

SEC Continues Focus on Alternative Trading System Compliance

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On June 6, 2014 the Securities and Exchange Commission (“SEC”) charged a New York-based brokerage firm that operates a dark pool alternative trading system (“ATS”) with improperly using subscribers’ confidential trading information in marketing its services that does not have the same effect on market price as trading on stock exchanges.

ATSs are organizations or systems that provide a market place for purchasers and sellers of securities. Generally regulated as a Broker rather than a stock exchange, they must be approved by the SEC. They are a private trading venue where investors can buy and sell anonymously unlike stock exchanges.

SEC regulations require ATSs to establish and enforce safeguards and procedures to protect the confidential trading information of their subscribers. One of these rules limits access to subscribers’ data to employees who operate or have a direct compliance role regarding the ATS.

The SEC concluded that Liquidnet violated its regulatory obligations and commitments to its ATS subscribers by providing a business unit outside the ATS access to the confidential trading data. The confidential information about Liquidnet’s dark pool subscribers was used in marketing presentations and communications to other customers, and in two ATS sales tools devised and used to expand its business. The data did not specifically identify ATS subscribers, but did describe them in terms of size, trading activity and similar characteristics.

Liquidnet has agreed to settle the SEC’s charges and pay a \$2 million penalty. Liquidnet neither admitted nor denied the SEC’s findings.

Andrew J. Ceresney, director of the SEC Enforcement Division said “Dark pool operators violate the law when they fail to protect the confidential trading information that their subscribers entrust to them, as Liquidnet did here when it used this confidential information to try to expand its business.” “We will continue to aggressively police broker-dealers who operate an ATS and fail to rigorously ensure the protection of confidential trading information.”

In recent years the SEC and Financial Industry Regulatory Authority (“FINRA”) have initiated broad investigations and brought actions against ATS and their operators for various violations. The proceedings against Liquidnet make clear that the SEC and FINRA will continue their focus on ATSs and will pursue any that do not strictly maintain confidentiality of subscriber trading information and comply with other SEC and/or FINRA rules applicable to ATSs.

For assistance with SEC-related investigations or other similar matters our attorneys are available. Contact Partner Michael Storck at mstorck@lippes.com or at (716)853-5100, ext. 369.

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