FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. HIGHLAND FINANCIAL, LTD. (CRD No. 25896) and GORDON D. SMITH (CRD No. 2006592), Respondents.	Disciplinary Proceeding No. 2011025591601 Hearing Officer – RLP **HEARING PANEL DECISION** September 27, 2013

By (i) failing to timely file currency transaction reports, Highland Financial, Ltd., through Gordon D. Smith, violated Exchange Act Section 17(a) and Rule 17a-8 and FINRA Rule 2010, and Smith violated FINRA Rule 2010; (ii) structuring cash deposits, Smith violated FINRA Rule 2010; (iii) commingling customer funds with non-customer funds, Highland and Smith violated FINRA Rules 2150(a) and 2010; and (iv) failing to implement procedures to detect and cause the reporting of suspicious activities, Highland violated FINRA Rules 3310(a) and 2010.

For failing to timely file currency transaction reports, Highland is fined $5,000. For commingling funds, Highland is fined $10,000. Highland also is fined $10,000 for failing to implement procedures regarding suspicious activities. For failing to timely file currency transaction reports, Smith is suspended in all capacities for six months and ordered to requalify as a general securities representative. For structuring cash deposits, Smith is barred from associating with any member in all principal capacities, suspended in all capacities for six months, and ordered to requalify as a general securities representative. For commingling funds, Smith is barred from associating with any member in all principal capacities. The suspensions will run concurrently.

Appearances

Thomas M. Huber, Esq., David M. Monachino, Esq., and William St. Louis, Esq., for the Department of Enforcement.

Stephen G. Topetzes, Esq., and Erin Ardale Koeppel, Esq., for Highland Financial, Ltd. and Gordon D. Smith.

DECISION

I. Introduction

In this case, liability is largely uncontested. Respondents Highland Financial, Ltd. and Gordon D. Smith, the firm's managing principal,[1] concede that, after receiving cash in excess of $10,000 from customer AE, Highland and Smith failed to timely file currency transaction reports ("CTRs"), in violation of FINRA Rule 2010.[2] Respondents also concede that Smith structured deposits of AE's cash, in violation of Rule 2010, and, in the process, Highland and Smith commingled some of AE's funds with non-customer funds, in violation of FINRA Rules 2150(a) and 2010. Finally, Respondents do not contest the Department of Enforcement's evidence that Highland failed to implement procedures designed to detect suspicious financial activities, such as Smith's structuring, in violation of FINRA Rules 3310(a) and 2010.[3]

The task faced by the Hearing Panel, then, is to determine what sanctions are appropriate. For the reasons set forth below, we conclude that bars in all principal capacities appropriately

[1] FINRA has jurisdiction over this proceeding because, at all pertinent times, Smith was associated with, and registered with FINRA through, Highland, a FINRA member.

[2] In the first count of its complaint, Enforcement alleged that Highland, through Smith, willfully violated Securities Exchange Act reporting requirements. *See infra* note 3. In post-hearing briefing, Respondents for the first time argued that Smith's failure to timely file CTRs cannot be attributed to Highland. We address this issue *infra* note 99.

[3] Enforcement filed its complaint on July 19, 2012, charging that Highland, through Smith, twice failed to file timely CTRs, and, therefore, Smith violated FINRA Rule 2010 and Highland willfully violated Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(a), Rule 17a-8, 17 C.F.R. § 240.17a-8, and FINRA Rule 2010. Enforcement also charged that Smith structured cash deposits, in violation of FINRA Rule 2010, and that, in the process, Highland and Smith commingled customer funds with non-customer funds, in violation of FINRA Rules 2150(a) and 2010. Finally, Enforcement charged that Highland failed to implement procedures to detect, investigate and report suspicious transactions, in violation of FINRA Rules 3310(a) and 2010. Smith and Highland filed an answer on August 30, 2012, admitting the bulk of the substantive allegations. A hearing was held in Pittsburgh, Pennsylvania, on April 22 through April 24, 2013.

remedy Smith's structuring and commingling violations and that, in addition, Smith should be suspended in all capacities for six months and ordered to requalify as a general securities representative for structuring. We also conclude that a six-month suspension and an order that he requalify as a general securities representative appropriately remedies Smith's failure to timely file CTRs. As for Highland, we conclude that the firm's violations are appropriately remedied by fines as set forth below.

II. Findings of Fact

A. Smith Establishes and Runs Highland.

Smith was and is an owner of Highland and its president and chief executive officer.[4] The firm, established in 1989, is a registered broker-dealer and investment adviser located in Johnstown, Pennsylvania.[5] The firm primarily engages in the sale of mutual funds.[6] It services fewer than 400 clients who collectively maintain 1,500 to 1,600 accounts.[7] In a typical month, those accounts engage in a combined total of 50 to 90 transactions, and most of those transactions are repetitive (*e.g.*, systematic, monthly 401(k) contributions). The firm thus effects only 20 to 30 unique transactions and opens only two or three new accounts per month.[8] Because the firm does not hold funds or securities for customers, it operates under an exemption from Rule 15c3-3, 17 C.F.R. § 240.15c3-3 (governing reserves and custody of securities), which requires the firm to maintain, among other things, a special bank account for the benefit of its

[4] When the firm was established, Smith was a part owner and one member of its four-person board. Smith is now the sole owner and board member. Joint Exhibit ("JX")-3, at 9; Tr. 97.

[5] Stipulation of Fact ("Stip.") 1; JX-2, at 1; JX-3, at 4; Complainant's Exhibit ("CX")-3, at 1; CX-6, at 1. Before he established Highland, Smith spent more than two decades in the banking industry, serving in executive positions with banks in Pennsylvania. *E.g.*, CX-6, at 1.

[6] *See* Stip. 1.

[7] Tr. 494.

[8] Tr. 438, 456; *see* CX-3, at 1.

customers.[9] In 2011, Highland maintained that account at Somerset Trust Company ("Special Account"). The firm maintained its operating account at 1st Summit Bank ("Operating Account").[10]

In 2011, Highland employed three registered persons: Smith, Donna McAlister, and Lisa Gindlesperger.[11] Smith brought in business and served as the customers' account representative.[12] He also was the firm's financial and operations principal, general securities principal, municipal fund securities principal, investment banking representative, operations professional, chief compliance officer ("CCO"), and anti-money laundering ("AML") compliance officer ("AMLCO").[13] McAlister was the office manager; her responsibilities included, among other things, accounting and bank statement reconciliation. Gindlesperger, an office assistant, processed transactions and maintained customer account documentation.[14] She also was responsible for maintaining the ledger and other documentation for the firm's Special Account.[15]

B. Smith Takes Approximately $40,000 in Cash from Customer AE for Investment.

Smith had known AE and her family, including her late husband and her brother-in-law RE, for many years,[16] when, in 2002, AE, then in her fifties, opened an account with Highland.[17]

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[9] Tr. 39, 122; CX-3, at 1.

[10] *E.g.*, Tr. 42, 258; Stip. 13.

[11] Stips. 4-6; Tr. 76-77, 101, 254, 371.

[12] *See* Tr. 446.

[13] Tr. 88, 97-98; JX-1, at 2; CX-3, at 1; CX-6, at 1. Smith has Series 7, 24, 27, 51, 63, 65, 79, and 99 licenses. Stip. 2; CX-6, at 1; Tr. 76-77.

[14] Tr. 59-60, 101, 254, 257, 371, 375.

[15] Tr. 376.

[16] Tr. 237-238, 515-516, 519-520, 578-579, 609; CX-1.

[17] Stip. 8; Tr. 124, 239; *see* JX-17, at 1; CX-1.

By 2011, she had opened two more accounts—one held jointly with her mother, RL, and another held jointly with her two siblings.[18] AE's interactions with Smith were infrequent, but the two did discuss investments over the phone several times each quarter and, together with RL, met in person once or twice a year.[19]

RL, a widowed nonagenarian, had moved into AE's home around 2007.[20] With her, she brought boxes and bags.[21] AE suspected that one or more of the boxes and bags contained stockpiled U.S. currency, but at first she did nothing to verify her suspicions.[22] Then, in May 2011, RL suffered an illness that ultimately left her in need of constant care.[23] With strangers coming in and out of AE's house as caregivers, AE's need to know whether RL had, in fact, hoarded cash took on a new urgency.[24] Accordingly, sometime before July 20, 2011, AE found that one of the bags contained cash—in an amount ultimately determined to be just less than $40,000.[25] The cash consisted of old bills in stacks of one thousand dollars, bundled together in some cases by wrappers bearing handwritten notations (dating back to the 1950s) that the bills were the proceeds of sales of farming equipment or livestock, or the payout from an insurance policy.[26]

Wanting to get the money out of the house and invested, AE turned to Smith, calling him early in the morning of July 20, 2011, and telling him that she had cash she wanted to remove

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[18] Stip. 9; Tr. 124, 126, 130-131, 239; JX-17; JX-19 – JX-22.

[19] Tr. 128-129, 208, 238-239, 519-520, 522.

[20] Tr. 516-517, 534-535, 575-576, 582.

[21] Tr. 581.

[22] Tr. 535-537; *see* Tr. 247, 582-583; CX-1.

[23] Tr. 517-519. RL died in September 2011. Stip. 10; Tr. 516.

[24] Tr. 535-537.

[25] Tr. 536-537; *see* Tr. 140, 522; JX-5.

[26] Tr. 247, 521, 527-528; JX-6; *see* Tr. 530-531, 582-583. In some instances, the cash was sewn into socks. Tr. 531.

from her house. She asked Smith if he would be willing to take the cash and invest it for the benefit of the account she held jointly with her siblings.[27] Smith agreed to meet AE at a location between her house and his office.[28]

Even though Highland's written policies prohibited the receipt of cash,[29] and receipt of cash could disqualify the firm from relying on the exemption it claimed from Exchange Act Rule 15c3-3,[30] Smith agreed to take AE's money to "solve her fear of having the money in the house."[31] He had no reason to believe that the cash was derived from an illegal source or that his receipt or disposition of the cash would somehow facilitate any illegal or otherwise improper end envisioned by AE. In particular, he had no reason to believe that he was being asked to facilitate any tax evasion. Shortly after he received the cash—likely the same day—he called RE, AE's brother-in-law, who was an accountant and "the recognized go-to person" for AE's tax issues and other matters formerly addressed by AE's husband.[32] Smith told RE that he had taken delivery of approximately $40,000 in cash from AE, and he sought reassurance that "there w[ere]

[27] Stip. 12; Tr. 134, 520-521, 523-525; CX-1.

[28] Tr. 136, 521; CX-1.

[29] CX-2, at 14. Smith testified, credibly, that he was not focused on the firm's policy at the time. *See infra* note 58. The only other time the firm had accepted cash involved the investment of $180 from Smith's grandchildren's piggy banks. Tr. 235, 287.

[30] CX-3, at 1; Tr. 40 (holding or depositing customer funds in other than the Special Account would cause the firm to lose its exemption and raise the firm's net capital requirement).

[31] CX-1; *see also* Stip. 12; Tr. 243, 248. Smith did not suggest to AE that she deposit the money into her bank account or that she allow him to deposit it into her account, and he had no reasonable explanation for failing to do so. *See* Tr. 138-139. As explained *infra* p. 28, this and similar testimony demonstrates not that Smith is lying about why he acted as he did, as Enforcement asserts, but that Smith had a lapse in judgment.

[32] Stip. 11; Tr. 591; Tr. 154, 167, 515-516, 572-573, 580, 602, 608.

no issues with the money, that the taxes had been paid, that it was appropriate to deposit the money, and . . . that there would be no issues for AE . . . ."[33] RE gave Smith that reassurance.[34]

C. Smith Structures Deposits of the Cash and Then Invests It.

After taking delivery of the cash, Smith gave AE a receipt for $40,000 and left.[35] He then drove to the Somerset Trust branch where the firm maintained its Special Account for customers.[36] Leaving the money in the car, he entered the branch and spoke to a manager. He explained that he had cash that he wanted to deposit and asked how best to proceed. The manager advised that if he deposited $10,000 or less on any one day, the bank would not need to report the deposit to the Internal Revenue Service.[37] Smith then returned to his car and called AE to let her know about the reporting requirement. AE expressed concern about a possible IRS inquiry, stating that "if they came, she … wouldn't know what to tell them."[38] Wanting to relieve AE of any further obligations with respect to the cash, Smith decided to deposit the

[33] Tr. 584; Tr. 167, 169, 210, 580, 583-585, 590-591. When he recounted the events of July and August to a FINRA examiner in September (*see infra* pp. 13-14), Smith did not mention this advice. Tr. 46-47. We nevertheless conclude, for three reasons, that this conversation (and a similar August conversation) took place. First, the examiner did not ask Smith about whether he received tax advice. Tr. 61. Second, and more important, both Smith and RE testified that the conversations took place, and they described the conversations consistently. Third, Smith testified (Tr. 236, 237) without contradiction that he had a history in AE's case of "always checking" with RE or RE's partner as to whether there were "any tax issues" that he had "to deal with at year end or any other time."

[34] Tr. 222, 580, 584; *see* Tr. 586.

[35] Stip. 12; Tr. 140, 278, 522; JX-5.

[36] Stip. 13; Tr. 142.

[37] Tr. 143-145, 156; CX-1. Enforcement asserts that Smith testified that he structured deposits *because* this bank employee (and one at another bank, *see infra* p. 8) *told him to* in an attempt to shift blame. We disagree. Smith simply recounted what he was told about when transactions needed to be reported. Tr. 156.

[38] Tr. 154; Tr. 152-154; *see* CX-1. Although AE did not recall expressing any concern about the IRS to Smith (Tr. 539, 549), we credit Smith's testimony that she expressed concern. First, AE was under a great degree of stress during the summer of 2011. Memory lapses would not be unexpected and, in fact, AE could not recall a number of pertinent events of that summer. As to those she did recall, she could not remember important details. *E.g.*, Tr. 520, 522, 523, 527, 529, 530, 543, 551, 557. Second, Smith's testimony was consistent with his nearly contemporaneous oral and written accounts of these events. *See infra* p. 14. Finally, based on his demeanor, we found this and other aspects of Smith's testimony credible.

money in amounts of $10,000 or less.[39] He deposited $9,500 cash into the Special Account and left the bank.[40]

Thereafter, Smith went to his office, obtained a deposit ticket for the firm's Operating Account, and drove to the 1st Summit branch where the firm maintained its Operating Account. Encountering the branch manager, he again had a discussion about depositing cash. As had the manager at the other bank, this manager stated that deposits of $10,000 or less on any one day would not be reported.[41] Smith then deposited $9,520 into the Operating Account.[42] Although Smith knew that commingling customer funds with non-customer funds was improper, he "was concerned about the safety of [AE's] money" and, therefore, wanted to complete the deposits as quickly as possible.[43]

The next day, July 21, 2011, Smith deposited $8,000 of the cash into the Special Account and $7,760 into the Operating Account. On July 22, Smith made a final deposit of $5,000 into the Special Account. Over three days, he made five deposits at two banks, totaling $39,780.[44]

On July 26, Smith had McAlister prepare a check drawn on the Operating Account for $17,280 (the amount deposited in the Operating Account) and make it payable to the firm. After the check was deposited into the Special Account, Smith purchased shares in a variety of mutual funds for AE and her siblings. The firm received about $1,100 in dealer concessions.[45]

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[39] Tr. 153-154, 212, 243. Our conclusion about why Smith structured is not affected by the illogic of his decision in light of the assurances that taxes were taken care of. *See infra* p. 28.

[40] Stip. 14; Tr. 145-146, 283-284; JX-9 at 1; JX-10, at 2; JX-11, at 2; JX-25.

[41] Stip. 15; Tr. 157-159, 176-177.

[42] Stip. 15; JX-12, at 1, 3; JX-25.

[43] Tr. 161; Tr. 159-161, 213. *See* Tr. 249 ("I had assumed the responsibility for her cash and I was liable for it . . . [a]nd I wanted to get it in the bank and get it over with and do it as quickly [as] possible.").

[44] Stips. 16-18; JX-9, at 1; JX-10, at 1, 2; JX-11, at 2; JX-12, at 1; JX-25.

[45] Stips. 19, 20; Tr. 290; JX-9, at 1; JX-10, at 2; JX-11, at 2; JX-12, at 1, 4; JX-15; JX-18; JX-25.

D. Through McAlister, Highland Failed to Implement Its AML Policies.

Each time Smith deposited cash, McAlister or Gindlesperger would prepare deposit slips or receive bank receipts from Smith, enabling them to perform bank statement reconciliations.[46] Based on what McAlister gathered from these bank receipts and deposit slips, from what she knew about Smith's receipt of cash from AE, and from what she understood about the reporting of currency transactions and suspicious activities, McAlister had reason to suspect that reporting requirements were being overlooked in some instances and evaded in others. McAlister nevertheless failed to follow the firm's AML policies concerning investigating and reporting suspicious transactions.

As McAlister testified, Smith made her aware on July 20 that AE had called "stating that she had money," that Smith was going to meet AE, and that he needed a receipt from the receipt book.[47] Then, likely the following day, Smith "came back with a deposit ticket" or bank receipt. Thereafter, McAlister "knew that [Smith] had cash and was depositing it because [she] was involved in writing deposit slips and recording it into [the firm's] software system."[48] As McAlister also testified, it was evident from the deposit slips that Smith had received more than $10,000 from AE, although, at the time, McAlister did not focus on the amounts of the deposits.[49]

McAlister was aware that the firm's AML policies prohibited the receipt of currency from clients. She also knew that the pertinent policy further stated: "If we discover currency has been received, we will file with FinCEN [the Financial Crimes Enforcement Network, a bureau

[46] *See* Tr. 298-300, 303-304, 352-354.

[47] Tr. 277-278.

[48] Tr. 284-285; Tr. 280.

[49] Tr. 285-286.

of the Treasury Department] CTRs for transactions involving currency that exceed $10,000."[50] Indeed, McAlister testified that, during the three days Smith was making deposits, she thought about whether the firm needed to file a CTR. But, as McAlister admitted, she never asked Smith about the propriety of receiving cash from a customer or the necessity of filing a CTR.[51]

In addition, the AML policies stated that when a firm employee detected a red flag, she should investigate further and potentially file (with FinCEN) a suspicious activity report ("SAR"). Structuring—breaking down large sums of money into amounts of $10,000 or less to avoid reporting requirements—was among the circumstances listed as a red flag that signaled possible money laundering.[52] The policies required that the firm file a SAR for any account activity involving $5,000 or more when Highland knew, suspected, or had reason to suspect that the transaction was designed to evade any Bank Secrecy Act regulation.[53] McAlister was familiar with the red flags listed in the policies; knew that structuring was one of them; understood what structuring was; and was familiar with the firm's policies concerning when to file a SAR.[54] Nevertheless, McAlister failed to take any action to investigate Smith's deposits.[55]

McAlister was not alone in failing to follow the firm's policies and procedures. Neither Smith nor Gindlesperger took any steps to see to it that a CTR was timely filed or suspicious activity investigated.[56] Smith failed to do so because he was unaware of the pertinent requirements. Aside from what the bank managers told him about currency transaction reporting, Smith testified that, in the summer of 2011, he was unaware of the currency

[50] CX-2, at 14; Tr. 272-273.

[51] Tr. 288-289.

[52] CX-2, at 11-13.

[53] CX-2, at 13.

[54] Tr. 264, 270-272.

[55] *See* Tr. 292, 331.

[56] *E.g.*, Tr. 407-408.

transaction reporting requirements, did not know what a CTR was, and was unaware of the prohibition on structuring.[57] And, despite having compiled the firm's AML policies, Smith also testified that he did not focus on the firm's prohibition of the receipt of cash nor its requirement that a CTR should be filed if cash were received.[58] Consequently, in contravention of its policies and the legal requirements governing the reporting of currency transactions and suspicious activities, Highland did not timely file a CTR after receiving AE's cash, and none of the firm's employees took steps to investigate to determine whether to file a SAR in the wake of Smith's structured deposits.[59]

E. Smith Accepts Cash from AE for Investment a Second Time, Structures Deposits of the Cash, and Then Invests It, and Highland Again Fails to Implement AML Policies.

In August 2011, AE uncovered in excess of $103,000 of additional hoarded currency.[60] On August 16, she called Smith again to seek his assistance in depositing and investing the cash, and arranged to meet.[61] They met later that day, and again Smith took the cash from AE to alleviate her fear of getting robbed.[62] This time, however, he did not give AE a receipt.[63] On or around the same day, Smith called RE, as he had just weeks before, letting him know that AE had made another delivery of currency and seeking "reassurance that all the issues related to the

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[57] Tr. 81, 83-84, 85, 87-89.

[58] Tr. 102-103, 113-114, 142-143, 243-244; *see* CX-2. We believe these disclaimers despite Smith's background and status at Highland because, as we explain *infra* p. 29, Smith's grasp of regulatory compliance matters was wholly inadequate. Although Smith was aware, by virtue of his July 20 conversations with bank employees that banks needed to report the receipt of cash in excess of $10,000, this does not lead us to disbelieve him. Instead, we conclude that he recklessly failed to recognize that the reporting requirement applicable to banks extended to brokerage firms as well. That he acted recklessly does not mean he acted knowingly, nor does it support a conclusion that he was lying about his knowledge of AML requirements.

[59] Tr. 96, 113.

[60] Tr. 529-531, 541-543; CX-1; *see* Tr. 164, 174.

[61] Stip. 21; Tr. 164, 171, 542; CX-1.

[62] Tr. 173, 532; CX-1.

[63] AE did not ask for a receipt because she "knew Gordon well enough. We didn't need a receipt." Tr. 544.

currency were taken care of . . . [that] the taxes had been paid on it [and that] there [were] no estate tax issues." RE gave him that reassurance.[64]

Again, Smith structured deposits. Indeed, because he "was worried that [he] had that money for the client" and it was "very important to [him] . . . that [AE] be protected," he set about completing the deposits "as quickly as possible."[65] Accordingly, this time he utilized not just the Operating Account and the Special Account, but also a bank account maintained by Highland Realty Enterprises ("Highland Realty Account"), another Smith-controlled entity.[66] Over the next five business days, Smith, with McAlister's assistance, made a total of 11 deposits across these accounts in increments of $10,000 or less, totaling $103,440.[67]

As she had done just weeks earlier, McAlister prepared slips reflecting Smith's deposits.[68] From performing these clerical tasks, McAlister learned that Smith again had received more than $10,000 in cash from AE.[69] She knew that he was making multiple deposits, some of them into non-customer accounts.[70] Indeed, at some point between August 16 and August 22, McAlister herself deposited some of AE's cash into the Special Account.[71] When she did, she "knew that [she] had to deposit less than $10,000."[72] Although she knew what

[64] Tr. 586-587; Tr. 188, 211. Even if RE and his partner had yet to definitively resolve all tax issues as Enforcement asserts, both RE and Smith testified consistently and credibly that Smith received assurances that there were no tax issues.

[65] Tr. 173.

[66] Tr. 100; JX-9, at 2; JX-13, at 1; JX-14, at 1; JX-25.

[67] Stips. 22-27, 30; Tr. 174; JX-25; *see* CX-1. Until he completed the deposits, Smith stored the currency in a locked filing cabinet in his office. McAlister had a key to that cabinet. Tr. 199, 307-308.

[68] *E.g.*, Tr. 295-296, 298-299, 303-304; JX-10, at 3; JX-11, at 4.

[69] Tr. 300.

[70] *E.g.*, Tr. 295-296, 298-299, 301-302, 315-316.

[71] Tr. 306.

[72] Tr. 308.

structuring was and viewed the deposits as structuring, she "just kind of let it go."[73] She did not question Smith about the propriety of the receipt and deposit of AE's cash.[74] Again, McAlister was not alone in failing to see to it that Highland timely filed a CTR and that the structuring was investigated.[75]

Within days of making the first August deposit, Smith began ensuring that all of AE's funds would be credited to the Special Account and then invested in mutual funds. Accordingly, on August 19 and August 22, 2011, checks drawn on the Highland Realty Account and the Operating Account in an aggregate amount of more than $58,000 were deposited into the Special Account.[76] Thereafter, using checks drawn on the Special Account, Smith invested $103,440 in mutual funds for the benefit of AE and her siblings. Highland and Smith's commission totaled approximately $2,800.[77]

F. Smith Volunteers Information to an Examiner Conducting a Routine Examination that Uncovers Smith's Receipt of Cash and Consequent Misconduct.

On September 12, 2011, FINRA commenced a routine examination of Highland.[78] In conducting a reconciliation test of the firm's Operating Account, the examiner was unable to trace some deposits to check numbers, so she asked for supporting documentation.[79]

Before supplying that documentation, Smith approached the examiner the next day and explained the deposits. He stated that in July he had received a phone call from a customer whose mother was ailing. He related that the customer had told him that she had found

[73] Tr. 309.

[74] Tr. 309, 321, 331.

[75] *E.g.*, Tr. 113.

[76] Stips. 28, 29, 31, 32; Tr. 322-324, 326-328, 330; JX-13, at 7; JX-14, at 1-3; JX-25.

[77] Stip. 33; JX-16; JX-18; JX-25.

[78] Tr. 38.

[79] Tr. 42.

approximately $39,000 in cash among her mother's belongings and that she did not want to deposit it into her bank account; instead, the customer had asked him if he could take the money and invest it for her.[80] He related further that he met the customer to get the cash, proceeded to the bank, inquired about depositing large sums of money, and was informed that deposits over $10,000 would need to be reported. He stated that he spoke to the customer and she became concerned because she would not know how to explain the source of the funds. Therefore, over a period of a few days, he made a number of bank deposits of the cash.[81]

The examiner then requested that Smith supply her with a signed, written statement memorializing what he had just related. She also asked for additional information, including bank statements from 2009, 2010, and August 2011, and account documentation for the securities transactions effected for AE and her siblings.[82]

The next day, Smith disclosed additional information to the examiner about a second meeting with AE in August 2011 when he received approximately $103,000, and that, as before, he made structured deposits of this money.[83] As the examiner acknowledged, by volunteering this information, Smith facilitated her investigation of the August deposits.[84] On the following day, September 15, 2011, Smith supplied the examiner with the written statement she had requested, restating the events of July and August 2011. In all material respects, that written statement is consistent with both the earlier account he had given the examiner and his hearing testimony.

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[80] Tr. 43.

[81] Tr. 43-44.

[82] Tr. 45, 68.

[83] Tr. 48, 58, 337, 588.

[84] Tr. 69.

G. Smith Causes Highland to File CTRs and Hires a Consultant to Evaluate and Improve the Firm's Compliance Procedures.

While the examination was ongoing, and after the examiner informed Smith that the firm should have filed CTRs after receiving AE's cash, Smith went to the bank to get a copy of a CTR. He was told that the bank filed the form electronically. On returning to the office, he asked McAlister to obtain a copy of the form, which she downloaded electronically.[85] Around one month later, Smith caused Highland to file two CTRs reflecting the receipt of AE's cash in July and August.[86]

In addition, before the examination was completed, Smith began searching for someone to assist him with the firm's compliance program "because of my failure."[87] Ultimately, he hired Brent Hippert to serve as the firm's CCO and AMLCO.[88] Hippert is well qualified to fill these positions. He has worked in the securities industry for more than three decades, first as a retail broker and then as a manager of several branch offices of a large national brokerage firm. Thereafter, he owned and served as the president, CEO, and CFO of a firm that employed more than 100 independent contractors engaged in general securities business. After he sold that firm, he became a consultant.[89]

As Highland's CCO, Hippert is responsible for the overall supervision of all compliance-related activities, including the review of all new accounts and securities transactions.[90] Hippert

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[85] Tr. 215, 217-218, 360.

[86] Tr. 96-97, 360; JX-23.

[87] Tr. 215; *see* Tr. 444.

[88] Tr. 338-339, 437.

[89] Tr. 440-441. Hippert has Series 3, 4, 7, 14, 24, 28, 53, 55, 56, 79, and 99 licenses. He also has served on the board of directors of the Boston Options Exchange Regulation, LLC, and the NASDAQ OMX BX. Tr. 441.

[90] Tr. 438, 445-446. Hippert reviews the firm's sales blotter, bank records, new account documentation, and correspondence, among other things. Tr. 338-340, 408-409, 439, 456, 459. Hippert is responsible for supervising transactions initiated by Smith. Tr. 445-446.

also is responsible for reviewing the firm's policies and procedures. Highland, through Hippert, has substantially revised the firm's written supervisory procedures after a "top-to-bottom . . . interactive review." Hippert also has taken steps to ensure that Highland employees understand the revised procedures.[91]

As Highland's AMLCO, Hippert is responsible for ensuring that Highland complies with anti-money laundering laws and has procedures in place to prevent and detect money laundering.[92] Highland, through Hippert, has revised the firm's AML policies. For example, the policies now state that, if money is received, everyone associated with the firm must be notified and a CTR must be filed when required. The policies further provide that anytime $5,000 or more is accepted, the firm will conduct a review to determine whether a SAR must be filed and, if the firm decides not to file a SAR, a written memorandum to the file will state the reasons.[93]

III. Conclusions of Law

A. By Failing to Timely File CTRs, Highland, Through Smith, Willfully Violated Rule 17a-8, and Smith and Highland Violated FINRA Rule 2010.

The Currency and Foreign Transactions Reporting Act of 1970, as amended by the USA PATRIOT Act of 2001 and other legislation, is commonly referred to as the "Bank Secrecy Act" ("BSA").[94] The BSA requires financial institutions to assist U.S. government agencies in detecting and prosecuting money laundering, tax evasion, and other criminal activity. As pertinent here, 31 U.S.C. § 5313(a) requires financial institutions to report the "payment, receipt,

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[91] Tr. 446; Tr. 338-339, 408, 446-447. Hippert also has conducted two annual compliance reviews that have included discussion of AML issues. Tr. 453-454.

[92] Tr. 439.

[93] Tr. 450-451. Hippert has made clear to all Highland employees, including Smith, that if any currency is received, they must notify Hippert immediately. Tr. 458-459, 477-478.

[94] The BSA is codified at 12 U.S.C. § 1829b; 12 U.S.C. §§ 1951–1959; 18 U.S.C. § 1956; 18 U.S.C. § 1957; 18 U.S.C. § 1960; and 31 U.S.C. §§ 5311–5332 and notes thereto, with implementing regulations at 31 C.F.R. Chapter X.

or transfer of United States coins or currency" as the Secretary of the Treasury prescribes. The term "financial institution" is defined to include "a broker or dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934." 31 U.S.C. § 5312(a)(2)(G).

The regulations implementing the BSA require financial institutions to file "a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to such financial institution which involves a transaction in currency of more than $10,000 . . . ." 31 C.F.R. § 1010.311. Under certain circumstances, multiple currency transactions totaling more than $10,000 in any one business day are treated as a single transaction for reporting purposes. *See* 31 C.F.R. § 1010.313(b). The required report must be filed by the financial institution "within 15 days following the day on which the reportable transaction occurred." 31 C.F.R. § 1010.306(a).[95]

At all times pertinent to this proceeding, financial institutions used Form 104 (referred to here as a "CTR") to comply with the reporting requirement. The form required the filer to provide, among other things, information concerning the persons involved in the transaction, the amount and type of transaction, and the name of the financial institution where the transaction took place.[96]

The Treasury Department (through FinCEN) is responsible for implementing, administering, and enforcing the requirements of the BSA. With respect to securities brokers and dealers, the Treasury Department has delegated to the Securities and Exchange Commission ("SEC") the responsibility for compliance oversight. *See* 31 C.F.R. § 1010.810(b)(6).

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[95] 31 C.F.R. §§ 1023.300 – 1023.320 separately specify that broker-dealers are subject to the reporting requirements set forth in, *e.g.*, § 1010.311.

[96] *See* JX-24. The form was filed with the IRS' Enterprise Computing Center – Detroit. *Id.* at 3.

Consistent with this delegation, the purposes of the Exchange Act, and the SEC's authority to impose broker-dealer recordkeeping requirements (under Section 17(a) of the Exchange Act, 15 U.S.C. §78q(a)), the SEC adopted Rule 17a-8 in 1981. 17 C.F.R. § 240.17a-8.[97]

Rule 17a-8 requires registered brokers or dealers subject to the requirements of the BSA to comply with the reporting, recordkeeping, and record retention requirements of the BSA's implementing regulations. The SEC adopted the rule, in part, to clarify the authority of self-regulatory organizations ("SROs"), such as FINRA, to assure compliance with the BSA. The rule accomplishes this goal by ensuring that CTRs, among other records, are made and retained in a manner that facilitates examination.[98]

Smith admits that he did not cause Highland to file CTRs within 15 days following AE's July 20 and August 16, 2011 deliveries of currency in amounts well in excess of $10,000. The Hearing Panel therefore concludes that Highland, through Smith, violated Exchange Act Section 17(a) and Rule 17a-8 thereunder.[99] Given that violations of federal securities laws "are viewed as violations of [FINRA Rule 2010] without attention to the surrounding circumstances because members of the securities industry are expected and required to abide by . . . applicable rules and

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[97] *Recordkeeping by Brokers and Dealers*, Exchange Act Rel. No. 18321, 1981 SEC LEXIS 2371 (Dec. 10, 1981).

[98] *Id.* at *2-3.

[99] In their post-hearing briefing, Respondents argue for the first time that because, in their view, Smith was not acting to serve any purpose of Highland, Highland cannot be held liable for Smith's conduct. Respondents predicate their argument on an application of the *respondeat superior* doctrine—a principle of secondary liability under which an employer is liable for the acts its employees commit in the scope of their employment. *See Dep't of Market Regulation v. Yankee Fin. Grp., Inc.*, No. CMS030182, 2006 NASD Discip. LEXIS 21, at *57 (N.A.C. Aug. 4, 2006), *aff'd in part, rev'd in part and remanded on other grounds sub. nom. Richard F. Kresge*, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407 (June 29, 2007). Respondents' argument is misplaced. Enforcement did not allege that Highland's violation was imputed to it by application of a secondary liability theory. *Cf. Michael T. Studer*, Exchange Act Rel. No. 50543A, 2004 SEC LEXIS 3157, at *21 (Nov. 30, 2004), *petition denied*, 260 F. App'x 342 (2d Cir. 2008). Instead, as Enforcement alleged in the complaint and proved at the hearing, Highland, and not Smith, is the primary violator of the Exchange Act reporting requirements. Of course, Highland can only act through natural persons, in this case its officer, Smith. As stated, there is no dispute that Smith failed to file CTRs as required.

regulations," the Panel further concludes that Highland violated Rule 2010.[100] Smith also violated Rule 2010 because he acted unethically in failing to ensure that Highland abided by pertinent regulations.[101]

Enforcement contends that Smith, and hence Highland, acted willfully. A finding of willfulness does not require intent to violate the law, but merely intent to do the act that constitutes a violation of the law.[102] Where, as here, the violation is a failure to file a required report, precedent establishes that the failure to file may be willful even though it was inadvertent.[103] Applying these principles, the Hearing Panel concludes that Smith and, therefore, Highland acted willfully in failing to timely file CTRs.[104] As a consequence, Highland is subject to a statutory disqualification under Exchange Act Section 3(a)(39)(F), 15 U.S.C. § 78c(a)(39)(F), and a disqualification under Article III, Section 4 of FINRA's By-Laws.

B. By Structuring Deposits, Smith Violated FINRA Rule 2010.

The BSA prohibits "structur[ing] or assist[ing] in structuring . . . any transaction with one or more domestic financial institutions" for the purpose of evading the reporting requirements of

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[100] *Dep't of Enforcement v. Schvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12-13 (N.A.C. June 2, 2000) (citations omitted).

[101] *Cf. Dep't of Enforcement v. Baker*, No. C8A010048, 2002 NASD Discip. LEXIS 40, at *17 (O.H.O. Aug. 5, 2002).

[102] *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976).

[103] *Stonegate Sec. Inc.*, 55 S.E.C. 346, 351 n.9 (2001) (citing *Hammon Capital Mgmt. Corp*., 48 S.E.C. 264, 265 (1985)); *Jesse Rosenblum*, 47 S.E.C. 1065, 1067 & n.9 (1984); *Oppenheimer & Co. Inc.*, 47 S.E.C. 286, 287-88 (1980) (citing *Haight & Co., Inc.*, 44 S.E.C. 481, 507 (1971), *aff'd without opinion* (D.C. Cir. 1971)).

[104] *See* pp. 24-25 *infra*. In making our determination about Smith's willfulness, we have rejected Respondents' contention that there is "no need or basis" to address whether Smith's conduct was willful because Enforcement seeks only a willfulness finding against Highland. Again, Highland acted through Smith, and its culpability is determined by looking to Smith's. *Cf., e.g., Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 366 (5th Cir. 2004). In addition, Respondents contend that a finding of a willful violation of Section 17(a) and Rule 17a-8 would be novel, and for that reason is to be avoided. We disagree. Firms have been found to have willfully violated Section 17(a) and implementing rules other than Rule 17a-8. *See, e.g., vFinance Investments, Inc.*, Exchange Act. Rel. No. 62448, 2010 SEC LEXIS 2216, at *35 (July 2, 2010); *Stonegate Sec.*, 55 S.E.C. at 351; *Dep't of Enforcement v. Merrimac Corporate Sec., Inc.*, No. 2007007151101, 2012 FINRA Discip. LEXIS 43, at *36-38 (Bd. of Gov. May 2, 2012). Nothing about Rule 17a-8 requires a different result.

Section 5313(a). 31 U.S.C. § 5324(a)(3). The regulation implementing this provision similarly mandates, "No person shall for the purpose of evading the transactions in currency reporting requirements of this chapter with respect to such transaction: . . . structure . . . or assist in structuring, or attempt to structure or assist in structuring, any transaction with one or more domestic financial institutions." 31 C.F.R. § 1010.314(c). Structuring occurs when a person "conducts or attempts to conduct one or more transactions in currency, in any amount, at one or more financial institutions, on one or more days, in any manner, for the purpose of evading the reporting requirements under . . . § 1010.311 . . . of this chapter." 31 C.F.R. §1010.100(xx). The regulations further specify that: "'In any manner' includes . . . the breaking down of a single sum of currency exceeding $10,000 into smaller sums . . . at or below $10,000 . . . ." *Id.*

Smith structured cash deposits to evade the currency reporting requirements. On three days in July 2011, Smith made five separate deposits of currency in sums below $10,000 at two banks and, on five days in August, with McAlister's help, he made 11 separate deposits of like amounts at three banks. The Hearing Panel concludes, therefore, that Smith engaged in conduct that was inconsistent with the high standards of commercial honor members of the securities industry are bound to observe, in violation of Rule 2010.[105]

C. By Commingling Customer Funds with Non-Customer Funds, Highland and Smith Violated FINRA Rules 2150(a) and 2010.

FINRA Rule 2150(a) prohibits members and their associated persons from making improper use of a customer's funds or securities. Improper use occurs when funds are used for a purpose not directed by the customer and can occur in instances where the associated person

[105] *See Dep't of Enforcement v. Trenham*, No. 2007007377801, 2010 FINRA Discip. LEXIS 15, at *9 (O.H.O. Mar. 18, 2010); *Baker*, 2002 NASD Discip. LEXIS 40, at *21-22.

does not misappropriate or convert the funds or otherwise benefit from the misuse.[106] Thus, customer funds have been used improperly when they have been commingled with non-customer funds and thereby subjected to a risk of loss.[107] Commingling is inconsistent with the high standards of commercial honor demanded of securities professionals and thereby violates FINRA Rule 2010.[108]

On eight separate occasions, and in an amount totaling more than $75,000, Smith deposited AE's cash into accounts containing non-customer funds. AE did not authorize this commingling,[109] and it subjected her funds to a risk of loss. Smith and Highland, through Smith, therefore made improper use of AE's funds, in violation of FINRA Rules 2150(a) and 2010.

D. By Failing to Implement Procedures to Detect and Report Suspicious Transactions, Highland Violated FINRA Rules 3310(a) and 2010.

In 1992, the Annunzio-Wylie Anti-Money Laundering Act added 31 U.S.C. § 5318(g) to the BSA. The provision granted the Treasury Department the authority to require that financial institutions report suspicious transactions relevant to a possible violation of law or regulation.[110] Acting pursuant to that authority, FinCEN adopted rules requiring banks, thrifts, and other banking organizations to file SARs.[111] Then, in 2001, with the enactment of the USA PATRIOT Act, the Treasury Department, in consultation with the SEC and the Board of Governors of the

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[106] *Dist. Bus. Conduct Comm. v. Roach*, No. C02960031, 1998 NASD Discip. LEXIS 11, at *15-16, 21 (N.B.C.C. Jan. 20, 1998) (citing cases); *Dep't of Enforcement v. Argomaniz*, No. C07990013, 1999 NASD Discip. LEXIS 49, at *19 & n.11 (O.H.O. Oct. 18, 1999) (citing cases).

[107] *Roach*, 1998 NASD Discip. LEXIS 11, at *16.

[108] *Dep't of Enforcement v. Tucker*, No. 2009016764901, 2013 FINRA Discip. LEXIS 19, at *9-10 (O.H.O. Jan. 11, 2013) (citing *Roach*, 1998 NASD Discip. LEXIS 11, at *21), *appeal pending*.

[109] Tr. 253; *see* JX-25.

[110] *See Amendment to the Bank Secrecy Act Regulations—Requirement that Brokers or Dealers in Securities Report Suspicious Transactions*, 67 FR 44048, 44048 & n.2 (July 1, 2002).

[111] *Id.* at 44049.

Federal Reserve System, was tasked with formulating rules requiring broker-dealers to file SARs.[112]

In the exercise of that responsibility, FinCEN adopted a rule requiring broker-dealers to report to FinCEN any transaction that, alone or in the aggregate, involves at least $5,000 in funds or other assets if the broker-dealer knows, suspects, or has reason to suspect that the transaction: (1) involves funds derived from illegal activity or is intended or conducted to hide or disguise funds or assets derived from illegal activity; (2) is designed, whether through structuring or other means, to evade the requirements of the BSA; (3) appears to serve no business or lawful purpose or is not the sort of transaction in which the particular customer would be expected to engage, and for which the broker-dealer knows of no reasonable explanation after examining the available facts; or (4) involves the use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 1023.320.[113]

The Annunzio-Wylie Anti-Money Laundering Act also added 31 U.S.C. § 5318(h) to the BSA, to authorize, but not require, the Treasury Department to issue regulations mandating that financial institutions establish AML programs and prescribing minimum standards for such programs. 31 U.S.C. § 5318(h)(1)-(2) (2000). Thereafter, Section 352 of the USA PATRIOT Act amended Section 5318(h) to provide a statutory mandate that financial institutions, including broker-dealers, develop and implement AML programs, effective 180 days after the enactment of the provision.[114] The amended provision continued to authorize the Treasury Department to prescribe minimum standards for such programs and, acting pursuant to that authority, FinCEN issued regulations that provided that broker-dealers would be deemed to be in compliance with

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[112] *Id.*; Section 356(a) of the USA PATRIOT Act, Public Law 107-56, 115 Stat. 324 (Oct. 26, 2001).

[113] *See* NASD Notice to Members 02-47 (Aug. 2002) (*available at* http://www.finra.org/Industry /Regulation/Notices).

[114] Section 352 of the USA PATRIOT Act, 115 Stat. 322.

Section 352 if they established and maintained AML programs as required by the SEC or SROs, such as FINRA.[115]

FINRA Rule 3310 embodies the minimum standards for the mandatory anti-money laundering program requirement contained in Section 352 insofar as FINRA members are concerned. The Rule requires, among other things, that members "establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. § 5318(g) and the implementing regulations thereunder."

Highland had such policies and procedures in place. However, none of Highland's employees followed up on the red flags raised by the receipt and structured deposits of AE's cash. Indeed, McAlister in particular suspected that Smith was structuring deposits and yet did nothing to follow up.[116] Accordingly, the Hearing Panel concludes that Highland violated FINRA Rules 3310(a) and 2010.

IV. Sanctions

We have found Smith liable for three violations (failing to timely file CTRs, structuring, and commingling), and Highland liable for three violations (failing to timely file CTRs, commingling, and failing to implement AML procedures). Because Highland primarily committed violations through Smith, we address first Smith's violations and the sanctions we conclude appropriately remedy those violations. We then set forth the sanctions we assess for the firm's violations.

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[115] *See Anti-Money Laundering Programs for Financial Institutions*, 67 FR 21110 (Apr. 29, 2002).

[116] Based on our findings concerning the circumstances surrounding this violation (*supra* pp. 9-11, 12-13), we conclude that both Smith and McAlister acted recklessly in failing to implement Highland's procedures to detect and cause the reporting of suspicious activities.

A. Smith's Failure to Timely File CTRs

For recordkeeping violations, the FINRA Sanction Guidelines suggest suspensions for responsible individuals in any or all capacities for up to 30 business days, and in egregious cases lengthier suspensions or a bar are suggested. Principal considerations include the nature of the missing information.[117]

Currency transaction reporting is an important law enforcement tool. It helps authorities deter, detect, and prosecute money laundering and other financial crimes, such as tax evasion.[118] Smith twice failed to ensure that CTRs were timely filed, each time in breach of his obligation to carefully comply with applicable regulatory requirements.

As we have stated, apart from what he was told by bank employees, Smith testified to an ignorance of the currency transaction reporting requirements at the time of his misconduct and we believed his testimony. This ignorance significantly aggravates the severity of his violation. Particularly given his status as AMLCO and CCO, he was charged with knowing the AML requirements and, therefore, his failure to attend to CTR filing requirements was a substantial departure from the standard of care he was bound to observe.[119] His interactions with the bank employees only exacerbated the extent to which his conduct fell short of what was expected. By virtue of his July 20, 2103 conversation with the Somerset Trust branch manager, Smith was put on notice that banks needed to report receipt of more than $10,000 and yet he did nothing to determine whether Highland was subject to a similar requirement. As the firm's AMLCO, that

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[117] FINRA Sanction Guidelines at 29 (2011).

[118] *See* Section 358 of the USA PATRIOT Act, 115 Stat. 326.

[119] *Harry Friedman*, Exchange Act Rel. No. 64486, 2011 SEC LEXIS 1699, at *29-30 (May 13, 2011) (agreeing with FINRA that industry experience and compliance responsibility were aggravating factors); *see also Philippe N. Keyes*, Exchange Act Rel. No. 54723, 2006 SEC LEXIS 2631, at *21 (Nov. 8, 2006) (finding that respondent's claimed ignorance of his obligations was "only aggravated in light of his fifteen years experience in the securities industry"); *Litwin Sec., Inc.*, 52 S.E.C. 1339, 1344 (1997) ("NASD member firms and their FINOPS are charged with knowing the applicable regulations").

would simply have meant consulting the policies and procedures he himself had compiled and, just one year earlier had initialed, affirming that he had a working knowledge of the BSA and its implementing regulations. As Smith repeatedly acknowledged, however, he failed to take even the simple step of reviewing and reacquainting himself with the firm's policies before receiving and depositing AE's currency.[120]

On the other hand, we weigh Smith's remorse for this (and his other misconduct) heavily in mitigation.[121] During the months closely following July and August 2011 and throughout this proceeding, Smith admitted his wrongdoing, recognized its severity, expressed sincere remorse, and acknowledged that serious sanctions were warranted.[122] For example, in describing his

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[120] *E.g.*, Tr. 213-214.

[121] *See Clarence Z. Wurts*, 54 S.E.C. 1121, 1132-33 (2001) (respondent's recognition of the wrongful nature of his misconduct, as well as his acceptance of responsibility, were among factors that "tempered" the SEC's assessment of the egregiousness of that misconduct); *Dep't of Enforcement v. McCartney*, No. 2010023719601, 2012 FINRA Discip. LEXIS 60, at *14 (N.A.C. Dec. 10, 2012) (finding respondent's recognition of the seriousness of his behavior, true remorse, and acceptance of the consequences of his actions mitigating); *Dep't of Enforcement v. Leopold*, No. 2007011489301, 2012 FINRA Discip. LEXIS 2, at *21 (N.A.C. Feb. 24, 2012) (citing *Dep't of Enforcement v. Cuozzo*, No. C9B050011, 2007 NASD Discip. LEXIS 12, at *35-36 (N.A.C. Feb. 27, 2007) (factors that militate against finding conduct egregious include accepting responsibility for misconduct, recognizing its severity, and expressing sincere remorse); *Dep't of Enforcement v. Kelly*, No. E9A2004048801, 2008 FINRA Discip. LEXIS 48, at *32 (N.A.C. Dec. 16, 2008) (considering it mitigating that respondent had accepted responsibility for his misconduct and consistently expressed remorse, including "deep regret" for his actions). Indeed, the fact that Smith has *consistently* acknowledged wrongdoing and expressed contrition during the course of FINRA's examination and during these proceedings reinforces our conclusion that these factors are mitigating. *See, e.g.*, *McCartney*, 2012 FINRA Discip. LEXIS 60, at *16 (citing cases).

[122] Enforcement argues first that remorse must be expressed before detection to be mitigating and second that remorse is not mitigating when misconduct is egregious. We disagree. First, we do not understand precedent or FINRA's Sanction Guidelines to require that mitigating *remorse* be expressed before detection and intervention by a firm or regulator. Acknowledgement of wrongdoing to a firm or regulator (which must be done before detection to be mitigating (*see* Principal Consideration 2) and remorse are not the same thing: a person can acknowledge wrongdoing but not be truly remorseful. Sincere remorse, consisting both of an appreciation of why an act is wrong and self-reproof, tends to show that wrongdoing will not be repeated and, in most circumstances, should be accorded some mitigative weight. *See, e.g.*, *Dep't of Enforcement v. Mizenko*, 2004 NASD Discip. LEXIS 20, at *18, 20 (N.A.C. Dec. 21, 2004), *aff'd, Mark F. Mizenko*, Exchange Act Rel. No. 52600, 2005 SEC LEXIS 2655 (Oct. 13, 2005) (holding that admission of wrongdoing that came after detection was not mitigating but treating contrition as a mitigating factor, that together with another mitigating factor, did not outweigh aggravating factors); *compare Kelly*, 2008 FINRA Discip. LEXIS 48, at *32 & n.34 (holding that, while accepting responsibility before intervention has "the greatest mitigative weight," later admission of wrongdoing has some mitigative weight). Notably *all* of the cases cited *supra* note 121, involve situations in which the respondent's misconduct was detected by the respondent's firm or FINRA *before* the respondent acknowledged wrongdoing or expressed remorse. Enforcement's second argument also is inconsistent with precedent. *E.g.*, *Kelly*, 2008 FINRA Discip. LEXIS 48, at *30, 32 (finding remorse mitigating in an "egregious" case of churning and unsuitable recommendations).

misconduct to Hippert in the fall of 2011, Smith labeled his misconduct the "mistake of a lifetime" and told Hippert that he regretted it.[123] Around six months later, in talking with his pastor about his misconduct, Smith admitted that he had done wrong and said, "I'll take the punishment for this."[124] Likewise, throughout the hearing, Smith's words and demeanor demonstrated that he is sincerely ashamed of what he did.

Other mitigating factors also are present. First, this misconduct was limited to two isolated instances over a two-month period.[125] Second, Smith volunteered information to the FINRA examiner that substantially assisted the examiner in identifying the full extent of his misconduct.[126] Smith also hired Hippert, who has recast the firm's policies and procedures. Although this subsequent corrective measure may not mitigate the severity of Smith's misconduct,[127] it supports a conclusion that Smith now appreciates the importance of scrupulous adherence to regulatory requirements and, therefore, is not likely to repeat the misconduct. Finally, there was no risk of harm to AE from this violation. Although the absence of harm is not mitigating, it nevertheless is a factor that "colors our evaluation" of the appropriate sanction.[128]

On balance, we conclude that Smith should be suspended in all capacities for six months. In addition, because this violation stemmed in large part from Smith's inexcusable ignorance of regulatory requirements, we also direct Smith to requalify as a general securities representative.

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[123] Tr. 444, 465-466.

[124] Tr. 565-566, 567.

[125] FINRA Sanction Guidelines at 6, Principal Considerations 8, 9.

[126] FINRA Sanction Guidelines at 7, Principal Consideration 12. Smith also filed CTRs around one month after FINRA's examination. Although this is not mitigating, it is a fact we have considered in assessing sanctions.

[127] Principal Consideration 3 requires that corrective measures be taken prior to detection by a regulator. FINRA Sanction Guidelines at 6.

[128] *Leopold*, 2012 FINRA Discip. LEXIS 2, at *23.

These sanctions are sufficient to impress on Smith and others the importance of adhering to applicable regulatory requirements, without being punitive.

B. Smith's Structuring

There is no sanction guideline specifically addressing structuring. Accordingly, we proceed to consider the nature of the violation and principal considerations governing all sanction determinations.

Structuring is quintessential suspicious financial activity.[129] Smith's structuring involved 16 deposits made on 8 business days in July and August 2011. The repetitive nature of the misconduct is aggravating,[130] as is the fact that Smith directed McAlister, whom he supervised, to make at least one of the deposits. In addition, as is true of his other violations, the severity of this misconduct is exacerbated because Smith was the firm's AMLCO and CCO at the time. Other aggravating factors include Smith's reckless handling of the currency in the course of structuring and his commingling AE's funds with non-customer funds.

Conversely, a number of factors mitigate the severity of Smith's misconduct. In addition to factors previously discussed (Smith's remorse and significant assistance to FINRA's examiner), Smith's desire—albeit a misguided one—to benefit his client is mitigating.[131] Smith

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[129] *See supra* p. 22. Indeed, structuring can be the subject of criminal prosecution and conviction. In support of its position that Smith must be barred, Enforcement asserts that Smith's conduct "constitutes (or came 'perilously close' to criminal activity)" and further that in administrative proceedings the SEC routinely bars individuals who have been found to have committed crimes. But the fact that Smith has not been convicted of a crime renders the SEC proceedings inapposite.

[130] *See* FINRA Sanction Guidelines at 6, Principal Consideration 8.

[131] *See Dep't of Enforcement v. Nouchi*, No. E102004083705, 2009 FINRA Discip. LEXIS 8, at *10-11 (N.A.C. Aug. 7, 2009) (finding it mitigating that respondent entered false disability waivers to benefit customers who were in financial difficulty); *Dep't of Enforcement v. Correro*, No. E102004083702, 2008 FINRA Discip. LEXIS 29, at *18 (N.A.C. Aug. 12, 2008) (same); *Dep't of Enforcement v. Hardin*, No. E072004072501, 2007 NASD Discip. LEXIS 24, at *16 (N.A.C. July 27, 2007) (finding it mitigating that CD parking and misrepresenting to firm that CDs were mistakenly purchased for customer "appeared to stem primarily from [respondent's] desire to assist his customers"); *Dep't of Enforcement v. McKinnis*, No. 2007010398802, 2011 FINRA Discip. LEXIS 53, at *22 (O.H.O. Oct. 13, 2011) (finding it mitigating that respondent altered firm records and substituted his email address for that of his customers to minimize burdens on customers and not to benefit himself).

acted as he did because he was motivated by a concern for AE and a desire to assist her. AE recognized that motivation when she testified that Smith acted as he did because he "was taking in my consideration, my situation."[132]

Unfortunately, in attempting to relieve AE of any regulatory or other obligation attending RL's cash hoarding, Smith acted rashly and without regard to basic norms governing the receipt and disposition of customer cash. He made structured deposits in an effort to ensure that AE would not have to deal with the IRS when, at the same time, he had reliable assurances that taxes had been taken care of. He chose to make multiple hasty deposits of AE's cash into non-customer accounts, thereby placing the funds at risk, because he wanted to safeguard the funds. Although Enforcement argues that the illogic of his explanations for his actions demonstrates that Smith has not been forthright, we believe it demonstrates his candor. We believe it shows that Smith has not contrived reasons for what he did and that, in fact, he has frankly admitted to a very serious lapse in judgment resulting from the unique circumstances presented by AE's request for assistance.[133]

Based on our consideration of the pertinent mitigating and aggravating factors, we conclude that a bar in all principal capacities, a six-month suspension in all capacities, and a requalification requirement appropriately address Smith's structuring.[134] We consider this violation very serious and, although we recognize that Smith is not charged with a supervisory

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[132] Tr. 521. AE's testimony corroborates Smith's consistent statements, (*e.g.*, CX-1), beginning with his oral statement to FINRA's examiner, that he acted to help AE. Smith's pastor also testified that, sometime in 2012, likely before June, Smith explained that he "was trying to help . . . a woman, a widow, and that he had made a mistake." Tr. 566, 567; *see* Tr. 466.

[133] In addition, it colors our sanction evaluation that AE was not harmed by this conduct, that Smith received no financial benefit other than standard commissions, and that Smith has sought to improve Highland's compliance practices by engaging a consultant.

[134] Respondents assert that we can and should structure any suspension or bar in such a way that Smith could retain his stock ownership in, and participate on the board of, Highland. Even if we had authority to issue such a sanction, we would decline to do so as it would have the inappropriate effect of overriding and obviating the normal membership continuance application process.

failure, we believe that, because he engaged in structuring while he was the firm's AMLCO, CCO, general securities principal, and managing principal, he has shown himself unfit to be in charge, not just of AML compliance, but of compliance-related matters in general. The evidence demonstrates that Smith is unable to attend to compliance matters as a supervisor should. Emblematic of this incapacity were his deposits of AE's funds into non-customer accounts and his involvement of McAlister in structuring. Moreover, when he was asked to explain, in light of the events of July and August 2011 and his confessed ignorance of BSA requirements, how he was comfortable with having affirmed, as of April 12, 2010, that, as the firm's AMLCO, he had a working knowledge of the BSA and its regulations, he replied: "I don't have a good answer for that."[135] We conclude that he lacked a basis for the affirmation.

On the other hand, based on his demeanor at the hearing and the record as a whole, including the testimony of Hippert in particular, we believe that if Smith associates with a firm exclusively on a supervised basis, he will attend to regulatory obligations. Before Smith begins such an association, however, he will be required to requalify as a general securities representative.

We reject Enforcement's argument that a bar in all capacities is "flatly dictate[d]" by the hearing panels' conclusions in *Department of Enforcement v. Baker*, No. C8A010048, 2002 NASD Discip. LEXIS 40 (O.H.O. Aug. 5, 2002) and *Department of Enforcement v. Trenham*, No. 2007007377801, 2010 FINRA Discip. LEXIS 15 (O.H.O. Mar. 18, 2010). First, nothing in *Baker* or *Trenham* establishes that structuring in and of itself is so grave that no circumstances can militate against the imposition of a bar in all capacities. Instead, as the *Baker* panel noted, Baker, unlike Smith, pointed to nothing that mitigated the severity of her misconduct. And in

[135] Tr. 244.

Trenham, the panel "had no confidence that Respondent would follow FINRA Rules, or for that matter, abide by a suspension, were the Panel to impose one . . . [b]ased upon his prior conduct [of engaging in principal activity while suspended] and his testimony at the hearing [which the panel found not credible]." None of these concerns is present here. Second, as the SEC has stated, it is well established "that the appropriateness of a sanction 'depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other proceedings.'"[136] Here, we believe that a bar in all capacities is unwarranted because Smith has not been shown to be unfit to participate in the securities industry. Finally, the absence of mitigating factors in *Baker*[137] and *Trenham*[138] counsels for different sanctions here.

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[136] *John M. E. Saad*, Exchange Act Rel. No. 62178, 2010 SEC LEXIS 1761, at *21-22 (May 26, 2010) (citations omitted), *petition granted and proceeding remanded on other grounds*, 718 F.3d 904 (D.C. Cir. 2013).

[137] While most of the aggravating factors present in this case were present in *Baker*, each case presents aggravating factors not present in the other. For example, unlike Smith, Baker did not function in a supervisory capacity or commingle her customer's funds with non-customer funds; she simply stored the funds in a desk drawer. On the other hand, the *Baker* panel noted that Baker "had no information whether [her customer] had paid taxes on the cash or was attempting to launder the cash for someone else." 2002 NASD Discip. LEXIS 40, at *26. This was problematic in light of Baker's customer's insistence: that a customer account not be opened in his name in "order to avoid probate" (*Id.* at *7); that account statements not be sent to his home address; and that his currency transactions not be reported "because he did not want to be associated with drug dealers." *Id.* at *8. Such suspicious circumstances are absent here. Additionally, in *Baker*, the customer felt "so strongly about the suggestion of such an association [with drug dealers] that he was prepared to put the cash back in his safe if the transaction had to be reported." *Id.* Accordingly, as the hearing panel pointed out in its sanctions analysis, Baker retained a customer because she structured. Here, there is no evidence that Smith structured the deposits to retain AE's business. More importantly, nothing in *Baker* indicates that Baker acted to benefit her client in any sense other than to facilitate his desire to evade reporting requirements. What Smith did here is much more nuanced. He did what he did to relieve AE of any further obligations with respect to her mother's hoarded cash. Most importantly, nothing in *Baker* establishes that Baker appreciated that she had violated regulatory obligations or that she experienced any remorse as a result. To the contrary, Baker attempted to excuse her conduct because she relied on the advice of a Comerica Bank teller. Here, Smith did not attempt to shift the blame for his actions.

[138] This case is similar to *Trenham* in that both respondents were AMLCOs and both twice engaged in structuring after twice receiving cash in excess of $10,000 from a customer. The similarities end there. Although Smith received more currency from his customer than did Trenham, Trenham structured because he considered reporting requirements "burdensome" (2010 FINRA Discip. LEXIS 15, at *17) and he revised his reasons for structuring over the course of the proceeding. In addition, none of the mitigating factors present here were present in *Trenham*.

C. Smith's Commingling

The sanction guideline for misuse of customer funds specifies that adjudicators should consider a bar, but in cases where mitigation exists, a suspension in all capacities (until the respondent pays restitution) should be considered.[139] Here, considering the mix of aggravating and mitigating factors, we believe that a minimal downward departure from a bar in all capacities is warranted.

Smith's commingling was wrongful not simply because it placed AE's funds at risk but also because it called into question the firm's ability to claim an exemption from Rule 15c3-3. Moreover, the severity of this misconduct is exacerbated because the commingling was done recklessly.[140] Finally, Smith engaged in commingling at the same time as he functioned as Highland's FINOP. As Smith aptly stated, he made a "terrible decision" in handling AE's cash as he did—one that calls for the assessment of a significant sanction.[141]

On the other hand, many of the same factors that mitigate the severity of Smith's other violations—the brief nature of the violations, Smith's remorse, and Smith's self-reporting—mitigate his commingling. In addition, although these facts are not mitigating, we note that AE was not harmed by Smith's misconduct, and Smith received no benefit.[142]

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[139] FINRA Sanction Guidelines at 36. Enforcement cites *Bernard D. Gorniak*, 52 S.E.C. 371 (1995) for the proposition that Smith must be barred for commingling. But *Gorniak* is distinguishable. *Gorniak* involved a registered representative who took customer monies intended for investment, and waited five or more months before making trades. When he finally made trades, they were cancelled for nonpayment. During the hearing before NASD, he had no explanation for his conduct. Later, before the SEC, Gorniak claimed that he had exercised discretionary authority over whether and when to invest the funds, a claim the SEC rejected. In this case, Smith twice caused AE's funds to be commingled with non-customer funds for a period of a few days. He did not use the funds for his own purposes. He did not misappropriate or convert the funds. *Gorniak* does not require a bar here.

[140] Smith testified that he was aware of the prohibition on commingling and that he took it seriously, but that, at the time he made the deposits, the fact that he was commingling was not part of his thought process. *See, e.g.*, Tr. 159-161. We believe his testimony and conclude that his conduct reflects a sufficiently serious lapse in judgment as to be reckless.

[141] Tr. 155.

[142] Although Smith sought to "safeguard" AE's funds by depositing them quickly and in three accounts, we do not consider this mitigating because he placed the funds at risk by doing so.

For much the same reason that we bar Smith in all principal capacities for structuring, we impose the same sanction for his commingling. Smith's reckless failure to heed regulatory requirements he admittedly knew and understood demonstrates that he is unfit to be in charge of even the most basic compliance matters.[143]

D. Highland's Failure to Timely File CTRs, Commingling, and Failure to Implement AML Procedures

The sanction guideline for recordkeeping violations directs adjudicators to consider suspending firms with respect to any or all activities for up to 30 business days and suggests fines of $1,000 to $10,000.[144] For the failure to timely file CTRs in violation of Exchange Act Section 17(a) and Rule 17a-8 as well as FINRA Rule 2010, the Hearing Panel orders Highland to pay a $5,000 fine. This fine, in the middle of the guideline's suggested range, takes into account the seriousness of the misconduct, which is mitigated in part by its isolated and aberrant nature.[145]

The sanction guideline for improper use of funds recommends fines ranging from $2,500 to $50,000.[146] We have determined to fine Highland $10,000 for commingling in violation of FINRA Rules 2150(a) and 2010. Although this misconduct was serious, the fine is at the lower

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[143] Respondents have erroneously asserted that the following factors mitigate the severity of each of Smith's violations. First, Respondents argue that the panel should consider Smith's lack of a disciplinary history to be mitigating. However, lack of disciplinary history is not mitigating because persons in the securities industry are required to comply with FINRA's standards of conduct at all times. *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006). Second, Respondents argue that the panel should consider Smith's lack of concealment as mitigating. However, lack of concealment is not mitigating because registered persons are obligated by FINRA's rules to cooperate with FINRA examinations and investigations. *See Dep't of Enforcement v. Keyes*, No. C02040016, 2005 NASD Discip. LEXIS 9, at *28 (N.A.C. Dec. 28, 2005), *aff'd in part*, *Philippe N. Keyes*, 2006 SEC LEXIS 2631. Finally, Respondents argue that the "isolated" nature of Smith's misconduct is mitigating. Smith's repetitive structuring and commingling cannot, however, be considered "isolated."

[144] FINRA Sanction Guidelines at 29.

[145] *See* FINRA Sanction Guidelines at 7, Principal Consideration 16. We also considered the corrective measures Highland took to ensure adherence to its compliance obligations in the future. While such subsequent corrective action taken after detection by a regulator is not mitigating, Highland's corrective action colors our evaluation of the sanctions needed to prevent a recurrence of the same or similar misconduct in the future.

[146] FINRA Sanction Guidelines at 36.

end of the suggested range to take into account the firm's self-reporting of part of the misconduct. It also takes into consideration the firm's small size.[147]

There is no guideline for failure to implement procedures regarding the investigation and reporting of suspicious activities. In determining the appropriate sanctions, the Hearing Panel considered the sanction guideline for failure to supervise, as well as the general principles and principal considerations applicable to all sanction determinations. For failure to supervise, the applicable sanction guideline recommends a fine of $5,000 to $50,000.[148] The Panel has determined to fine Highland $10,000. Although we have found that this violation was reckless, we consider this sanction to be appropriate in light of the aberrant nature of this violation, the firm's small size, and the substantial assistance provided to the FINRA examiner.[149]

V. Conclusion

For failing to timely file CTRs in violation of Exchange Act Section 17(a) and Rule 17a-8 and FINRA Rule 2010, Highland Financial, Ltd. is fined $5,000. For commingling funds in violation of FINRA Rules 2150(a) and 2010, Highland is fined $10,000. For failing to implement procedures regarding suspicious activities in violation of FINRA Rules 3310(a) and 2010, Highland is fined $10,000.

For failing to timely file CTRs in violation of FINRA Rule 2010, Gordon D. Smith is suspended from associating with any member in any capacity for six months and ordered to requalify as a general securities representative. For commingling funds in violation of FINRA Rules 2150(a) and 2010, Smith is barred from associating with any member in any principal capacity. For structuring cash deposits in violation of FINRA Rule 2010, Smith is barred from

[147] FINRA Sanction Guidelines at 2 (General Principle 1).

[148] FINRA Sanction Guidelines at 103.

[149] FINRA Sanction Guidelines at 2 (General Principle 1), 6-7 (Principal Considerations 2, 16).

associating with any member in any principal capacity, suspended from associating with any member in any capacity for six months, and ordered to requalify as a general securities representative. The suspensions shall run concurrently.

In addition, Smith and Highland are jointly and severally ordered to pay costs of this proceeding in the amount of $6,658.30, which costs include the hearing transcript fees and an administrative fee of $750.

The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final action in this disciplinary proceeding. If this decision becomes FINRA's final action, Smith's suspensions shall commence at the opening of business on November 18, 2013, and end on May 17, 2014, and run concurrently. If this decision becomes FINRA's final disciplinary action, the bars shall become effective immediately.

HEARING PANEL.

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Rada Lynn Potts
Hearing Officer

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