

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Glendale Securities, Inc.
Sherman Oaks, CA,

George Alberto Castillo
Sherman Oaks, CA,

Paul Eric Flesche
Sherman Oaks, CA,

Albert Raymond Laubenstein
Anaheim, CA,

Jose Miguel Abadin
Sherman Oaks, CA,

and

Huanwei Huang
New York, NY,

Respondents.

DECISION

Complaint No. 2016049565901

Dated: October 6, 2021

Member firm and the AMLCO failed to maintain a reasonable AML program and failed to identify and investigate red flags. The firm, AMLCO, and CCO failed to supervise. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., John R. Baraniak, Esq., Payne L. Templeton, Esq., Melissa Turitz, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For Respondents: Arash Shirdel, Esq., Jeffrey Kob, Esq.

Decision

FINRA's Department of Enforcement ("Enforcement") appealed, and the National Adjudicatory Council ("NAC") called for review, portions of an April 5, 2019 Extended Hearing Panel decision (the "Decision"). The respondents did not appeal any part of the Decision.

This case involves Glendale Securities, Inc.'s ("Glendale" or the "Firm") primary business of accepting for deposit and liquidating microcap securities. Enforcement alleged that Glendale and its president engaged in market manipulation and that the Firm and other respondents participated in the unlawful distribution of restricted securities with respect to its activities related to the stock NuGene International, Inc. ("NuGene"). Enforcement also alleged that Glendale and the other respondents violated anti-money laundering ("AML") rules by failing to maintain a reasonable AML program and by failing to identify and investigate red flags with respect to NuGene and two other stocks, Broke Out, Inc. ("Broke Out") and Vitaxel Group Limited ("Vitaxel"). Finally, Enforcement alleged that Glendale and other respondents failed to properly supervise one of the Firm's registered representatives.

The Hearing Panel found the respondents liable for some, but not all, of the alleged violations. The Hearing Panel found that Enforcement failed to prove that the respondents engaged in market manipulation and failed to prove that the firm participated in the unlawful distribution of restricted securities. However, the Hearing Panel found that Glendale and its AML compliance officer ("AMLCO") failed to maintain a reasonable AML program given the Firm's high-risk microcap liquidation business, and failed to identify and investigate red flags in connection with activity in NuGene, Broke Out, and Vitaxel. The Hearing Panel also found that Glendale, its AMLCO, and its chief compliance officer ("CCO") failed to supervise one of the Firm's registered representatives who had opened accounts for customers based in Asia and were liquidating microcap securities, and that Glendale and the AMLCO failed to conduct due diligence on accounts introduced to the Firm by a foreign bank. The AMLCO and CCO were the designated supervisors for these matters.

At issue on appeal is whether there is sufficient evidence that, as Enforcement alleges, Glendale's president had the requisite intent to engage in market manipulation with respect to NuGene. Also at issue is whether the NuGene shares Glendale customers sold were restricted because the customers purchased their shares from affiliates of NuGene. Finally, we review the Hearing Panel's findings that respondents violated AML and supervisory rules.

After an independent review of the record, we affirm the Hearing Panel's findings of violations and modify the sanctions it imposed.

I. Background

A. Glendale

Glendale has been a FINRA member since 2003. The firm is based in Sherman Oaks, California, and maintains a branch office in New York City. During the relevant period, Glendale's business primarily consisted of liquidating and making a market¹ in microcap and low-priced over-the-counter securities—so-called “penny stocks.” The firm did not solicit securities transactions. At any one time during the relevant period, Glendale was liquidating approximately five penny stocks and reviewing another five to ten for deposit. More than 75 percent of Glendale's revenue was generated by liquidating penny stocks, and approximately half of that trading activity involved market making by the firm in the securities it was liquidating. At the time, Glendale employed six registered representatives, but only two of them engaged in market-making activities.

B. George Alberto Castillo

George Alberto Castillo was Glendale's president during the relevant period. Castillo joined the securities industry in 1985. Castillo registered with Glendale in 2005, after purchasing an ownership interest in the firm. At the time of the hearing, Castillo owned 22 percent of Glendale. Castillo was registered with Glendale as a general securities representative, general securities principal, equity trader limited representative, and registered options principal.²

Castillo was Glendale's head trader during the relevant period and oversaw the Firm's day-to-day business operations. As head trader, Castillo traded the Firm's capital. Under Glendale's written supervisory procedures (“WSPs”) in effect during the relevant period, Castillo was responsible for approving new accounts, reviewing all trading on a trade day “plus one” basis and, along with the Firm's CCO and AMLCO, Castillo was jointly responsible for reviewing activity in accounts designated by the firm as “high risk.”

C. Paul Eric Flesche

Paul Eric Flesche entered the securities industry in 1999. Flesche associated with Glendale in 2005 after acquiring an ownership interest in the firm. Flesche owned 22 percent of Glendale at the time of the hearing. Flesche was registered with Glendale as a general securities representative, general securities principal, financial and operations principal, general securities sales supervisor, municipal securities principal, securities trader representative, and investment banking representative.

¹ Market makers are firms “that stand[] ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price.” See <https://www.investor.gov/introduction-investing/investing-basics/how-stock-markets-work/executing-order>.

² Castillo was also registered as an operations professional and securities trader.

Flesche served as Glendale's chief financial officer ("CFO"), financial & operations principal ("FINOP"), and CCO, and was responsible for maintaining the firm's WSPs and for general supervision at the firm. Flesche was also responsible for reviewing customers' deposits of securities to determine if the securities were eligible for resale and, along with Castillo and Albert Laubenstein, Flesche was jointly responsible for reviewing activity in accounts designated by the firm as "high risk."

D. Albert Raymond Laubenstein

Laubenstein entered the securities industry in 1974 and associated with Glendale in 2010. Laubenstein owned six percent of Glendale, which he sold to Castillo when he left the firm in 2016. Laubenstein retired from the securities industry shortly after leaving Glendale.

In 2010, Glendale named Laubenstein its AMLCO as part of its corrective action in response to a letter of acceptance, waiver and consent resulting from an Enforcement investigation (the "2010 AWC"). At the time, Laubenstein had five years of experience as an AMLCO. Laubenstein served as Glendale's AMLCO during the relevant period and was responsible for updating portions of the firm's WSPs, including the portions addressing AML compliance. The WSPs also stated that Laubenstein was responsible for reviewing electronic communications.

E. Jose Miguel Abadin

Jose Abadin entered the securities industry in 1986. Abadin joined Glendale in 2006 and, at the time of the hearing, owned five percent of the Firm. Abadin was registered with Glendale as a general securities representative, general securities principal, equity trader limited representative, general securities sales supervisor, registered options principal, securities trader, and proprietary trader principal. Abadin was supervised by Castillo.

Abadin acted as an individual broker and engaged in market making, often in the securities his customers were trading. During the relevant time period, Abadin had approximately 150 customers, most of whom were referred by existing customers of the firm. Abadin received as compensation 80 percent of the commissions Glendale charged his customers.

II. Facts

A. Glendale's Procedures for the Deposit and Resale of Penny Stocks

Glendale's procedures for preventing unregistered resales of restricted securities during the relevant period were contained in fewer than two pages of the Firm's WSPs. The WSPs designated Castillo and Flesche as the principals responsible for supervising the deposit of securities and determining whether securities were registered or eligible for resale based on an available exemption from registration. The WSPs provided that, before allowing the resale of unregistered securities, Glendale "must take reasonable steps to ensure that [a] transaction

qualifies for [an] exemption,” and directed that the Firm take “whatever steps necessary” to ensure that a transaction was not prohibited. The WSPs included a bullet-point list of resources the Firm could consult and actions the Firm could take in conducting due diligence. The WSPs also include a bullet-point list entitled “Action,” which stated:

- Review certificate for Restrictive Legend, Forgery or Fraud
- Review new Account for Employment Information
- Review DRS for Provenance of Certificate
- Review Attorney Opinion Letter—Ensure Attorney is not Prohibited
- Call Delivering Broker
- Call or write to transfer agent
- Review and Investigate Incoming ACATs, DWACs and Certificates
- Review Edgar for Current Financials
- Review Pink Sheets Market Tiers for Caveat Emptor listing
- Determine Registration Status—Ensure Company is not a Shell for 144 sales
- Determine quantity of outstanding shares on deposit at the firm in comparison to shares being deposit [sic] to check for concentration
- Obtain background documentation surrounding deposit to determine the resalability [sic] of the shares.³

The WSPs also stated that the Firm must “[m]aintain a file with all documents reviewed.”

Glendale’s due diligence process required the customer and the Firm to complete what Glendale staff referred to as a “deposit due diligence package.” As part of the process, the customer was required to complete a form provided by Glendale’s clearing firm titled “Deposit Securities Request for Bulletin Board, Pink Sheet and Unregistered Securities” (the “DSRQ”). Among other things, the DSRQ asked the customer how many shares of the stock he or she controlled, from whom and under what circumstances the shares were acquired, and whether the stock was subject to any restriction. The customer was also asked the purpose for which the shares were being deposited (e.g., resale), whether the customer intended to deposit additional shares in the future, how many shares the customer had acquired within the last year, and whether the customer or a family member was an officer, director, affiliate, or owned certain percentages of the issuer. The customer was asked whether the shares were subject to a

³ The WSPs included a non-exhaustive list of such “background documentation” that may be obtained, including purchase agreements, copies of forms of payment, opinion letters, S-1 registration statements, subscription agreements, warrant exercise agreements, option exercise agreements, S-8 registration statements, gift letters, consulting agreements, loan documents, bankruptcy discharges, corporate resolutions, note conversions, and concentration documentation.

registration statement and was required to provide documentation reflecting how the shares were acquired. Finally, the customer was required to complete and sign a two-page “Client Checklist for Deposit Documentation” form, which required the customer to provide certain documentation.

In connection with the deposit of nonregistered securities, firm employees were required to complete a nine-page document titled “Broker Checklist for Deposit Due Diligence.” The form called for information about the stock being deposited, including the current trading price, whether the stock had recently split, and whether the transfer agent was properly registered with the SEC. The form also asked whether the customer depositing the stock was an affiliate of the issuer and whether the customer had provided all the required supporting documentation for the deposit. The form included a series of questions about how the customer had acquired the shares being deposited, and included a section titled “Tradability of Shares” in which the employee answered questions about whether the shares were registered or eligible for an exemption from registration.

Finally, the form included an area in which Glendale documented certain searches for information. In connection with its review of a deposit, Glendale ran searches using the names of persons associated with the deposit in a number of databases, including Google, SEC filings, and the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”). The persons on whom searches were run included the officers of the issuer and the sellers of the stock to the customer.

Several people signed the Broker Checklist for Deposit Due Diligence document. The registered representative signed the form and indicated whether he or she recommended that Glendale accept or reject the deposit. Flesche also approved and signed the form as the Firm’s CCO. Flesche was responsible for determining if the shares were registered or eligible for an exemption from registration by tracing the chain of owners of the securities. Laubenstein was responsible for reviewing the issuer’s press releases and looking for promotional activity and signing off on the deposit as the AMLCO.

B. Glendale Accepts for Deposit and Liquidation Millions of Shares of NuGene

In the first half of 2015, Glendale accepted for deposit and liquidation millions of shares issued by NuGene, a company which developed and sold skincare products.

1. NuGene Becomes Publicly Traded Via a Reverse Merger

On December 26, 2014, NuGene became a publicly traded company via a reverse merger with Bling Marketing, Inc. (“Bling”), a Nevada corporation with offices in New York City. NuGene was the surviving entity of the merger. Prior to the merger, Bling was engaged in marketing and selling through distributors affordable jewelry and had nominal revenues. For the quarter ending June 30, 2014, Bling reported in a Form 8-K that it had begun working with

distributors to sell its jewelry and, accordingly, was “no longer a shell company.”⁴ That quarter, Bling reported sales revenue of \$22,025. DK, Bling’s CEO, signed the Form 8-K. As part of the merger, DK surrendered her Bling shares, and the shares were cancelled.

In May 2014, about seven months before the merger with NuGene, another broker-dealer filed a Form 211 seeking approval from FINRA to initiate quoting Bling on the OTC Bulletin Board.⁵ FINRA approved the Form 211 on September 5, 2014. BS, a Glendale customer, was involved in the filing of Bling’s Form 211. There was no trading in Bling before the merger with NuGene.⁶

On December 26, 2014, the same day Bling entered the reverse merger agreement with NuGene, the company approved a 15-to-1 stock split in the form of a dividend paid to Bling common stockholders.⁷ Three days later, on December 29, 2014, the day the reverse merger closed, Bling completed the placement of an additional 2,000,000 shares of common stock. Taking into account the stock split, the stock placement, and the surrender and cancellation of shares owned by DK, NuGene had approximately 41 million shares of common stock outstanding after the reverse merger.

That same day, 30 Bling shareholders sold approximately 11 million shares of common stock to 38 individuals in private transactions. Seven million of these shares were restricted by a “lock-up, leak-out” agreement (the “Lock-Up Agreement”). The Lock-Up Agreement provided that purchasers of the 7 million shares were prohibited from selling the shares for 75 days from the date the purchase agreements were executed—i.e., through February 28, 2015.⁸ After 75

⁴ Exchange Act Rule 12b-2 defines a shell company as one having no or nominal operations and either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets. 17 C.F.R. § 240.12b-2.

⁵ Form 211 is the form that market makers must file with FINRA to initiate or resume quotations in a non-exchange listed security on a quotation medium. By completing the form, a market maker represents that it has satisfied all applicable requirements of Rule 15c2-11 promulgated pursuant to the Securities and Exchange Act of 1934, and the filing and information requirements of FINRA Rule 6432. See <https://www.finra.org/filing-reporting/otcbb/otcbb-forms-documentation>.

⁶ Post-merger, the company was listed under the symbol “BLMK,” until it adopted “NUGENE” as its new ticker symbol on February 3, 2015.

⁷ For each share of common stock held that day, shareholders received an additional 14.04 shares of common stock. The stock split was publicly announced on January 6, 2015, and completed by the end of the month.

⁸ The Lock-Up Agreement was not publicly available, but the terms of the agreement are described in a January 5, 2015 Form 8-K filed by NuGene. FINRA obtained a copy of the Lock-Up Agreement from another broker-dealer and a copy was admitted as evidence at the hearing.

days, the Lock-Up agreement permitted the “leak out”—or gradual sale—of the shares over a 150-day period, as long as no shareholder sold more than 20 percent of their shares over any 30-day period. The Lock-Up Agreement stated that stock certificates for shares subject to the agreement would include a legend summarizing the terms of the agreement and that the transfer agent would maintain records reflecting the resale restrictions on these shares.

The Lock-Up Agreement also provided that the 75-day period during which sales were prohibited would be limited or nullified if NuGene achieved certain levels of market capitalization.⁹ If NuGene reached a market capitalization of \$160 million for three consecutive days, 50 percent of each shareholder’s shares subject to the Lock-Up Agreement would be immediately released from the restrictions. If NuGene reached a market capitalization of \$200 million for three consecutive days, all the shares would be released immediately from the Lock-Up Agreement. NuGene had approximately 41 million shares outstanding during the relevant period. Accordingly, NuGene shares would have to trade at approximately \$5 per share for three consecutive days for the restrictions to be removed from all the shares before the end of the lock-up period.

2. BS Deposits and Sells NuGene Shares

Customer BS opened an account with Glendale in 2012 at the same time he referred an issuer to the Firm. Castillo was the broker for BS’s account. In May 2014, Castillo and Laubenstein identified and designated BS as a “high-risk customer” after BS liquidated microcap securities that Laubenstein believed BS had acquired under suspicious circumstances.¹⁰ As a result of this designation, all of BS’s trades were included on a log of high-risk trades that Laubenstein reviewed for AML purposes.¹¹

On October 23, 2014, approximately two months before NuGene’s reverse merger, BS deposited 2,000 shares of Bling in his Glendale account. In connection with this deposit, BS completed Glendale’s DSRQ form. BS represented on the form that his purpose for depositing the shares was to liquidate them. BS also represented that he acquired the shares in March 2014 for \$100 pursuant to an S-1 registration statement. BS stated that he initially purchased 400 shares, which split 5-to-1 a week after he bought them, resulting in his 2,000 shares. Finally, BS stated that he owned an additional 50,000 shares of Bling that he held away from Glendale.

⁹ Market capitalization refers to the total value of a company’s outstanding shares of stock, including publicly traded shares and restricted shares held by company officers and insiders. To calculate market capitalization, the total number of a company’s shares outstanding are multiplied by the company’s current stock price. *See* <https://www.finra.org/investors/insights/market-cap>.

¹⁰ Laubenstein suspected that BS had seven investors act as proxies to purchase the shares of a company for which his spouse had been CEO and then resell the shares to him to avoid the shares being restricted based on his affiliate relationship with the issuer.

¹¹ Laubenstein testified that the high-risk log included approximately 3-4 trades per day.

Laubenstein and Flesche reviewed and approved BS's deposit and determined that the shares were eligible for resale. Laubenstein testified that, before approving the resale, Glendale searched for promotional activity related to Bling and found none.

On January 6, 2015, the same day NuGene announced the coming 15-to-1 stock split in a Form 8-K, BS asked Castillo to sell 500 shares of NuGene.¹² To facilitate BS's order, Castillo started making a market in NuGene. Castillo purchased BS's 500 shares in Glendale's proprietary account for \$0.13 per share. This was the first and only trade under the pre-merger ticker symbol for Bling. BS received \$30 in net proceeds from this sale and placed no other orders for NuGene at Glendale. About three months later, on April 13, 2015, BS transferred his remaining NuGene shares (22,560 shares after the stock split) to an account at another broker-dealer ("Firm A").

3. Castillo Trades NuGene in Glendale's Account

After NuGene's 15-to-1 stock split, Glendale owned 7,520 shares of NuGene from its purchase of BS's shares. On February 4, 2015, the first day the stock traded under its post-merger ticker symbol, Castillo began trading the stock. At 8:19 a.m., Castillo placed an opening bid to buy NuGene at \$0.11 per share. Over the next two hours, Castillo increased the bid twice, to \$0.25 and then \$0.51. At 10:24 a.m., Castillo placed the first ask quote offering to sell NuGene at \$2.00 per share. No other market makers had placed an ask quote.

That day, only two individuals purchased NuGene stock on the open market. At 10:52 a.m., an individual with an account at another firm, JB, made the first of three purchases of NuGene shares. JB purchased 1,000 shares of NuGene at \$2.00 per share in an account at another firm ("Firm B"). Glendale did not fill this order. At the hearing, Enforcement presented evidence that JB was listed on NuGene's website as a company contact for its products.

By 10:56 a.m., Castillo's bid for NuGene had increased to \$1.01 and his ask quote had increased to \$2.25. At 10:57 a.m., through Firm B, JB entered a buy order for 450 shares of NuGene at \$2.00 per share. Glendale filled JB's order with its shares at \$2.00 per share. The trade was executed through another broker-dealer ("Firm C"). In connection with this sale, Castillo sent a Pink Link message to Firm C, indicating that he would fill JB's buy order.¹³ There is no evidence that Castillo knew at the time that JB was the ultimate purchaser of these shares.

¹² Although NuGene was still trading under the ticker symbol "BLMK," this trade occurred after the reverse merger in which NuGene was the remaining entity. Accordingly, we refer to these shares as NuGene shares.

¹³ Pink Link is an over-the-counter instant messaging service which allows market makers and broker-dealers to communicate. Pink Link allows traders to send market makers order messages that market makers can execute, negotiate, or decline through an execution report message. See <https://www.otcmarkets.com/otc-link/overview>.

At 11:32 a.m., JB entered another order for 100 shares of NuGene at \$2.25 per share. Castillo also filled this order through Firm C. Again, there is no evidence that Castillo knew JB was the purchaser of the shares. Castillo subsequently increased his ask quote to \$2.50. Throughout the rest of the trading day, Castillo entered unpriced ask quotes, indicating interest in selling without specifying a price. Castillo also decreased his bid quotes from a high of \$2.00 per share at 10:57 a.m. to \$1.01 and later \$0.25 per share.

4. ND Trades NuGene in Her Glendale Account

ND opened an account with Glendale in January 2015. In late November 2014, ND had posted photographs and statements on social media discussing NuGene's partnership with a well-known model and indicated that ND and her husband were investing in the company. In her Glendale account opening documents, ND stated that she had learned about Glendale through a Google search, but could not recall the search terms she had used. She also stated that she was self-employed in the real estate business with an estimated net worth of \$4 million, an annual income of \$500,000, had extensive experience investing in stocks, and that her primary investment objective was speculation. Castillo was ND's registered representative, and he testified that ND opened her account at Glendale because she had learned that Glendale was making a market in NuGene, perhaps from other NuGene shareholders or others following NuGene. Laubenstein reviewed and approved ND's account opening documentation.

On February 4, 2015, ND contacted Castillo about buying NuGene shares. There had been no previous trading activity in ND's account. Castillo placed a day limit order for ND to purchase 7,500 shares of NuGene at \$0.26 per share.¹⁴ At 1:39 p.m., Castillo partially filled ND's order by selling her 5,170 shares of NuGene from Glendale's proprietary account for \$0.26 per share. These shares were the last of the shares Glendale had purchased from BD. ND's purchase set the closing price for NuGene at \$0.26 per share on February 4, 2015. JB and ND were the only two persons who purchased NuGene on the open market that day.

The next day, February 5, 2015, ND placed through Castillo a day limit order to sell NuGene for \$10 per share. The order expired unfulfilled at the end of the day. One day later, on February 6, 2015, ND placed through Castillo another day limit order to sell NuGene for \$5.00 per share that also expired unfulfilled at the end of the day. ND subsequently placed a day limit order to sell NuGene for \$5.00 each day through February 10, 2015. Each order expired unfulfilled. On February 11, 2015, ND placed through Castillo a good-til-canceled order to sell 5,000 shares of NuGene at \$5.00.¹⁵ There were no trades in NuGene from February 6 through February 23, 2015.

¹⁴ Day limit orders are orders to buy or sell a security at a specified price that expires at the end of the trading day if it is not executed. *See* <https://www.finra.org/investors/alerts/understanding-order-types-can-save-time-and-money>.

¹⁵ Good-til-canceled orders are orders to purchase or sell a security that remain in effect until executed or canceled. *See* <https://www.sec.gov/fast-answers/answersgtrcordhtm.htm>

On February 24, 2015, ND's good-til-canceled order was partially filled. Castillo testified that a trader at Firm A used pink link to "prefer" —i.e., specifically accept—ND's sell order to purchase 250 shares from ND at \$5 per share. The inside bid¹⁶ for most of February 24, 2015 was \$2.25, and Glendale's sell order for ND was the only one asking to sell for \$5.00 per share.

On February 25, 2015, ND sold through Castillo an additional 1,020 shares at \$5.00 per share from her good-til-canceled order. The shares were sold in three transactions. In the first transaction at 9:30 a.m., ND sold 120 shares. The trade was executed through Firm C on behalf of a buyer with a Firm B account.

At 12:47 p.m., ND sold an additional 100 shares from the good-til-canceled order through another firm ("Firm D"). Castillo testified that Firm D used Pink Link to preference ND's sell order at Glendale. Firm D had received a limit order to buy 50 shares at \$5.00 from a different firm ("Firm E"). The Firm E order originated with a Firm A customer. Firm D purchased 100 shares from ND at \$5.00 per share, filling the Firm E order for 50 shares and keeping the remaining 50 shares.

At 1:57 p.m., ND sold another 800 NuGene shares to Firm D at \$5 per share. Firm D in turn sold the shares to another firm ("Firm F"). Castillo testified Firm D likely once again "preferenced" Glendale's quote for the sale of ND's shares.

On February 26, 2015, ND sold 1,000 shares of NuGene at \$5 per share through Castillo just seconds before the market closed for the day. Firm D purchased the shares and then sold them to Firm F. The Firm F customer who purchased the shares lived in the same city and worked in the same field as another person connected to NuGene. This was ND's final NuGene trade at Glendale. After these trades, ND held 2,900 shares of NuGene in her Glendale account.

5. As a Result of ND's Transactions, NuGene Shares Are Released from the Lock-Up Agreement

ND's sales of NuGene on February 24, 25, and 26 accounted for 100 percent of the daily market volume in NuGene on those days and caused the stock to close at \$5 on each day. On the same days, NuGene had approximately 41 million shares outstanding. Accordingly, the daily closing price of \$5 caused NuGene's market capitalization to exceed \$200 million for three consecutive days. Consequently, as of February 27, 2015, any NuGene shareholders subject to the Lock-Up Agreement were released from its restrictions.

¹⁶ "Inside bid" or "best bid" refers to the highest bid—i.e., buy order—for all market makers to buy a particular stock at any given time. See <https://www.finra.org/filing-reporting/otcbb/otcbb-glossary>.

6. Three New Glendale Customers Deposit and Liquidate Large Amounts of NuGene

In February 2015, three new customers—RC, JH, and SEI—opened accounts at Glendale and deposited NuGene shares. RC, JH, and SEI eventually sold their NuGene shares for proceeds totaling \$7,304,354, \$812,989, and \$459,467, respectively.

a. RC's NuGene Sales

RC was incorporated in Nevada on January 29, 2015.¹⁷ RC opened its Glendale account on February 4, 2015, with Abadin as the assigned registered representative. Abadin testified that an existing Glendale customer referred RC. RM, RC's 100 percent owner, president, and CEO, signed the account documentation. In its account opening documentation, RC stated that it was in the business of advertising and marketing consulting, had a net worth of \$4 million, and income of more than \$250,000. RC also stated that its primary investment objective was speculation and that it had extensive investment experience with stocks. RC stated that its primary activities were "investment purposes, appreciation, speculation." Abadin testified that he understood that RC intended to deposit and sell low-priced securities and that RC opened an account with Glendale because it was one of the few remaining broker-dealers in this business.

Approximately one week after opening its Glendale account, RC submitted to Glendale a stock certificate for NuGene shares. The certificate, dated February 3, 2015, was for 2,899,878 shares.¹⁸ In connection with its NuGene shares, RC filed with the SEC a Schedule 13D ("Beneficial Ownership Reporting Requirements Acknowledgement") and provided a copy to Glendale in connection with its deposit.¹⁹ In it, RC stated that it owned 7.4 percent of NuGene's outstanding stock. RC's shares represented 26 percent of NuGene's public float of approximately 11 million shares.²⁰ Because Glendale had a policy of not accepting for deposit securities representing more than 20 percent of an issuer's public float for any one customer, or 40 percent of any issuer's public float in all customer accounts, Glendale instructed its clearing

¹⁷ RC had previously been incorporated in California in 2008 until 2010, when it was suspended from registration by the state.

¹⁸ The date of the deposit reflected in RC's account is February 11, 2015.

¹⁹ When a person or group of persons acquires beneficial ownership of more than five percent of a voting class of a company's equity securities registered under the Securities Exchange Act, they are required to file a Schedule 13D with the SEC. Schedule 13D reports the acquisition and other information within 10 days after the purchase. *See* <https://www.investor.gov/introduction-investing/investing-basics/glossary/schedules-13d-and-13g>.

²⁰ Public float refers to the number of shares owned by the investing public that are available for trading.

firm to return 720,000 shares to RC, reducing the number of shares RC deposited in its Glendale account to 2,179,878 shares, or approximately 19.5 percent of NuGene's public float.²¹

In connection with its NuGene deposit, RC provided Glendale with information and documentation concerning its acquisition of the shares. RC provided four identical stock purchase agreements, all dated December 18, 2014, reflecting the purchase by RC of Bling shares from four individuals with the same last name. The stock purchase agreements showed that RC bought 49,900 shares each from NF, KF, and FF, and that it bought 34,111 shares from SF, for a total price of \$6,009 or \$0.031 per share.²² After Bling's 15-to-1 stock split and reverse merger with NuGene, these purchases became the 2,899,878 shares of NuGene RC deposited at Glendale. All four stock purchase agreements referenced a lock-up agreement attached as an exhibit, but none of the agreements provided by RC included the exhibit.

Abadin signed Glendale's checklist recommending that the firm accept RC's NuGene shares for deposit. Flesche reviewed and approved the deposit on February 12, 2015. Flesche also performed the AML review because Laubenstein was not available.²³ Flesche testified that he reviewed the four stock purchase agreements, including the addresses listed for the sellers. Flesche also reviewed an attorney opinion letter provided by RC representing that RC's shares were freely tradable. The attorney opinion letter represented that the four sellers had acquired their shares pursuant to an S-1 registration statement. Flesche testified that he did not consider it a red flag that the sellers were in New York and the buyer was in California because, in his experience, attorneys handling a reverse merger often connected buyers and sellers. Nor did Flesche consider it a red flag that RC came to Glendale to deposit its shares because, he testified, shareholders in the same company often referred each other to the Firm.

A key factual issue in the case is the relationship between the four individuals who sold their shares to RC, on one hand, and Bling's pre-reverse merger president, DK, on the other. Specifically, based on social media posts, Enforcement contends that NF (one of the sellers) and DK were married at the time of the sales to RC. Flesche testified that he personally conducted Google and SEC filing searches of the sellers and NuGene officers, including DK, and found nothing that indicated a relationship between NF and DK. Glendale's procedures, however, did not include reviewing social media posts. Abadin testified that he did not ask RC's principal, RM, if sellers had any connection to each other because small offerings in companies like Bling

²¹ The 720,000 shares were debited from RC's Glendale account on March 17, 2015. At Glendale's instruction, the clearing firm divided the debited shares into eight stock certificates of 90,000 shares each. FINRA's investigation later revealed that RC sold those 720,000 shares to four investors in private transactions who later deposited the shares at Firm A.

²² The stock purchase agreement included addresses for the sellers. KF and FF listed the same address in Far Rockaway, New York. NF and SF listed the same address in Woodmere, New York.

²³ Castillo testified that he did not review RC's deposit of NuGene and was unaware that RC owned NuGene until RC started selling its NuGene shares on February 27, 2015.

often result in shares being sold to friends and family. For the same reason, neither Flesche nor Abadin considered the common last name a red flag.

Flesche testified that he noticed at the time that the stock purchase agreements referenced a lock-up agreement. Flesche testified that he did not attempt to get a copy of the agreement but did ask the issuer's attorney and transfer agent about it. Flesche testified that the issuer's attorney said there was no lock-up agreement. The transfer agent said that the shares were free trading and not subject to a lock-up. Flesche testified that he was satisfied from these representations that a lock-up did not apply to RC's shares. Abadin testified that RM told him the shares were not restricted by a lock-up and that he did not have a copy of a lock-up agreement. An Enforcement staff member testified that the staff were unable to conclude whether RC's shares were, in fact, subject to the lock-up agreement.

On February 27, 2015, the day after the Lock-Up Agreement was nullified, RC began selling its NuGene Shares.²⁴ From February 27, 2015, through August 2015, RC sold 2,573,252 shares of NuGene for proceeds of more than \$7 million, at prices ranging from \$1.37 to \$4.28 per share.²⁵ From early April 2015 through mid-August 2015, RC wired out \$4,990,595 of the proceeds from its sales of NuGene shares. RC's liquidations of NuGene shares generated more than \$193,000 in commissions for Glendale. RC traded only NuGene at Glendale. Flesche testified that he reviewed RC's trades and saw nothing suspicious, but rather saw only normal trading activity.²⁶

b. JH's NuGene Sales

On February 18, 2015, two weeks after RC opened its Glendale account and one week after RC deposited its NuGene stock certificate, JH opened two accounts at Glendale. JH was incorporated in Nevada in October 2014. KS, JH's sole owner and officer, signed the account opening documents. In its account opening documents, JH stated that its business was "investments," and that it had an estimated net worth of \$4 million and an annual income of \$500,000. JH also stated that it had "extensive" investment knowledge and a primary investment objective of speculation. Abadin was the registered representative for JH's account, and Flesche approved the account opening documentation.

²⁴ The shares had been approved for resale by Glendale and available for trading on February 24, 2015.

²⁵ From late May 2015 through mid-June 2015, RC also purchased a total of 577,200 NuGene for a total cost of approximately \$2.5 million. Some of RC's sales of NuGene at Glendale included these shares.

²⁶ Enforcement's investigator testified that most of the shares RC sold were purchased by Firm A customers who also deposited their own shares of NuGene in their Firm A accounts. In some cases, Pink Link communications between Glendale and Firm A preceded the trades.

On February 20, 2015, before depositing any shares, KS emailed to Glendale two stock purchase agreements related to his purchases of Bling shares. Castillo was copied on another email forwarding the agreements to Glendale staff. In the body of his email, KS stated that he acquired the stock in private transactions and that he was “not an affiliate or an insider.” The stock purchase agreements were signed by JH but not dated. Copies of the checks for payment to the sellers were dated December 18, 2014. JH purchased 40,578 shares of Bling from EF for \$1,264.62, and 49,900 shares of Bing from MF for \$1,555.15—or approximately \$0.031 per share. Both stock purchase agreements referenced a lock-up agreement attached as exhibit A, but neither included a copy of the agreement.

On February 27, 2015, JH deposited a stock certificate dated February 3, 2015, for 272,158 shares of NuGene. The stock certificate contained a legend indicating that the shares were subject to the Lock-Up Agreement. Specifically, the legend stated that the shares were prohibited from resale until March 1, 2015, after which the shares were permitted to be sold consistent with the “leak-out” terms. The legend also stated that 50% of the shares would be released from the restriction if NuGene reached an aggregate market capitalization of \$160 million for three consecutive days, and that all the shares would become unrestricted if the market capitalization reached \$200 million for three consecutive days.

Along with the stock certificate, JH submitted a signed DSRQ in which it stated that it controlled 1,465,790 shares of NuGene and intended to deposit another 1,193,632 shares at Glendale.²⁷ JH also stated that the sellers, MF and EF, had purchased their shares from Bling in March 2014. Glendale’s paperwork for the deposit indicated that the Firm had searched Google, OFAC, and SEC filings for information about the sellers and NuGene officers and found nothing that raised a red flag. Abadin recommended that the deposit be accepted, and Flesche and Laubenstein approved the deposit the same day JH submitted the stock certificate—February 27, 2015.

On March 10, 2015, JH submitted four additional stock certificates to Glendale. Each was for 272,158 shares and was dated February 3, 2015.²⁸ All of the certificates contained the same restrictive legend as the first stock certificate except that, consistent with the leak-out provisions of the Lock-up Agreement, for each certificate the shares were restricted in later increments of 30 days—i.e., the shares for each certificate were restricted until April 1, May 1, June 1, and July 1, 2015, respectively. Accordingly, under the Lock-Up Agreement, all JH’s NuGene shares were restricted until March 1, after which 272,158 became unrestricted every 30 days, unless the restrictions were lifted earlier based on NuGene’s market capitalization.

²⁷ JH’s NuGene shares represented 3.5% of its outstanding shares and 13% of its public float.

²⁸ JH ultimately deposited a total of 1,360,790 shares of NuGene at Glendale. In the paperwork it submitted to Glendale, JH indicated that it controlled an additional 105,000 shares of NuGene that were ultimately never deposited in the account.

JH submitted to Glendale an attorney opinion letter dated March 6, 2015, along with its March deposit. The letter opined that JH's shares were freely tradable because NuGene had reached a market capitalization of \$200 million for three consecutive days.²⁹ The letter did not address whether the shares might be restricted because JH purchased them from affiliates of the issuer.

Abadin recommended that Glendale accept JH's March 10, 2015 deposits, and Flesche and Laubenstein approved them. Flesche testified that he checked whether the attorney providing the opinion was on the prohibited list. Flesche also testified that he did not consider it a red flag that JH's sellers had the same last name as the shareholders who sold to RC because it is common for a small company to sell shares to friends and family that are then sold in connection with a reverse merger.

JH's only transactions at Glendale were in NuGene. On April 7, 2015, JH sold 560 NuGene shares for \$1,208 in net proceeds. On June 9, 2015, JH sold an additional 80,000 shares of NuGene for \$349,203 net proceeds. On June 10, 2015, JH made its only purchase at Glendale when it purchased 52,000 shares of NuGene for \$233,799. In July 2015, JH sold 95,880 shares of NuGene. In total, JH sold 247,950 shares of NuGene for net proceeds of \$812,989, and wired \$469,000 of this money out of its Glendale account. Glendale received \$18,427 in commissions from JH's transactions.

c. SEI's NuGene Sales

SEI opened an account with Glendale on February 23, 2015, with Abadin as the registered representative for the account. SEI was a Nevada corporation formed in 1995, under a different name and with a different principal. Abadin testified that SEI's principal, LB, found Glendale through an internet search. In its account opening documents, SEI stated that it had a net worth of \$1 million, annual income of \$200,000, extensive investment knowledge, and a primary investment objective of speculation.

On March 2, 2015, SEI submitted to Glendale a stock certificate for 216,410 shares of NuGene and a signed DSRQ in which it stated that it controlled no additional shares of NuGene. SEI also provided Glendale with copies of two stock purchase agreements dated December 15, 2014. The stock purchase agreements reflect that SEI purchased 13,333 shares of Bling from TA for \$41,533 (or \$0.031 per share) and 1,038 shares of Bling from SA for \$32.25 (also \$0.031 per share). The sellers had the same last name and address and acquired their shares in March 2014 pursuant to an S-1 Registration Statement.³⁰ Abadin recommended that Glendale accept SEI's deposit, and Flesche and Laubenstein approved it.

²⁹ JH did not provide an attorney opinion letter in connection with its first deposit.

³⁰ Neither the stock certificate nor the stock purchase agreements reference the Lock-Up Agreement and there is no allegation that SEI's shares were restricted by it. After the reverse merger and 15-to-1 stock split, SEI's Bling shares became 216,410 shares of NuGene.

From June 1, 2015, through the end of July 2015, SEI sold 125,140 shares of NuGene for net proceeds of \$459,467, and wired \$360,000 of the money out of Glendale. Glendale earned \$8,987 in commissions from SEI's sales.³¹

7. RC Sponsors Promotional Activity in NuGene

Beginning in March 2015, RC sponsored promotional activity in NuGene. RC paid for a 28-page color brochure distributed by a stock promoter. The brochure claimed that NuGene's stock price could exceed \$25 per share by mid-2016. The brochure also claimed that "decisive action" by investors could result in "short-term gains of 394% by September [2015] or a [sic] 887% gain by December [2015]." The brochure's disclaimer disclosed that RC had paid \$4.4 million to market NuGene and that RC intended to sell its NuGene position.³²

In March and June 2015, market observers published articles raising suspicions about the trading and promotional activity in NuGene. One article in March claimed that a few people were pushing up the price of NuGene. In June, another article discussed that RC had paid for promotional activity to inflate NuGene's stock price. At least two articles claimed RC had funded a pump and dump scheme in NuGene stock.

In June 2015, the promotional activity and increased trading volume in NuGene came to the attention of the OTC Markets Group ("OTC Markets"), the operator of the market on which NuGene was quoted. OTC Markets asked NuGene to issue a statement addressing the activity. On June 10, 2015, NuGene issued a press release stating that neither the company nor its management, directors, or controlling shareholders were associated with the promotional activity, and that none of those people had sold shares of NuGene in the last 30 days.

The promotional activity resulted in a price increase in NuGene from \$1.27 per share on March 9, 2015, to \$4.31 per share on June 10, 2015, the day NuGene issued the press release disclaiming the promotional activity. During this period, RC's sales of NuGene constituted much of the trading volume. On some days, RC's sales accounted for as much as 97 percent of NuGene's daily market volume.

There is no evidence that anyone at Glendale saw the promotional activity funded by RC, including the brochure, during the period RC was selling his NuGene shares through Glendale. There is also no evidence that anyone at Glendale saw any of the articles raising concerns about

³¹ In addition to selling NuGene, SEI purchased one other security in its Glendale account in mid-July.

³² In addition to the promotional activity sponsored by RC, from early February 2015 through mid-July 2015, NuGene issued several press releases touting its products and expected revenue growth. NuGene's press releases disclosed, among other things, an increase in orders and distribution locations for its products and a new advertising campaign. There is no evidence that anyone at Glendale saw any of these press releases at or around the time they were released.

the promotional activity related to NuGene.³³ In September 2015, FINRA informed Glendale that there had been promotional activity in NuGene. Castillo testified that this was the first time Glendale learned of the promotional activity, including the brochure funded by RC. Laubenstein testified that the firm would search for promotional activity when a stock was deposited, but not necessarily after the deposit had been approved.

C. Glendale Accepts for Deposit and Liquidation Millions of Shares of Broke Out

1. Broke Out Issues Shares of Stock

Broke Out was started as a sole proprietorship in December 2013 and was in the business of designing, manufacturing, and selling casual and fitness apparel. Broke Out was owned by the same person who designed its products and sold them on its website. The company's first sales were in 2014. The company was incorporated in Nevada in December 2014, and had a wholly owned subsidiary formed in the United Kingdom in August 2014, Broke Out, Ltd.

On April 24, 2015, Broke Out filed an S-1 registration statement for an offering of 50 million new shares of common stock. The shares were offered at \$0.004 per share. The S-1 stated that the purpose of the offering was to raise \$200,000 to finance the development of new products and to manufacture and market products. Broke Out's stock was quoted on OTC Link.

Broke Out's S-1 stated that, as of December 31, 2014, the company had \$24,651 in assets, \$47,269 in liabilities, and annual revenue of \$30,714. In 2015, according to the S-1, Broke Out had two employees who worked a total of 30 hours per week for the company. The S-1 also indicated that the company's auditor had issued a going concern opinion for Broke Out. The S-1 was approved by the SEC on May 11, 2015.

2. ECM Deposits Broke Out Shares at Glendale

On December 2, 2015, ECM, an individual in Malaysia, emailed Huanwei Huang, a Glendale registered representative, about opening an account at Glendale.³⁴ ECM said he had been referred by a Malaysian friend who had recently become Huang's customer. ECM also wrote that he wanted help "clearing" some shares he had recently purchased in Broke Out. Neither Huang nor anyone else at Glendale knew ECM before he opened his account. Huang testified that he did not know how ECM and his other customer knew each other.

³³ FINRA's investigator testified that these articles were easily found by searching for NuGene's stock symbol in Google.

³⁴ Huang entered the securities industry in 1999 and joined Glendale in 2005. Huang was the sole registered representative located at Glendale's New York City branch office. Huang's customer base included a large number of Asian Americans and customers residing in Asia. Huang speaks Mandarin, Cantonese, and English.

Two days later, on December 4, 2015, Castillo began making a market in Broke Out. Castillo purchased for Glendale's proprietary account 2,500 shares of Broke Out for \$0.50 per share from another Glendale customer who had deposited Broke Out shares.³⁵

ECM opened an account with Glendale on December 11, 2015. Huang signed the account agreement, Laubenstein approved it as the AMLCO, and Castillo reviewed it. Because ECM was a foreign national, he completed Glendale's 5-page "Foreign Account Questionnaire," in addition to Glendale's regular account opening documents.

In his account opening documents, ECM reiterated that a friend had referred him to Glendale. ECM also stated that he was the production supervisor at a trading company, had an estimated net worth of \$1.5 million, an annual income of \$75,000, and liquid assets of \$250,000. ECM listed his investment knowledge as "good," and his primary investment objective as speculation. ECM also stated that the source of the funds for his Glendale account was his "savings and income," and that he intended to deposit shares of Broke Out. ECM's documents listed a Malaysian bank at which he maintained an account, but ECM represented that he would not be transferring money to or from any foreign countries. ECM also provided a copy of his Malaysian passport and a utility bill as proof of his identity and residence.

On the same day he opened his account, ECM submitted a stock certificate dated December 7, 2015, for 1,310,000 shares of Broke Out. ECM's shares represented 4.8 percent of Broke Out's 27.2 million outstanding shares and more than 10 percent of the company's public float of 12.2 million shares. ECM submitted a signed DSRQ in which he represented that he had acquired his shares from two individuals residing in the United Kingdom. The shares ECM acquired were registered pursuant to the Form S-1 approved by the SEC in May 2015.

ECM provided to Glendale two purchase agreements dated November 30, 2015. According to the agreements, ECM paid one seller \$5,000 for one million shares of Broke Out and paid another seller \$1,550 for 310,000 shares—in both cases the stock was priced at \$0.005 per share.³⁶ In his account opening documentation, however, ECM estimated the value of his shares at \$200,000.

Flesche and Laubenstein approved ECM's deposit after completing Glendale's Broker Checklist. Laubenstein conducted the AML review, which included background checks and Google, OFAC, and SEC filing searches. Laubenstein also confirmed that ECM was not an

³⁵ This same customer sold another 2,500 shares of Broke Out for \$0.50 per share on February 3, 2016, the day before ECM began liquidating his Broke Out shares.

³⁶ ECM's documents reflected that the two individual sellers had paid a total of \$5,240 for the 1,310,000 shares in May 2015, or \$0.004 per share. ECM provided to Glendale a copy of Broke Out's bank statements for April through June 2015 that showed that the sellers had paid the issuer for the shares they then sold to ECM.

affiliate of Broke Out and searched the internet for promotional activity relating to the company.³⁷

On January 20, 2016, ECM sent Huang an email saying he expected to start selling his Broke Out shares the next day, but ECM did not do so.

3. Broke Out Enters into a Reverse Merger and ECM Sells His Shares

On January 28, 2016, Broke Out filed a Form 8-K reporting that, on January 27, 2016, it had entered into a reverse merger with an existing company located in Central America.³⁸ Broke Out reported that, after the reverse merger, the company's new business would be developing applications and games for Google and Apple platforms. According to the 8-K, the new company purchased the assets of an application developer in Germany and would be based in Berlin. The company into which Broke Out merged had gross revenue of €22,251, net profits of €16,306, assets of €1,945, and liabilities of €625 for the nine-month period ending September 30, 2015. The Form 8-K stated that, after the reverse merger, Broke Out was the surviving entity and was controlled by an individual residing in Malaysia.

From February 4, 2016, through March 14, 2016, ECM sold 472,782 Broke Out shares for prices ranging from \$1.37 to \$3.42 per share. Flesche reviewed ECM's sale transactions. Prior to ECM's sales, there was very little trading volume in Broke Out. Huang testified that he noticed that ECM's sales constituted a large percentage of the trading volume on the days of the sales. ECM's total proceeds from his sales of Broke Out were \$1,279,352. Glendale earned commissions of \$38,438 from these sales. ECM did not deposit or trade any shares at Glendale other than Broke Out.

On March 3, 11, and 16, 2016, ECM wired \$1,212,000 from his Glendale account to a bank account in Singapore. Huang testified that he learned later that this bank was an affiliate of the Malaysian bank ECM disclosed in his account opening documents. Laubenstein approved every wire.³⁹ Neither Huang, Laubenstein, nor anyone else at Glendale verified that the account at the Singapore bank was ECM's, or whether the Singapore or Malaysia banks were affiliated.

³⁷ On January 1, 2016, a few weeks after his deposit of Broke Out shares, ECM submitted a signed document prepared by Glendale in which he represented that he was not an affiliate of Broke Out and was not acting in concert with others in connection with his acquisition or sale of Broke Out shares.

³⁸ Broke Out reported that it entered a share exchange which functioned effectively as a reverse merger.

³⁹ Laubenstein delayed one wire for \$147,000 until the sale of ECM's had cleared to ensure there were enough funds in the account.

4. Glendale Discovers a Promotional Campaign for Broke Out

In the first half of March 2016, several stock promotion websites started promoting Broke Out in newsletters and emails. For example, one website listed Broke Out as one of its 20 most promoted stocks in March 2016 and claimed it had the “promise of much more [sic] gains to come.” When Broke Out was trading at \$2.70, this website claimed it would reach a price of \$10 per share. Later, the website claimed Broke Out would reach \$20 per share. Another stock promotion website sent out an email recommending Broke Out and claiming it would result in “massive gains.” The promoters’ disclosed that they were paid fees to promote the stock by a company called Bullseye Holdings, LLC (“Bullseye”).⁴⁰ From March 4, 2016, through March 16, 2016, Broke Out’s share price rose from \$2 to \$14.77, and the daily trading volume increased from 5,200 to 747,000 shares per day.

Laubenstein testified that on March 9, 2016, he was told about promotional activity for Broke Out. Laubenstein testified that he searched the internet and found a newsletter from a website promoting Broke Out.⁴¹ Laubenstein emailed the article to, among others at Glendale, Huang, Castillo, and Flesche, and pointed out the promoter’s disclosure that it had been paid \$110,000 by a third party. Laubenstein testified that he emailed the article to Castillo, Huang, and Flesche so that they would know “that was a problem.”

ECM’s two biggest sales of Broke Out—a total of 343,000 shares sold on March 7 and March 8—were made during the promotional activity. These two sales yielded 70 percent of ECM’s proceeds from his sales of Broke Out—about \$918,000. Prior to the promotional activity, ECM had sold fewer than 70,000 Broke Out shares for proceeds of less than \$161,000.

The same day he found the promotional activity, Laubenstein asked Huang to send ECM a document entitled “Stock Promotion Affidavit.”⁴² The document explained that stock promotion was a “target” for regulators as a “potential source of suspicious activity, specifically [indicative of] ‘pump and dump’ schemes,” and asked ECM a series of questions about his knowledge of or involvement in promotional activity for Broke Out. While entitled an “affidavit,” the document did not require ECM to affirm or swear to his representations.⁴³ ECM

⁴⁰ The website disclosed that Bullseye had paid it \$70,000. Another website disclosed that Bullseye had paid it \$110,000 to disseminate information on Broke Out. A third website was paid \$75,000, and a fourth website was paid \$60,000. In total, it appears that Bullseye paid at least \$315,000 to promote Broke Out.

⁴¹ Laubenstein testified that he could not remember from whom he learned of the promotional activity.

⁴² Flesche testified that Glendale often asks customers about any involvement in promotional activity.

⁴³ Laubenstein testified that it was Flesche’s idea to have customers sign the Stock Promotion Affidavit to determine if the customer was involved in or had paid for stock

[Footnote continued next page]

returned the Stock Promotion Activity the same day it was sent. In it, ECM stated that he was not aware of promotional activity for Broke Out and did not know the people or entities sponsoring the campaign. ECM did not answer the question of whether he had contributed “financially or otherwise” to the stock promotion, or whether he believed the information presented in the promotion was “truthful and balanced.” In his cover email, ECM stated that he had answered the questions “to the best of [his] knowledge,” and he specifically acknowledged not answering the question about whether the information in the promotion was truthful and balanced because, he claimed, he had not seen the promotional materials. ECM wrote that he was not aware of the promotional activity, not related to it, and did not know the persons sponsoring it.

Neither Laubenstein nor any other Glendale principal signed the Stock Promotion Affidavit because ECM did not fill it out completely. Instead, Laubenstein asked Huang to send ECM copies of the promotional materials. Huang testified that ECM subsequently completed a second Stock Promotion Affidavit, but it is not in the record.

On the same day he forwarded the Stock Promotion Affidavit to ECM, Huang also completed Glendale’s “Promotion Checklist,” an internal form Glendale used when the firm identified promotional activity in a stock a customer was selling. Huang’s responses on the checklist indicated that ECM was not mentioned in the promotional materials and ECM denied participating in the promotion. Huang also responded that the promotion had resulted in spikes in Broke Out’s price and volume and that the promotion had been financed by a third party, but that ECM had not appeared to act on the promotion and had denied participating in it. Huang concluded that this was not an illegal “pump and dump” and that ECM should be allowed to continue trading. Because Huang concluded that there was no pump and dump and did not make a referral to the AMLCO, no Glendale principal signed the Promotion Checklist.⁴⁴

ECM continued selling Broke Out after Glendale discovered the promotional activity. On March 10 and 14, 2016, ECM sold a total of 50,000 shares for proceeds of \$170,000. Flesche testified that on March 14, Glendale decided to no longer accept orders from ECM.

On March 17, 2016, three days after ECM’s last sale at Glendale, the SEC announced that it was suspending trading in Broke Out until March 31, 2016. The SEC attributed the suspension to “concerns regarding the accuracy and adequacy of information in the marketplace and potentially manipulative transactions in [Broke Out’s] common stock.”

At the time of the suspension, ECM had sold 472,782 shares of Broke Out and still held 837,218 in his Glendale account. Huang informed ECM of the suspension and ECM responded

[cont’d]

promotion. Laubenstein testified that he has never known of a customer who admitted involvement in stock promotion.

⁴⁴ Laubenstein testified that during his time at Glendale he had never seen a Promotion Checklist that recommended rejecting a deposit or halting trading.

by asking if he could continue selling after the suspension was lifted or whether he should look for another broker-dealer. On May 23, 2016, Huang emailed ECM and informed him that Glendale had decided to close his account and he could transfer his remaining shares to another broker-dealer. ECM abandoned the Broke Out shares in his Glendale account and no one at Glendale heard from him again.

D. Glendale Accepts for Deposit and Liquidation Shares of Vitaxel

In May 2015, Glendale was contacted by AB, the president of a company called Albero Group (“Albero”). Castillo testified that AB found Glendale through a Google search. Albero was formed in November 2013 in Nevada and was based in Northern Ireland. Its purported business was breeding horses, but in early 2015, Albero had no operations, no revenue, and assets of \$5,254. For the quarter ending January 31, 2015, Albero had net losses of \$6,046. In May 2015, Albero issued 825,000 shares of common stock to 29 investors residing in Northern Ireland.

On May 28, 2015, Glendale submitted a Form 211 to FINRA requesting approval to begin quoting Albero on the OTC Bulletin Board and OTC Link[®] ATS. Castillo and Flesche prepared and signed the Form 211. The form stated that Albero’s president purchased his shares in an October 2014 Regulation S offering.⁴⁵ Laubenstein testified that in connection with his review of the Form 211, he reviewed Albero’s SEC filings and searched for internet promotions. FINRA cleared Glendale’s request to quote Albero on July 27, 2015.

1. Albero Becomes Vitaxel and Enters into a Reverse Merger

In or around December 2015, 30 investors located in Asia purchased Albero’s stock from the shareholders in Northern Ireland. On January 8, 2016, Albero changed its name to Vitaxel and its ticker symbol to “VXEL.” Vitaxel also increased its authorized stock from 75 million shares to seven billion shares of common stock and 100 million shares of preferred stock.

On January 10, 2016, Vitaxel entered into share exchange agreements with two companies based in Malaysia. After the exchange, the Malaysian companies became subsidiaries of Vitaxel. On January 22, 2016, Vitaxel filed a Form 8-K reporting that it had acquired the Malaysian companies and changed its business from horse breeding to a business it described as “multi-level marketing model with an emphasis on travel, entertainment and lifestyle products and services.” The 8-K also reported that the company had transferred all the assets and liabilities in Albero’s former business to AB and the Northern Ireland shareholders in exchange for the cancellation of their stock.

2. KTO Opens a Glendale Account

On October 30, 2015, KTO, an individual residing in Malaysia, opened an account with Glendale through Huang. KTO worked for a financial and marketing consultant that assisted

⁴⁵ Regulation S applies to offerings of securities made outside the United States.

companies with mergers and acquisitions and initial public offerings.⁴⁶ KTO's employer had been retained by Vitaxel in early 2015 to assist with the acquisition of Albero. Vitaxel and KTO's employer had offices on different floors in the same building in Kuala Lumpur. KTO represented the 30 purchasers of stock in the share exchange merger transaction and later helped some of those new Vitaxel shareholders open accounts at Glendale. KTO testified that he opened his own account at Glendale first so that he could learn the process and help the other shareholders open their accounts.

KTO's account opening documents stated that he had an estimated net worth of \$200,000, liquid assets of \$50,000, and annual income of \$33,000. KTO stated that his first and second investment objectives were preservation of capital and income, respectively. KTO told Huang that he intended to deposit and sell Vitaxel shares in the account. Along with Glendale's standard customer agreement, KTO also submitted a Foreign Account Questionnaire in which he stated that he had known Glendale and Huang less than one week. KTO also submitted copies of his Malaysian passport and driver's license for identification and residence purposes.⁴⁷ Laubenstein reviewed and approved the account opening.

On January 11, 2016, KTO deposited a stock certificate dated January 20, 2016, for 83,270 shares of Vitaxel.⁴⁸ KTO submitted a signed DSRQ with the stock certificate, in which he represented that he had purchased his shares of Vitaxel on December 18, 2015, when the company was still Albero. KTO said that the three sellers from whom he purchased the shares had acquired the shares in Albero's May 2015 Regulation S offering. KTO submitted copies of two stock purchase agreements, which showed that he paid \$41,483 for 83,270 shares (approximately \$0.50 per share).

According to Glendale's contemporaneous calculations, KTO held slightly more than 2 percent of Vitaxel's outstanding shares and just under 10 percent of Vitaxel's public float. KTO submitted a letter in connection with his deposit acknowledging that he owned 2.18 percent of Vitaxel's outstanding shares and representing that he was not an affiliate of Vitaxel, was not acting in concert with others in connection with the sale of the shares, and that he did not possess material, nonpublic information about Vitaxel.

Glendale purportedly searched OFAC, SEC filings, and Google for information about the sellers of KTO's shares and found nothing negative. Huang recommended that Glendale accept the deposit, and Laubenstein and Flesche approved it.

⁴⁶ KTO testified at the hearing by telephone.

⁴⁷ Huang translated portions of the account application by adding typewritten Chinese characters but did not translate the entire agreement, including certain disclosures in the agreement.

⁴⁸ There is no explanation in the record why the stock certificate was dated later than the deposit.

3. Other Vitaxel Shareholders Open Accounts at Glendale

Starting in early November 2015, Huang began receiving requests to open accounts from other Vitaxel shareholders located in Malaysia, Singapore, and China. They were referred to Glendale, and specifically to Huang, by KTO and his assistant. All 20 of the referrals were Vitaxel shareholders. Huang received the account opening documents and share deposit paperwork by email from KTO or his assistant. KTO and his assistant also acted as intermediaries when Huang needed more information from the prospective customer. Huang testified that KTO and his assistant acted as representatives for the customers. Glendale, however, did not have powers of attorney or other authorizations from the customers KTO and his assistant were purportedly representing. Glendale nonetheless approved and opened all the accounts and accepted their deposits of Vitaxel shares.

Laubenstein reviewed and approved the account opening documentation for these customers. Laubenstein knew some of the customers had been referred by KTO, but he did not know anything about KTO's background, including his connection to Vitaxel's reverse merger. Laubenstein testified that he never spoke directly to any of the Vitaxel customers, and that he did not know if Huang or anyone else at Glendale had spoken to them directly. Laubenstein also testified that he assumed the customers could speak and read English.

KTO testified that he did not know any of the customers before they acquired their Vitaxel stock in the reverse merger, and that he met some of them in person for the first time in connection with opening their Glendale accounts. KTO also testified that, while he spoke English with some of the customers, he spoke mainly Chinese or Malay with them and did not know if they could read English.

Huang testified that he emailed new account numbers and wire transfer instructions directly to the Vitaxel customers so that they could fund their accounts, and that some of them responded in English or Chinese. Huang also testified that he translated portions of the account applications into Chinese to help the customers understand the documents.

Months after the customers opened their Glendale accounts and deposited their shares, Laubenstein asked Huang to have the customers sign powers of attorney giving KTO and his assistant authority to act on their behalf. Huang sent the powers of attorney to KTO and his assistant asking them to forward the documents to the customers for execution. Huang testified that he only spoke to a "few" of the customers, and that he verified the signatures on the powers of attorney by comparing them to other documents in the customers' files. All but two of the powers of attorney were dated and signed the same day.

Laubenstein was responsible for reviewing Huang's emails. Laubenstein testified that he conducted this review by doing keyword searches and reviewing a sample of Huang's emails. During the relevant period, Laubenstein did not have the ability to search Huang's email using Chinese characters. Laubenstein also testified that he occasionally used Google to translate Huang's foreign language emails to English. Flesche and Laubenstein allowed Huang to add his own translations to the Firm's account applications and send them to customers without determining if Huang's translations were accurate. Flesche testified that he assumed Huang was

reviewing the account applications directly with the customers and that he believed Glendale was entitled to assume that the customers understood the account application. Accordingly, Flesche believed there was no need to translate the entire document to the customer's language.

4. Glendale Customers Sell Vitaxel

During February and March 2016, KTO and the customers he referred deposited a total of 63 million shares of Vitaxel into their Glendale accounts. By early April 2016, KTO had sold a portion of his Vitaxel shares for total proceeds of almost \$39,000. Two other customers had sold portions of their Vitaxel shares for proceeds of \$1,685. Glendale earned commissions of \$1,343 from these sales.

E. Glendale Opens Accounts on Behalf of a Bank in Belize

In 2007, Glendale was introduced to a bank in Belize ("Belize Bank"). Glendale had acquired customer accounts from a broker-dealer that had gone out of business. These accounts included accounts that had been introduced by Belize Bank. Castillo and Flesche flew to Belize to meet with the bank's management, and subsequently agreed to open accounts at Glendale for the bank and its customers. Glendale agreed to share a portion of the commissions and fees earned in these accounts with the bank. Belize Bank ultimately introduced 33 accounts to Glendale.

For 18 of the 33 accounts introduced by Belize Bank, the identities of the beneficial owners were never disclosed to Glendale. Instead, Belize Bank assigned a four-digit number to identify these accounts. The record contains the account application for only one of these undisclosed accounts. That account application is signed by a representative of Belize Bank and contains no customer signature.

Castillo testified that Belize Bank represented to Glendale that it would follow AML rules. Castillo also testified that Belize Bank agreed to identify the beneficial owners of the undisclosed accounts if Glendale requested it. Accordingly, Castillo said Glendale felt comfortable accepting the accounts. There is no evidence in the record that Glendale requested the identities of the beneficial owners, or that Belize Bank ever provided that information to Glendale. Laubenstein, who joined Glendale in 2010, three years after the undisclosed accounts were opened, testified that he never asked for the names of the beneficial owners of the accounts. Laubenstein testified that he believed Glendale was entitled to consider Belize Bank as the customer because the bank had demonstrated that it was not a shell company and had provided Glendale with a copy of its AML procedures. Laubenstein acknowledged that he did not perform due diligence or review Belize Bank's AML procedures because he assumed it had been done when the accounts were opened.⁴⁹

⁴⁹ The record contains no documentary evidence about the nature or volume of trading in any of the Glendale accounts introduced by the Belize bank. Laubenstein testified that the accounts held exchange listed stocks and did not trade penny stocks. Both Castillo and Flesche testified that there was very little trading in the accounts.

In 2010, the SEC conducted an examination of Glendale, including its relationship with Belize Bank. The SEC determined that Glendale had relied unreasonably on Belize Bank and failed to fulfill its customer identification obligations. Consequently, in December 2010, Flesche told Belize Bank that Glendale could no longer rely on the bank's AML procedures and offered the bank three options. Flesche told the bank it could either identify the beneficial owners, arrange for the beneficial owners to open accounts directly with Glendale, or close the accounts. Glendale subsequently closed and liquidated the accounts for all of the customers who did not provide identifying information. By early 2012, Laubenstein told Belize Bank that Glendale would not open any additional accounts for the bank's customers and, by the end of 2012, all the Belize Bank customer accounts at Glendale were closed.

III. Procedural History

A. The Complaint

On October 5, 2017, Enforcement filed a six-cause complaint against Glendale, Castillo, Flesche, Laubenstein, Abadin, and Huang. Cause one alleged that Glendale and Castillo willfully violated Section 10(b) of the Securities and Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010 by manipulating the price of NuGene stock. Cause two alleged that Glendale, Flesche, and Abadin violated FINRA Rule 2010 by facilitating the unlawful sale of restricted securities—NuGene stock—in contravention of Section 5 of the Securities Act of 1933 (the "Securities Act"). Cause three alleged that Glendale, Castillo, Flesche, Laubenstein, Huang, and Abadin violated FINRA Rules 3310 and 2010 by failing to establish and implement a reasonable AML system and by failing to identify and investigate AML red flags. Cause four alleged that Glendale, Castillo, Flesche, and Laubenstein failed to supervise in violation FINRA Rules 3110 and 2010.⁵⁰

B. The Extended Hearing Panel Decision

In July and August 2018, the Hearing Panel conducted a twelve-day hearing, at which eight witnesses testified, including the individual Respondents, and more than 150 exhibits were received in evidence.

The Hearing Panel issued its decision on April 5, 2019. The Panel dismissed the allegations under causes one and two. The Hearing Panel found the respondents liable for some,

⁵⁰ Causes five and six alleged violations by Huang. Cause five alleged that Huang misused confidential nonpublic information in contravention of Regulation SP and FINRA Rule 2010 when he communicated with KTO and his assistant concerning customers' accounts. Cause six alleged that Huang violated the recordkeeping requirements of FINRA Rules 4511 and 2010 when he communicated with KTO and his assistant using an application (WeChat) and failed to retain and submit those communications to the Firm. Neither cause five nor six were appealed by the parties or called for review by the NAC. Accordingly, the Hearing Panel's decision is FINRA's final action with respect to these causes.

but not all, of the AML and supervisory violations alleged under causes three and four. For the AML violations under cause three, the Hearing Panel fined Glendale \$125,000 and censured the Firm, and fined Laubenstein \$20,000 and suspended him in all capacities for 18 months. For the supervisory violations under cause four, the Hearing Panel fined Glendale and Flesche \$30,000, jointly and severally, censured Glendale, suspended Flesche for 30 business days in all capacities, fined Laubenstein \$5,000, and suspended Laubenstein for 15 business days in all capacities.

C. The Chief Hearing Officer's Stay of Appellate Deadlines

A week after the Hearing Panel issued its decision, the Chief Hearing Officer entered an order staying the case, including all of the appeal deadlines, pending a review by outside counsel.

During a conference call with the parties on April 15, 2019, the Chief Hearing Officer explained that the Office of Hearing Officers ("OHO") had an obligation to ensure that disciplinary proceedings are fair and that OHO had policies related to conflicts and bias. The Chief Hearing Officer told the parties that information had come to her attention that "need[ed] to be reviewed in connection with this case," and that FINRA had retained outside counsel to conduct that review. The Chief Hearing Officer notified the parties that she intended to issue an order staying the case so that the time for appeal would not run while outside counsel conducted its review. Specifically, the Chief Hearing Officer explained,

I don't want your time for the appeal or the NAC's time to review the decision for its call for review if it chooses to, to be – I don't want the clock ticking on your appeal while outside counsel is conducting . . . this review.

Later that day, the Chief Hearing Officer entered an order stating that "[f]or the reasons stated during the [conference] call, this case is stayed." No party objected to the stay either during the call or subsequently.

On May 2, 2019, the Chief Hearing Officer entered an order stating that the review by outside counsel had been completed and that the stay was lifted. The order specified that the "Parties appeal period will run from the date of this order."

On May 23, 2019, Enforcement appealed a portion of the Hearing Panel's decision. On June 17, 2019, a Review Subcommittee ("RSC") of the NAC called for review another portion of the Hearing Panel decision. The parties were notified of the NAC's call for review by letter dated June 26, 2019.

D. Respondents' Motion to Dismiss Enforcement's Appeal and the RSC's Call for Review

On July 17, 2019, Castillo and Flesche filed a motion to dismiss Enforcement's appeal and the NAC's call for review on grounds that both were untimely. They also requested information concerning the review by outside counsel that initiated the stay. On July 30, 2019,

Glendale and Abadin filed a notice joining in the motion to dismiss. On July 29, 2019, Enforcement filed an opposition to the motion to dismiss Enforcement's appeal.

The NAC Subcommittee appointed to this case considered the motions and, on August 28, 2019, issued a decision denying the motions.

IV. Discussion

A. The NAC Subcommittee Properly Denied the Motion to Dismiss

We affirm the NAC Subcommittee's denial of the motion to dismiss Enforcement's appeal and the RSC's call for review. The Chief Hearing Officer's order staying the case was appropriate. It is a basic requirement that FINRA disciplinary proceedings be conducted free of bias and conflicts of interest. *See, e.g.*, FINRA Rule 9160 (providing that no person should participate as an adjudicator who has a conflict of interest or bias with respect to a particular matter). FINRA rules explicitly acknowledge the role of the Chief Hearing Officer in ensuring that proceedings are free of bias and conflicts of interest. *See* FINRA Rule 9233 (providing that the Chief Hearing Officer must investigate and rule on motions to disqualify a hearing officer); FINRA Rule 9234 (providing that the Chief Hearing Officer may disqualify a hearing panelist on a party's motion or her own order where she "determines that a conflict of interest or bias exists"). The Chief Hearing Officer reasonably discharged her duty to ensure that the proceedings were fair, while preserving the rights of the parties to appeal and the RSC to review the decision.

Once the Chief Hearing Officer lifted the stay, it was appropriate to allow Enforcement's appeal and the RSC's call for review to proceed because Enforcement and the RSC reasonably relied on the Chief Hearing Officer's stay in delaying the filing of the appeal and call for review. During the April 15, 2019 conference call, the Chief Hearing Officer made it clear that she was staying the entire case, including the time to file an appeal and for the RSC to call the case for review. In her May 2, 2019 order lifting the stay, the Chief Hearing Officer stated that the appeal period would begin running from the date of that order. Significantly, none of the respondents objected either to the imposition of the stay or to the terms of the Chief Hearing Officer's order lifting the stay. Enforcement and the RSC, accordingly, reasonably relied on the stay and the Chief Hearing Officer's orders.⁵¹ Concerns about the finality of the Hearing Panel's decision do not apply here where the delay in the time for appeal was relatively short, the parties

⁵¹ With respect to the RSC's call for review, the NAC Subcommittee requested and received a declaration verifying that the call for review occurred within the time proscribed by FINRA Rule 9312. FINRA Rule 9312(a) provides that decisions "are subject to a call for review" by a member of the NAC within 45 days of service of the decision. The call for review here occurred within 45 days of the Chief Hearing Officer's May 2, 2019 order. Rule 9312 does not specify a time for notification of the call for review to the parties. The NAC Subcommittee found, and we agree, that the notification letter was sent within a reasonable period after the call for review.

were made aware of the stay and the reasons for it, and the movants did not object to the stay until filing their motions to dismiss.

We also agree with the NAC Subcommittee's denial of the Respondents' request for information concerning the review by outside counsel that initiated the stay. That information is not part of the record on appeal before the NAC—nor is it required to be. FINRA Rule 9267 sets forth the required contents of the record. The rule does not require that the contents of a confidential investigation conducted by OHO into possible conflicts of interest or bias be included in the record, and there is no precedent for doing so.

Accordingly, we affirm the NAC Subcommittee's denial of the respondents' motion to dismiss.

B. Enforcement Failed to Present Sufficient Proof that Glendale and Castillo Manipulated the Price of NuGene

The Hearing Panel found that “there is insufficient evidence that Glendale and Castillo had the requisite scienter . . . to manipulate NuGene” and dismissed cause one. We agree.

Section 10(b) of the Exchange Act makes it “unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of . . . rules and regulations” prescribed by the Commission. 15 U.S.C. § 78j. Exchange Act Rule 10b-5 makes it unlawful, in connection with the purchase or sale of any security, “(a) to employ any device, scheme, or artifice to defraud, . . . or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . .” 17 CFR § 240.10b-5.⁵² Manipulation is “virtually a term of art when used in connection with securities markets.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Manipulation “connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.” *Id.* “Manipulation is the creation of deceptive value or market activity for a security, accomplished by an intentional interference with the free forces of supply and demand.” *Swartwood Hesse, Inc.*, 50 S.E.C. 1301, 1307 (1992).

Scienter is required in order to establish a claim of market manipulation. “[S]cienter refers to a mental state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst*, 425 U.S. at 193 n.12. Scienter may be established by proving by a preponderance of the evidence that the respondent knew or was reckless in not knowing that a customer's trades were for a manipulative purpose. *See Dep't of Enforcement v. Edward S. Brokaw*, Complaint No.

⁵² FINRA Rule 2020 is FINRA's antifraud rule which is similar to Exchange Act Rule 10b-5. *See Dep't of Enforcement v. Kirlin Sec., Inc.*, Complaint No. EAF0400300001, 2009 FINRA Discip. LEXIS 2, at *39 (FINRA NAC Feb. 25, 2009). A violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, or FINRA Rule 2020 is also a violation of FINRA Rule 2010. *See Id.*, at *39 n.28.

2007007792902, 2012 FINRA Discip. LEXIS 53, at *34 (FINRA NAC Sept. 14, 2012), *aff'd*, Exchange Act Release 70883, 2013 SEC LEXIS 3583 (Nov. 15, 2013).

Enforcement alleged that Castillo, acting in concert with Glendale customers, placed orders to buy and sell NuGene to inflate the stock price with the goal of causing the price per share to close at \$5.00 for three consecutive days. Enforcement alleged that the inflation of the share price was for the purpose of releasing two Glendale customers, RC and JH, from the Lock-Up Agreement that prevented them from selling their shares. Enforcement further alleged that once the customers were freed from the Lock-Up Agreement, Glendale facilitated the sales of more than \$8 million of NuGene shares during a stock promotion campaign. Enforcement argues that we should infer intent from Castillo's trading activity, which Enforcement claims made no economic sense. This includes BS's initial deposit and sale of NuGene, Castillo's market-making activity for NuGene, and ND's good-til-canceled order to sell NuGene for \$5.00 per share.

Scienter can be proven with circumstantial evidence and can be inferred from a pattern of trading. *See Brokaw*, 2012 FINRA Discip. LEXIS 53, at *34; *see also Brooklyn Capital & Sec. Trading, Inc.*, 52 S.E.C. 1286, 1290 (1997) (stating that "[i]n determining whether a manipulation has occurred, [the Commission has] depended on inferences drawn from a mass of factual detail including patterns of behavior, apparent irregularities, and from trading data."). We agree with the Hearing Panel, however, that the evidence of scienter here is insufficient.

First, the record does not establish that RC's NuGene shares were, in fact, subject to the Lock-Up Agreement. Indeed, Enforcement's witness conceded that he was unable to conclude that RC's shares were subject to the Lock-Up Agreement. Accordingly, the allegation that Castillo engaged in market manipulation for the purpose of releasing RC from the Lock-Up Agreement and allowing it to sell its NuGene shares is unsupported.

There is also insufficient evidence that Castillo knew that RC and JH owned NuGene shares that he believed were subject to the Lock-Up Agreement, or that Castillo knew the terms of the Lock-up Agreement at the time Castillo entered ND's good-til-canceled order on February 11, 2015, or when the allegedly manipulative sales were executed for ND on February 24, 25, and 26, 2015. While a good-til-canceled order can be indicative of an effort to "pump" a stock, there is insufficient evidence that Castillo knew an increase in the price of NuGene would result in nullifying a lock-up agreement and benefit these customers. RC deposited its NuGene stock on February 11, 2015. RC was Abadin's customer and Castillo testified that he did not know that RC owned NuGene shares until RC started trading NuGene after ND's trades. There is nothing in the documentary evidence that contradicts Castillo's testimony. RC's stock certificate did not contain a restrictive legend and, while its stock purchase agreements referenced a lock-up agreement, RC's documents did not contain a copy of it. RC provided an attorney opinion letter which represented that RC's NuGene shares were free trading and not subject to restrictions, and the transfer agent represented the same.

JH deposited its first NuGene shares on February 27, 2015. While JH sent copies of its stock purchase agreements to Glendale on February 20, 2015, these did not include copies of the Lock-up Agreement itself. Indeed, there is no evidence that Castillo, or anyone else at Glendale,

saw the terms of the Lock-Up Agreement until February 27, 2015, when JH deposited a stock certificate which set forth the terms of the Lock-Up Agreement, including the market capitalization levels required for nullification of the Lock-Up Agreement and the dates and amounts of the leak-out.

While it is undisputed that JH was subject to the terms of the Lock-Up Agreement, the record establishes that JH's sales of NuGene did not depend on release from the Lock-Up Agreement. JH's first sale of NuGene was 560 shares on April 7, 2015. Its next sales were in mid-June when JH sold 132,000 shares. In July, JH sold 95,880 shares of NuGene. JH would have been permitted to make all these sales under the terms of the Lock-Up Agreement even if the \$200 million market capitalization had never been reached. These facts further undercut the allegation that Castillo engaged in market manipulation for the purpose of releasing JH from the restrictions of the Lock-Up Agreement.

Finally, Enforcement alleges that Castillo's initial purchase of Bling shares from BS was "suspicious," and points to BS's involvement in filing the Form 211 for Bling through another broker-dealer. There is no evidence, however, that Castillo, or anyone else at Glendale, knew of BS's involvement with the Form 211. Further, BS's NuGene transactions occurred weeks before RC and JH opened their Glendale accounts.⁵³

We find that there is insufficient evidence that Castillo acted with the requisite scienter and, accordingly, affirm the dismissal of cause one.

C. Enforcement Failed to Prove that Glendale, Fleche, and Abadin Distributed Shares of NuGene in Contravention of Section 5 of the Securities Act

The Hearing Panel found that Enforcement failed to prove that Glendale, Flesche, and Abadin violated FINRA Rule 2010 by facilitating the unlawful sale of restricted securities in contravention of Section 5 of the Securities Act. We affirm the Hearing Panel's findings.

Section 5 of the Securities Act prohibits the sale of securities in interstate commerce unless a registration statement is in effect for that offer and sale, or there is an applicable exemption from the registration requirement. 15 U.S.C. § 77e(a), (c); *see Dep't of Enforcement v. Spencer Edwards, Inc.*, Complaint No. 2013035865303, 2019 FINRA Discip. LEXIS 56, at *12-13 (FINRA NAC Dec. 10, 2019). The purpose of the registration requirement is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions." *See Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *46 n.63 (Jan. 20, 2012). Liability under Section 5 extends to anyone who is a "necessary participant" or "substantial factor" in the unlawful sale of securities, including a broker who facilitates the deposit and sale of restricted shares. *Zacharias v. SEC*, 569 F.3d 458, 467 (D.C. Cir. 2009). Participating in the offer and sale of unregistered, non-exempt securities in

⁵³ Enforcement also points to the fact that JB, the buyer who purchased Glendale's shares of NuGene on February 4, 2015, was a person associated with the issuer. Again, there is no evidence that Castillo knew who was on the buy side for these trades.

contravention of Securities Act Section 5 is a violation of FINRA Rule 2010. *Midas Sec.*, 2012 SEC LEXIS 199, at *26.

To establish a prima facie case for a violation of Section 5, Enforcement must establish that (1) no registration statement was in effect for the securities; (2) respondents sold the securities on behalf of the customers; and (3) the securities were offered or sold using interstate facilities or mail. *See Midas Sec.*, 2012 SEC LEXIS 199, at *27. Scierter is not required to establish a Section 5 violation. *Id.* Once a prima facie case of a violation of Section 5 is established, the burden shifts to the person claiming that an exemption from registration applies to the transaction. *See Spencer Edwards, Inc.*, 2019 FINRA Discip. LEXIS 56, at *13-14. Enforcement established a prima facie case here because there is no dispute that no registration statement was in effect for the NuGene shares or that Glendale sold the shares on behalf of its customers, JH and RC, using interstate facilities.

While respondents do not dispute the elements establishing a prima facie Section 5 violation, they contend that their sales of NuGene stock were exempt from Section 5 under the so-called “broker’s exemption.” Securities Act Section 4(a)(4) exempts from Section 5’s registration requirements “brokers’ transactions executed upon customers’ orders on any exchange or in the over-the-counter market but not the solicitation of such orders.” 15 U.S.C. § 77d(a)(4). The Section 4(a)(4) exemption is designed to exempt ordinary brokerage transactions and “is not available to a registered representative if he knows or has reasonable grounds to believe that the selling customer’s part of the transaction is not exempt from Section 5 of the Securities Act.” *John A. Carley*, Exchange Act Release No. 57246, 2008 SEC LEXIS 222, at *34 (Jan. 31, 2008). Brokers invoking the exemption have a duty to investigate the facts related to the proposed transaction and the “amount of inquiry required of the broker necessarily varies with the circumstances of each case.” *Id.* The respondents assert that the NuGene sales were broker’s transactions executed on customers’ orders and that they had no reason to suspect the shares were restricted.

Enforcement contends that the respondents failed to establish that they are entitled to the broker’s exemption for their sales of NuGene shares. Enforcement argues that the respondents have not established the applicability of the broker’s exemption here because RC’s and JH’s NuGene shares were restricted. Pursuant to Rule 144(a)(3)(i), “restricted securities” include “[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering.” Under Rule 144(a)(1), an “affiliate” of an issuer is defined as a “person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.” The CEO of an issuer is an affiliate. Rule 144(a)(2) also defines “person” to include “[a]ny relative or spouse of such person, or any relative of such spouse, any one of whom has the same home as such person.” Enforcement asserts that NF, MF, and EF, from whom RC and JH purchased their NuGene shares, were affiliates of NuGene by virtue of their relationship with DK, the CEO of NuGene’s predecessor Bling. Specifically, Enforcement alleges that NF was DK’s spouse and shared a common address with MF and EF. Enforcement further alleges that respondents did not conduct an inquiry sufficient to invoke the broker’s exemption because respondents did not review DK’s social media posts.

The Hearing Panel found that the broker's exemption applied to the respondents' sales of NuGene shares. First, the Hearing Panel found that Enforcement failed to prove that MF and EF, NF's parents, lived with DK and NF. Accordingly, the Panel found that MF and EF were not affiliates of Bling, and the Panel did not consider whether any of JH's sales of NuGene, all of which were purchased from MF and EF, were restricted. The record supports this finding, and we affirm it.

Second, the Hearing Panel found that, although DK and NF were married as of December 18, 2014, as Enforcement alleged, respondents conducted adequate due diligence before engaging in the transactions at issue. The Panel's finding that DK and NF were married as of December 18, 2014, was based on DK's social media posts referring to the couple's wedding anniversary, reflecting that they were married in August 2011, and on the fact that DK identified herself using NF's surname in social media postings. Enforcement located these social media postings in 2016. The Hearing Panel also concluded that the DK and NF were living together at the same residential address on the date of NF's Bling/NuGene sale to RC based on evidence that they had provided common addresses during their marriage. Notwithstanding this finding, the Panel dismissed cause two because it found that Glendale, Flesche, and Abadin "performed adequate due diligence and engaged in a reasonable inquiry" into whether the customers had acquired their shares of Bling from affiliates of the issuer.

We find that the record does not establish that DK and NF were married at the time of NF's sales of Bling/NuGene to RC and, therefore, NF was not an affiliate of Bling. The record contains a marriage certificate for DK and NF reflecting that they were married in the State of New York on November 17, 2017. Given this documentary evidence, and the specific facts of this case, we decline to find that DK and NF were married in 2014 on the basis of the uncorroborated social media posts that were identified by Enforcement long after the NuGene transactions at issue.

We acknowledge that the NuGene transactions at issue raised red flags. We find, however, that given the specific facts of this case, respondents have established by a preponderance of the evidence that Glendale's inquiry was reasonable.

Accordingly, we affirm the dismissal of the allegations under cause two against Glendale, Flesche, and Abadin.

D. Glendale and Laubenstein Failed to Develop and Implement a Reasonable AML Program

Cause three of the Complaint alleges AML violations related to three subject matters: (1) the failure to detect and report suspicious activities related to customer deposits of NuGene, Broke Out, and Vitaxel; (2) the failure to comply with AML-related obligations to verify the identity of Asia-based customers; and (3) the failure to conduct adequate due diligence on customers introduced by Belize Bank.

FINRA Rule 3310 requires FINRA members to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the

Bank Secrecy Act (“BSA”) and its implementing regulations. FINRA Rule 3310(a) requires that, at a minimum, AML programs “[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under [the Bank Secrecy Act] and the implementing regulations thereunder.” FINRA Rule 3310(b) requires that firms “[e]stablish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder.” A firm’s AML procedures must be reasonably tailored to the specific nature of its business. *See Dep’t of Enforcement v. Domestic Sec., Inc.*, Complaint No. 2005001819101, 2008 FINRA Discip. LEXIS 44, at *22-23 (FINRA NAC Oct. 2, 2008).

FINRA has provided guidance to firms concerning how to structure their AML compliance programs. *See NASD Notice to Members 02-21*, 2002 NASD LEXIS 24 (Apr. 2002). In Notice to Members 02-21, FINRA advised firms that an AML program “must reflect the firm’s business model and customer base,” and must be tailored to take into account factors such as a firm’s “size, location, business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.” *Id.* at *17-20.

The notice defines “money laundering” as “engaging in acts designed to conceal or disguise the true origin of criminally derived proceeds so that the unlawful proceeds appear to have derived from legitimate origins or constitute legitimate assets.” *Id.*, at *7. The notice also contains a non-exhaustive list of examples of “red flags” which could indicate suspicious activity, including: (1) the customer, for no apparent reason or in conjunction with other red flags, engages in transactions involving certain types of securities, such as penny stocks; (2) the customer engages in transactions that lack business sense or apparent investment strategy, or are inconsistent with the customer’s stated business strategy; and (3) the customer (or a person publicly associated with the customer) has a questionable background or is the subject of news reports indicating possible criminal, civil, or regulatory violations. *Id.*, at *37-41.

A different notice, *NASD Notice to Members 02-47*, reminded firms of their obligation to file a suspicious activity report (“SAR”) for certain suspicious transactions within 30 days of becoming aware of it. *See NASD Notice to Members 02-47*, 2002 NASD LEXIS 59, at *10 (Aug. 2002). That notice referred to the red flags listed in Notice to Members 02-21, and stated that the obligation to report “extends to patterns of transactions . . . that taken together, form a suspicious pattern of activity.” 2002 NASD LEXIS 59, at *6.

Finally, another notice, *FINRA Regulatory Notice 09-05*, reminded firms of obligations for determining whether unregistered securities are eligible for resale, and instructed firms that their AML programs must address red flags associated with resales of unregistered securities. *See Regulatory Notice 09-05*, 2009 FINRA LEXIS 19, at *21 (Jan. 2009).

1. Glendale and Laubenstein Failed to Tailor Glendale’s AML Procedures to the Firm’s Penny Stock Business and Failed to Detect and Investigate Red Flags of Suspicious Activity

The Hearing Panel found that Glendale and Laubenstein “failed to employ monitoring appropriate to [Glendale’s microcap] liquidation business,” and that Glendale and Laubenstein

failed to identify and investigate red flags of suspicious activity with respect to NuGene, Broke Out, and Vitaxel. We affirm these findings.

Laubenstein was responsible for developing and implementing Glendale's AML program, including investigating suspicious activities, and taking appropriate action when suspicious activity was identified, including filing SARs. We agree with the Hearing Panel's finding that Glendale's AML procedures appear to have been based on FINRA's small firm AML template, and were not appropriately tailored to Glendale's business. *See Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, Complaint No. 2011027666902, 2017 FINRA Discip. LEXIS 16, at *36-41 (FINRA NAC May 26, 2017) (finding that the adoption of FINRA's small firm template with virtually no tailoring to a firm's business did not satisfy the firm's AML compliance obligations), *aff'd in relevant part*, Exchange Act Release No. 86404, 2019 SEC LEXIS 1771 (July 17, 2019). For example, while Glendale's AML procedures listed 42 red flags that could signal money laundering, only a few of those were relevant to Glendale's business model.

We also agree that the exception reports Glendale and Laubenstein relied upon to monitor for suspicious activity were not appropriate for Glendale's primary business—liquidating microcap securities. For example, Laubenstein reviewed a high commission report, a volume concentration report, and a report containing trades by customers designated by the firm as “high risk.” None of these was relevant to Glendale's primary business line. Laubenstein testified that the high commission report was intended to identify churning, which was not a concern at Glendale as the firm did not solicit trades. Flesche admitted that the volume concentration report was of little use because Glendale's customers traded low-volume stocks and these trades would often constitute a large percentage of the stock traded. Accordingly, Glendale's policies and procedures were not appropriately tailored to ensure compliance with AML requirements.

Glendale's inadequate monitoring resulted in Glendale and Laubenstein failing to detect and investigate red flags of suspicious activity in its customers' deposits and liquidations of NuGene, Broke Out, and Vitaxel.

The deposit and liquidation of NuGene shares by JH, RC, and SEI presented numerous red flags. NuGene had recently entered into a reverse merger with Bling, a company with virtually no business. NuGene had started a new skin care business and its filings indicated that an investment in the company involved a high degree of risk. JH, RC, and SEI were unknown to Glendale before opening their accounts, opened new accounts shortly before depositing their NuGene shares, and quickly deposited large blocks of the stock. All three customers sold large amounts of NuGene around the same time and within months of the first trading in NuGene. RC and JH purchased their shares on the same day from six people with the same last name. All three customers paid very little for the shares as compared to the proceeds they realized from sales of the stock. RC immediately started wiring out the proceeds from his sales of NuGene. RC and JH only traded NuGene at Glendale. Notwithstanding these numerous red flags, Glendale and Laubenstein did not undertake any investigation of NuGene while the stock was trading and, despite readily available information raising concerns about promotional activity related to NuGene, did not discover the promotional activity until months later when FINRA brought it to the Firm's attention.

We also agree with the Hearing Panel that Laubenstein failed to consider transactions in NuGene in the context of other trading activity. For example, we agree that when ND opened her Glendale account, purchased NuGene for \$0.26, and began placing sell orders at much higher prices, Laubenstein should have further scrutinized BS's initial NuGene trade at Glendale. This is especially true because BS was identified as a high-risk customer based on previous potentially suspicious activity. Nonetheless, Laubenstein did not undertake any investigation. Additionally, RC's deposit of NuGene right after ND's trading warranted an investigation, as did JH's deposit on February 27, 2015, of a stock certificate reflecting the terms of the Lock-Up Agreement. JH deposited its shares on the day after NuGene had achieved a market capitalization of \$200 million for three consecutive days, which released all JH's shares from the Lock-Up Agreement. This timing was a red flag that should have been investigated at the time of the deposit.

Castillo testified that on March 10, 2015, he asked Laubenstein to investigate NuGene. While Laubenstein testified that he did not find anything suspicious, he did not document his investigation. We agree with the Hearing Panel that even if Laubenstein had investigated and found nothing on this date, the continuing liquidations of NuGene by the customers and the wiring out of millions of dollars of proceeds warranted further investigation. Laubenstein, however, did not further investigate until FINRA brought NuGene promotional activity to his attention in September 2015, months after the customers had stopped selling the stock.⁵⁴

ECM's deposit and sale of Broke Out presented similar red flags. ECM, a resident of Malaysia, purchased his Broke Out shares from sellers in the United Kingdom. A week later, ECM, who was previously unknown to Glendale, opened a new account at Glendale and deposited his Broke Out shares for the purpose of selling them. The next month, Broke Out announced a reverse merger and changed its line of business from designing and manufacturing apparel to developing applications and games. Days after the reverse merger, ECM began selling his Broke Out stock, ultimately realizing more than \$1.25 million dollars in proceeds and wiring more than \$1 million out of his Glendale account. In early March 2016, Laubenstein was alerted to promotional activity for Broke Out and asked Huang to have ECM complete the Firm's Stock Promotion Affidavit. We agree with the Hearing Panel that the presence of red flags should have resulted in Laubenstein investigating ECM and Broke Out long before he did so.

Many of the same red flags were also present with respect to the deposit and liquidation of Vitaxel by KTO and Huang's other customers. Vitaxel had recently conducted a reverse merger, changed its business, and replaced its former shareholders, based primarily in Northern

⁵⁴ Glendale and Laubenstein point to press releases by NuGene as justifying the trading activity and increased price of the stock. We agree with the Panel's finding, however, that "the press releases were evidence of an effort to manipulate the stock, not a true reflection of significant company developments." In any event, Laubenstein testified that he did not see these press releases because he only looked for press releases when a customer deposited the stock and did not do so later.

Ireland, with shareholders based in Malaysia. Vitaxel was thinly capitalized and its Malaysia shareholders, who were previously unknown to Glendale, opened new accounts at Glendale and deposited their shares for the purpose of selling them. KTO had acted as both the representative of the buyers in the reverse merger and as their agent in opening their Glendale accounts. Glendale, however, did not have any written authorization for KTO to act as agent and Huang only communicated directly with a few of these 20 customers. KTO himself owned a significant number of Vitaxel shares and also opened an account at Glendale through which he sold shares. Laubenstein did not timely investigate the activity in Vitaxel despite these red flags.

* * *

We therefore affirm the Hearing Panel’s findings that Glendale and Laubenstein violated FINRA rules 3310 and 2010 by failing to establish and implement reasonable AML policies and procedures and failing to detect, investigate and report, where appropriate, suspicious activity.⁵⁵

2. Glendale and Laubenstein Failed to Comply with the Firm’s Customer Identification Program to Verify Huang’s Customers’ Identities

FINRA Rule 3310(b) requires firms to establish and implement a written AML program reasonably designed to achieve and monitor the member’s compliance with the requirements of the Bank Secrecy Act, and its implementing regulations, including the regulation requiring a customer identification program (“CIP”) for broker-dealers. 31 C.F.R. § 1023.220. The CIP Regulation requires broker-dealers to “establish, document, and maintain a written [CIP] appropriate for its size and business,” and this CIP “must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable.” 31 C.F.R. § 1023.220(a)(1). The regulation provides that, in order for a firm to verify an individual’s identification using documentary means, the customer must provide an unexpired government-issued identification evidencing nationality or residence and bearing a photograph, such as a driver’s license or passport. *See Dep’t of Enforcement v. Dratel Group, Inc.*, No. 2008012925001, 2014 FINRA Discip. LEXIS 6, at *88 (NAC May 2, 2014), *aff’d*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035 (Mar. 17, 2016).

Glendale’s CIP provided that the firm would use non-documentary methods of verifying identity when the customer and Glendale “do not have face-to-face contact” or when “there are other circumstances that increase the risk that the firm will be unable to verify the true identity of the customer through documentary means.” The CIP stated that the non-documentary methods the firm would use included contacting the customer; independently verifying the customer’s identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source; checking references with other financial institutions; or obtaining a financial statement from the customer.

⁵⁵ We also affirm the dismissal of these AML-related allegations against Castillo, Flesche, Abadin, and Huang. Under the specific facts of this case, we decline to extend liability for AML-related violations to these respondents.

Huang testified that he dealt primarily with KTO and KTO's assistant when he opened the accounts for the Vitaxel shareholders. KTO and his assistant provided Huang the documents used to verify the customers' identities. Huang did not meet the customers in person and communicated by email with only a few of them. These facts, along with the other red flags associated with Vitaxel (*see supra* Part IV.C.2), presented a risk that Glendale could not verify the customers' identities with documentary means alone and, accordingly, Glendale's CIP required the use of non-documentary means of identification. Laubenstein, who was primarily responsible for implementing the Firm's CIP as part of Glendale's AML program, did not require non-documentary means of identification for these customers.

Accordingly, Laubenstein and Glendale violated FINRA rules 3310(b) and 2010 by failing to employ non-documentary evidence to verify the customers' identities.

3. Glendale and Laubenstein Failed to Conduct Adequate Due Diligence on Belize Bank and the Customers It Introduced

Section 312 of the USA PATRIOT Act, as implemented by 31 C.F.R. § 1010.610, requires that broker-dealers exercise due diligence when accepting correspondent accounts for a foreign financial institution ("FFI"), including a bank organized under foreign law. 31 U.S.C. § 5318(i). Under the regulation, broker-dealers must implement "appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to enable the [broker-dealer] to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account." 31 C.F.R. § 1010.610(a). A broker-dealer's policies and procedures must "assess[] the money laundering risk presented by [the FFI] correspondent account, based on a consideration of all relevant factors." 31 C.F.R. § 1010.610(a)(2). Such factors may include: (1) the nature of the FFI's business and the markets it serves; (2) the type, purpose, and anticipated activity of such correspondent account; (3) the nature and duration of the covered financial institution's relationship with the FFI (and any of its affiliates); (4) the AML and supervisory regime of the jurisdiction that issued the charter or license to the FFI; and (5) information known or reasonably available to the covered financial institution about the FFI's AML record. 31 C.F.R. § 1010.610(a)(2)(i)-(v). A failure to comply with the Bank Secrecy Act, including 31 C.F.R. § 1010.610, constitutes a violation of FINRA Rule 3310(b) and 2010.

We agree with the Hearing Panel's findings that Glendale and Laubenstein failed to perform the required risk-based due diligence on the accounts opened through Belize Bank, a covered FFI under the Bank Secrecy Act. Rather than conduct their own due diligence on the accounts introduced by Belize Bank, Glendale and Laubenstein relied on Belize Bank ensuring AML compliance for these customers, including fulfilling the CIP obligations with respect to the accounts opened for undisclosed customers.

Glendale and Laubenstein argue that they could rely on Belize Bank to fulfill AML obligations, and stressed their visit to Belize Bank and Belize Bank's alleged agreement to identify the customers upon request from Glendale. A broker-dealer may, under certain circumstances, rely on the CIP of another financial institution. In order to do so, however, certain requirements must be met, including: (1) the reliance must be reasonable; (2) the other

financial institution must be subject to the PATRIOT Act and its implementing regulations and regulated by a U.S. regulator; and (3) the other financial institution must contractually agree to certify annually to the broker-dealer that it has implemented its AML program and will perform the CIP duties. *See NASD Notice to Members 03-34*, 2003 NASD LEXIS 41, at *30-31 (June 20, 2003). These requirements were not met here. Belize Bank was not subject to the PATRIOT Act and had no contract with Glendale to perform the CIP functions and certify that it had done so annually. We find that it was unreasonable for Glendale to rely on Belize Bank to perform the CIP functions, particularly in the case of the accounts for which the customer was undisclosed to Glendale.⁵⁶

Accordingly, we find that Glendale and Laubenstein violated FINRA Rules 3310 and 2010 by failing to conduct reasonable due diligence into the accounts introduced by Belize Bank.

E. Allegations of Supervision Violations

FINRA Rule 3110(a) requires member to “establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.” FINRA Rule 3110(b) provides that members must “establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.” “Assuring proper supervision is a critical component of broker-dealer operations.” *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007). A firm’s supervision system must be reasonably tailored to its business and includes the responsibility to investigate red flags indicating possible misconduct. *See Dep’t of Enforcement v. Newport Coast Sec., Inc.*, Complaint No. 2012030564701, 2018 FINRA Discip. LEXIS 14, at*166-67 (FINRA NAC May 23, 2018), *aff’d*, Exchange Act Release No. 3-18555, 2020 SEC LEXIS 911 (Apr. 3, 2020).

1. Glendale’s Procedures in Connection with the Sale of Unregistered Securities Were Adequate

The Hearing Panel found that Glendale’s procedures related to the resale of unregistered securities were adequate. We affirm these findings.

Glendale’s process when a customer deposited unregistered securities was to prepare a due diligence package. The due diligence package included forms to be completed by both the customer and Glendale staff. Multiple firm principals reviewed and approved these deposits. The firm required the customer to provide documentation sufficient to trace the ownership of the

⁵⁶ We also agree with the Hearing Panel’s rejection of Glendale’s and Laubenstein’s reliance on a June 2015 statement from the Financial Action Task Force. As the Hearing Panel explained, the statement does not address a broker-dealer’s obligations under the Bank Secrecy Act and applies to customers of a correspondent bank, not bank customers who are also customers of a broker-dealer.

shares from the issuer. Customers were also required to provide proof that they paid for the shares. Glendale staff reviewed SEC filings for the issuer and conducted background checks, OFAC searches, and Google searches for any negative information about the customer or persons associated with the issuer. On the basis of this record, we conclude that the firm's procedures were adequate.

2. Glendale, Flesche, and Laubenstein Failed to Reasonably Supervise Huang

Flesche and Laubenstein approved the account opening documents and deposits for Huang's Asia-based customers and Laubenstein was responsible for reviewing Huang's email. We find that Flesche, Laubenstein, and Glendale failed to reasonably supervise Huang's dealings with these customers. Neither Flesche nor Laubenstein asked Huang about how he communicated with these customers, including whether these customers understood Huang's written communications. While they knew Huang had translated portions of Glendale's account opening documents for these customers, they took no steps to ensure the accuracy of these translations and asked no questions about whether the customers understood the portions of the documents Huang did not translate.

In his review of Huang's emails, Laubenstein conducted word searches in English. Laubenstein knew, however, that Laubenstein communicated with these customers in Mandarin and Chinese. His searches were ineffective to identify red flags in Huang's communications with these customers, including Huang's communications with KTO about other customers' accounts before Glendale had authorization from those customers to speak to KTO about them.

Accordingly, we find that Glendale, Flesche, and Laubenstein failed to reasonably supervise Huang, in violation of FINRA Rules 3110 and 2010.

V. Sanctions

In assessing the sanctions, we have considered FINRA's Sanction Guidelines ("Guidelines"), including the General Principles Applicable to All Sanction Determinations ("General Principles") and the Principal Considerations in Determining Sanctions (the "Principal Considerations").⁵⁷

A. Glendale and Laubenstein's AML Violations Related to NuGene, Broke Out, Vitaxel

For Glendale's violations of FINRA Rules 3310 and 2010 for failure to maintain a reasonable AML program and failure to identify and investigate red flags, the Hearing Panel

⁵⁷ See *FINRA Sanction Guidelines* (2019), https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf (hereinafter "Guidelines"). In this case, we apply the same Guidelines as those in the Decision.

fined Glendale \$125,000 and censured it. For the same violations, the Hearing Panel fined Laubenstein \$20,000 and imposed an 18-month suspension in all capacities. We find that these sanctions are appropriately remedial and affirm them, except that we also order Glendale to retain a consultant to review and revise its AML-related procedures to appropriately tailor them to its microcap stock liquidation business model.

The Guidelines do not contain recommendations specific to AML-related violations. We agree with the Hearing Panel that the most comparable Guidelines are those for systemic supervisory failures.⁵⁸ The Guidelines recommend a fine of \$10,000 to \$77,000 for responsible individuals and \$10,000 to \$310,000 for firms.⁵⁹ We may consider higher fines where aggravating factors predominate.⁶⁰ The Guidelines also provide that we consider suspending a responsible individual in any or all capacities for a period of 10 business days to six months, or a longer suspension of up to two years or a bar, where aggravating factors predominate.⁶¹ For firms, where aggravating factors predominate, the Guidelines recommend suspending the firm with respect to any or all functions for 10 business days to two years or an expulsion.⁶² The Guidelines also recommend that we consider “imposing undertakings, ordering the firm to revise its supervisory systems and procedures, or ordering the firm to engage an independent consultant to recommend changes to the firm’s supervisory systems and procedures.”⁶³

The Guidelines list specific considerations when assessing sanctions for systemic supervisory failures, including: (1) whether the deficiencies allowed violative conduct to occur or to escape detection; (2) whether the firm or individual failed to timely correct or address deficiencies once identified, failed to respond reasonably to prior warnings from FINRA or another regulator, or failed to respond reasonably to other “red flag” warnings; (3) whether the firm appropriately allocated its resources to prevent or detect the supervisory failure, taking into account the potential impact on customers or markets; (4) the number and type of customers, investors or market participants affected by the deficiencies; (5) the number and dollar value of the transactions not adequately supervised as a result of the deficiencies; (6) the nature, extent,

⁵⁸ The Guidelines explain that we should consider applying the Guideline for systemic supervisory failures “when a supervisory failure is significant and is widespread or occurs over an extended period of time.” *Guidelines*, at 105. The Guideline is appropriate both in cases involving “failures to implement or use supervisory procedures that exist” and where “supervisory systems that have both ineffectively designed procedures and procedures that are not implemented.” *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.* at 106.

⁶³ *Id.*

size, character, and complexity of the activities or functions not adequately supervised as a result of the deficiencies; (7) the extent to which the deficiencies affected market integrity, market transparency, the accuracy of regulatory reports, or the dissemination of trade or other regulatory information; and (8) the quality of controls or procedures available to the supervisors and the degree to which the supervisors implemented them.⁶⁴

We find that numerous aggravating factors apply to Glendale's and Laubenstein's misconduct and affirm the Hearing Panel's finding that their misconduct was egregious. The deficiencies in Glendale's AML program allowed other violative conduct to occur and Glendale and Laubenstein failed to reasonably respond to red flags with respect to trading by the Firm's customers. Glendale and Laubenstein did not adequately investigate liquidations of NuGene, Broke Out, and Vitaxel by Glendale customers. Significantly, despite numerous red flags, Laubenstein did no investigation for promotional activity while customers were trading and realizing substantial gains. The failures to investigate with respect to these liquidations lasted for almost a year and involved numerous customers and millions of dollars of liquidation transactions.⁶⁵ Glendale's and Laubenstein's AML deficiencies allowed misconduct to occur that affected market integrity and transparency and the investing public. For example, Laubenstein's failure to conduct an adequate investigation allowed RC to liquidate millions of dollars of NuGene stock at a time when promotional activity it had paid for was inflating the price of the stock. Glendale's violations resulted in gains to it of almost \$260,000 in commissions.⁶⁶

Additionally, Glendale's prior disciplinary history is relevant here.⁶⁷ In 2010, by submitting the 2010 AWC, Glendale settled allegations by FINRA of AML and related supervisory violations. The AWC states that Glendale failed to adequately enforce and implement its AML procedures. As a result, Glendale permitted the deposit and liquidation of 279 million shares of penny stocks from 51 foreign accounts controlled by one individual without conducting adequate AML review. The AWC also states that, during a two-year period, while Glendale's primary source of revenue was derived from transactions in penny stocks, it had no written procedures to detect and prevent the firm's participation in unregistered distributions of securities, but instead relied primarily on transfer agents to determine whether securities were free trading. In connection with the AWC, Glendale was censured and fined \$45,000. Accordingly, the AWC, which Castillo signed, involved similar allegations of deficiencies in the firm's AML program as those here.

Glendale's business of liquidating low-priced securities presents significant AML risks for which the Firm's policies and procedures were not properly tailored. Accordingly, we affirm

⁶⁴ *Id.* at 105-06.

⁶⁵ *Id.*, at 7 (Principal Considerations Nos. 8, 9).

⁶⁶ *Id.*, at 8 (Principal Considerations No. 16).

⁶⁷ *Id.*, at 7 (Principal Consideration No. 1).

the sanctions imposed by the Hearing Panel and order Glendale to retain a consultant to review and revise its AML-related procedures to appropriately tailor them to its business model.

B. Violations Related to Belize Bank

For the violations related to Glendale's relationship with Belize Bank, the Hearing Panel imposed no additional monetary fines or suspensions on Glendale or Laubenstein, but rather provided that the decision would serve as a Letter of Caution to Glendale and Laubenstein. Given the fact that the Belize Bank accounts are closed and the relationship with Belize bank has ended, we affirm the Hearing Panel's sanction.

C. Failure to Supervise Huang

For failure to supervise Huang, the Hearing Panel imposed a \$5,000 fine and 15 business day suspension in all capacities on Laubenstein, to run consecutively with his 18-month suspension for his AML violations. For Glendale and Flesche, the Hearing Panel imposed a joint and several fine of \$30,000. The Hearing Panel also censured Glendale. Additionally, the Panel suspended Flesche in all capacities for 30 business days. We affirm these sanctions.

There is a specific Guideline for failure to supervise in violation of FINRA Rule 3110.⁶⁸ The Guidelines recommend that we consider a fine of \$5,000 to \$77,000 and that we consider separate monetary sanctions for the firm and any responsible individuals.⁶⁹ The Guidelines further recommend that we consider suspending responsible individuals in supervisory capacities for up to 30 business days and, in egregious cases, in any and all capacities for up to two years or imposing a bar.⁷⁰ For firms, the Guidelines direct us to consider limiting the activities of the appropriate branch, office, or department for up to 30 business days and, in egregious cases, to consider a longer limitations of the activities of the appropriate branch or office or a suspension of the firm with respect to any or all activities or function for up to 30 business days.⁷¹

In assessing sanctions under the Guidelines for failure to supervise, we are directed to consider: (1) whether respondent ignored red flag warnings that should have resulted in additional supervisory scrutiny; (2) the nature, extent, size and character of the underlying misconduct; and (3) the quality and degree of supervisor's implementation of the firm's supervisory procedures and controls.⁷²

⁶⁸ *Id.*, at 104.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

Flesche and Laubenstein were aware that Huang was communicating with Asia-based customers in languages other than English, including by translating portions of Firm documents. We agree with the Hearing Panel that these were red flags that required Flesche and Laubenstein to consider additional supervisory measures. Neither Flesche nor Laubenstein asked Huang how he was communicating with these customers. They did not check the accuracy of Huang's translations of Firm documents and did not consider whether the customers could understand the portions of the documents that were not translated. Moreover, Laubenstein's review of Huang's email communications were based on English language key-word searches even though Laubenstein knew Huang was emailing customers in other languages. We agree with the Hearing Panel that both Laubenstein and Flesche failed to ensure that Huang's customers understood Huang's communications and Firm documents.

We also agree with the Hearing Panel's assessment that Huang was not subject to consistent and reasonable oversight. Huang was based in New York City, while Flesche and Laubenstein were located in California. Huang's customers were engaging in liquidations of microcap securities, for which Flesche's and Laubenstein's supervision was inadequate given the significant risks associated with this business.

Accordingly, we find the sanctions imposed—a \$30,000 joint and several fine on Glendale and Flesche, a censure of Glendale, a 30 business day suspension in all capacities on Flesche, and a \$5,000 fine and 15 business day suspension in all capacities on Laubenstein—to be appropriately remedial and we affirm them.

VI. Conclusion

The allegations that Glendale and Castillo engaged in market manipulation, in violation of Exchange Act § 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010 are dismissed. The allegations that Glendale, Flesche, and Abadin violated FINRA Rule 2010 by participating in the sale of restricted securities in contravention of Exchange Act Section 5 also are dismissed.

Glendale and Laubenstein failed to maintain a reasonable AML program and failed to identify and investigate red flags, in violation of FINRA Rules 3310 and 2010. The allegations under this cause are dismissed with respect to the other respondents. For these violations, Glendale is fined \$125,000 and censured and Laubenstein is fined \$20,000 and suspended in all capacity for 18 months.

Glendale, Flesche, and Laubenstein failed to supervise Huang, in violation of FINRA Rule 3110 and 2010. The allegations of failure to supervise to ensure compliance with Securities Act Section 5 is dismissed. For these violations, Glendale is censured, Glendale and Flesche are fined \$30,000, jointly and severally, and Laubenstein is fined \$5,000. Additionally, Flesche is suspended in all capacities for 30 business days and Laubenstein is suspended in all capacities

for 15 business days. Laubenstein's suspension will run consecutively with his 18-month suspension for the AML violations.⁷³

On Behalf of the National Adjudicatory Council,

Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

⁷³ The Hearing Panel also found that Huang violated FINRA Rule 2010 improperly sharing personal information in violation of Regulation S-P. For this violation, the Hearing Panel ordered that the Decision serve as a letter of caution. The Hearing Panel also found that Huang violated FINRA Rules 4511 and 2010 by using an unapproved cell phone messaging application for securities business. For this violation, Huang was fined \$5,000 and suspended from associating with any member in any capacity for 10 business days. As set forth above, the findings and sanctions imposed related to this misconduct were not before us on appeal, and this decision does not disturb these findings and sanctions.