

January 25, 2017

TSE Imposes Disciplinary Action against Interactive Brokers Securities Japan, Inc.

Japan Exchange Regulation (hereinafter "JPX-R") has inspected Interactive Brokers Securities Japan, Inc. (hereinafter "the Company") and deemed that there was insufficient trading management to prevent acceptance of orders, etc., which could potentially result in the creation of manipulative quotations.

Tokyo Stock Exchange, Inc. (hereinafter "TSE") has taken disciplinary action (imposition of a JPY 20 million fine) against the Company pursuant to the provisions of Rule 34, Paragraph 1 of the Trading Participant Regulations and requested the Company to submit a business improvement report pursuant to the provisions of Rule 19, Paragraph 1 of the same Regulations.

- Outline of Violation

- Insufficient trading management to prevent acceptance of orders, etc., which could potentially result in the creation of manipulative quotations

(1) Identification of unfair trading by the Company

Trading management to prevent unfair trading is conducted only by the Head of Compliance in the Company. Per the Company's request, its parent company in the U.S., IBGLLC, identifies issues and customers for trading surveillance via the use of the Surveillance Report Generation System (hereinafter the "SRG system"), and the Head of Compliance receives such identified data.

However, during the period from March 1, 2010 to July 7, 2015 (until the system was modified to address issues highlighted by internal audits in the IBGLLC group), (i) issue codes for TSE listed companies were duplicated by mistake on the Company's system, and the Company calculated each trading volume for two different issues instead of one; subsequently, (ii) it produced trading volume without separating sell and buy order executions on the system and added them together. Due to these deficiencies and other faulty settings for identification criteria, identification related to high trading ratios of individual issues and at-the-close purchases on the SRG system were not conducted properly, and spoofing was not properly identified due to glitches in the SRG system.

(Reference Translation)

(2) Trading surveillance by the Company

The Head of Compliance checked data identified with the SRG system every morning in his own way, which was a mere formality, and neglected almost all cases, assuming that no measures were necessary. In addition, even if customers for which it was assumed that no measures were necessary were identified once again due to the same surveillance item, the Head of Compliance only checked if there were any big changes in frequency of identification and completed investigations without checking details or forms, etc. of the trading that was once again identified.

Furthermore, on and after August 20, 2014, the Company did not keep any records of two cases out of 13 where the JPX-R Market Surveillance & Compliance Department gave explanations to the Company on actual conditions, because trading might lead to violations concerning forms of order and execution from specific entrustors. The Company did not have detailed knowledge of the trading nor made any analysis on forms of trading for the eight cases and only reported the contents of the explanations given by JPX-R to the compliance department at IBGLLC. Regarding the other three cases, the Company also did not identify nor analyze the transactions for which JPX-R had given explanations and only determined to continue monitoring them without assuming that these were subject to trading surveillance.

The results from the identification that the Company conducted later showed that 3,667 cases of 625 issues in total were identified as trading that was likely to be spoofing made via IBGLLC in the U.S. by non-resident customers on 62 business days from May to July 2015. JPX-R verified the transactions for July 16 due to many transactions having been identified as cases that were likely to be spoofing, and deemed that 88 cases of 24 issues were traded in the form of spoofing and the like, where cancelling of large orders had taken place immediately after order placement.

(3) The Company's internal management system

The Company has increased acceptance of orders of Japanese stocks from non-resident customers via group companies, a situation which requires attention in terms of trading management. The Company is provided with services by IBGLLC that include system development and trading management operations. The Company needed to know and manage the trading surveillance operations that group companies had conducted and ensure cooperation with operations in Japan to build its trading management system and make it effective as a whole. However, the representative director of the Company did not provide sufficient guidance and training on operations of trading management to the Head of Compliance who had taken over said responsibilities; and, even after recognizing that the trading management operation might have problems, the representative director only reported to IBGLLC about customers in question

(Reference Translation)

without checking the process of the Company's trading management operations nor knowing the problems.

In addition, the Company suggested that they focus on trading management operations when an internal audit was conducted within the group. Operations were checked, but checking for whether the trading surveillance was properly conducted according to the laws and regulations in Japan was insufficient.

The deficiencies in the Company, which were deemed so in (1) and (2), have breached Rule 4, Items 1, 3, and 4 of TSE's Rules concerning Trading Supervision Systems at Trading Participants to Prevent Unfair Trading, and the Company's trading management falls under cases in which "the trading management is deemed to not be sufficiently established for prevention of making an entrustment, etc. for a sale or purchase pertaining to listed financial instruments, etc., which may result in the formation of a manipulative quotation not reflecting actual market status" as prescribed in the Financial Instruments and Exchange Act.

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