# Notice, Pursuant to Exchange By-Law 18-2, of Disciplinary Action Against Keystone Trading Partners, Member Organization, and Timothy D. Lobach, Associated Person of Keystone

**To:** Members, Member Organizations, Participants and Participant Organizations

**From:** John C. Pickford, Enforcement Counsel, NASDAQ OMX PHLX[SM]

**DATE:** July 7, 2011

**FINRA Matter No. 20100229926**
**Enforcement No. 2011-04**

On June 8, 2011, the Business Conduct Committee (the "Committee") issued a disciplinary decision against Keystone Trading Partners ("Keystone" or the "Firm"), a member organization of the Exchange, and Keystone's General Partner, Timothy D. Lobach ("Lobach") (collectively, the "Respondents"). In response to a Statement of Charges issued in this action, the Respondents submitted an Offer of Settlement, Stipulation of Facts and Consent to Sanctions ("Offer"). Solely to settle this proceeding, and without admitting or denying the charges, the Respondents consented to findings that during the period between August 1, 2006 and July 17, 2009 (the "Relevant Period"), they had violated Rules 203(b)(1) and 203(b)(3) of Regulation SHO promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Exchange Rules 707, 748, and 1014(b)(ii)(D)(1) by, among other things: (i) failing to close-out fail-to-deliver positions ("fails") within the timeframe specified under Regulation SHO; (ii) improperly utilizing Regulation SHO's locate and hedge exemptions; (iii) effecting sham transactions to reset Keystone's delivery obligations; and (iv) failing to satisfy Keystone's quoting obligations in its assigned options series.

Specifically, Respondents consented, without admitting or denying the charges, to findings by the Committee that they had effected numerous short sale transactions in at least ten hard-to-borrow, threshold securities. Respondents had not arranged to borrow these securities because they had improperly relied on the market marker exemption from the locate requirement under Regulation SHO. Respondents subsequently failed to deliver the securities they had sold short by settlement date and were notified by Keystone's clearing firm that they had to close out the fail-to-deliver positions by the thirteenth settlement day. Typically, a firm would satisfy its close-out obligation by making large open-market purchases of the threshold securities with little or no control over execution, and with significant exposure to directional market risk. During the Relevant Period, Respondents satisfied their close-out obligations by routinely effecting short-term, paired transactions of stock and options that made it appeared that they had purchased threshold securities and had satisfied their close-out obligations on the books and records of Keystone's clearing firm. In reality, however, these paired transactions yielded no economic benefit to Respondents and did not close out their short positions in the threshold securities but

rather had simply served to improperly "reset" the 13-day clock to zero, prolong the Respondents' short position in each of the ten threshold securities beyond 13 consecutive settlement days, and eventually permitted Respondents to reap approximately $2 million in profits.

Respondents also consented, without admitting or denying the charges, to findings by the Committee that during the Relevant Period they had: (i) on 51 occasions on the very same day they had been "bought-in" by Keystone's clearing firm, negated the clearing firm's buy-in and contradicted guidance provided by the Securities and Exchange Commission requiring that Respondents be a net purchaser of the open fail position in the security, by selling a near equivalent number of shares; (ii) not acted as a bona fide market maker in the ten threshold securities in that they had failed to quote in their assigned options series and their threshold security option activity predominantly consisted of transactions that enabled Respondents effect a synthetic stock position and accompanying reset transactions rather than engage in genuine market making activity; (iii) failed to locate securities prior to effecting short sales in the ten threshold securities in light of the fact they had not engaged in bona fide market making activity; and (iv) failed to meet their obligation to continuously disseminate two-sided markets electronically in at least 60% of the options series to which Keystone had been assigned.

Finally, Respondents consented, without admitting or denying the charges, to findings that Keystone had failed to implement reasonable supervisory systems and controls that were designed to ensure compliance with the requirements of Regulation SHO.

Respondents' Offer was accepted by the Committee and was the basis of its Decision. The Committee found that Respondents had violated Rules 203(b)(1) and 203(b)(3) of Regulation SHO promulgated under the Exchange Act, and Exchange Rules 707, 748, and 1014(b)(ii)(D)(1), concurred in the sanctions consented to by them, and ordered the imposition of the following sanctions against Keystone: (i) a censure; (ii) a fine in the amount of $500,000; and disgorgement of profits in the amount of $2,000,000; and against Lobach: (i) a censure; and (ii) a three-month suspension in a supervisory capacity.

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For more information, contact:

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