Securities Regulation Daily Wrap Up, ENFORCEMENT—SEC brings first case against high frequency trading firm and imposes largest penalty for net capital violations, (Sep. 17, 2014)

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By Jacquelyn Lumb

The SEC today charged Latour Trading LLC, a high frequency trading firm located in New York City, with violations of the net capital rule and charged its former chief operating officer with causing the violations. The firm will pay a record $16 million to settle the charges. Former COO Nicolas Niquet will pay $150,000. SEC Enforcement Director Andrew Ceresney said the record penalty underscores the seriousness of the violations. He also noted that it is the Commission's first action against a high frequency trading firm. While Latour may not be a household name, Ceresney advised that during the period at issue, Latour's trading at times accounted for as much as 9 percent of the trading volume in equity securities for the entire U.S. market.

According to the SEC's order, Latour uses algorithmic high-frequency trading strategies to engage in proprietary trading in ETFs. Latour seeks to hedge its ETF positions by trading futures and the component securities of the ETFs. During today's news conference to discuss the case, Ceresney made clear that the action was not about a manipulative trading strategy, but about a fundamental tenet of the financial responsibility rules for broker-dealers.

Latour repeatedly miscalculated its net capital amounts in 2010 and 2011 and failed to take proper haircut deductions. The firm incorrectly used hypothetical positions that it did not hold, which resulted in haircuts that were far too low. Niquet designed the code for the haircut calculations, though he had no prior experience in calculating net capital. The net capital violations also resulted in violations of the books and records and financial reporting provisions of the federal securities laws.

In response to a question about whether high frequency trading increases the likelihood of a net capital violation, Ceresney acknowledged that the volume of trading and size of positions make compliance more complicated. Latour's trading was extensive, so its calculations were more complicated. Ceresney added that the net capital calculation is something the staff looks at during examinations, which is how this matter came to light.

In response to a question about the risk to the broader market, Ceresney said violations of the net capital rule could have significant implications. It is a safety buffer, he explained. When asked whether the size of the penalty was intended to send a message to other high frequency trading firms, Ceresney said it was based on the circumstances, including the number of violations, the period of time over which they occurred, and the extent to which the firm was out of compliance. The violations here were quite serious, he said.

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