FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

Department of Enforcement, Complainant, v. Wedbush Securities Inc., CRD No. 877, Respondent.	Disciplinary Proceeding No. 2012033105901 Hearing Officer DW **ORDER ACCEPTING OFFER OF SETTLEMENT** Date: February 5, 2018

INTRODUCTION

Disciplinary Proceeding No. 2012033105901 was filed on May 27, 2016, by the Department of Enforcement ("Enforcement") of the Financial Industry Regulatory Authority ("FINRA") ("Complainant"). Respondent Wedbush Securities Inc. ("Wedbush," or "the Firm") submitted an Offer of Settlement ("Offer") to Complainant dated February 1, 2018. Pursuant to FINRA Rule 9270(e), the Complainant and the National Adjudicatory Council ("NAC"), a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA") have accepted the uncontested Offer. Accordingly, this Order now is issued pursuant to FINRA Rule 9270(e)(3). The findings, conclusions and sanctions set forth in this Order are those stated in the Offer as accepted by the Complainant and approved by the NAC.

Under the terms of the Offer, Respondent has consented, without admitting or denying the allegations of the Complaint (as amended by the Offer), and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, to the entry of findings and violations consistent with the allegations of the Complaint (as amended by the Offer), and to the imposition of the sanctions set forth below, and fully understands that this Order will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA.

BACKGROUND

Wedbush (known as Wedbush Morgan Securities Inc. until April 2010) is a full-service brokerage firm headquartered in Los Angeles, California. Wedbush, a self-clearing firm, conducts a general securities business through approximately 647 registered individuals in approximately 100 branch offices. Wedbush also provides clearing services for approximately 88 introducing/correspondent broker-dealers. Wedbush has been a FINRA regulated broker-dealer since July 1955 and is subject to FINRA's jurisdiction pursuant to Article IV, Section 1 of FINRA's By-Laws.

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:

BACKGROUND

The Customer Protection Rule protects customer assets from being improperly used by a broker-dealer for its own purposes, and ensures the prompt return of customer assets in the event of broker-dealer insolvency, by (1) requiring broker-dealers to maintain physical possession or control of customers' fully paid and excess margin securities (the "possession or control" requirement), and (2) requiring broker-dealers to establish a special reserve bank account for the benefit of customers (the "customer reserve account" or "reserve account") and to fund that account in accordance with Exhibit A to the Rule, which sets forth in detail the computational formula ("customer reserve formula" or "reserve formula") for calculating the required balance (the "customer reserve account" requirement).

Over the course of four exams, from 2009 through 2012, FINRA discovered that Wedbush had repeatedly violated both of these requirements by creating or increasing deficits in the number of securities required to be in the Firm's possession or control, and by failing to accurately calculate its customer reserve formula and adequately fund its customer reserve account in accordance with the Customer Protection Rule.

FIRST CAUSE OF ACTION

(Possession or Control (Exchange Act Section 15(c), Exchange Act Rule 15c3-3(b)(1) and FINRA Rule 2010))

Exchange Act Section 15(c) and Rule 15c3-3(b)(1) thereunder requires a broker-dealer to promptly obtain and maintain physical possession or control of fully-paid securities and excess margin securities carried for customer accounts. The Rule, along with controlling Rule Interpretation 15c3-3(b)(2)/03, prohibits a firm from delivering or removing securities from its possession or control if doing so would create or increase a deficiency in the quantity of securities required to be in its possession or control.

The quantity of securities required to be in a firm's possession or control is known as the firm's segregation requirement.

A violation of Exchange Act Section 15(c) and Rule 15c3-3 constitutes a violation of FINRA Rule 2010, which requires firms to "observe high standards of commercial honor and just and equitable principles of trade."

In exams in 2009, 2010 and 2011, from a sample of securities taken from a two- to four-week period each year, FINRA found 30 separate instances in which Wedbush created and/or increased deficits in its segregation requirement through deliveries or returns of securities.

In 2009, Wedbush created or increased three deficits, involving approximately 900 shares of stock worth approximately $12,000. Two of the deficits were caused by stock borrow returns, when the Firm returned shares of stock it had borrowed without having sufficient excess shares above the Firm's segregation requirement. The other deficit was caused by the Firm making a delivery of shares to settle a trade without sufficient excess.

In 2010, Wedbush created or increased eight deficits, involving over 12,850 shares of stock worth approximately $360,000. Six of the deficits were caused by stock borrow returns. Two of the deficits were caused by stock loans that the Firm made without having sufficient excess of shares above the Firm's segregation requirement.

In 2011, Wedbush created or increased 19 deficits, involving over 96,600 shares of stock worth approximately $6.6 million. Seven of the deficits were from stock borrow returns, where the Firm returned shares of stock borrowed without having sufficient excess over its segregation requirement. Five of the deficits were from stock loans, when the Firm loaned shares without having sufficient excess. Four of the deficits were caused by the same day receipt of shares from a returned stock loan and the impermissible redelivery of those shares ("turnaround") and three of the deficits were caused by deliveries through the National Securities Clearing Corporation's ("NSCC") Continuous Net Settlement system ("CNS"), which nets the securities delivery and payment obligations of all NSCC participants. All of the deliveries were made when the Firm did not have sufficient excess of the shares above its segregation requirement.

Each of these 30 deficits are specifically identified in the attached Exhibit A, which delineates the date the deficit was created and/or increased, the symbol of the security, the number of shares in deficit, the cause of the deficit, and the value of the deficit.

The 30 deficits identified by FINRA involved a combined total of approximately 110,000 shares of stock worth approximately $7 million.

Each creation or increase of a deficit in the Firm's segregation requirement constitutes a separate and distinct willful violation of Exchange Act Section 15(c), Exchange Act Rule 15c3-3(b)(1) and FINRA Rule 2010.[1]

SECOND CAUSE OF ACTION

(Customer Reserve (Exchange Act Section 15(c), Exchange Act Rule 15c3-3(e) and FINRA Rule 2010))

Exchange Act Section 15(c) and Rule 15c3-3(e) thereunder requires a broker-dealer to maintain a "Special Reserve Bank Account for the Exclusive Benefit of Customers" and to fund the reserve account in accordance with the provisions of Exhibit A to the Rule, which sets forth in detail the computational "Formula for Determination of Reserve Requirement for Brokers and Dealers."

In general, the reserve formula requires a broker-dealer to calculate any amounts it owes customers, called credits, and compare that amount to any amounts its customers owe it, called debits. If credits exceed debits, the broker-dealer must deposit the difference in the customer reserve account. A hindsight deficiency occurs when it is discovered that a customer reserve account funding deficiency existed in the required deposit.

From February 2011 through June 2012, the Firm willfully violated Securities Exchange Act Section 15(c), Exchange Act Rule 15c3-3(e) and FINRA Rule 2010 on 14 occasions by improperly calculating its customer reserve formula, which, on eight occasions, resulted in hindsight deficiencies between $945,000 and $77 million.

[1] A willful violation of the securities laws means "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (*quoting Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (*quoting Gearhart & Otis, Inc. v. SEC,* 348 F.2d 798, 803 (D.C. Cir. 1965)).

I. Customer Reserve Violations Resulting from Bank Loans Secured by Customer Collateral

Exchange Act Rule 15c3-3a item 2 states that "monies borrowed collateralized by securities carried for the accounts of customers" should be included in the reserve formula as a credit.

In early 2011, the Firm began taking out bank loans to fund certain activities, and using customer securities to collateralize those loans.

From February to November 2011, the Firm failed, as required, to include the amount of bank loans that were collateralized by customer securities as credits in the reserve formula on eleven occasions, six of which resulted in deficiencies ranging between $11 million and $77 million, as follows:

i. February 18, 2011 – failed to include approximately $15 million in bank loans collateralized by customer securities;

ii. March 3, 2011 – failed to include approximately $47 million in bank loans collateralized by customer securities, resulting in a hindsight deficiency of approximately $24 million;

iii. March 18, 2011 – failed to include approximately $93 million in bank loans collateralized by customer securities, resulting in a hindsight deficiency of approximately $77 million;

iv. April 21, 2011 – failed to include approximately $20 million in bank loans collateralized by customer securities, resulting in a hindsight deficiency of approximately $14 million;

v. June 17, 2011 – failed to include approximately $5 million in bank loans collateralized by customer securities;

vi. August 12, 2011 – failed to include approximately $55 million in bank loans collateralized by customer securities, resulting in a hindsight deficiency of approximately $44 million;

vii. September 20, 2011 – failed to include approximately $41 million in bank loans collateralized by customer securities, resulting in a hindsight deficiency of approximately $28 million;

viii. September 22, 2011 – failed to include approximately $9 million in bank loans collateralized by customer securities;

ix. October 7, 2011 – failed to include approximately $4.6 million in bank loans collateralized by customer securities;

x. October 31, 2011 – failed to include approximately $11.6 million in bank loans collateralized by customer securities; and

xi. November 11, 2011 – failed to include approximately $27 million in bank loans collateralized by customer securities, resulting in a hindsight deficiency of approximately $11 million.

II. Customer Reserve Violations Resulting from CNS Fail to Deliver vs. Box

Exchange Act Rule 15c3-3a item 12 and Rule Interpretation 15c3-3 (Exhibit A – Item 12)/081, provides, in pertinent part, that failed to deliver of customers' securities not older than 30 calendar days that are allocated to a box location—formerly a physical safe-deposit box location, now typically a book-entry type account held at a custodian entity where the securities are segregated by firm—may be included as a debit in the reserve formula if, among other things, the failed to deliver arose from a customer sale transaction. If the failed to deliver did not arise from a customer sale transaction, the contract value should not be included as a debit in the reserve formula.

On two occasions in 2011, the Firm erroneously included as debits in the customer reserve formula the contract value of failed to deliver transactions that allocated as "CNS fail to deliver vs. box" but did not arise from customer sale transactions. Specifically, on March 3, 2011, the Firm erroneously included approximately $22 million as a debit, resulting in a hindsight deficiency of at least $4 million; and on April 15, 2011, the Firm erroneously included approximately $16.7 million as a debit, resulting in a hindsight deficiency of $945,000.

III. Customer Reserve Violation from Customer Securities Pledged for Firm Options Clearing Corporation ("OCC") Requirements

When customer securities are used to collateralize Firm OCC margin requirements, the market value of the securities are required to be included as credits in the customer reserve formula. In 2012, the Firm failed to include as credits in the customer reserve formula the market value of securities that were pledged in support of Firm OCC margin requirements. Specifically, as of June 29, 2012, the Firm failed to include as a credit in the customer reserve formula at least $1.35 million in customer securities that were allocated as "customer long vs. firm bank loan" and had been pledged in support of Firm OCC margin requirements.

Each of the 14 improper calculations of the customer reserve formula, including the eight hindsight deficiencies, constitute separate and distinct willful violations of Exchange Act Section 15(c), Exchange Act Rule 15c3-3(e) and FINRA Rule 2010.

THIRD CAUSE OF ACTION

(Supervision (NASD Rules 3010(a) and 3010(b) and FINRA Rule 2010))

NASD Rule 3010(a) requires each member to establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA rules.

NASD Rule 3010(b) requires each member to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA rules.

A violation of NASD Rule 3010 constitutes a violation of FINRA Rule 2010.

Wedbush failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with both the possession or control requirement and the customer reserve account requirement of the Customer Protection Rule.

I. Supervision of Possession or Control

At all relevant times during the 2009, 2010 and 2011 exams (the "Relevant Period"), the Firm relied on an unreasonably designed and implemented manual system to prevent the creation and increase of segregation deficits.

The Firm made deliveries and returns of securities manually, outside of Thompson Reuters' BETA system ("BETA"), which the Firm used to calculate the Firm's segregation requirement for each customer and each security on a daily basis. BETA prevents deliveries or returns of securities made through the BETA system if the delivery or return would decrease the Firm's position below its segregation requirement and, thereby, create or increase a deficit.

When the Firm made deliveries or returns of securities manually outside of BETA, however, BETA could not and did not prevent, and the Firm had no other systemic control to prevent, the delivery of shares from the Firm's account at the JKL Company ("JKL") that would create or increase a deficit.

Rather, when the Firm made deliveries or returns manually, Firm personnel were supposed to access the Firm's online segregation analysis system ("SEGA"), which would calculate and display the number of shares of a particular security that were in excess of the Firm's segregation requirement. This was the Firm's process for determining whether a particular delivery of securities would create a deficit. This procedure, however, was not adequate to prevent the creation or increase of segregation deficits, as segregation deficits continued to be created or increased during the Relevant Period.

Additionally, the Firm had no written procedure in place between January 1, 2009 and September 1, 2011 that required Wedbush personnel to use SEGA to determine if there was an excess of a security prior to making a stock loan.

Firm staff was also, in certain situations when the Firm made deliveries or returns manually, supposed to make manual entries at JKL, identified as "hard seg" entries, which would prevent shares being delivered out of JKL if such delivery would create or increase a deficit. This procedure, however, was also not reasonably designed to prevent the creation or increase of segregation deficits, and segregation deficits continued to be created or increased during the Relevant Period.

Similarly, the Firm had no system that would automatically prevent the turnaround of stock, that is, the receipt and immediate redelivery of stock, on a stock loan, even if such delivery created and/or increased a deficit.

The Firm's manual system was not reasonably designed to achieve compliance with the possession or control requirement of the Customer Protection Rule as the Firm created or increased at least 30 deficits, worth a combined total of approximately $7 million during the Relevant Period.

Given the volume of transactions processed by the Firm, and the size of the Firm's securities lending business, the Firm's manual system was not reasonably designed to prevent the creation or increase of deficits for deliveries and returns made outside of the Firm's back-office system.

In exams conducted in 2004, 2006, and 2008, FINRA found a total of 15 segregation deficits in the number of securities required to be in the Firm's possession or control and issued a Letter of Caution to the Firm in 2008. Some of the deficits found by FINRA in 2004, 2006, and 2008 were, like in the instant matter, the result of deliveries and returns made outside of the BETA system.

Wedbush knew that FINRA had identified possession or control deficit violations. After each exam, the Firm was provided with written examination reports in connection with each exam that delineated the deficits found by FINRA. Moreover, these deficits were discussed orally in exit meetings held between FINRA staff and Firm personnel at the end of each exam.

Nevertheless, despite this notice, Wedbush failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with the possession or control requirement of the Customer Protection Rule and continued to violate the possession and control requirement of the Customer Protection Rule. FINRA exams in 2009, 2010 and 2011 continued to identify deficits each year.

In September 2011, the Firm finally began using an automated system for preventing shares from being delivered out of JKL if such delivery would create or increase a segregation deficit. No possession or control deficits were identified by FINRA in the 2012 and 2013 exams, after the automated system was adopted.

Accordingly, from at least January 2009 to September 2011, Wedbush violated NASD Rules 3010(a) and 3010(b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with the possession or control requirement of the Customer Protection Rule.

II. Supervision of Customer Reserve Formula

From February 2011 to June 2012, the Firm also failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with the customer reserve account requirement of the Customer Protection Rule. Specifically, the Firm failed to have a system that required certain Firm departments, including the Cash Management Department, to provide, or the Accounting Department to consider, all relevant information, which would result in the accurate calculation of its customer reserve formula.

From February 2011 to June 2012, the Wedbush Accounting Department calculated the customer reserve formula for the Firm every Monday and on the first business day of every month using allocation reports from BETA, the Firm's general ledger, trial balance and cash reconciliation reports. These reports were collected from several other departments at Wedbush, including Credit, Cash Management, Street Settlement, and Internal Controls and Audit.

A. Supervision Related to Bank Loans

From February to November 2011, the Firm's systems and procedures did not require the Cash Management Department to provide notice to the Accounting Department when customers' securities were used to secure Firm obligations. Thus, during that period, the Cash Management Department failed to notify the Accounting Department to include the value of bank loans secured by customer securities as credits in the customer reserve formula, leading to customer reserve account violations.

Only after the Firm was notified of a problem with its customer reserve formula in late 2011 did the Firm put a system in place that required the Cash Management Department to notify the Accounting Department when it used customer securities as collateral for bank loans. The Firm did not have a final written procedure memorializing that system, however, until 2013.

The procedure the Firm used to address the bank loan issue, however, only addressed customer securities used as collateral for bank loans and was insufficient to prevent the Firm from violating the Customer Protection Rule by failing to include as credits in the customer reserve formula the market value of securities used to collateralize Firm OCC margin requirements, which FINRA identified as a violation in the 2012 exam.

B. Supervision related to CNS Fail to Deliver vs. the Box

From March to May 2011, the Firm's systems and procedures did not require the Accounting Department to consider whether items in the "CNS fail to deliver vs. box" allocation were customer-related. Thus, during that period, the Firm erroneously included non-customer transactions as debits in the customer reserve formula on at least two occasions.

C. Supervision related to Firm OCC Margin Requirements

From at least December 2011 to June 2012, the Firm did not have a process for, or written procedures requiring, Cash Management to notify Accounting when it was using customer securities as collateral for Firm OCC requirements, even though by that time it had put a procedure in place for Cash Management to notify Accounting when it was using customer securities to secure Firm bank loans.

Thus, although Accounting received a report showing a "customer long vs. firm bank loan" allocation that included the value of customer securities used to support the Firm's OCC margin requirements, Accounting disregarded this report when calculating its customer reserve formula.

As a result, on June 29, 2012, the Accounting Department failed to include at least $1.35 million in customer securities that allocated as "customer long vs. firm bank loan" and had been pledged in support of Firm OCC margin requirements as credits in the customer reserve formula and additionally failed to determine whether the remaining $4.7 million in customer securities that allocated as "customer long vs. firm bank loan" were required to be included as credits in the customer reserve formula.

Accordingly, from February 2011 to June 2012, Wedbush violated NASD Rules 3010(a) and 3010(b) and FINRA Rule 2010 by failing to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with the customer reserve account requirements of the Customer Protection Rule.

ADDITIONAL FINDINGS

Under the terms of the Offer, the Firm has also consented, without admitting or denying the allegations, and solely for the purposes of this proceeding and any other proceeding, brought by or on behalf of FINRA, or to which FINRA is a party, to the entry of findings and violations arising out of examinations of the Firm conducted by FINRA in 2014, 2015 and 2016, as described below, and to the imposition of the sanctions contained herein. Wedbush fully understands the Order Accepting Offer of Settlement will become part of the Firm's permanent disciplinary record and may be considered in any future action brought by FINRA.

The additional findings are as follows:

NET CAPITAL VIOLATIONS
Exchange Act Section 15(c), Exchange Act Rule 15c3-1(c), and FINRA Rule 2010

Section 15(c)(5) of the Exchange Act provides that no broker or dealer shall make use of interstate commerce to effect any transaction in any security in contravention of such rules and regulations as the Securities and Exchange Commission shall prescribe.

Exchange Act Rule 15c3-1 requires broker-dealers to maintain a minimum amount of net capital and to compute their net capital in accordance with specified formulas.

When calculating net capital, 17 C.F.R. § 240.15c3-1(c)(2)(vii) requires broker-dealers to deduct 100 percent of the carrying value of securities for which there is no ready market. In addition, when a broker-dealer holds a combined position consisting of certificates of deposit ("CDs") issued by a single bank for more than five business days, the broker-dealer must deduct from its net worth the value of that position that exceeds 30% of the broker-dealer's tentative net capital ("TNC") before the application of any adjustments.

A violation of Exchange Act 15(c) and Rule 15c3-1 constitutes a violation of FINRA Rule 2010.

From November 2015 through March 2016, the Firm held multiple positions in CDs issued by major financial institutions for which there was no “ready market,” as that term is defined in the Rule, for over five business days, but failed to deduct the value of each position exceeding 30% of the Firm’s TNC.

As of November 30, 2015, the Firm’s TNC was approximately $160 million. As of the same date, the Firm held $100 million in CDs issued by one bank and $75 million issued by each of a second, third and fourth bank. Accordingly, the Firm was required to deduct the value of each CD position exceeding 30% of its TNC – or approximately $48 million – when computing its net capital for November 2015. Accordingly, the Firm should have made net capital deductions of approximately $52 million on its CD position from the first bank and $27 million on each of its positions from the second, third, and fourth banks – for a total net capital deduction in the aggregate amount of approximately $133 million. The Firm did not take the deductions above and, as a result, reported approximately $137.4 million in net capital as of November 30, 2015, when in reality it had a net capital of approximately $4.4 million. Because the Firm was subject to a net capital requirement of approximately $23.1 million, Wedbush was net capital deficient in the amount of approximately $18.7 million as of November 30, 2015.

The Firm continued to hold multiple CD positions for which there was no “ready market” for over five business days from December 2015 to May 2016, but failed to deduct the value of each position exceeding 30% of the Firm’s TNC. The Firm’s failure to take the appropriate deductions for the CD positions when computing its net capital resulted in net capital deficiencies of approximately $10.5 million as of December 31, 2015; $35.7 million as of January 31, 2016; $59.4 million as of February 29, 2016; and $59.4 million as of March 31, 2016.

By failing to make the required deductions, the Firm was net capital deficient between November 30, 2015 and March 31, 2016, in amounts ranging between approximately $10.5 million and $59.4 million, in willful violation of SEA Rule 15c3-1(c)(2)(vii). During the time period of these violations, the Firm also willfully violated Exchange Act § 15(c)(5) by failing to maintain adequate net capital and FINRA Rule 2010.

CUSTOMER RESERVE VIOLATIONS
Exchange Act Section 15(c), Exchange Act Rule 15c3-3(e), and FINRA Rule 2010

Between May 6, 2014 and May 10, 2016, the Firm included ineligible certificates of deposit in its customer reserve account, causing the Firm to underfund its customer reserve bank account on 110 occasions and resulting in hindsight deficiencies ranging from approximately $9 million to approximately $375 million. From March 2013 through June 2014, the Firm improperly calculated its customer reserve requirement in at least three ways on 70 occasions, resulting in 65 separate hindsight deficiencies ranging from approximately $2 million to approximately $39.4 million. Thus, for nearly the entire period of March 1, 2013 through May 10, 2016, the Firm failed to maintain an adequate customer reserve.

The Firm’s inclusion of ineligible certificates of deposit in its customer reserve account from May 6, 2014 to May 10, 2016, and the 110 hindsight deficiencies resulting therefrom, constitute willful violations of the Section 15(c) and Rule 15c3-3(e) of the Exchange Act and FINRA Rule 2010. Each of the Firm’s 70 incorrect calculations of the customer reserve, and the 65 hindsight deficiencies resulting therefrom, also constitute separate and distinct willful violations of Section 15(c) and Rule 15c3-3(e) of the Exchange Act and FINRA Rule 2010.

I. Violations Resulting from the Firm's Use of Ineligible Certificates of Deposit to Fund Its Customer Reserve Obligations

The Customer Protection Rule permitted firms like Wedbush to include CDs in the reserve account provided they were subject to withdrawal at any time pursuant to the requirements of Regulation Q of the Federal Reserve System.

From May 6, 2014 to May 10, 2016, the Firm intentionally used certificates of deposit to fund its customer reserve account even though the CDs were not subject to withdrawal at any time. The Firm's decision to use these CDs resulted in 110 hindsight deficiencies ranging from approximately $9 million to approximately $375 million.

II. Violations Resulting from the Firm's Treatment of Accounts Held By a Principal Officer of the Firm and his Wife

For purposes of the reserve formula, a customer includes, inter alia, any individual from whom, or on whose behalf, the broker-dealer has received or acquired or holds funds or securities except those individuals specifically excluded as non-customers. Directors or principal officers of the Firm are considered non-customers; however, wives of a broker-dealer's principal officers are considered customers.

When a joint account is owned equally by a customer and a non-customer, the portion of the debit balance attributable to the non-customer must be excluded from the reserve formula unless the broker-dealer can demonstrate that the debit balance is directly related to credit items in the reserve formula.

From March 1, 2013 through June 30, 2014, the Firm treated two joint accounts held by a principal officer of the Firm and his wife as non-customer accounts when performing the customer reserve calculation. As a result, the Firm included debits to which it was not entitled when preparing its customer reserve calculation, thereby understating the amount the Firm was required to maintain in its customer reserve in amounts ranging between approximately $464,000 and $4.7 million.

III. Violations Resulting from the Firm's Treatment of the Wedbush Inc. Account

For purposes of the reserve formula, accounts carried by a broker-dealer for a non-broker-dealer parent or affiliate corporation are considered to be accounts of customers of the broker-dealer. Credit balances held for these accounts are required to be included in the reserve formula and debit balances are subject to the restrictions in SEA Rule 15c3-3.

From March 1, 2013 through June 30, 2014, Wedbush, Inc., the Firm's parent company, maintained a securities account at the Firm. During that same period, the Firm treated the Wedbush, Inc. securities account as a non-customer account, thereby understating the amount the Firm was required to maintain in its customer reserve in amounts ranging between approximately $6.8 million and $16.5 million.

IV. Violations Resulting from the Firm's Customer Long vs. Non-Customer Short Allocations

For purposes of the reserve formula, when customers' fully paid or excess margin securities allocate to a customer, non-customer or proprietary short position, the short market value is includable as a credit in the customer reserve computation.

From March 1, 2013 through June 30, 2014, however, the Firm failed to include customer long vs. non-customer short allocations as credits in its reserve calculation, thereby understating the amount the Firm was required to maintain in its customer reserve in amounts ranging between approximately $2.8 million and $15.4 million.

POSSESSION OR CONTROL VIOLATIONS
Exchange Act Section 15(c), Exchange Act Rule 15c3-3(b)(1), and FINRA Rule 2010

From March 2013 through at least August 2016, the Firm violated its possession or control requirements by holding customers' fully-paid and/or excess margin securities in the following seven locations the Firm treated as "good control" locations when, in fact, they did not meet the Customer Protection Rule's possession or control requirements:

(a) Location 4404 (ABC foreign custody account) ("ABC Account");
(b) Location 104 holding customers' limited partnership interests ("Location 104");
(c) Location 603 holding mutual funds through the NSCC Fund/SERV system ("Location 603");
(d) Location 56 (conduit account at JKL) ("JKL Conduit Box 56");
(e) Location 54 ("NSCC Fully-Paid-For Box 54);
(f) Location 94 ("DEF Clearance Account"); and
(g) Location 4404 ("GHI Settlement Account").

The Firm continued to use the ABC Account, Location 104 and Location 603 through at least August 2016. As a result, the customer assets held in each of the seven locations were not protected and subject to claims by third parties, including creditors of the Firm or their agents.

I. ABC Account

For purposes of Rule 15c3-3(c)(4), securities under Wedbush's control but custodied with a foreign depository, clearing agency or custodian bank are considered to be held in a satisfactory control location if the securities are not subject to any right, charge, security interest, lien or claim of any kind in favor of the foreign entity.

From March 1, 2013 through at least August 2016, the Firm held customers' fully-paid and/or excess margin securities in Canada in its ABC Account. However, the ABC account did not constitute a "good control" location under Rule 15c3-3 because, pursuant to the terms of the

Firm's custody agreement with ABC, the customer securities held therein were not protected from, and in fact were subject to, any claim, security interest, or lien lodged against or by ABC.

By failing to obtain a custody agreement with ABC that complied with the requirements of Rule 15c3-3, and continuing to hold customer assets in its ABC account without adequate protection, the Firm violated Rule 15c3-3(c)(4).

II. Location 104

For purposes of Rule 15c3-3(c)(7), Wedbush may treat the general partner of any private limited partnership in which its customers hold uncertificated investments as a good control location if Wedbush obtains "written assurances that [the] limited partnership interests are not subject to any right, charge, security interest, lien, or claim of any kind in favor of the general partner or any person claiming through the general partner."

From March 1, 2013 to at least August 2016, the Firm treated the general partner of each private limited partnership in which its customers invested as a good control location and recorded each such security on its books and records as held at "Location 104." During that time period, the Firm held 219 uncertificated private limited partnership interests owned by customers' individual retirement accounts in Location 104, which interests constituted customers' fully-paid and/or excess margin securities.

The Firm, however, failed to obtain written assurances from the general partners of all those partnerships stating that the limited partnership interests they held on behalf of the Firm's customers "in" Location 104 were not subject to adverse interests.

By failing to obtain the written assurances required by the rule, and continuing to hold customers' uncertificated limited partnership interests in a location away from the Firm that was subject to adverse interests, the Firm violated Rule 15c3-3(c)(7).

III. Location 603

For purposes of Rule 15c3-3(c)(1), uncertificated mutual fund shares carried by a fund or its custodian bank in an account designated as a Special Custody Account for the Exclusive Benefit of Customers of the broker-dealer may be considered held in a good control location provided the account contains only customer securities, is carried free of any lien or payment, and the Firm obtains acknowledgement letters from the mutual funds demonstrating that there are no liens against the securities.

From March 1, 2013 to at least August 2016, the Firm treated customers' uncertificated mutual fund shares, which interests constituted customers' fully-paid and/or excess margin securities, as being "held" under "good control" in "Location 603." The Firm did not, however, obtain the required acknowledgement letters from all of the mutual funds in which its customers invested, stating that there were no liens against the securities "held" in Location 603.

By failing to obtain the written assurances required by the rule, and continuing to hold those assets away from the Firm, the Firm violated Rule 15c3-3(c)(1) during the period of March 1, 2013 to at least August 2016.

IV. JKL Conduit Box 56 and NSCC Fully-Paid-For Box 54

Under Rule 15c3-3(d)(1), a broker-dealer must determine the quantity of fully paid securities and excess margin securities in its possession or control and not in its possession or control. If, as of the close of business, the broker-dealer does not have physical possession or control of all fully paid and excess margin securities it is required to hold under the Rule, known as a deficit, then the broker-dealer shall, no later than the following business day, issue instructions for the release of any securities subject to a lien or the return of any securities loaned to another broker-dealer or clearing corporation and obtain physical possession or control of those securities within the next two business days. A broker-dealer is also prohibited from delivering or removing securities from any good control location if doing so would create or increase a deficit.

However, when a broker-dealer conducts a "conduit" business, in which the broker-dealer borrows securities from one party and then lends those securities to another, and has a deficit as to its possession and control requirements, the broker-dealer is not required to freeze returned securities or recall securities loaned in the conduit account to eliminate the deficit if the broker-dealer establishes a separate clearing account at a depository and does not use intra-company borrows and loans between its conduit and customer books to circumvent its possession or control or customer reserve requirements.

During the Relevant Period through the present, the Firm used JKL Conduit Box 56 to transact stock loan activity and NSCC Fully-Paid-For Box 54 to make intra-day deliveries of customer securities to the Firm's JKL general account.

From March 1, 2013 through June 30, 2014, the Firm held customers' fully-paid and/or excess margin securities in JKL Conduit Box 56 and NSCC Fully-Paid-For Box 54. The Firm utilized a mechanism called "memo segregation" to protect anticipated, fully-paid for customer securities held by the Firm in its JKL general box from being used to satisfy the Firm's delivery obligations. This mechanism required the Firm to instruct JKL to establish or adjust its memo segregation positions when certain transactions were effectuated. Otherwise, fully-paid for customer securities would be used to satisfy the Firm's delivery obligations pursuant to those transactions, thereby causing possession or control deficits to be created or increased.

From March 1, 2013 through June 30, 2014, however, the Firm failed to increase its memo segregation requirements for the Firm's JKL general box when securities were loaned from JKL Conduit Box 56 or delivered from the NSCC Fully-Paid-For Box 54 to the JKL general box.

The Firm's failure to properly instruct JKL as to its segregation requirements created and/or increased possession or control deficits and, as a result, the Firm did not hold the requisite amount of customer fully paid securities and excess margin securities in good control during the period of March 1, 2013 through June 30, 2014, as required by the Rule.

V. DEF Clearance Account and GHI Settlement Account

From March 1, 2013 through June 30, 2014, the Firm used two accounts held at other financial institutions – its DEF Clearance Account and GHI Settlement Account – for the settlement of securities trades. Specifically, securities purchased by the Firm that settled in the DEF and GHI accounts were moved to the Firm's custody account, where they were held until they were sold. At that time, the Firm moved them from the custody account to the DEF and GHI accounts for delivery.

The DEF and GHI accounts are not considered "good control" locations under Rule 15c3-3. Because the Firm lacked an automatic mechanism to move securities from the DEF and GHI accounts to the Firm's custody account, and the Firm improperly coded the two accounts as "good control" locations, the Firm allowed securities to remain in these two accounts for an extended period of time.

By failing to timely move securities from the DEF and GHI accounts to the Firm's custody account during the period of from March 1, 2013 to June 30, 2014, the Firm placed customer assets at risk in violation of Rule 15c3-3.

By reason of the foregoing, the Firm violated Exchange Act Section 15(c), Exchange Act Rule 15c3-3(b)(1), and FINRA Rule 2010. In addition, each creation or increase of a deficit in the Firm's segregation requirement constitutes a separate and distinct willful violation of Exchange Act Section 15(c), Exchange Act Rule 15c3-3(b)(1) and FINRA Rule 2010.

BOOKS AND RECORDS VIOLATIONS
Exchange Act Section 17(a), Exchange Act Rule 17a-3, FINRA Rule 4511(a) and FINRA Rule 2010

FINRA Rule 4511 requires each member to, among other things, make and preserve books and records in conformity with Exchange Act Rules 17a-3 and 17a-4.

Exchange Act Rule 17a-3(a)(2) requires broker-dealers to maintain accurate ledgers reflecting all assets and liabilities, income and expense and capital accounts.

Exchange Act Rule 17a-3(a)(11) further requires (with exceptions not applicable here) broker-dealers to make and maintain a record of the proof of money balances of all ledger accounts in the form of trial balances, and a record of the computation of aggregate indebtedness and net capital, as of the trial balance date, pursuant to Rule 15c3-1.

A violation of Exchange Act Rule 17a-3 and FINRA Rule 4511 also constitutes a violation of FINRA Rule 2010.

By failing to prepare accurate customer reserve formula calculations for nearly the entire period of March 1, 2013 through May 10, 2016 as discussed above, the Firm created and maintained inaccurate books and records in willful violation of Exchange Act Section 17(a) and Exchange Act Rule 17a-3 and FINRA Rules 4511 and 2010.

INACCURATE FOCUS REPORTS
Exchange Act Section 17(a), Exchange Act Rule 17a-5 and FINRA Rule 2010

Pursuant to Exchange Act Section 17(a) and Exchange Act Rule 17a-5(a) thereunder, broker-dealers are required to prepare and file quarterly FOCUS reports containing certain accurate accounting and financial information, including minimum net capital required, net capital, and excess net capital.

A violation of Exchange Act Section 17(a) and Exchange Act Rule 17a-5(a) also constitutes a violation of FINRA Rule 2010.

For nearly the entire period of March 1, 2013 through May 10, 2016, the Firm filed 37 FOCUS reports that inaccurately reported the amounts the Firm was required to maintain in its customer reserve account during that period.

Additionally, from November 30, 2015 through March 31, 2016, the Firm filed FOCUS reports that inaccurately reported its net capital.

As a result of the foregoing conduct, the Firm willfully violated Exchange Act Section 17(a), Exchange Act Rule 17a-5(a) and FINRA Rule 2010.

SUPERVISION
NASD Rules 3010(a) and 3010(b), FINRA Rules 3110(a) and 3110(b) and FINRA Rule 2010

NASD Rule 3010(a) and FINRA Rule 3110(a) require each member to establish and maintain a system, including written procedures, reasonably designed to supervise the activities of each registered representative, registered principal, and other associated person and to achieve compliance with applicable securities laws and regulations, including applicable NASD and FINRA rules.

NASD Rule 3010(b) and FINRA Rule 3110(b) require each member to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and NASD and FINRA rules.

A violation of NASD Rule 3010 and FINRA Rule 3110 also constitutes a violation of FINRA Rule 2010.

From March 1, 2013 through at least October 2016, the Firm failed to establish and maintain a supervisory system, including written procedures, reasonably designed to ensure that it complied with the requirements of Rule 15c3-3.

During the period of March 1, 2013 through February 3, 2016, Wedbush Securities had no written supervisory procedures addressing Rule 15c3-3, or the measures taken by the Firm to monitor its compliance with the rule, including no procedures for the calculation of the Firm's customer reserve requirement or compliance with its possession or control requirements.

Instead, during the period of March 2013 to February 2016, the Firm's regulatory accounting staff who worked on the customer reserve calculation relied on a folder of internal memoranda relating to Rule 15c3-3 issues accumulated over a 25-year period by Employee B, a staff accountant with (and later consultant to) the Firm. The folder of memoranda contained piecemeal guidance on various issues, and was not distributed to all of the regulatory staff who worked on the customer reserve calculation. Neither Employee B nor the Firm had any system to ensure that the guidance contained in the folder was accurate or up to date.

On or about February 4, 2016, the Firm finally adopted written procedures concerning Rule 15c3-3 (the "2016 WSPs").

However, the 2016 WSPs were deficient in several ways directly related to the violations of Rule 15c3-3 described above:

(a) The 2016 WSPs failed to identify any specific ways in which the Firm would review and/or monitor its operations for compliance with Rule 15c3-3's possession or control requirements, and failed to delegate supervisory responsibility for this area to any specific individual or department.

(b) The 2016 WSPs did not instruct supervisors on the steps required to determine how an asset or account should be treated for purposes of the customer reserve calculation. For example, they did not instruct supervisors on how to review assets or accounts belonging to "affiliated persons," "relatives," and "officers and directors." Instead, the 2016 WSPs merely stated that accounts held by such persons would be identified on “sub schedule[s],” without specifying who was responsible for creating such schedules, or how it should be done.

(c) The 2016 WSPs contained definitions inconsistent with the FINRA Interpretations of Rule 15c3-3, defining “noncustomer” to include “principal[s], officers and directors, affiliated parties and relatives of the broker dealer” [sic], when, in fact, family members of directors and principal officers are defined and treated as “customers” under the rule.

(d) Rather than explain how the Firm should supervise to ensure it properly accounted for customer long vs. non-customer short allocations, the 2016 WSPs stated merely that the reserve calculation should “[a]dd [a]llocations,” noting without elaboration that “[a]llocation reports are canned reports extracted from [the Firm’s software].” The 2016 WSPs did not specify how these “canned reports” should be “extracted,” nor did they provide any supervisory mechanism to ensure that the reports – which provided the inputs for the Firm’s customer reserve calculation – were created consistent with the Rule’s requirements.

The Firm’s failure to maintain adequate written procedures concerning Rule 15c3-3 compliance continued until at least October 2016.

From March 1, 2013 through at least October 2016, the Firm also failed to adequately supervise the performance of its customer reserve calculations and its compliance with the possession or control requirements of SEA Rule 15c3-3, and to ensure that the individuals responsible for supervision of its customer reserve obligations were properly licensed as principals of the Firm.

Specifically, from November 2013 until June 2014, Employee A was responsible for, and performed, a supervisory review of the Firm’s customer reserve calculation. From November 2014 through at least October 2016, Employee B was responsible for, and performed, a supervisory review of the Firm’s customer reserve calculation. Neither Employee A nor Employee B was qualified to perform a supervisory function, because neither had (1) obtained the required Series 27 license; (2) received specialized accounting training; or (3) received any formal training at the Firm or elsewhere regarding preparation of the customer reserve calculation (except for one day of training that Employee B received from her then-Firm supervisor in 1990). Indeed, prior to November 2013, Employee A had never worked on the customer reserve calculation on a consistent basis. Additionally, Employee B never reviewed the 2016 WSPs after they were adopted and implemented and lacked specific knowledge of the computer systems the Firm used to source inputs for its customer reserve calculation.

Employee A and Employee B's ability to perform an appropriate supervisory review was further hampered by the fact that the Firm had no written supervisory procedures defining the scope of their review or the tasks they were to undertake. As a result, the supervisory review performed by Employee A and Employee B was limited to ensuring that the numbers contained in the Firm's calculation of its customer reserve matched the inputs on the various "canned reports" generated by the Firm's internal systems. It did not consider, and the Firm never took steps to review, whether, among other things: (i) the accounts held by principal officers of the Firm or Wedbush, Inc. (or any others) were properly coded; (ii) the "canned reports" were accurate; or (iii) the Firm's customer reserve calculation complied with Rule 15c3-3.

Accordingly, from March 1, 2013 through at least October 2016, the Firm violated NASD Rule 3010(a) and (b) (for conduct prior to December 1, 2014), FINRA Rule 3110(a) and (b) (for conduct on or after December 1, 2014), and FINRA Rule 2010 by failing to (i) establish, maintain and enforce a supervisory system, including written procedures, reasonably designed to achieve compliance with Rule 15c3-3, and (ii) adequately supervise its compliance with Rule 15c3-3.

FAILURE TO MAINTAIN AN ADEQUATE SUPERVISORY SYSTEM
NASD Rules 3010(a) and 1021, FINRA Rule 3110(a) and FINRA Rule 2010

NASD Rule 3010(a)(5) and FINRA Rule 3110(a)(5) require each member to establish and maintain a supervisory system that provides for the assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities.

NASD Rule 1021(a) provides, in pertinent part, that all persons engaged or to be engaged in the investment banking or securities business of a member who are to function as principals shall be registered as such with NASD in the category of registration appropriate to the function to be performed as specified in Rule 1022.

In addition, NASD Rule 1022(b)(1) requires each person associated with a member who performs the duties enumerated in NASD Rule 1022(b)(2) to register as a FINOP. NASD Rule 1022(b)(2) provides, in pertinent part, that the term FINOP shall mean a person associated with a member whose duties include supervision of individuals who assist in the preparation of reports submitted to any duly established securities industry regulatory body; supervision of and responsibility for individuals who are involved in the actual maintenance of the member's books and records from which such reports are derived; supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the Exchange Act; or any other matter involving the financial and operational management of the member.

The Firm violated NASD Rule 3010(a) and FINRA Rule 3110(a) by failing to establish and maintain a supervisory system that provided for supervision of Rule 15c3-3 compliance by appropriately registered representatives and/or principals. Specifically, the Firm allowed Employee A and Employee B to perform the activities of a FINOP without holding the required licenses.

From November 2013 to at least October 2016, Employee A supervised the Firm's regulatory accounting group, which oversaw the Firm's compliance with Rule 15c3-3 and prepared the Firm's FOCUS reports. From November 2013 through June 2014, Employee A performed a supervisory review of the Firm's customer reserve calculation pursuant to Rule 15c3-3. After July 1, 2014, Employee A also provided training to Firm employees regarding the customer reserve calculation.

By performing the above duties, Employee A acted as a FINOP under NASD Rule 1022(b)(2). However, he never held the required Series 27 license.

From 1990 through October 2014, Employee B prepared the Firm's net capital and customer reserve calculations under Rules 15c3-1 and 15c3-3, respectively. In addition, Employee B trained other regulatory and staff accountants at the Firm in the performance of similar and related duties. Although Employee B retired on October 14, 2014, the Firm retained her as a consultant on November 10, 2014 to perform supervisory review of customer reserve calculations prepared by Firm staff and to provide guidance and training to Firm staff regarding the customer reserve calculation.

By performing the above duties, Employee B acted as a FINOP under NASD Rule 1022(b)(2). However, she never held the required Series 27 license.

Accordingly, by permitting: (1) Employee A to act as a FINOP from November 2013 through at least October 2016, without holding the required Series 27 license; and (2) Employee B to act as a FINOP from March 1, 2013 through October 2014 and from November 10, 2014 through at least October 2016, without holding the required Series 27 license, the Firm violated NASD Rules 3010(a) (for conduct prior to December 1, 2014) and 1021, and FINRA Rules 3110(a) (for conduct on or after December 1, 2014) and 2010.

Based on the foregoing, Respondent willfully violated Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 15c3-3, 17a-3, and 17a-5 thereunder. Respondent also violated NASD Rules 1021 and 3010, and FINRA Rules 3110, 4511 and 2010.

Based on these considerations, the sanctions hereby imposed by the acceptance of the Offer are in the public interest, are sufficiently remedial to deter Respondent from any future misconduct, and represent a proper discharge by FINRA of its regulatory responsibility under the Securities Exchange Act of 1934.

SANCTIONS

It is ordered that Respondent be

1. Censured;
2. Fined in the amount of $1,500,000; and
3. Required to submit an undertaking pursuant to which the Firm's President, Edward W. Wedbush, or his successor-in-interest, shall within 30 days of the completion of the Firm's implementation of the recommendations received from the Independent Consultant to be retained by the Firm in connection with the Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, entered concurrently herewith with the U.S. Securities and Exchange Commission, certify in writing to the Executive Vice President and Head of Enforcement that, as of the date of the certification, Wedbush has in place policies, systems and procedures to address and correct the violations described in this Offer of Settlement.
4. Upon written request showing good cause, FINRA staff may extend any of the procedural dates set forth above.

Wedbush agrees to pay the monetary sanction(s) upon notice that this Offer has been accepted and that such payment(s) are due and payable. Wedbush has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Wedbush shall be permitted to pay the fine payable to FINRA in three equal installments of $500,000 each, with the first payment due on February 15, 2018, the second on February 15, 2019, and the third on February 14, 2020.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

SO ORDERED.

FINRA

Signed on behalf of the
Director of ODA, by delegated authority

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