reg. 55006, 1994 SEC LEXIS 3330, at *20 (Oct. 27, 1994) (“Payment for Order Flow Release”).

⁸ Payment for Order Flow Release, at n. 28.

⁹ NTM 15-46 at 6.

¹⁰ NTM 15-46 at 6.

a. TradeStation Failed to Conduct a Reasonable Regular and Rigorous Review of Its Equities Order Flow

i. *Marketable Equity Orders*

From 2014 to September 2016, the Firm prioritized¹¹ the routing of marketable equity orders to market-makers and exchanges that paid for that order flow. The Firm, however, failed to review separately the execution quality that was provided by each individual market. Instead, the Firm only reviewed the execution quality that it received in the aggregate from all markets. In addition, although TradeStation compared that aggregate execution quality data to an industry average, the Firm did not evaluate whether superior execution quality existed for marketable equity orders at specific competing markets until May 2019.

From April 2016 to May 2019, the Firm reviewed and compared the execution quality it received from each market-maker to which it routed its customers' marketable equity orders. But while the Firm compared the execution quality it received from each market-maker to each other, it only further compared the market-makers' execution quality to the *average* execution quality of exchanges. The Firm did not reasonably review whether superior execution quality, such as opportunities for price improvement, existed at any of the individual exchanges that made up the average. As a result, the Firm did not reasonably consider the quality of executions that the Firm could have obtained from competing markets as compared to its current routing arrangements for marketable equity orders. From May 2019 to February 2021, the Firm reviewed the execution quality that may have been available at additional competing markets, but failed to document its reviews.

ii. *Non-Marketable Equity Orders*

From 2014 until January 2017, although the Firm prioritized the routing of non-marketable orders to exchanges that paid the highest rebates, it did not review the fill rates it received from such markets or evaluate whether it could have received better fill rates from competing markets.

iii. *Odd Lot Equity Orders*

From 2014 until September 2019, the Firm prioritized the routing of odd lot equity orders to market-makers that paid the Firm for that order flow. The Firm, however, did not conduct any review of the execution quality it received from these markets for this order type, and did not consider whether it could obtain better execution quality for such order type from competing markets. As a result, the Firm did not conduct a reasonable review of odd lot equity orders to determine whether material differences in execution quality,

¹¹ The Firm used a smart order router that employed a routing algorithm. The algorithm employed a ranking system whereby the Firm assigned a hard-coded ranking to each market. The markets that paid the Firm for order flow appeared at the top of the ranking system. If liquidity did not exist within the highest ranked markets, only then would lower ranked markets receive the order.

such as opportunities for price improvement, existed between specific competing markets. Beginning in September 2019, the Firm started to review and compare the execution quality it received from each market-maker and competing markets. The Firm, however, did not document its reviews of the execution quality available from competing markets until February 2021.

b. TradeStation Failed to Conduct a Reasonable Regular and Rigorous Review of Its Options Order Flow

i. *Marketable Option Orders*

From 2014 to June 2016, the Firm routed marketable option orders to exchanges and market-makers, which paid the Firm for that order flow. While the Firm conducted a daily random sampling of option orders to confirm they were executed within the National Best Bid and Offer (NBBO), it did not conduct a regular and rigorous review of the execution quality it received from these markets.

From July 2016 to February 2021, the Firm routed its marketable option orders only to market-makers that paid for that order flow. Although, in July 2016, the Firm began reviewing and comparing the execution quality it received from those market-makers, the Firm did not review execution quality information, such as data related to price improvement opportunities, of competing markets until February 2021. As a result, the Firm did not reasonably consider the quality of executions that the Firm could obtain from competing markets for marketable option orders.

ii. *Non-Marketable Option Orders*

From 2014 to February 2021, the Firm prioritized the routing of non-marketable option orders to market-makers that paid the Firm for that order flow. Prior to February 2019, the Firm did not conduct reviews of the execution quality it received from those market-makers and did not consider whether the Firm could obtain better execution quality from competing markets. Although, since February 2019, the Firm has been reviewing and comparing the execution quality for non-marketable orders that it received from market-makers, the Firm did not review execution quality information, such as data related to the likelihood of execution, of competing markets until February 2021. As a result, the Firm did not reasonably consider the quality of executions that the Firm could obtain from competing markets for non-marketable option orders.

iii. *Multi-leg Option Orders*

From 2014 to February 2020, the Firm prioritized the routing of multi-leg option orders to market-makers that paid the Firm for that order flow. The Firm, however, did not conduct reviews of the execution quality it was receiving from these market-makers and did not consider whether the Firm could obtain better execution quality from competing markets. Since February 2020, the Firm has been reviewing and comparing the execution quality for multi-leg options that it receives from market-makers, but the Firm did not

review execution quality information, such as data related to price improvement opportunities, of competing markets until February 2021. As a result, the Firm did not reasonably consider the quality of executions that the Firm could obtain from competing markets for multi-leg option orders.

By virtue of the foregoing, TradeStation violated FINRA Rules 5310(a), 5310.09, and 2010.

4. TradeStation Did Not Reasonably Supervise for Best Execution

FINRA Rule 3110(a), and its predecessor NASD Rule 3010(a), requires 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 with applicable FINRA and NASD rules, including but not limited to, the establishment and maintenance of written procedures as prescribed by FINRA Rule 3110(b) and NASD Rule 3010(b).

FINRA Rule 3110(b), and its predecessor NASD Rule 3010(b), requires 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 with applicable FINRA and NASD Rules.

The Firm's supervisory system was not reasonably designed to achieve compliance with FINRA Rule 5310 and Supplementary Material .09 because the Firm's supervisory reviews for best execution disregarded several order types and factors set forth in FINRA Rule 5310.09(b), and failed to reasonably account for comparisons of the quality of executions the Firm obtained via current order routing and execution arrangements to the quality of the executions that the Firm could have obtained from competing markets.

The Firm's Best Execution WSPs, dated June 2013, set forth the Firm's obligation to provide best execution to its customers' orders by using reasonable diligence to determine the best markets to buy or sell a security and obtaining a price as favorable as possible under prevailing market conditions. The procedures, however, provided no guidance as to how the Firm's BEC and PMT should supervise to achieve compliance with the Firm's best execution obligations beyond requiring a regular and rigorous review of "data regarding prices and executions."

In 2016, the Firm amended its WSPs to include an obligation to conduct a comparative review of execution quality that included a review of competing markets. The 2016 WSPs also provided that the Firm's regular and rigorous review should include consideration of specific execution quality factors. But they failed to provide any guidance as to how the supervisor should conduct a comparative review to determine whether any material differences in execution quality existed among competing markets. The WSPs also failed to detail whether the BEC or the PMT was responsible for

modifying order routes and what execution quality factors should be considered when doing so.

By virtue of the foregoing, the Firm violated NASD Rules 3010(a) and (b), FINRA Rules 3110(a) and (b), and FINRA Rule 2010.

5. The Firm Failed to Disclose Material Aspects of Its Relationships with Venues

Rule 606 requires a firm to make publicly available for each calendar quarter a report on routing of orders in NMS securities. The report must include, inter alia, a discussion of the material aspects of the firm's relationship with the venues to which it routes most of its order flow, including a description of any arrangement for payment for order flow and any profit-sharing relationship it may have with a routing venue. The purpose of requiring disclosure concerning the relationships between a broker-dealer and the venues to which it routes orders is to alert customers to potential conflicts of interest that may influence the broker-dealer's order routing practices.

From January 2014 through October 2016, although TradeStation disclosed in its 606 report that it maintained payment for order flow arrangements with venues to which it routed non-directed equity and option orders for execution, it failed to report all of the material aspects of those relationships. Specifically, TradeStation failed to report the per share or per order payments that it received from the venues identified in its quarterly 606 reports. As a result, the Firm violated Rule 606 of the Securities Exchange Act of 1934 and FINRA Rule 2010.

B. The Firm also consents to the imposition of the following sanctions:

1. a censure; and
2. a fine in the amount of \$850,000.

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 herein 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 testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

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.

February 24, 2021

Date

Peter Korotkiy

TradeStation Securities, Inc
Respondent

Peter Korotkiy

Print Name: _____

Title: President & COO

Reviewed by:
MS

Kerry Zinn

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Accepted by FINRA:

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

March 2, 2021

Date

John P. Hewson

John P. Hewson
Senior Counsel
FINRA Department of Enforcement