

BEFORE THE NATIONAL ADJUDICATORY COUNCIL  
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Continued Membership  
of  
Firm X  
with  
FINRA

Redacted Decision

Notice Pursuant to  
Rule 19h-1  
Securities Exchange Act  
of 1934

SD13004

Date: 2013

**I. Introduction**

On May 3, 2010, Firm X (“Firm X” or the “Firm”) submitted a Membership Continuance Application (“MC-400A” or “the Application”) with FINRA’s Department of Registration and Disclosure. The Application seeks to permit the Firm, a FINRA member subject to a statutory disqualification, to continue its membership with FINRA. A hearing was not held in this matter. Rather, pursuant to FINRA Rule 9523, FINRA’s Department of Member Regulation (“Member Regulation”) recommended that the Chair of the Statutory Disqualification Committee, acting on behalf of the National Adjudicatory Council, approve the Firm’s continued membership with FINRA pursuant to the terms and conditions set forth below.

For the reasons explained below, we approve the Firm’s Application.

**II. The Statutorily Disqualifying Events Underlying the Application**

The Firm filed the Application as a result of two statutorily disqualifying consent judgments entered by a United States District Court in 2010 (the “First Judgment” and the “Second Judgment”) (collectively, the “Judgments”). The First Judgment, among other things, permanently enjoined the Firm from violating Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 10b-5 thereunder.<sup>1</sup> The First Judgment was based on a complaint filed by the SEC alleging that the Firm, through three of its proprietary traders, was involved in serial insider trading conducted by a ring of Wall Street traders and hedge fund managers. The complaint further alleged that the

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<sup>1</sup> Exchange Act Sections 3(a)(39) and 15(b)(4)(C) provide that a member firm is subject to statutory disqualification if it is enjoined from, among other things, engaging in any conduct or practice as a broker-dealer or in connection with the purchase or sale of any security.

insider traders made more than \$20 million in illicit profits by trading ahead of corporate acquisition announcements using insider information tipped by an attorney at a law firm in exchange for kickbacks.

The Second Judgment, among other things, permanently enjoined the Firm from violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Section 17(a) of the Securities Act of 1933. The Second Judgment was based on a separate complaint filed by the SEC alleging that the Firm, through the same three proprietary traders employed by the Firm, traded on material, non-public information as part of a widespread and repeated insider trading scheme.

The First Judgment ordered that the Firm disgorge approximately \$742,000, representing profits gained and losses avoided as a result of the misconduct, together with prejudgment interest in the amount of approximately \$96,000, and pay a civil penalty in the amount of approximately \$371,000. The Second Judgment ordered that the Firm disgorge approximately \$460,000, representing profits gained and losses avoided as a result of the misconduct, together with prejudgment interest in the approximate amount of \$72,000, and pay a civil penalty in the amount of approximately \$230,000. In total, the Judgments ordered that the Firm disgorge and pay interest and penalties totaling approximately \$1,973,000.

The Judgments also required the Firm to comply with certain undertakings, including implementing recommendations made by the Firm's outside counsel who conducted an internal compliance review designed to enhance the Firm's controls and compliance mechanisms. The Firm agreed to retain an independent consultant within one year of the Judgments to conduct a review of the Firm's controls and compliance mechanisms to ensure that the Firm fully implemented the recommendations that resulted from the internal compliance review and to ensure that the Firm's controls and compliance mechanisms were reasonably effective to prevent the misuse of material non-public information by the Firm or its associated persons. The Judgments required that the independent consultant submit to the Firm and the SEC, within 30 days of the completion of its review, a report describing the scope and results of the independent consultant's review.

The record shows that Firm X complied with the terms of the Judgments. In its Application, the Firm states that the events underlying the Judgments were "caused by a small group of rogue traders" and that "none of the Firm's owners, directors, officers, principals or current associated persons or employees were alleged to have had any involvement with, or knowledge about, the insider trader scheme." The Firm terminated the three proprietary traders who engaged in the insider trading schemes in 2007 and 2008. The Firm further states that once it discovered the activities of these traders, "it took prompt proactive steps to review and revise its existing control and compliance mechanisms and supervisory procedures." Further, prior to learning of the SEC's investigation that led to the filing of the complaints underlying the Judgments, the Firm undertook a corporate reorganization, pursuant to which an affiliated entity provided the

Firm's proprietary trading platform and the entity through which proprietary traders executed their transactions.

### **III. Background Information**

Firm X has been a member of FINRA since 2004. It has one office in City 1, which is an office of supervisory jurisdiction. The Firm employs approximately 18 registered individuals and 3 non-registered individuals.

#### **A. Routine Examinations**

The Firm's most recent cycle examination was conducted in 2012. This examination did not identify any exceptions.<sup>2</sup>

The Firm's 2008 cycle examination resulted in a FINRA Cautionary Action for the following violations: (1) failing to establish adequate Anti-Money Laundering policies and procedures and for monitoring suspicious activities; (2) failing to establish an adequate supervisory control system and a process to identify and address any gaps in the Firm's procedures when compared to relevant securities rules and regulations; (3) failing to review employee accounts maintained with other broker-dealers; (4) failing to establish written supervisory procedures concerning the review of funds and securities transmittals and changes to customer accounts; and (5) failing to timely file Uniform Applications for Securities Industry Registration or Transfer for registered representatives. The Firm responded in writing stating that it had corrected the deficiencies noted.

#### **B. Regulatory Actions**

In April 2008, the Firm entered into a Letter of Acceptance, Waiver and Consent ("AWC") with FINRA for violations of NASD Rules 6955, 3010, and 2110. Without admitting or denying the allegations of the complaint, the Firm consented to findings that for several months in 2005, it failed to transmit reportable order events to the Order Audit Trail System ("OATS") and failed to establish an adequate supervisory system designed to comply with OATS reporting rules. FINRA censured the Firm and fined it \$15,000.

Other than the AWC and the Judgments, FINRA's Central Registration Depository ("CRD"®) does not reveal any other any other complaints, disciplinary proceedings, or arbitrations against the Firm.

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<sup>2</sup> Member Regulation also represents that the SEC conducted an examination of the Firm in March 2013, and while SEC staff noted certain potential deficiencies it did not view the examination as precluding FINRA from acting on the Firm's Application.

#### **IV. The Firm's Proposed Continued Membership with FINRA and Proposed Supervisory Plan**

Firm X seeks to continue its membership with FINRA notwithstanding the Judgments. The Firm included a supervisory plan with the Application to address deficiencies relating to the underlying cause of the statutory disqualifications, which includes changes made as a result of recommendations by the Firm's retained outside counsel and independent consultant, as required by the Firm's agreed-upon undertakings with the SEC. The plan discusses, in detail, a number of measures that Firm X represents it has undertaken in connection with the events underlying the statutory disqualifications.

Specifically, the Firm represents that it has adopted new policies and procedures related to a number of different areas, including: (1) educating and training the Firm's registered persons concerning insider trading and the Firm's insider trading policies; (2) identifying inside information and measures to be taken when an individual at the Firm possesses inside information; (3) creating and supervising information barriers regarding material, non-public information; (4) prohibiting the origination or circulation of market rumors; (5) using email, instant messages, and the internet; (6) reporting violations of the Firm's procedures; and (7) restricting and disclosing outside activities.

The enhancements to the Firm's procedures also include, in addition to the reviews of communications and trading that the Firm's compliance staff already conducted, new surveillance procedures to prevent and detect insider trading. They incorporate generally event-driven trade reviews, measures to prevent the dissemination of material, non-public information once the Firm's chief compliance officer determines that anyone at the Firm is in possession of such information, trading restrictions in certain securities, and maintaining restricted lists and watch lists for securities. Further, "Floor Captains" (i.e., associated persons appointed to sit on the trading floor and maintain a general awareness of market events relevant to securities traded by the Firm's traders) are required to inform the Firm's compliance staff whenever they become aware of certain triggering events.

Member Regulation has represented that subsequent to any approval of the Firm's continued membership in FINRA notwithstanding its statutory disqualification, FINRA staff's first examination of the Firm will evaluate whether it has complied with the proposed plan. After the Firm's initial examination, FINRA will determine whether to subject the plan to further review, considering (among other things) FINRA's overall risk-based assessment of the Firm.

#### **V. Discussion**

Member Regulation recommends approval of the Firm's request to continue its membership in FINRA. After carefully reviewing the entire record in this matter, we approve the Firm's Application.

In evaluating an application like this, we assess whether the statutorily

disqualified firm seeking to continue its membership in FINRA has demonstrated that its continued membership is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors. *See* FINRA By-Laws, Art. III, Sec. (3)(d); *cf. Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (holding that FINRA “may deny an application by a firm for association with a statutorily-disqualified individual if it determines that employment under the proposed plan would not be consistent with the public interest and the protection of investors”). Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, and whether there has been any intervening misconduct.

We recognize that the Judgments involved serious violations of securities rules and regulations. The record indicates, however, that the Firm has fully complied with all of the terms of the Judgments, including the various undertakings required of it. The record shows that the Firm has implemented enhanced policies and procedures, recommended by the Firm’s outside counsel and independent consultant, to address insider trading and the potential for future regulatory problems related to insider trading. The Firm also represents that the three traders who engaged in the misconduct underlying the Judgments are no longer with the Firm and have not been employed by the Firm for a number of years.

Moreover, we agree with Member Regulation that Firm X’s disciplinary history does not prevent it from continuing its FINRA membership. Since the Judgments, FINRA’s examinations of the Firm have not detected violations similar to the misconduct underlying the Judgments. Indeed, other than the Judgments, the Firm’s only disciplinary event was a 2008 AWC related to OATS reporting. The Firm’s 2012 cycle examination did not identify any exceptions, and the Firm corrected the deficiencies noted in the 2008 Cautionary Action. Further, in connection with the SEC’s March 2013 examination of the Firm, although the SEC noted certain potential deficiencies, Member Regulation represents that SEC staff did not view the examination as precluding FINRA from acting on the Firm’s Membership Continuance Application.

At this time, we are satisfied, based in part upon the Firm’s representations concerning its compliance with the plan, Member Regulation’s representations concerning FINRA’s future monitoring of the firm, and the record currently before us, that the Firm’s continued membership in FINRA is consistent with the public interest and does not create an unreasonable risk of harm to the market or investors. Accordingly, we approve the Firm’s Application to continue its membership in FINRA.

FINRA certifies that the Firm meets all qualification requirements and represents that it is registered with several other self-regulatory organizations, including NYSE ARCA, NQX, and BATS.

Accordingly, we approve the Firm’s Application to continue its membership in FINRA as set forth herein. In conformity with the provisions of SEC Rule 19h-1, the

continued membership of the Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith  
Senior Vice President and Corporate Secretary