

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9313 / April 16, 2012

SECURITIES EXCHANGE ACT OF 1934
Release No. 66815 / April 16, 2012

INVESTMENT COMPANY ACT OF 1940
Release No. 30034 / April 16, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-14848

In the Matter of

**optionsXpress, Inc.,
Thomas E. Stern, and
Jonathan I. Feldman,**

Respondents.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-
AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933,
SECTIONS 15(b) AND 21C OF THE
SECURITIES EXCHANGE ACT OF
1934, AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF
1940 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Section 9(b) of the Investment Company Act of 1940 (“Investment Company Act”) against optionsXpress, Inc. (“optionsXpress”) and Thomas E. Stern (“Stern”). Further, the Commission also deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act against Jonathan I. Feldman (“Feldman”).

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This case involves a complex short selling scheme to profit by circumventing the delivery requirements of Regulation SHO of the Exchange Act (“Reg. SHO”). From at least October 2008 to March 18, 2010, optionsXpress, Inc. (“optionsXpress”), a wholly-owned subsidiary of The Charles Schwab Corporation (“Schwab”), failed to satisfy its close-out obligations under Rules 204 and 204T of Reg. SHO by repeatedly engaging in a series of sham transactions, known as “resets,” designed to give the appearance of having purchased shares to close-out an open failure-to-deliver position while in fact not doing so.

2. Further, one of optionsXpress’ customers, Jonathan I. Feldman (“Feldman”), committed fraud in violation of Section 10(b) of the Exchange Act and Rules 10b-21 and 10b-5 thereunder and Section 17(a) of the Securities Act when he sold options knowing that he had no intention of fulfilling his obligations under those contracts. optionsXpress and its Chief Financial Officer (“CFO”) aided and abetted Feldman in this fraud.

3. The sham resets were accomplished by optionsXpress facilitating its customers buying shares and simultaneously selling deep in-the-money call options that were essentially the economic equivalent of selling shares short. The purchase of shares created the illusion that the firm had satisfied the close-out obligation; however, the shares that were ostensibly purchased in the reset transactions were never actually delivered to the purchasers because on the same day the shares were “purchased,” the deep in-the-money calls were exercised, thereby effectively reselling the shares.

4. These paired reset transactions were not bona fide purchases because their purpose was to perpetuate an open short position while giving the illusion of satisfying the delivery and close-out requirements of Reg. SHO. These sham transactions thus allowed optionsXpress and its customers to engage in what amounts to a stock-kiting scheme that deprived true stock purchasers of the benefits of ownership.

5. During the relevant period, optionsXpress and several customers, including Feldman, routinely engaged in these paired sham transactions in a number of securities, including Sears Holding Corporation, American International Group, Chipotle Mexican Grill, Inc., Joseph A. Bank Clothiers, Inc. and Mead Johnson Nutrition Company. As a result, optionsXpress and its customers had continuous failures to deliver in these and other securities that persisted for months, thereby undermining the purpose of Rules 204 and 204T of Reg. SHO.

6. These sham reset transactions also impacted the market for the issuers. For example, from January 1, 2010 to January 31, 2010, the customers who engaged in the above-described activity, including Feldman, accounted for on average 47.9% of the

daily trading volume in Sears.

7. In 2009 alone, the six optionsXpress customer accounts in total purchased approximately \$5.7 billion worth of securities and sold short approximately \$4 billion of options. In 2009, Feldman himself purchased at least \$2.9 billion of securities and sold short at least \$1.7 billion of options through his account at optionsXpress.

B. RESPONDENTS

8. **optionsXpress** is a Delaware corporation with a principal place of business in Chicago, IL. optionsXpress is a self-clearing, retail, on-line broker specializing in options and futures. It is a broker-dealer registered with the Commission. It is also a member of the Financial Industry Regulatory Authority (“FINRA”), the Chicago Board Options Exchange (“CBOE”), various stock exchanges, and is registered with 53 states and territories. optionsXpress was a wholly-owned subsidiary of optionsXpress Holdings, Inc. (“Holdings”) until September 1, 2011, when it became a wholly-owned subsidiary of Schwab.

9. **Stern**, 66, of Chicago, IL, was the Chief Financial Officer of optionsXpress; the Chief Administrative Officer of Holdings; the President and Chief Executive Officer, Chief Compliance Officer and Director of optionsXpress International, Inc.; the Chief Financial Officer and Director of brokersXpress, LLC; and the Chief Financial Officer, Secretary, Director, and Chief Compliance Officer of OX Trading, LLC. He is a board member of the Options Clearing Corporation (“OCC”). Stern holds himself out as an options industry expert. He holds Series 3, 4, 7, 24, 27, and 63 licenses.

10. **Feldman**, 55, of Baltimore, MD, was a retail customer of optionsXpress. In June 2010, the Office of Thrift Supervision fined Feldman for making material misrepresentations and/or concealing material facts as part of a scheme to defraud a federally-insured financial institution. He is a Senior Vice President at a regional savings bank.

C. REGULATION SHO

11. Rules 203, 204, and 204T of Reg. SHO deal with the requirement to close-out failures to deliver. Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009. 17 C.F.R. § 242.204.

12. Rules 204 and 204T require participants of a registered clearing agency to deliver equity securities to a registered clearing agency when delivery is due; that is, by settlement date. Settlement date is generally three days after the trade date (“T+3”). optionsXpress is a participant of a registered clearing agency.

13. For short sales, if the participant does not deliver securities by T+3 and it has a failure-to-deliver position at the clearing agency, it must purchase or borrow securities of

like kind and quantity to close out the failure-to-deliver position by no later than the beginning of regular trading hours on the settlement day following the settlement date (“T+4”).

14. A participant of a clearing agency does not fulfill its requirements under Rules 204 and 204T if it enters into an arrangement with another person to purchase or borrow securities as required, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow. 17 C.F.R. § 242.204(f); 73 FR 61706, 61714-61715 n.78 (Oct. 17, 2008).

15. Where a participant of a clearing agency subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant’s fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement. 74 Fed. Reg. 38266, 38272 n.82 (July 31, 2009).

16. To satisfy the close-out requirements under Rules 204 and 204T, a clearing broker must take affirmative action to close out the failure-to-deliver position by purchasing or borrowing securities. 73 Fed. Reg. at 61710-11.

17. In narrowly limited instances, Rules 204 and 204T provide credit for certain activity conducted by a broker-dealer prior to the occurrence of the fail. Under Rule 204’s pre-fail credit provision, a broker-dealer can meet its close-out obligation by purchasing or borrowing securities after the trade date but no later than the end of regular trading hours on the settlement date of the transaction if (1) the purchase or borrow is bona fide; (2) the purchase or borrow is of a quantity of securities sufficient to cover the entire amount of the broker-dealer’s failure to deliver; and (3) the broker-dealer can demonstrate that it has a net flat or net long position on its books and records on the day of the purchase or borrow. 17 C.F.R. § 242.204(e). Rule 204T contained a similar provision, however, the broker-dealer could not meet the requirements of the provision unless it purchased the shares. 17 C.F.R. § 242.204T(e).

18. Under Rule 10b-21 of the Exchange Act, it is a manipulative or deceptive device or contrivance for any person to submit an order to sell an equity security if such person deceives a broker or dealer, a participant of a registered clearing agency, or a purchaser about its intention or ability to deliver the security on or before the settlement date, and such person fails to deliver the security on or before settlement date.

19. Rule 10b-21 and Rules 204 and 204T were adopted, among other things, to address abusive “naked” short selling and failures to deliver. Abusive “naked” short selling generally refers to selling short without having stock available for delivery and failing to deliver stock within the standard three-day settlement cycle.

20. Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security, or possibly to avoid borrowing costs associated with

short sales, especially when the costs of borrowing stock are high. Failures to deliver, however, can negatively affect purchasers of stock by depriving them of the benefits of ownership, such as voting and lending, and create a misleading impression of the market for an issuer's stock.

D. ALLEGATIONS

The Violative Trading

21. Six customer accounts at optionsXpress, including Feldman ("the Customers"), engaged in reverse conversions and similar options trading strategies starting no later than October 2008.

22. To execute these strategies, the Customers simultaneously entered into the sale of a put and purchase of call with identical strike prices and expiration dates creating a synthetic long position. The Customers would also create a short position to hedge their synthetic long position. They generally did this by selling deep-in-the-money calls. The synthetic long position and the short position were for an equal number of shares/contracts. Through this set of transactions, the Customers eliminated directional risk in the stock price.

23. An option that is "deep in-the-money" has a strike price that is far below (in the case of a call option) or far above (in the case of a put) the market price for the given security.

24. The deep-in-the-money calls sold to create the short position referenced hard-to-borrow securities and were frequently exercised. After the options were exercised and assigned to the Customers, the Customers had a synthetic long position and a short stock position for which they (and optionsXpress) were required to deliver shares by T+3.

25. However, neither optionsXpress nor the Customers delivered the shares by T+3 thus creating a failure-to-deliver position.

26. Instead of delivering the shares, optionsXpress and the Customers would give the appearance of closing out their fails by entering into a "buy-write," *i.e.*, they would simultaneously buy the shares they needed to cover the failure-to-deliver position and write (sell) deep-in-the-money calls representing an equivalent number of shares.

27. optionsXpress, Stern, and the Customers knew, or were reckless in not knowing, that most, if not all, the calls that were sold as part of the buy-writes would be exercised and assigned on the same day they were sold, resulting in shares not being delivered on settlement. Thus, optionsXpress, Stern, and the Customers knew, or were reckless in not knowing, that these transactions would result in failures-to-deliver.

28. Selling deep-in-the-money calls is essentially the economic equivalent of

selling shares unless the stock price drops precipitously and therefore approaches the strike price.

29. To enter into the buy-write, the Customers paid a certain amount, generally between 1 and 2 pennies per share.

30. The newly written deep-in-the-money calls were generally exercised the same day they were sold (and thus were assigned to the Customers later the same day) putting the Customers back in their original short position, continuing the fails, and causing them to enter into another buy-write the following day. As a result, optionsXpress maintained a net short position at the end of each day.

31. The buy-writes continued on a daily basis until the original synthetic long position was unwound or expired. As a result, optionsXpress had a negative position in the National Securities Clearing Corporation's ("NSCC") continuous net settlement ("CNS") system for extended periods of time.

32. While the daily use of buy-writes gave the impression that optionsXpress was closing out the failures to deliver as required, optionsXpress and the Customers were simply kiting stock to maintain the naked short position.

33. Put another way, the buy-write was a matched order entered for the improper purpose of appearing to close out delivery fails without actually delivering the shares.

34. The transactions were profitable for the Customers because they: (i) sold the initial position "for a credit"; (ii) took no risk with respect to the change in the price of the stock and options that occurred over the life of the position; and (iii) did not incur the costs associated with borrowing or purchasing sufficient shares to make delivery on the short sale. optionsXpress received Commissions on the transactions.

35. The Customers received a net credit for their initial position because of a difference in the relative value of the put and the call. Normally, the price of the put and the call will be in parity; however, the stock associated with the options traded by the Customers was generally hard-to-borrow and therefore expensive to borrow. Because of this, the cost of borrowing the stock was incorporated into the price of the put. Thus, the value of the put was higher relative to the value of the call.

36. Due to the cost of borrowing such hard-to-borrow stocks, the increased price the Customers received for selling the put would have been completely offset by the cost of instituting and maintaining the stock position, had optionsXpress and the Customers complied with their delivery obligations. In order to comply with those obligations, they would have had to borrow or purchase shares of the underlying stock in order to close-out the failure-to-deliver position.

37. By engaging in the buy-writes and thus having a constant unsettled stock

position, optionsXpress and the Customers were able to evade the requirements of Reg. SHO at a relatively minimal cost, thereby maintaining the profitability of the trade.

38. By not delivering shares, optionsXpress and its Customers were extracting a profit at the expense of the true purchasers of the shares. There was no legitimate economic purpose to the buy-write transactions.

39. Indeed, the buy-writes standing alone were economically nonsensical because they cost the Customers money. Their purpose was to perpetuate a failure to deliver. This is not a legitimate economic purpose.

40. optionsXpress' website notes that under normal circumstances the chance to execute profitable reverse conversions is extremely limited: "Individual investors and most other off-the-floor traders don't have an opportunity to do conversions and reversals because price discrepancies typically only exist for a matter of moments. Professional option traders, on the other hand, are constantly on the lookout for these opportunities. As a result, the market quickly returns to equilibrium."

41. From at least October 7, 2008 to March 18, 2010, the Customers conducted the trading strategy described above in the following securities and time periods.

Security	Ticker	1st Buy-Write	Last Buy-Write
American International Group, Inc.	AIG	11/23/2009	1/6/2010
American International Group, Inc.	AIG	7/23/2009	10/7/2009
AMEDISYS Inc.	AMED	12/30/2009	2/17/2010
AMEDISYS Inc.	AMED	2/22/2010	3/18/2010
A-Power Energy Generation Systems, Ltd.	APWR	11/5/2009	11/10/2009
A-Power Energy Generation Systems, Ltd.	APWR	11/20/2009	11/30/2009
A-Power Energy Generation Systems, Ltd.	APWR	3/4/2010	3/10/2010
BioCryst Pharmaceuticals, Inc.	BCRX	11/16/2009	12/17/2009
Citigroup, Inc.	C	6/19/2009	7/24/2009
Chipotle Mexican Grill, Inc.	CMG	7/29/2009	8/12/2009
Chipotle Mexican Grill, Inc.	CMG	11/23/2009	12/17/2009
Chipotle Mexican Grill, Inc.	CMG	9/11/2009	11/12/2009
Chipotle Mexican Grill, Inc.	CMG	1/2/2009	1/21/2009
Chipotle Mexican Grill, Inc.	CMG	6/26/2009	7/21/2009
China Sky One Medical, inc.	CSKI	1/12/2010	2/17/2010
Direxion Daily Financial Bull 3X Shares	FAS	10/8/2009	11/23/2009
FUQI International, Inc.	FUQI	12/7/2009	1/11/2010
Greenhill & Co., Inc.	GHL	12/29/2008	2/23/2009
Greenhill & Co., Inc.	GHL	12/9/2008	12/17/2008
Interoil Corporation	IOC	4/3/2009	5/12/2009
Interoil Corporation	IOC	5/15/2009	5/22/2009

Jos. A. Bank Clothiers Inc.	JOSB	10/7/2008	10/21/2008
Jos. A. Bank Clothiers Inc.	JOSB	11/11/2008	11/20/2008
Jos. A. Bank Clothiers Inc.	JOSB	10/29/2008	11/5/2008
Jos. A. Bank Clothiers Inc.	JOSB	12/9/2008	12/12/2008
Jos. A. Bank Clothiers Inc.	JOSB	1/23/2009	2/24/2009
Life Partners Holdings, Inc.	LPHI	2/22/2010	3/18/2010
Life Partners Holdings, Inc.	LPHI	2/2/2010	2/12/2010
Mead Johnston Nutritional Company	MJN	11/27/2009	12/8/2009
Mead Johnston Nutritional Company	MJN	12/10/2009	12/18/2009
MannKind Corp.	MNKD	12/29/2009	2/17/2010
M&T Bank Corp.	MTB	7/2/2009	9/17/2009
M&T Bank Corp.	MTB	3/24/2009	4/14/2009
OSIRIS Therapeutics, Inc.	OSIR	10/5/2009	10/13/2009
RINO International Corporation	RINO	3/11/2010	3/17/2010
Origin Agritech Limited	SEED	12/1/2009	12/23/2009
Sears Holding Corporation	SHLD	10/7/2008	3/24/2009
Sears Holding Corporation	SHLD	4/8/2009	3/18/2010
Shanda Interactive Entertainment Ltd.	SNDA	7/21/2009	9/17/2009
Synaptics Inc.	SYNA	1/5/2010	2/17/2010
The Talbots Inc.	TLB	2/5/2010	3/18/2010
Texas Industries Inc.	TXI	8/17/2009	10/13/2009
Under Armour, Inc.	UA	7/10/2009	7/20/2009
Under Armour, Inc.	UA	7/30/2009	8/10/2009

42. As a result of the trading, optionsXpress had a continuous failure-to-deliver position in these securities for extended periods of time. For instance, optionsXpress had a failure-to-deliver position in Sears for at least 236 continuous settlement days during the 2009-2010 period. In total during the relevant period, optionsXpress had failures to deliver in at least 25 issuers at least 1,317 times.

43. During this period, the NSCC sent optionsXpress numerous notices of intention to buy-in for many of the securities listed above. NSCC sends these notices to the clearing broker with the oldest failure-to-deliver position when requested to do so by clearing brokers with failures to receive.

44. From at least June 2009 to March 18, 2010, Feldman conducted the trading strategy described above in at least the following securities and time periods:

Security	Ticker	1st Buy-Write	Last Buy-Write
American International Group, Inc.	AIG	7/29/2009	10/2/2009
AMEDISYS Inc.	AMED	1/7/2010	2/12/2010
AMEDISYS Inc.	AMED	2/23/2010	3/17/2009
A-Power Energy Generation Systems, Ltd.	APWR	11/5/2009	11/10/2009
A-Power Energy Generation Systems, Ltd.	APWR	11/20/2009	11/30/2009

A-Power Energy Generation Systems, Ltd.	APWR	3/4/2010	3/10/2010
Citigroup, Inc.	C	6/19/2009	7/24/2009
China Sky One Medical, inc.	CSKI	1/12/2010	2/17/2010
Mead Johnston Nutritional Company	MJN	11/27/2009	12/8/2009
Mead Johnston Nutritional Company	MJN	12/10/2009	12/18/2009
Life Partners Holdings, Inc.	LPHI	2/2/2010	2/12/2010
Life Partners Holdings, Inc.	LPHI	2/22/2010	3/18/2010
OSIRIS Therapeutics, Inc.	OSIR	10/5/2009	10/13/2009
Origin Agritech Limited	SEED	12/4/2009	12/17/2009
Sears Holding Corporation	SHLD	9/22/2009	11/12/2009
Sears Holding Corporation	SHLD	12/2/2009	3/9/2010
The Talbots Inc.	TLB	2/16/2010	3/18/2010
Texas Industries Inc.	TXI	8/20/2009	10/13/2009
Under Armour, Inc.	UA	7/10/2009	7/20/2009
Under Armour, Inc.	UA	7/30/2009	8/10/2009

45. The daily volume of the Customers' trades in some of these issuers was a significant portion of the securities' total daily trading volume. For example, between January 1, 2010 and January 31, 2010, the Customers traded between 832,100 shares and 1,603,000 shares of Sears Holding Corporation ("Sears") stock a day which accounted for between 15.6% and 62.2% of Sears' daily trading volume. On average in the month of January 2010, the Customers accounted for 47.9% of the daily trading volume in Sears.

46. In 2009, the Customers combined purchased a total of approximately \$5.7 billion worth of securities and sold short a total of approximately \$4 billion of options through their accounts at optionsXpress. In 2009, Feldman purchased at least \$2.9 billion of securities and sold short at least \$1.7 billion of options through his account at optionsXpress.

The Law Was Clear: The Reset Transactions Were Violations of Reg. SHO

47. In 2003, the SEC issued guidance to "disabuse traders of any notion" that a married stock/option trade designed to give the appearance of a long position could be used to circumvent regulatory requirements. SEC Interpretive Rel. 34-48795 (Nov. 21, 2003). "Even viewed in the most favorable light, these married put transactions appear to be nothing more than temporary stock lending agreements designed to give the appearance of a 'long' position in order to effect sales of stock in a manner that would otherwise be prohibited." *Id.* "The Commission has previously indicated that where transactions involve no market risk and serve no purpose other than rendering a person an owner of a security in order to accomplish indirectly what was prohibited directly, the activity may violate the federal securities laws." *Id.*

48. In July 2007, the American Stock Exchange ("AMEX") fined several entities and individuals for violating Reg. SHO Rule 203 based on trading activity similar to what the Customers were doing. *In the Matter of Scott H. Arenstein and SBA Trading,*

LLC (July 20, 2007); In the Matter of Brian A. Arenstein and ALA Trading, LLC (July 20, 2007). In the *Arenstein* cases, the respondents engaged in a series of reset transactions, mostly married puts, but also some buy-writes, that employed short-term options to circumvent the close-out obligation of Rule 203.

49. Following the release of the *Arenstein* cases, CBOE sent a regulatory circular to its members, including optionsXpress, “strongly cautioning” its members that transactions “pairing the close-out with one or more short-term options positions that are utilized to reverse that close-out are deemed improper reset arrangements that do not satisfy the Regulation SHO close-out requirement.” CBOE Regulatory Circular RG07-87 (Aug. 9, 2007). “Short sales of threshold securities (that result in fails to deliver) paired with one or more short-term option transactions, for example, including, but not limited to, *reverse conversions and deep in-the-money long call/short stock*, are highly indicative of transactions that may be assisting a contra-party faced with a close-out obligation in creating the appearance of a bona-fide stock purchase.” *Id.* (emphasis added). CBOE then noted that while its examples involved market-makers, “the same analysis would apply to similar arrangements between any market participants.” *Id.*

50. The following year, CBOE reiterated its caution: “When accompanied by certain option transactions, stock purchases that are intended to effect close-outs of fail to deliver positions may bring into question whether a bona-fide purchase has occurred.” The Circular also noted that while it was permissible to re-establish a short stock position the business day following a close-out, “if the underlying stock purchase was not bona-fide or did not completely satisfy any close-out requirement, a pre-borrow of stock is required for the subsequent establishment of the new short stock position on the following business day until the close-out is satisfied.” CBOE Regulatory Circular RG08-63.

51. The CBOE regulatory circulars were reviewed by optionsXpress’ compliance officers in connection with the trading.

52. On October 14, 2008, the SEC adopted Rule 204T noting that “the purchase of paired positions of stock and options that are designed to create the appearance of a bona fide purchase of securities but that are nothing more than a temporary stock lending arrangement would not satisfy Regulation SHO’s close-out requirement.” 73 Fed. Reg. at 61715 n.78.

53. In July 2009, when the SEC adopted Rule 204 it reiterated its guidance: “where a participant subject to the close-out requirement purchases or borrows securities on the applicable close-out date and on that same date engages in sale transactions that can be used to re-establish or otherwise extend the participant’s fail position, and for which the participant is unable to demonstrate a legitimate economic purpose, the participant will not be deemed to have satisfied the close-out requirement.” 74 Fed. Reg. at 38272 n.82.

54. Less than a month later, the SEC brought settled enforcement actions

against several entities and individuals regarding similar options trading and violations of Rule 203. *In the Matter of Hazan Capital Management, LLC and Steven M. Hazan*, Exchange Act Release No. 34-60441 (Aug. 5, 2009); *In the Matter of TJM Proprietary Trading, LLC, Michael R. Benson, and John T. Burke*, Exchange Act Release No. 34-60440 (Aug. 5, 2009). In the *Hazan* and *TJM* cases, the respondents engaged in a series of sham reset transactions that employed short-term paired stock and options positions (married puts and/or buy-writes using both FLEX options and standard exchange-traded options) to circumvent the close-out obligations of Rule 203.

55. Three months later, the SEC brought settled enforcement actions against several other entities regarding similar trading and violations of Reg. SHO. *In the Matter of Rhino Trading, Fat Squirrel Trading Group, Damon Rein, and Steven Peter*, Exchange Act Release No. 34-60941 (Nov. 4, 2009).

Red Flags

56. optionsXpress knew early on that the trading was problematic. On October 15, 2008, less than one month after the Commission issued its emergency order putting Rule 204T into effect, one of optionsXpress' traders sent an internal email which described the trading: "the customer has short positions on hard to borrow stocks where the customer has to buy in every day. Our customer is buying back the short and writing in the money calls which are assigned on a daily basis."

57. In late October 2008, the Clearing Department raised concerns that the stock was not being bought in at market open. The Compliance Department replied back to the Clearing Department and the traders telling them: "According to the rules, they need to be closed out at the opening. The industry is pushing back on this, and requesting the [whole] day, but as it is now, we need to cover at the open." Nonetheless, the Compliance Department did not subsequently follow up with the Clearing Department to ensure that failures to deliver were in fact bought in at market open.

58. The following month, the optionsXpress Clearing Department informed an optionsXpress senior officer of the "vicious cycle" that the buy-writes were causing: "Since we have an open CNS fail and as soon as we buy to cover, the customer shorts a call which gets assigned immediately, we are in a vicious cycle."

59. In mid-November 2008, the optionsXpress senior officer sent an email to the Clearing Department about a *Wall Street Journal* article describing the trading activity in the *Arenstein* case and noting that the FINRA had several cases involving this activity: "There is an article in the WSJ about how short sellers in [Sears] are using options to circumvent the SEC cover rule. I think we need to review this." The Clearing Department emailed back: "[The Customers are] definitely doing this."

60. The Clearing Department also raised its concerns to the Compliance Department noting that the trading was "suspicious." The Compliance Department reached out to the trader who executed the buy-writes and he explained the process again:

“What he’s doing is short covering on hard to borrow stock. It’s cheaper for him to do the deep in the money buy write and get assigned the next day than to put on a married put.”

61. Despite this and other indications that optionsXpress was aware of the Customers’ trading strategy, optionsXpress told FINRA in an August 10, 2009 letter that “OXPS did not know—and could not know—the customers’ motive for selling calls. . . . We do not know, and cannot speculate, as to the motive for the strategy employed by our customers. Therefore, although maintenance of a short position in GHJ may have been a result of the customers’ actions, OXPS does not know the customers’ motives during the review period.”

62. Starting in November 2008, CBOE began asking optionsXpress for information related to its Reg. SHO compliance. On February 26, 2009, CBOE notified optionsXpress that it was investigating the trading to determine whether SEC Rule 204T had been violated. Stern, who functioned as optionsXpress’ primary regulatory liaison, was also involved in the response to CBOE’s investigation and reviewed the Customers’ trading.

63. In May 2009, FINRA initiated its first investigation related to the activity described above.

64. In July 2009, optionsXpress asked an exchange for a fee modification for the buy-writes. As part of the request, an optionsXpress’ senior officer noted that “[w]e do have some larger retail clients that have developed some ‘predictable’ strategies/behavior.”

65. According to the optionsXpress’ senior officer, the market makers using the exchange had begun to anticipate the buy-writes – meaning that the counterparties to the buy-writes were anticipating that the buy-writes would occur each day. Because of the fees at the exchange, optionsXpress worked to find another market for the buy-writes.

optionsXpress Institutes a Policy for “Perpetual” Buy-Ins

66. On August 5, 2009, the SEC instituted the *Hazan* and *TJM* actions. The following day, a trader at optionsXpress notified the Customers that “[u]nfortunately we will need to change how buy ins are covered. . . . This means once we get the buy in lists, the shares will need to be covered immediately in the morning. I apologize for this unfortunate change, but the SEC won’t budge on these rules.”

67. In response to a question from Feldman, a trader at optionsXpress elaborated: “Compliance has also notified me that this could change further by having us place the covers in your account at the market, and have the customer place any option orders.”

68. Despite the Compliance Department’s advice in 2008 discussed above in

paragraph 57, optionsXpress was still not placing the buy-in orders at market open. In fact, optionsXpress never consistently executed the buy-writes at or near market open.

69. On August 10, 2009, one of optionsXpress' traders emailed the Compliance Department with concerns about the short sale process: "[W]e're still getting the buy in report pretty late in the morning." He then raised concerns about optionsXpress' stock borrowing process noting that the "SEC is really cracking down on this."

70. Later the same day the trader noted that buy-ins were another issue: "I know we're the traders over here, but it seems we're giving them too much leeway with these buy writes instead of covering them on the short shares first." The Compliance Department responded: "I agree that we need to tighten up our procedures on the buy-ins. To do this, we will no longer allow customers to conduct their own buys. We will process the buy-in for each account at the open."

71. The decision to no longer allow customers to conduct their own buy-ins was made by a group of people that included Stern.

72. On August 19, 2009, optionsXpress' Compliance Department instituted new buy-in procedures. The decision to implement the new procedures was made by a group, including Stern. In addition, Stern oversaw the implementation of the new procedures and in the process, became intimately familiar with the Customers' trading activity.

73. The new procedures called for two buy-in lists instead of one: a regular list and a list of failure-to-deliver positions where "the fail is continuously open due to customers being assigned in the money short calls," also known internally as the "perpetual," "chronic," or "rolling fails" list. There were different procedures for the two lists.

74. After the new procedures were instituted, one of optionsXpress' traders asked the Clearing Department what qualifies as a "perpetual buy in." The Clearing Department replied: "Always short, covers your buys by buying [sic] short options deep in the money, so they get assigned. More or less, their trade date position stays constant, settled position never closes or goes long."

75. According to an optionsXpress compliance officer, a "perpetual fail" was "a fail where the issue, specific issue or security is failing a number of days...to me it would be if firms didn't close out the fail and left it alone and it would be a perpetual fail if they didn't meet their close-out obligations and let that fail continue." He also noted that "the rule requires us to reduce that fail to deliver, so you would violate Rule, you know, 203 and 204 if you had a fail and you didn't close it out within the required time frames."

76. After the new procedures were issued, an optionsXpress senior officer

followed up with the trading desk saying: “Did we contact our largest clients?” An optionsXpress trader responded: “Definitely, spent a lot of time on the phone with Feldman [and the other Customers] yesterday.” The traders communicated to the Customers that: “Basically they have told us our practices our [sic] not consistent with the rules, and that changes must be made.”

77. The buy-ins for these “largest clients,” the Customers, were treated differently than the buy-ins for optionsXpress’ other customers. Those other customers were treated less favorably by optionsXpress. As explained by one of the traders: “For list #1, [a trader] will take care of contacting the big names: [including Feldman and the other Customers]. If any other names are on list #1 that are not above, go ahead and place market orders to cover at 8:25 a.m. and send the normal email notification to the customers.”

78. When optionsXpress received complaints from other customers who received buy-ins without prior notice, optionsXpress responded that it was complying with Reg. SHO (“I again apologize for this inconvenience, but we are following the SEC regulations regarding short selling.”); (“The rule clearly states on page 6, section B, that any short position that cannot be delivered, must be closed out ‘immediately.’”); (“I understand your frustration over this buy in, but even though you held the security for six months, we couldn’t continuously locate the shares to hold against your position. I will be happy to credit back your commission, but the loss will not be reinstated by optionsXpress. This is a risk of shorting stocks.”).

79. An optionsXpress trader forwarded Feldman a copy of Rule 204 as part of the implementation of the new procedures. optionsXpress’ Clearing Department had previously sent Feldman a copy of Rule 204 on August 3, 2009.

80. On August 21, 2009, Feldman asked if he could “roll the AUG 5 short calls to SEP 5 calls during the day Friday? If I did, they wouldn’t be assigned over the weekend . . . then whatever I end up with is like a new position to be dealt with Monday morning, isn’t it?” An optionsXpress trader replied: “It all comes down to end of the day, what are we net. If you did roll the Aug 5 calls, then we have shares of AIG that we failed to cover. We can use the exercises/assignments to cover the short shares on expiration, but we can’t turn around and say exercises/assignments don’t apply to short positions at the end of the day, this is a huge red flag to the SEC.”

Compliance Says “Absolutely Not” to the Buy-Writes

81. On August 20, 2009, one of the optionsXpress traders asked the Compliance Department if they could continue to place the buy-writes. A compliance officer responded citing Reg. SHO and the Rule 204 issuing release: “we . . . must execute the buy-in on the open for the specified amount to cover the fail. The customer then can do whatever other transaction they want but it is a separate transaction.” He also reminded the trader that “[i]t is expected that buy-ins are occurring at or close to the open, within the first 30 minutes of trading has been accepted to be the ‘beginning’ of

trading hours.”

82. A second compliance officer also responded: “the answer is absolutely not. We do not want to be an active party in the call transactions. We are fulfilling our obligation to issue the buy-in. If we process the buy-write, regulators could consider the buy-ins as sham transactions.” That compliance officer forwarded his response to another compliance officer adding: “I believe that if we do the buy-write for them, auditors will consider them sham transactions as the SEC did with the two fined prop trading institutions [Hazan and TJM].”

83. After receiving the guidance from the compliance officers, the optionsXpress trader told the other traders: “Compliance is telling us that buy-writes can no longer be used to cover a buy-in. We must place the orders separately. Since this will ultimately shut down these orders, we can place them another way. . . . Execution will put in market orders to cover the shares at the open. All we require the customer to do is call in and place a not held option order with execution. The outcome will basically be the same, but two separate orders will be in customers [sic] account, which the SEC wants to see.”

84. Despite the guidance that the Customers needed to call in an order for the sale of the options, this did not necessarily occur. As Feldman told an optionsXpress senior officer in a November 2009 email: “I usually give ‘standing orders’ to [the optionsXpress trader] and don’t even talk to him each day.”

85. Following the issuance of the new procedures, the traders generally entered the buy-in order at or before market open, but marked the order as “do not send to exchange”—meaning that the order was not automatically routed to an exchange for execution.

86. Instead, the traders paired the stock order with the option order and called a floor broker to manually place the buy-write later in the day. This change did not substantively alter the buy-write procedures except the Customers contacted optionsXpress earlier in the day.

87. According to an optionsXpress senior officer, the buy-writes would not be executed at market open because they were being sent to a floor broker on a best efforts basis.

88. Nonetheless, Stern allowed the Customers’ buy-writes to continue.

**optionsXpress Limits the Number of Buy-Writes Due to Regulatory Risk
But Allows Them to Continue**

89. On September 8, 2009, optionsXpress limited Feldman to no more than 8,000 short contracts in AIG. An optionsXpress senior officer explained to Feldman that there was a risk that the regulators could say that the buy-write activity was prohibited.

90. According to the optionsXpress senior officer: “I spoke several times [with Feldman] about my concerns about being involved in an investigation into the trading behavior that they were engaged in. I indicated that I was concerned about market risk and one of the market risks would be an interpretation by a regulator that the action of selling calls and buying stock in a hard-to-borrow security might be scrutinized and that the actions might be deemed not appropriate.”

91. The senior officer also told one of the other Customers that the trading “may attract attention.”

optionsXpress Receives a Letter of Caution from CBOE

92. On September 23, 2009, optionsXpress received a letter of caution from CBOE. CBOE noted that optionsXpress’ procedures called for a buy-in on the morning of T+4, but found that the firm called certain customers prior to the execution of those buy-ins, which was a deviation from optionsXpress’ procedures. That deviation allowed the Customers to buy themselves in with a buy-write.

93. In response, to CBOE’s concerns, optionsXpress claims they began emailing the Customers, instead of calling them. Otherwise, there were no changes and optionsXpress continued to execute the Customers’ buy-writes.

**An optionsXpress Trader Refuses to Execute the Buy-Writes
But Is Told to Continue**

94. On September 23, 2009, the same day that optionsXpress received the CBOE letter of caution, an optionsXpress trader forwarded a copy of the *Hazan* order to an optionsXpress senior officer at 8:16 a.m., citing the language about sham transactions. The trader then stated: “I am not placing any orders today.” The senior officer responded minutes later: “Please execute the buy ins and customer orders today. Compliance has reviewed and is not convinced this applies. They have asked our regulator for an opinion and have not received it.”

95. At 9:02 a.m., an optionsXpress compliance officer sent an email to a group of senior executives, including Stern: “We addressed this issue back in August when the SEC issued its findings in these cases. Although I see issues with what our customers are doing, I pointed out distinguishing factors in my response back in August. . . Additionally, we have responded to four inquiries regarding this issue: one from

CBOE and three from FINRA. While the FINRA issues are still ongoing, CBOE didn't seem to have any issues with our response.”

96. On the same day, the Clearing Department sent an email to the Compliance Department noting that the Compliance Department had previously addressed the issue by saying buy-writes were not allowed: “Don't want to get anyone in trouble, but somewhere down the road this is going to bite us.”

97. Also, on the same day, optionsXpress emailed the *Hazan* order to Feldman.

optionsXpress Calls FINRA and the SEC

98. On September 24, 2009, optionsXpress' in-house counsel, Stern, and two compliance officers called FINRA to ask questions about the trading. FINRA said it would not discuss the issue because of its ongoing investigation.

99. The same day, optionsXpress' in-house counsel, Stern, and the two compliance officers called the SEC's Division of Trading and Markets (“Trading & Markets”). According to optionsXpress, Trading & Markets told optionsXpress to “keep doing what you're doing—keep closing out” and that Trading & Markets would get back to the firm on whether it had a best execution obligation requiring it to combine the Customers' buy-in orders with the sale of calls as buy-writes.

100. However, the trading example that optionsXpress gave to Trading & Markets, as well as other information optionsXpress provided on the call, were inaccurate and incomplete.

101. Upon further investigation, Trading & Markets learned additional facts that optionsXpress did not disclose on the call, including that FINRA had an open investigation and that the customers were using deep-in the-money calls to circumvent Reg. SHO. As a result, on October 2, 2009, Trading & Markets called optionsXpress and spoke to its in-house counsel and Stern telling them that the SEC declined to get involved and that it could provide optionsXpress with “no comfort.”

102. After the October 2, 2009 call with Trading & Markets, optionsXpress' in-house counsel, Stern, and two compliance officers called FINRA. optionsXpress told FINRA that it had received a call from the SEC, and that the SEC had declined to be involved. optionsXpress also said that it was at a loss about what to do and was seeking guidance on the activity.

103. FINRA told optionsXpress that if it wanted guidance, it should send a request in writing to FINRA's general counsel or the SEC.

104. optionsXpress did not submit a written request for guidance to either the SEC or FINRA's general counsel. Instead, optionsXpress continued executing the

Customers' buy-writes.

105. Two weeks after the call, the Compliance Department sent an email about another Reg. SHO issue and noted that “[w]e are already under heavy scrutiny from regulators on our short sale practices, and this problem could push us over the edge.”

Feldman Transfers Part of His Account to Another Broker-Dealer

106. In early November 2009, Feldman transferred part of his holdings from optionsXpress to another broker-dealer based on a recommendation from a floor broker through whom some of the buy-writes were being traded. Feldman had negotiated a deal with the floor broker for lower costs based on the volume of the daily buy-writes.

107. Less than a month later, Feldman transferred his positions back to optionsXpress because the new broker-dealer's clearing broker did not want the business.

108. In an internal email the clearing broker noted that because Feldman was getting assigned every day on the buy-write calls “the position is continuously on the books. In other words his ‘cover’ never removes the position because a new assignment recreates it and in the CNS world it is the same position continuously open on the books.”

109. While at the other broker-dealer, Feldman had a series of conversations with one of its registered representatives regarding the fact that Feldman's shares were not settling. For example, Feldman explained: “I don't settle the stock@all so what diff wld t+2 be?”

110. Upon being told that the clearing broker planned to settle the stock before transferring the position back to optionsXpress, Feldman stated: “They are going to settle the stock? [The clearing broker] is going to settle that, actually settle the stock?”

111. After receiving an assignment notice on Sears, Feldman emailed: “So how many SHLD do I have to buy-in today (to avoid settlement)?”

112. Similarly, in a phone conversation discussing how Feldman would cover shares of Sears that were going to settle on a certain date, Feldman stated: “So I could do a buy-write and then I wouldn't settle,” to which the registered representative replied, “Exactly. You do a buy-write so you don't”

113. Feldman and the registered representative also discussed the fact that there were daily assignments. For example, the registered representative explained to Feldman: “See the problem is if I roll today it doesn't really solve anything because you're just going to get assigned again and again and again.” He also explained to Feldman that optionsXpress could not transfer his deep-in-the-money calls because “they wouldn't have the DEC 30 calls to deliver until they settle but they settle and are assigned same day so nothing to move.”

114. The registered representative also told Feldman that there was no reason the counterparty would not exercise the options and that “market-makers are always going to assign what you’re short.” Feldman had a similar conversation with a trader at optionsXpress who explained: “the market maker is usually always going to assign whatever call [it purchases] . . . normally you’ll always going to get assigned,” to which Feldman replied, “Yeah that’s what I’m saying.”

115. When Feldman was asked to leave the new broker-dealer, he and the registered representative also discussed which brokers would allow Feldman to continue the trading and concluded that it would be difficult to find one. As Feldman summarized: “Right, so they [another clearing firm] might let you get away with certain things because they don’t notice but if it doesn’t fit their rules, they’re not going to make any exceptions.”

116. The registered representative also told Feldman that no other major broker-dealer was doing this type of activity. In early January 2010, Feldman also discussed with one of the optionsXpress traders that no one else on the “street” was doing the buy-writes on Sears.

117. The registered representative also explained to Feldman why the activity would violate Reg. SHO: “[The clearing broker] finally had a CNS fail, not net flat outside of Reg. SHO where they said their compliance told them that they had to go out and buy this stock no matter what, whether you have a net flat position in your account or not they have to go out and borrow them.”

118. The registered representative also told Feldman that the regulators were concerned about this type of activity. “I don’t think [optionsXpress is] going to take you because the CBOE regulators are starting to get heavy on this activity, that’s why [the clearing broker] is getting more than likely skittish.”

119. Nonetheless, optionsXpress allowed Feldman to return, but raised his rate for buy-ins by \$.005 per share.

120. When another Customer threatened to leave optionsXpress shortly after Feldman’s return, an optionsXpress senior officer told others within optionsXpress that the Customer would not be able to leave: “We had another customer [Feldman] move to [the other broker-dealer] and they were kicked back to us []. They do not want this business.”

Feldman Asks about “Restarting the Clock”

121. On December 4, 2009, an optionsXpress compliance officer explained Reg. SHO to Feldman again: “when an assignment results in a short sale in a security we are already failing to deliver, we have to take action to clean up the entire fail immediately.”

122. Feldman responded: “Wow, that’s a wonderfully thorough explanation. . . . This gives me some food for thought. I’m wondering if there might not be some different strategies I could use to avoid buyins, or ‘restart the clock’ sometimes. Is there a time we can talk?”

123. optionsXpress took no action regarding Feldman’s desire to “restart” the settlement clock.

optionsXpress Is Contacted by Multiple Regulators

124. On December 15, 2009, optionsXpress received a letter of caution from FINRA for violating Rule 204T by failing to timely close out a failure-to-deliver position in October 2008.

125. FINRA noted in the letter that it had decided to provide a Cautionary Action Letter as a “compliance aid to assist the Firm in ensuring that it is in compliance with SEC Rule 204T;” however, “any subsequent violations of SEC Rule 204T may result in disciplinary action.”

126. optionsXpress did not change its procedures following the receipt of this letter and the buy-writes continued.

127. On December 30, 2009, the SEC Division of Enforcement made its first request for information to optionsXpress.

128. On January 14, 2010, Stern, optionsXpress’ in-house counsel, and two compliance officers had a call with FINRA staff. During the call, FINRA staff expressed concern that the buy-ins did not result in a net flat or long position at the end of the day.

129. Despite the expression of concern from an employee of FINRA, optionsXpress continued to allow the buy-writes.

130. On February 12, 2010, optionsXpress sent a letter to FINRA falsely stating that “[i]nitially the customers may have been notified before the buy-in purchase was executed, but after late December 2008, they would have been notified after the buy-in purchase was executed.” The letter also contained other inaccuracies.

131. On February 17, 2010, optionsXpress and all of the Customers received subpoenas from the SEC.

132. On February 23, 2010 and March 4, 2010, SEC staff told optionsXpress that they had “grave concerns” about the trading. The buy-writes continued.

optionsXpress Increases Commissions

133. In January 2010, after the Division of Enforcement made its first request for information, optionsXpress told Feldman that it was going to keep in place the commission increase that it imposed following Feldman's return from the other broker-dealer.

134. optionsXpress told Feldman that the reasons for the increase included regulatory concerns and increased compliance costs. "We have had discussions with the regulators about these strategies. It seems several market-makers have been complaining to the regulators about them. We continue to ask the regulators for guidance on these trades. . . . it continues to be a drain on our compliance staff."

135. Several days later, optionsXpress told Feldman that "[r]egulators continue to ask questions, we provide answers and ask for guidance."

136. optionsXpress was not seeking guidance from regulators during this period.

137. In February 2010, optionsXpress began charging the other Customers an increased commission as well. In explaining the increased commissions, a trader at optionsXpress explained that the trades were so large the regulators might start to notice.

138. After optionsXpress increased the commission, Feldman complained: "Millions of \$\$ inc [sic] commissions[sic],,,,yet treat me/us like criminals. . . . But, in the big picture..it's still quite the gig..where can you get such mkt-bating [sic] retuens [sic] consistently? So, as disgusting as [optionsXpress] are [sic], have to bend over and get raped, and take the punishment,,,,"

The Trading Finally Ceases

139. On March 9, 2010, Stern and two other optionsXpress officers called CBOE, asking it to advocate on optionsXpress' behalf in connection with the SEC investigation. CBOE instead referred optionsXpress to the CBOE's regulatory circulars which discussed sham transactions.

140. The same day, optionsXpress decided to halt the trading, but allowed it to continue until the March options expiration. The decision to halt the trading was made by Stern and two other optionsXpress officers.

**optionsXpress, Stern, and Feldman Knew or Were Reckless in Not Knowing
That the Calls Would Be Exercised**

141. optionsXpress, Stern, and Feldman knew or were reckless in not knowing that the buy-write calls would be exercised and assigned.

142. optionsXpress' buy-in procedures – authorized by Stern – reference the “perpetual” list and acknowledge that the list is based on the premise that the calls were being exercised and assigned on a daily basis.

143. optionsXpress employees referenced the “daily,” “chronic,” “perpetual,” and “rolling” buy-ins on numerous occasions, expressed the expectation that the options would be assigned, and explained to the customers that “the market maker is usually always going to assign whatever call [it purchases] . . . normally you’ll [sic] always going to get assigned.”

144. Feldman acknowledged on numerous occasions that the options were being exercised the same day that they were sold. For example, Feldman sent an instant message to a friend: “it almost [sic] doesn’t matter, JUL or SEP, as u get assigned that night anyway, so what’s the diff?”; emailed an optionsXpress senior officer: “a buy-write of 2500 SHLD, incurs a commission of \$1,250 each and every day”; and emailed optionsXpress’ Risk Department: “it’s part of my daily routine. Brush teeth, get coffee, rest [sic] C [Citigroup, Inc.], cover buyin on C [Citigroup, Inc.]”

145. According to Feldman: “[Y]ou’d be stupid to say, oh, I’m going to write these and none them are going to get exercised.”

146. A registered representative at Feldman’s other broker-dealer also told Feldman: “You know your counterparty is dropping on almost every one.” Dropping on almost everyone signifies that the counterparty would almost always choose to exercise the deep-in-the-money calls written by Feldman as part of the buy-write.

147. Feldman and the traders at optionsXpress followed the open interest and daily volume of the options.

148. Open interest is the number of contracts in existence at the beginning of trading. The daily volume is the number of contracts that traded during the day.

149. Feldman admitted that he used the open interest to determine which options he would use and that he paid “a lot of attention to” the volume.

150. An examination of the open interest and volume would have shown that the call options were being exercised the same day. For example, the following is the open interest and volume on SHLD January 5 calls:

Date	optionsXpress Buy-Write	Volume Traded	Open Interest
Nov. 27, 2009	1359	1359	2
Nov. 30, 2009	1383	1383	2
Dec. 1, 2009	1407	1407	2
Dec. 2, 2009	1525	1525	2

151. When asked by a registered representative what the open interest was on a particular option strike, Feldman replied: “probably not very high because they exercise.” Similarly when a registered representative told Feldman “you should of got assigned on 1914 according to open interest.” Feldman replied: “Yup, since 214 of [] stayed open and OI [open interest] was 300. Good use of math!”

152. Further, it generally made no economic sense for the counterparty not to exercise the options (and, therefore, maintain a short stock position). The counterparty faced the same carrying costs as the Customers (*i.e.*, it would have to pay the hard to borrow rate on shares sold short). Also, every day that the options were exercised the Customers needed to do more buy-writes. The counterparty was making a penny or more a share each day that the Customers did the buy-writes. If the options were not exercised, then the counterparty would have not only been exposed to the borrow rate, but would have lost out on a guaranteed return of one penny a share the following day.

Feldman and OptionsXpress Knew the Effect of the Trading

153. In late 2009 and early 2010, Feldman discussed with a friend an electronic message board where there was speculation regarding the buy-write activity. In late December, the friend told Feldman that the participants in the message boards “think Sears is buying back shares. . . . they have no idea.”

154. In late January, when the message board posts were discussing daily “mystery trades,” “illusory trades,” and “faux trades” in Sears, including possible manipulation of its daily trading volume and violations of Reg. SHO, Feldman told his friend: “I read the latest thread on the SHLD ‘volume spikes’. Very entertaining. (Until someone notifies the SEC and they shut down the strategy!!).”

155. Feldman also admitted that he was aware that “everybody was out there just like getting worked up in a tizzy.” In fact, he bragged about his effect on the market to the floor broker who executed the buy-writes.

156. Feldman also reviewed a website which discussed the “manipulative” activity noting that it was “consistent with the illegal ‘reset’ transaction” described in

Hazan.

157. Feldman sold options knowing that the calls would be exercised and assigned, and that he did not intend to deliver the shares by settlement date, and in fact on numerous occasions he did not deliver the shares as required. In doing this “stock kiting,” he deceived clearing brokers and the ultimate purchasers (or recipients) of the stock about his intention to deliver the shares.

158. Feldman’s use of buy-writes was the equivalent of doing matched orders. Feldman used the buy-writes (and optionsXpress allowed him to use the buy-writes) for the improper purpose of appearing to close out delivery fails without actually delivering the shares. Feldman’s use of buy-writes was a manipulative device and deceived the market.

159. When optionsXpress and Feldman failed to deliver shares, the unsettled position was assigned via lottery to clearing brokers who had a net purchase of shares on that day and thus to the ultimate purchasers of those shares. These ultimate purchasers and clearing brokers reasonably presumed that they would receive the shares they bought in the open market (within the standard three-day settlement period), when in fact they did not.

160. Indeed, many of the clearing brokers submitted notices to CNS (who in turn sent them to optionsXpress) requesting immediate delivery of the shares that were not delivered by settlement date.

161. When a seller of securities fails to deliver securities on settlement date, the seller effectively unilaterally converts a securities contract (which is expected to settle within the standard three-day settlement period) into an undated futures-type contract, to which the buyer might not have agreed, or that might have been priced differently.

E. VIOLATIONS

162. As a result of the conduct described above, optionsXpress willfully violated Rules 204 and 204T of Reg. SHO which require participants of a registered clearing agency to deliver securities by settlement date. If the participants do not deliver securities by settlement date in connection with a short sale, they must purchase or borrow securities of like kind and quantity to close out the failure-to-deliver position by no later than the beginning of regular trading hours on the settlement day following the settlement date.

163. As a result of the conduct described above, Feldman willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

164. As a result of the conduct described above, Stern caused and willfully

aided and abetted optionsXpress' violations of Rules 204 and 204T and Feldman's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder.

165. As a result of the conduct described above, optionsXpress caused and willfully aided and abetted Feldman's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents optionsXpress and Stern pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents optionsXpress and Stern pursuant to Section 9(b) of the Investment Company Act; and

D. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, all Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Reg. SHO Rule 204, Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rules 10b-5 and 10b-21 thereunder, and whether all Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange Act, and whether all Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, and Sections 21B(e) and 21C(e) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary