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SEC Director of the Division of Enforcement Discusses Market Structure Enforcement

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On November 2, 2015, the Director of the SEC Division of Enforcement Andrew Ceresney spoke at the "SIFMA Compliance & Legal Society New York Regional Seminar" and outlined the SEC's enforcement priorities with respect to market structure issues. This is yet another response by regulators to the growth of algorithmic trading and alternative trading venues, which we have blogged about here, here and here.

The Director noted that although the increased speed and automation in the markets provide benefits, they also present "new and complex threats to investors," leading the SEC to focus on the following areas of concern:

- Fairness in Trading Venues. The Director noted the SEC's interest in the exchanges' approach to executing, reporting and regulating trading. The Director noted that this is a relatively new area because, prior to 2012, the SEC had never imposed a civil penalty on an exchange.

- Misuse of Confidential Customer Order Information. This issue relates to dark pools and their obligation under Regulation ATS to have safeguards to protect confidential customer information. The Director discussed the recent SEC enforcement matters in the area, including the ITG matter (that we blogged about here, where a firm improperly used customer information to drive the firm's proprietary trading algorithms, and suggested the SEC will continue to take action in this area.

- Failure to Guard against Risks of Direct Market Access. The Director noted that Rule 15c3-5, which requires risk management controls for firm's having direct market access, is a critical tool to prevent out-of-control algorithms from harming the market, and that the SEC has been particularly active in this area. The Director discussed the recent cases in this area, including the Latour matter that we blogged about here. The Director noted that Latour (and the other matters) deliver two important messages: (1) firms must have controls over their automated trading, including designing safeguards that anticipate mistakes and limit the harm they can cause, and (2) market structure violations can have severe consequences and prejudice other market participants, even when those violations do not involve fraud.

- High Volume Manipulative Trading. The Director reiterated that detecting, investigating and bringing cases for market manipulation is a core responsibility of the SEC. The Director discussed the recent cases the SEC has brought regarding marking the close, layering and spoofing and noted that the SEC has successfully used innovative data analytics to identify such conduct. The Director also noted that manipulative trading often originates overseas, which adds complexity to those matters and reinforces the importance of broker-dealers' obligations under Rule 15c3-5 in preventing potential wrongdoing.

The Director also stated that the SEC will continue focus on the disclosure firms make concerning their dark pools, and the way their dark pools operate and whether those statements are incomplete or misleading. In addition, the Director stated that the SEC will continue to focus on market access violations and that it "will be particularly interested in whether broker-dealers are fulfilling their obligations both for pre-trade regulatory requirements and also post-trade surveillance." Third, the Director also stated that the SEC will continue to focus on layering and spoofing as well as other manipulative and abusive trading, including trading that cuts across different markets such as the stock and options markets.

Lastly, the Director emphasized that the SEC has the necessary expertise and resources to conduct these technology-intensive investigations, which may include review of computer code and analysis of extremely large data sets.

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