

**THE NASDAQ STOCK MARKET LLC  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2015044918101**

TO: The NASDAQ Stock Market LLC  
c/o Department of Enforcement  
Financial Industry Regulatory Authority (“FINRA”)

RE: Charles Schwab & Co., Inc., Respondent  
Broker-Dealer  
CRD No. 5393

Pursuant to Rule 9216 of The Nasdaq Stock Market LLC (“Nasdaq”) Code of Procedure, Charles Schwab & Co., Inc. (“Schwab” or the “firm”) 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, Nasdaq will not bring any future actions against the firm alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. The firm 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 Nasdaq, or to which Nasdaq 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 Nasdaq:

**BACKGROUND**

Schwab became registered with FINRA in 1970, with the Securities and Exchange Commission in 1971, and with Nasdaq in 2006. The firm has more than 9,600 registered representatives and approximately 400 branches. Schwab is a subsidiary of The Charles Schwab Corporation, a savings and loan holding company in San Francisco. Schwab’s customers consist of retail customers and investment advisers. The firm does not have a relevant disciplinary history.

**SUMMARY**

1. This investigation was initiated by the Quality of Markets Section of FINRA’s Department of Market Regulation following a certain market event in March 2015. A Schwab customer had entered a market order to buy 42,000 shares of ABC.<sup>1</sup> Schwab routed the order to another broker-dealer, which executed the order at prices ranging

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<sup>1</sup> For this settlement, the identity of the stock that was the subject of the limit up-limit down pause is not disclosed.

from \$8.94 to \$9.89 in nineteen seconds, a rapid price increase that resulted in a limit up-limit down trading pause (the “Market Event”).

2. This matter concerns the firm’s compliance with Section 15(c)(3) of the Securities Exchange Act of 1934 and Rule 15c3-5 thereunder and the supervision rules of Nasdaq during the period from March 2015 through the present (the “review period”). As set forth below, FINRA’s investigation revealed that, during the review period, Schwab’s controls for orders directly routed to Nasdaq and for orders routed to other broker-dealers were not reasonably designed to prevent the entry of erroneous orders because they were unreasonably high, failed to fully take into account the trading characteristics of the underlying securities, and failed to reject orders that were not reasonably related to the quoted prices of securities.

### **FACTS AND VIOLATIVE CONDUCT**

#### **Rules at Issue**

3. SEC Rule 15c3-5(b) requires a broker-dealer with market access, or that provides a customer or any other person with market access, to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.
4. SEC Rule 15c3-5(b) further requires a broker-dealer with market access to preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with Exchange Act Rule 17a-4(e)(7).
5. SEC Rule 15c3-5(c)(1)(ii) requires every broker-dealer that provides market access to have risk management controls and supervisory procedures reasonably designed to “[p]revent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders.”
6. Nasdaq Rule 3010(a), now General 9, Section 20,<sup>2</sup> requires each member to establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable Nasdaq rules. Nasdaq Rule 3010(a) requires members to comply with FINRA Rule 3110 as if it were part of Nasdaq’s rules, and FINRA Rule 3110, as applied to Nasdaq members, requires each member to establish, maintain, and enforce written procedures that are reasonably

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<sup>2</sup> Effective December 6, 2019, Nasdaq relocated its rules from its then-current rulebook to its new rulebook shell, relocating Rule 3010 to General 9, Section 20. Exchange Act Release No. 87778 (Dec. 17, 2019), 84 Fed. Reg. 70590 (Dec. 23, 2019).

designed to achieve compliance with applicable federal securities laws and regulations and Nasdaq rules.

7. Nasdaq Rule 2010A, now General 9, Section 1(a), requires members, in the conduct of their business, to observe high standards of commercial honor and just and equitable principles of trade.

#### **Violations Associated with Direct Market Access Orders**

8. During the review period, Schwab routed approximately 96% to 99% of its customer orders to other broker-dealers, which either executed the orders as market makers or provided their market access to enter the customer orders into an exchange or ATS.
9. During the review period, approximately 1% to 4% of Schwab customer orders had direct access to Nasdaq or another exchange.
10. During the review period, with respect to orders Schwab routed directly to Nasdaq, Schwab failed to establish, document, and maintain a system of risk management controls and supervisory procedures that were reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceeded appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicated duplicative orders.
11. Until approximately April 2016, Schwab's market access controls for order flow routed directly to Nasdaq consisted of certain credit and risk checks,<sup>3</sup> an unreasonably high single order quantity limit of 999,999 shares, and a "soft" block to warn a customer if an order was priced through the national best bid or offer, which the customer could override. These controls were not reasonably designed to prevent the entry of erroneous orders and failed to fully take into account the trading characteristics of individual securities or to reject orders that were not reasonably related to the quoted prices of securities.
12. Schwab retired the controls described in paragraph 11 in approximately March 2016. From approximately April 2016 to approximately July 2018, Schwab's direct Nasdaq order flow passed through Schwab's STAMP-CRS and Autoboater controls. The STAMP-CRS and Autoboater controls required an order to exceed multiple, unreasonably high thresholds in order for the order to be subject to manual review instead of being automatically routed to Nasdaq. For example, the STAMP-CRS controls only remanded an order for manual review where it was a buy order exceeding 50,000 shares and the order crossed one or more additional thresholds—such as a \$750,000 single order notional value or a \$5,000,000 aggregate maximum notional value. During the review period, the Autoboater controls consisted of a single order check, where orders greater than 30,000 shares for a security priced at or

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<sup>3</sup> SEC Rule 15c3-5(c)(1)(i) requires a firm to have controls to prevent the entry of orders that exceed appropriate preset credit or capital thresholds. Schwab specifically instituted a set of credit and risk checks, such as limiting an order's size to the funds available in the account. Such a control, however, would not prevent the entry of an erroneous order so long as the customer had sufficient funds to effect the trade.

below \$6.00 were subject to manual review, and an average daily volume (“ADV”) check remanding orders for review only where the ADV was less than 1 million shares and the order was 200% of ADV. These controls failed to fully take into account the trading characteristics of individual securities or to reject orders that were not reasonably related to the quoted prices of securities, and were not reasonably designed to prevent the entry of erroneous orders.

13. In addition, although Schwab established procedures that described certain credit and risk controls, these procedures failed to fully document or include written descriptions of the risk management controls described in paragraphs 11 and 12.
14. By engaging in the conduct described in paragraphs 10–13, Schwab failed to establish and maintain a system of risk management controls and supervisory procedures that were reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceeded appropriate price or size parameters, on an order-by-order basis or over a short period of time. Schwab further did not preserve a complete written description of its risk management controls as part of its books and records. Schwab’s conduct violated SEC Rules 15c3-5(b) and (c)(1)(ii) and Nasdaq Rules 3010(a) and 2010A.

#### **Violations Associated with Orders Routed to Other Broker-Dealers**

15. With respect to orders that Schwab routed to other broker-dealers, the firm failed to have in place a supervisory system and written supervisory procedures reasonably designed to ensure that such orders placed into trading systems were not entered in error.
16. For example, since at least March 2015, when the Market Event occurred, to approximately July 2018, when Schwab completed transitioning to a new credit and risk review system, described below at paragraphs 19–20, orders that Schwab routed to other broker-dealers passed through the STAMP-CRS and Autobooter controls described in paragraph 12. The controls required an order to exceed multiple unreasonably high thresholds in order for the order to be subject to manual review instead of being automatically routed to other broker-dealers for execution.
17. In addition, since at least March 2015 to approximately July 2018, Schwab subjected a portion of its order flow routed to broker-dealer DEF<sup>4</sup> for execution to a set of 32 controls the firm referred to as “Blast checks” prior to routing. The only size control in the Blast checks limited an order to 1–10,000 shares, and the only price control was that an order had to be marketable. These controls were not reasonably designed to check for order accuracy or to ensure that orders placed into trading systems were not entered in error or in a manner inconsistent with Nasdaq rules. Further, the controls failed to fully take into account the trading characteristics of underlying securities, and the firm did not have controls to reject orders that were not reasonably

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<sup>4</sup> The broker-dealer’s name has been anonymized.

related to the quoted prices of securities other than that the order had to be marketable.

18. By engaging in the conduct described in paragraphs 15–17, Schwab violated Nasdaq Rules 3010(a) and 2010A by failing to establish a supervisory system and written supervisory procedures reasonably designed to ensure that orders placed into trading systems were not entered in error or in a manner inconsistent with Nasdaq rules.

#### **Schwab's Current Controls**

19. From approximately June 2016 through approximately July 2018, Schwab gradually instituted another set of risk and credit controls to replace the STAMP-CRS, Autoboater, and Blast check controls described above. During the transition period, Schwab began applying the new controls to orders that it routed to other broker-dealers, and since approximately July 2018, Schwab's direct Nasdaq order flow has passed through the new controls, which remain in place through the present.
20. The new system has a number of credit and risk controls, and the system evaluates orders in certain price ranges and remands them for manual review if they exceed certain percentages of the relevant stock's ADV. The system, however, lacks reasonably designed controls to prevent the entry of erroneous orders, such as a pre-trade control reasonably designed to reject orders with prices that are not reasonably related to the quoted price of the security. Although the firm has certain controls to prevent the entry of orders at a price a certain percentage away from the last sale or closing price, the percentage thresholds are set at such high levels, the controls are not reasonably designed to prevent erroneous orders from entering the market. In addition, Schwab's procedures do not document or include written descriptions of the risk management controls described in this paragraph.
21. Thus, with respect to orders that Schwab routes to other broker-dealers, the foregoing conduct violates Nasdaq Rules 3010(a) and 2010A, now General 9, Sections 20 and 1(a), by failing to establish a supervisory system and written supervisory procedures reasonably designed to ensure that orders placed into trading systems are not entered in error or in a manner inconsistent with Nasdaq rules. With respect to Schwab's direct Nasdaq order flow, the foregoing conduct constitutes a failure to establish and maintain a system of risk management controls and supervisory procedures that are reasonably designed to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time. Schwab further failed to preserve a written description of its risk management controls in its current risk and credit system as part of its books and records. Schwab's conduct violates SEC Rules 15c3-5(b) and (c)(1)(ii) and Nasdaq Rules 3010(a) and 2010A, now General 9, Sections 20 and 1(a).

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

1. A censure, a fine in the amount of \$50,000, of which \$25,000 shall be payable to Nasdaq;<sup>5</sup> and
2. An undertaking to implement risk management controls and procedures reasonably designed to achieve compliance with the rules and regulations cited herein, and an undertaking to revise the firm's written supervisory procedures and written description of its risk management controls described in this AWC.

Within 120 business days of notice of acceptance of this AWC, a registered principal of Schwab shall submit to the COMPLIANCE ASSISTANT, DEPARTMENT OF ENFORCEMENT, FINRA, 15200 OMEGA DRIVE, THIRD FLOOR, ROCKVILLE, MD 20850-3241, a signed, dated letter, or an e-mail from a work-related account of the registered principal to MarketRegulationComp@finra.org, providing the following information: (1) a reference to this matter; (2) a representation that Schwab has implemented risk management controls and procedures, and revised its written supervisory procedures and written description of its risk management controls, to address the deficiencies as indicated above; and (3) the date the controls and procedures, and revised written procedures and description of controls, were implemented. Acceptance of this AWC is conditioned upon acceptance of a similar settlement agreement in a related matter between Schwab and NYSE Arca, Inc.

The firm agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. It has submitted a Payment Information form showing the method by which it proposes to pay the fine imposed.

The firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

## II.

### WAIVER OF PROCEDURAL RIGHTS

The firm specifically and voluntarily waives the following rights granted under Nasdaq's Code of Procedure:

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

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<sup>5</sup> Of the \$50,000 fine, \$25,000 shall be payable to Nasdaq and \$25,000 shall be payable to NYSE Arca, Inc.

- 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 Nasdaq Review Council and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the firm specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Regulatory Officer, the Nasdaq Review Council, or any member of the Nasdaq Review Council, 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 acceptance or rejection of this AWC.

The firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of 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**

The firm 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 FINRA's Department of Enforcement and the Nasdaq Review Council, the Review Subcommittee, or the Office of Disciplinary Affairs ("ODA"), pursuant to Nasdaq Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the firm; and
- C. If accepted:
  - 1. This AWC will become part of the firm's permanent disciplinary record and may be considered in any future actions brought by Nasdaq or any other regulator against the firm;
  - 2. Nasdaq may release this AWC or make a public announcement concerning this agreement and the subject matter thereof in accordance with Nasdaq Rule 8310 and IM-8310-3; and
  - 3. The firm 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. The firm may not take any position in any proceeding brought by or on behalf of Nasdaq, or to which Nasdaq is a

party, that is inconsistent with any part of this AWC. Nothing in this provision affects the firm's right to take legal or factual positions in litigation or other legal proceedings in which Nasdaq is not a party.

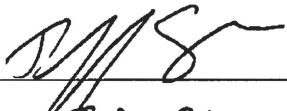
- D. The firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by Nasdaq, nor does it reflect the views of Nasdaq or its staff.




The undersigned, on behalf of the firm, certifies that a person duly authorized to act on its 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 it 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 herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the firm to submit it.

4/27/20  
Date

Charles Schwab & Co., Inc.  
Respondent

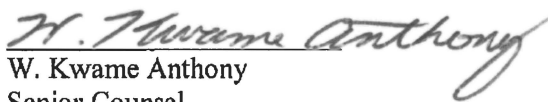
By:   
Name: Jeff Starn  
Title: Senior Vice President

Reviewed by:

  
Greg Scallion  
Counsel for Respondent  
Vice President & Associate General Counsel  
Charles Schwab & Co., Inc.  
9800 Schwab Way (DENR3-03-186)  
Lone Tree, CO 80124  
Phone (720) 418-2286

Accepted by Nasdaq:

May 26, 2020  
Date

  
W. Kwame Anthony  
Senior Counsel  
Department of Enforcement

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

**PAYMENT INFORMATION**

The fine amount will be reflected on an upcoming invoice directed to your firm's chief compliance officer. ***Please DO NOT submit payment at this time.*** If you need to arrange for an alternative method of payment, please contact Nasdaq at (301) 978-8310.

Respectfully submitted,

Respondent

Charles Schwab & Co., Inc.

4/27/20

Date

By: G. SCANLIN  
Name: GREGORY SCANLIN  
Title: VICE PRESIDENT