FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. LEK SECURITIES CORPORATION (CRD No. 33135), and SAMUEL FREDERIK LEK (CRD No. 1642936), Respondents.	Disciplinary Proceeding No. 2009020941801 Hearing Officer—LOM **HEARING PANEL DECISION** December 30, 2014

The Respondent Firm failed to establish and implement anti-money laundering policies and procedures that were reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations promulgated by the Department of the Treasury. This misconduct violated NASD Conduct Rules 3011(a) and 2110 and FINRA Rules 3310(a) and 2010, as alleged in the First Cause of Action. For this misconduct, the Firm is censured, fined $100,000, and ordered to pay costs.

The Department of Enforcement failed to prove that Respondents' supervisory systems and written supervisory procedures relating to portfolio margining for a particular customer violated NASD Conduct Rules 3010 and 2110 and FINRA Rule 2010, as alleged in the Second Cause of Action. That Cause of Action is dismissed.

Appearances

Jeffrey P. Bloom, Rockville, Maryland, and Michael A. Gross, Boca Raton, Florida, representing the Department of Enforcement.

Kevin J. Harnisch, David M. Crane, and Conor P. Brady, Steptoe & Johnson LLP, Washington, DC, representing Respondents.

I. INTRODUCTION

The Department of Enforcement ("Enforcement") for the Financial Industry Regulatory Authority ("FINRA")[1] brought this disciplinary action against Samuel Frederik Lek ("Lek") and the FINRA member firm that he founded, Lek Securities Corporation (the "Firm"). The Firm provides clearing and execution services primarily to institutional and professional traders brought to the Firm by introducing broker-dealers. Many of those traders engage in high-volume, high-frequency day trading. An average of 450 to 500 trades per minute pass through the Firm's systems to the securities markets.

Lek is the majority owner of the Firm, the Chief Executive Officer ("CEO"), the Chief Compliance Officer ("CCO"), and the Anti-Money Laundering ("AML") Officer. Lek controls the Firm and expects that any unusual or suspicious activities will be "escalated" to him by the Firm's staff. Because the Firm is relatively small, with approximately twenty staff members, and Lek sits at the center of a room within twenty feet of the staff as they all conduct the Firm's business, "escalation" to Lek may consist of shouting out and drawing Lek's attention to some event occurring in the Firm's systems. Lek typically resolves issues without pausing to document his review or determination.

The First Cause of Action charges that from January 1, 2008, through October 31, 2010 (the "Review Period"), the Firm failed to establish and implement AML policies, procedures, and internal controls that could be reasonably expected to detect and cause the reporting of suspicious

[1] FINRA is a self-regulatory organization responsible for regulatory oversight of securities firms and associated persons who do business with the public. It is the successor organization to NASD. FINRA's rules include NASD procedural and conduct rules. Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulations into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* FINRA Regulatory Notice 08-57 (Oct. 2008). Because the Complaint in this case was filed after December 15, 2008, FINRA's procedural rules apply. The conduct rules that apply are those that existed at the time of the conduct at issue. FINRA's rules, including NASD conduct rules, are available at http://www.finra.org/Rules.

transactions and that were reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations promulgated by the Department of the Treasury. The Firm's failure to establish and implement adequate AML policies, procedures, and internal controls is alleged to violate NASD Conduct Rules 3011(a) and 2110 and FINRA Rules 3310(a) and 2010.[2]

As discussed more fully below, the Hearing Panel finds that the Firm committed the violations alleged in the First Cause of Action. For this misconduct, the Panel censures the Firm, fines it $100,000, and orders it to pay costs.

The Firm committed the violations relating to its AML policies, procedures, and internal controls during the first half of the Review Period by depending upon an ad hoc, undocumented, manual system of surveillance for potential wash trades and other types of manipulative activities. The Firm's staff was looking at hundreds of trades per minute as they came across the trading desk. Even Lek's own testimony supports the conclusion that this informal system was inadequate in the high-volume electronic trading environment in which the Firm operated. He acknowledged that he came to realize at some point that the Firm needed a better system of surveillance.

The Firm also committed violations in the latter half of the Review Period, through October 31, 2010. Although the Firm instituted new surveillance procedures and mechanisms, its approach to its AML responsibilities remained inadequate in design and implementation. For example, in the summer of 2009, in response to regulatory inquiries, the Firm instituted an exception report for potential wash sales, but the Firm did not specify the procedures for investigating such suspicious trading and determining whether a suspicious activity report

[2] FINRA Rule 3310 superseded NASD Rule 3011, effective January 1, 2010. FINRA Rule 2010 superseded NASD Rule 2110, effective December 15, 2008.

("SAR") should be filed. Nor did it document the actual review, investigation, and determination with respect to any particular potential suspicious trading.

The lack of specific instructions regarding AML procedures and responsibilities rendered the design of the AML program inadequate. The failure to document the performance of AML duties rendered the implementation inadequate.

The Second Cause of Action charges that Respondents violated NASD Rules 3010 and 2110 and FINRA Rule 2010. In that Cause of Action, Enforcement alleges that Lek and the Firm failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with applicable securities laws and regulations, and that they failed to establish, maintain, and enforce written procedures to supervise the types of business in which the Firm engaged.

The Second Cause is linked to the Firm's provision of portfolio margining to a customer named Dimension Trading International ("DTI"), which was introduced to the Firm by Dimension Securities LLC ("Dimension"). The Firm provided portfolio margining to DTI's "parent" account and multiple subaccounts on an aggregate basis. DTI had several hundred active subaccounts at the Firm and several thousand subaccounts over the Review Period, but Respondents understood that DTI funded all the subaccounts, the DTI traders were employees or independent contractors, and DTI was the only entity that was responsible for payment if there was a margin call. The subaccounts were established to allow DTI to monitor the performance of the traders and different trading strategies in the various subaccounts. The Firm's staff compared the structure of DTI to that of a hedge fund, noting that the Firm would deal with the hedge fund as its customer, not the traders.

The Complaint does not charge that Respondents actually violated the applicable portfolio margining rule, NASD Rule 2520 (now superseded by FINRA Rule 4210), when they extended portfolio margining to DTI. However, Enforcement presumes that there were strong signs that it was improper for Respondents to extend portfolio margining to DTI. On that basis, Enforcement charges that Respondents' investigation and supervisory procedures were insufficient because they failed to recognize the signs that portfolio margining to DTI was improper.

The Complaint alleges that Respondents were confronted by three specific red flags requiring investigation, and that Respondents failed to respond to each appropriately: (i) a letter from FINRA staff dated February 1, 2010, mandating that Respondents stop providing portfolio margining to DTI as a single entity; (ii) an April 2010 Regulatory Notice (FINRA Regulatory Notice 10-18) indicating that the existence of multiple subaccounts is a red flag (among others) requiring an investigation into whether the subaccounts actually had separate beneficial owners; and (iii) a second letter from FINRA staff dated April 27, 2010, apparently modifying the staff's original mandate, since the second letter no longer required Respondents to treat each subaccount as a separate customer. The second letter required Respondents to investigate the beneficial ownership of the DTI subaccounts and satisfy themselves as to the beneficial ownership of each. It also contained a request pursuant to FINRA Rule 8210 for information regarding the investigation.

Respondents' counsel replied to each of the FINRA staff's letters on Respondents' behalf. Counsel's response to the first letter explained how the staff's view was incorrect. Lek viewed counsel's response to the second letter as the report requested by the second letter (and no Rule 8210 violation is charged). Lek also testified that, as instructed by the second letter, he conducted some additional investigation in response to the regulatory concerns. He concluded that DTI was the sole beneficial owner of the subaccounts.

Even though there was some evidence that casts doubt on Lek's conclusion regarding beneficial ownership of the subaccounts, the record does not contain sufficient evidence to determine that Lek's investigation and the Firm's supervisory procedures were insufficient.

The Hearing Panel finds that Enforcement did not carry its burden of proof to establish that the Firm's supervisory systems and procedures relating to portfolio margining violated NASD Rules 3010 and 2110 and FINRA Rule 2010. Accordingly, the Hearing Panel dismisses the Second Cause of Action.

II. FACTS

A. Jurisdiction

Lek and his Firm are each currently active in the securities industry. The Firm is a FINRA member, and Lek is registered through the Firm. FINRA therefore has jurisdiction.[3]

B. Proceeding

A three-person Hearing Panel conducted a five-day hearing, and the parties later conducted closing arguments by telephone and filed post-hearing briefs. After careful

[3] CX-1; CX-2. Members and their associated persons agree to comply with FINRA's rules, as well as the securities laws and other applicable regulations, and with FINRA's rulings, orders, directions, and decisions. FINRA By-Laws, Art. IV, Sec. 1(a)(1); Art. V, Sec. 2(a)(1); and FINRA Rule 140.

consideration of the record, the Hearing Panel issues this decision setting forth its findings and conclusions.[4]

C. Respondents

The Firm provides trade execution and clearing services to introducing broker-dealers and institutional clients. It does not engage in proprietary trading. The only retail business the Firm does is with high net worth people such as retired specialists and market makers.[5]

The Firm has a high-volume, fast-paced trading business. It offers automated access to the securities markets to clients who engage in high-volume, high-frequency trading. Lek describes the Firm's service as "filtered" access because the Firm has automated screens or filters that will

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[4] References to the hearing transcript are cited "Hearing Tr. (name of witness) page number." For example, a citation to Lek's testimony would be "Hearing Tr. (Lek) 357." Exhibits are referred to with a prefix identifying the proponent, as in CX-number for Complainant's Exhibit and RX-number for Respondents' Exhibit. For example, a citation to Regulatory Notice 10-18 that was introduced into evidence by Enforcement is "CX-34." A citation to the clearing agreement between the Firm and the introducing broker for DTI that was introduced into evidence by Respondents is "RX-534."

The following witnesses testified: Caitlin Farrell-Starbuck ("Farrell-Starbuck") (the Firm's former compliance officer); Samuel Lek ("Lek") (the Firm's CEO, CCO, and AML Officer), Robert Morris ("Morris") (a FINRA investigator); Alexander Posharow ("Posharow") (an associate director in FINRA's Department of Market Regulation); William Park ("Park") (a supervisor of investigations and case development for Enforcement); Aaron Fox ("Fox") (Enforcement's expert on AML policies and procedures); Phillip Potter ("Potter") (a principal with Dimension Securities LLC, a now-defunct introducing broker); Frank Calimano ("Calimano") (a compliance consultant who conducted AML audits of the Firm); Vincent Pfalzer ("Pfalzer") (Respondent's expert on margin analysis); and Stewart Mayhew ("Mayhew") (Respondent's expert on securities trading and market manipulation).

[5] Answer, Preliminary Statement at 1; Hearing Tr. (Lek) 330, 1306, 1432-33. Although the Firm had a few retail accounts during the Review Period (Hearing Tr. (Lek) 1306), it is clear that the Firm's business is not a retail business. It serves introducing brokers and institutional and professional traders. The Firm says as much on its own website, which declares that its electronic order execution platform, called ROX, "is <u>not</u> suited for individual investors." CX-3 (emphasis in original).

This decision sometimes speaks in the present tense about conditions at the Firm during the Review Period. When it does, there is no intention to imply that those conditions are current. The Firm has continued to evolve and change so that some of the facts set forth here may no longer be true. For instance, during the Review Period, the Firm did not have a process for memorializing its review of transactions to see if its system was constantly blocking the same trader over and over again for the same thing. Now the Firm does. Hearing Tr. (Lek) 1575-77. Similarly, during the Review Period, the Firm did not document when an employee raised an issue with Lek; now the Firm does. Hearing Tr. (Lek) 1580-82.

block a trade that exceeds size or credit limits set by the Firm.[6] Many of the Firm's clients are day traders. Lek testified that such traders care about split seconds, even nanoseconds, and he acknowledged that part of what the Firm sells to its clients is a quick response.[7] The Firm executes an average of nearly 44 million trades per year. During the six-and-a-half hours the markets are open on a trading day, the Firm processes roughly 200,000 trades. Thus, on average, in a given trading day as many as 500 trades per minute pass through the Firm's automated systems.[8]

Lek is the central figure and decision-maker at the Firm. He started the Firm with a friend in 1990. He is the majority owner, through a holding company, and he is also the CEO, CCO, and AML Officer.[9]

Ultimately, the answer to any question at the Firm about what should be done with regard to any significant issue is—talk to Lek. Lek and his staff sit close together in a single room. No one sits further than twenty feet from Lek. He hears everything that goes on, and his staff knows to bring anything unusual to his attention immediately. In this environment, he gives ad hoc training.[10] Lek expects any unusual or suspicious activities to be "escalated" up to him by the staff. For instance, he testified that, if a Firm employee saw evidence of prearranged trading, the staff knew to come and bring it to his attention. He emphasized that the Firm is small and is

[6] Hearing Tr. (Lek) 506-07, 1438.

[7] Hearing Tr. (Lek) 327-28.

[8] CX-37 (Lek average trades per day); RX-543 at p. 5 (Firm executes 200,000 trades per day); Hearing Tr. (Calimano) 1296-97.

[9] Hearing Tr. (Lek) 326, 337-38; Hearing Tr. (Farrell-Starbuck) 96; Answer, Preliminary Statement at 1.

[10] Hearing Tr. (Lek) 1409-10; Hearing Tr. (Farrell-Starbuck) 313-14. The Firm also gives formal training that includes AML. Hearing Tr. (Lek) 342, 1389-1409.

managed “hands-on.”[11] Lek said that if someone saw something suspicious, “All they have to do is turn their head and [say], ‘Sam, look at this, this is what I’m seeing….’”[12] Similarly, Lek testified that, if he saw something he wanted to alert his staff about, he might stand up and yell “watch out for this.”[13]

Lek determines what should be done about suspicious activities and whether a SAR should be filed.[14] He has final approval of any revisions to AML procedures,[15] and he has the ultimate responsibility for all aspects of AML compliance and supervision.[16]

During the Review Period, Lek began delegating some compliance and AML responsibilities to a member of his staff, Caitlin Farrell-Starbuck. There is no record, however, of exactly what compliance and AML tasks were assigned to her.[17] Farrell-Starbuck testified that, if someone came to Lek with a compliance question she could handle, then Lek would point the person to her.[18] She further testified that there was not a lot of bureaucracy, and if someone did not know what to do or where to turn for guidance, “people at [the Firm] are not shy to just yell

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[11] Hearing Tr. (Lek) 1565-66.

[12] Hearing Tr. (Lek) 1441-42.

[13] Hearing Tr. (Lek) 507-08.

[14] Hearing Tr. (Lek) 1421-22.

[15] Hearing Tr. (Lek) 338-39.

[16] Hearing Tr. (Farrell-Starbuck) 251.

[17] Hearing Tr. (Farrell-Starbuck) 101, 103-04, 312-13; Hearing Tr. (Lek) 340-41.

[18] Hearing Tr. (Farrell-Starbuck) 313-14. Farrell-Starbuck left the Firm in September 2010, not long before the end of the Review Period in October 2010, to become a vice president and compliance officer of another firm. Hearing Tr. (Farrell-Starbuck) 93-94.

out."[19] Farrell-Starbuck described her primary focus as conducting Know-Your-Customer investigations.[20]

D. Dimension And DTI

Dimension was a small introducing broker-dealer that cleared through the Firm.[21] It had approximately a dozen open accounts at any particular time.[22]

Dimension introduced customers on a "fully disclosed" basis, which meant that it disclosed to the clearing firm the name and other characteristics of the account.[23] The clearing agreement between Dimension and the Firm, like almost all the clearing agreements the Firm had with introducing brokers, allocated different functions between the introducing broker and the clearing firm and delegated the Know-Your-Customer obligations to the introducing broker.[24]

[19] Hearing Tr. (Farrell-Starbuck) 314.

[20] Hearing Tr. (Farrell-Starbuck) 123-25, 167-68. "Know-Your-Customer" is a short-hand term for customer account information that a broker-dealer must collect and maintain for various purposes. As a matter of industry practice, it is customary for a new account form to collect most of the required information. FINRA has taken the position that its conduct rules impose a Know-Your-Customer obligation on member firms. *Broker-Dealer Regulation*, 13-10 through13-17 and n.72 (2d Ed.) (Kirsch, Clifford ed.); NASD Notice to Members 01-23, Suitability Rule and Online Communications (Apr. 2001), n.7.

[21] Hearing Tr. (Potter) 1094-95, 1101.

[22] Hearing Tr. (Potter) 1143-44. Dimension was founded in 2005 by Phillip Potter and a partner to develop software to enable high-frequency day trading. It aimed to provide high-speed electronic access, what Potter called "direct market access," to the securities markets. Hearing Tr. (Potter) 1095, 1097-98. In March 2012, subsequent to a merger, the broker-dealer entity known as Dimension was shut down. Hearing Tr. (Potter) 1100-02, 1173-75.

[23] Hearing Tr. (Farrell-Starbuck) 107-10; Hearing Tr. (Lek) 1311-12.

[24] Hearing Tr. (Lek) 1320-25; RX-534.

Dimension introduced DTI to the Firm.[25] DTI opened an account at the Firm[26] and the Firm agreed to provide margin credit to DTI.[27] The customer relationship was between the Firm and DTI, and, as far as Lek knew, DTI was the only party with an interest in the DTI account.[28]

DTI, a corporation registered in the British Virgin Islands, hired and trained traders offshore to trade in the U.S. securities markets. The traders generally used a high-frequency trading strategy.[29] The business model for DTI was a high-volume, low-margin business. It employed a large number of people who used a variety of different trading strategies. It took small profits on many small transactions. The individual traders were all over the world in foreign countries where a successful trader could make enough on such transactions to support himself and his family. Even a successful trader with DTI would not have been able to do that if he had lived in New York.[30] The "vast majority" of the traders were employees.[31]

DTI was organized as a limited partnership with a general partner and nine or ten limited partners. Each limited partner had a number of subaccounts in various locations that were

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[25] Hearing Tr. (Farrell-Starbuck) 109-10. Although Dimension and DTI shared the Dimension name, Potter, Dimension's principal, testified that the two did not share the same ownership. Hearing Tr. (Potter) 1106-07.

[26] Hearing Tr. (Lek) 1325-33; RX-530.

[27] Hearing Tr. (Potter) 1129; Hearing Tr. (Lek) 1333-34.

[28] Hearing Tr. (Lek) 1329-30.

[29] Hearing Tr. (Potter) 1103-04.

[30] Hearing Tr. (Potter) 1130-32, 1153-54, 1233.

[31] Hearing Tr. (Potter) 1129-30.

associated with that limited partner.[32] The limited partners were described by a Dimension principal as trading managers.[33]

GS was the individual owner of DTI's general partner.[34] GS or DTI provided the money traded by DTI's traders.[35] Pursuant to its Know-Your-Customer obligations, Dimension examined DTI's corporate formation documents and obtained information on the limited partners.[36] Both Dimension and the Firm ran OFAC (Office of Financial Assets Control of the U.S. Department of the Treasury) checks related to DTI, its limited partners, and at least some of its traders.[37]

In the Firm's records, DTI was organized as a master or "parent" account with over 3,000 subaccounts or "child" accounts.[38] The subaccounts were set up for DTI's benefit.[39] They were an accounting mechanism to track the performance of individual traders or aggregation units.[40] As of July 2009, the Firm's records showed 3,984 separate subaccount identifiers associated with

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[32] CX-38; CX-40. If traders were associated with a limited partner of DTI, then Lek assumed that they were working for that limited partner. Hearing Tr. (Lek) 1519-20. *See also* Hearing Tr. (Potter) 1160-62.

[33] Hearing Tr. (Potter) 1219. Potter testified that many of the limited partners were American citizens who would return to their native countries to build their businesses because the cost of living is so much lower in those countries. They traded for DTI and ultimately would be entitled to profit sharing. Hearing Tr. (Potter) 1219-20.

[34] Initials are used for GS because he did not testify.

[35] Hearing Tr. (Potter) 1105-06; Hearing Tr. (Lek) 395-96; Hearing Tr. (Farrell-Starbuck) 250.

GS and the owners of Dimension, Potter and his partner, had done business together in the past and were still business partners with regard to certain software technology used by DTI's traders. Hearing Tr. (Potter) 1106-07, 1122, 1244-45. However, Potter and his partner had no capital in DTI. Hearing Tr. (Potter) 1107. Although the partnership agreements between GS and the limited partners provided for capital contributions to be made, Potter testified that to his knowledge the limited partners did not contribute any money. Hearing Tr. (Potter) 1104-06, 1118-19; RX-740.

[36] Hearing Tr. (Potter) 1116-26; RX-740; RX-741.

[37] Hearing Tr. (Potter) 1123-26; Hearing Tr. (Lek) 385-86.

[38] Hearing Tr. (Farrell-Starbuck) 113-14; Hearing Tr. (Lek) 353-54; CX-41.

[39] Hearing Tr. (Lek) 360, 367-69.

[40] Hearing Tr. (Potter) 1110.

the DTI account. The Firm had at the time a total of 7,669 accounts.[41] On average, approximately 550 subaccounts were active at any one time from 2008 through 2010.[42]

Each individual subaccount in the Firm's records had an acronym, but all the trade activity was on behalf of DTI and was aggregated up to the "parent" level.[43] DTI provided the acronyms labeling the subaccounts, and any other information that the Firm had about the subaccounts came from DTI.[44] The entities listed in the titles for the various subaccounts did not have the right to demand assets from the DTI accounts or the subaccounts; nor did they have any right to deposit assets in the accounts or subaccounts.[45] The limited partners and traders for the subaccounts could not access the Firm's website for DTI's account. Only GS could do so on behalf of DTI.[46] The subaccounts did not receive separate statements or tax forms.[47] The Firm did not charge the subaccounts separately for commissions, clearance, or any similar expenses. Those were all charged to the DTI parent account.[48]

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[41] CX-41; Hearing Tr. (Lek) 1376-77.

[42] Hearing Tr. (Lek) 1377.

[43] Hearing Tr. (Farrell-Starbuck) 113-14.

[44] Hearing Tr. (Farrell-Starbuck) 123-25.

[45] Hearing Tr. (Farrell-Starbuck) 248-49.

[46] Hearing Tr. (Farrell-Starbuck) 249. Lek testified that the principals of DTI and Dimension could log onto DTI's account and subaccounts in the Firm's system. Hearing Tr. (Lek) 387. The two Dimension principals, Potter and his partner, and two Dimension operations and technical staff also could log onto DTI's account on Lek's system for purposes of providing system support and compliance review. Hearing Tr. (Potter) 1112-16.

[47] Hearing Tr. (Potter) 1127-28.

[48] Hearing Tr. (Lek) 1371-72. Dimension's principal testified that each subaccount represented a database entry. It could signify a trader or a "black box" or algorithm that was being segregated because of following a particular strategy. Hearing Tr. (Potter) 1110, 1221-22.

The Firm and its staff viewed the subaccounts as a recordkeeping convenience.[49] They understood that DTI could use the subaccounts to evaluate the performance of different traders and trading strategies.[50] The DTI subaccounts could be searched to attribute gains and losses to individual subaccounts.[51] The subaccounts were not viewed as customers of the Firm.[52]

Farrell-Starbuck compared the structure of DTI to the structure of a hedge fund that opens an account with a broker-dealer. The hedge fund may have a number of different traders but the hedge fund is the customer. The broker-dealer does not ask for every single trader's name. The broker-dealer relies on the hedge fund to monitor its own traders' activity for potential market manipulation.[53] She said that she had no idea where the traders for the subaccounts were, what strategies they employed, or whether they discussed their trading with each other.[54]

During the Review Period, DTI was the Firm's largest source of transaction business, accounting for 37% to 65% of the trades at the Firm during the Review Period.[55] DTI also constituted over 90% of Dimension's business.[56]

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[49] Hearing Tr. (Farrell-Starbuck) 125-26, 127-28.

[50] Hearing Tr. (Farrell-Starbuck) 221-23.

[51] Hearing Tr. (Farrell-Starbuck) 144, 149.

[52] Hearing Tr. (Farrell-Starbuck) 109-10, 120-29, 224-26. An expert on margin analysis testified that in his view DTI was the Firm's customer. Hearing Tr. (Pfalzer) 1667. Similarly, Dimension viewed DTI, and not the subaccounts as its customer. Dimension looked at DTI's corporate formation documents to satisfy its Know-Your-Customer obligations and gathered information about DTI's limited partners and traders for purposes of its OFAC checking. Hearing Tr. (Potter) 1116-30; RX-741.

[53] Hearing Tr. (Farrell-Starbuck) 223-26. Lek made the same comparison. Hearing Tr. (Lek) 467-71. An expert on margin analysis testified that subaccounts are commonly set up for the convenience of a client to enable the tracking of performance. Hearing Tr. (Pfalzer) 1625, 1639-41.

[54] Hearing Tr. (Farrell-Starbuck) 125-28.

[55] Hearing Tr. (Morris) 568-74; CX-35.

[56] Hearing Tr. (Potter) 1171. Dimension and DTI stopped doing business with the Firm in 2011. Hearing Tr. (Lek) 497-98.

E. The Firm's AML Surveillance And Reporting

1. The Firm's Practices Prior To Summer 2009

During the first half of the Review Period, from January 1, 2008, through summer 2009, the Firm had no automated exception reports for potentially manipulative trading, such as wash trades, pre-open order cancellations, or marking the close.[57] Instead, it relied on everyone sitting at their screens to review trades in real time and be alert to suspicious trading. Moreover, the staff would simply look for suspicious activity as part of the Firm's overall compliance program, without specifically focusing on AML issues.[58] This surveillance took place against the backdrop (described below) of an AML manual and Written Supervisory Procedures ("WSPs") that were not tailored to the Firm's business and lacked specific guidance regarding how to review and investigate manipulative trading for purposes of determining whether a SAR should be filed.

On its face, in the fast-paced electronic trading environment at the Firm, this ad hoc, undocumented, manual review was not well designed to uncover potential manipulative trading. Lek acknowledged that it is possible to miss a problem when trades are coming in at a pace of 500 or more a minute, but he minimized the danger.[59] When asked how it was "humanly possible" in the Firm's high-speed environment for anyone to respond on a timely basis to a problem, Lek asserted that, although they could not "catch everything," their controls would stop "typical" violations.[60] The controls or filters employed by the Firm, however, were not specifically

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[57] Hearing Tr. (Farrell-Starbuck) 160-61 (the Firm first implemented a wash sale exception report in August 2009), 202, 210 (the Firm first implemented a pre-market cancel exception report in October 2009). Hearing Tr. (Parties' stipulation on the record) 1612 (the Firm first implemented an exception report for marking the close in March 2010).

[58] Hearing Tr. (Farrell-Starbuck) 152.

[59] Hearing Tr. (Lek) 1503-05.

[60] Hearing Tr. (Lek) 1588-89. Lek added that they might do periodic reviews of customers. Hearing Tr. (Lek) 1590. But there was no evidence of an established system for doing so.

designed to flag potential manipulation. They simply rejected orders that were outside authorized parameters such as credit and size limits or prohibitions against odd lots.[61] To the extent the Firm's controls and filters could have been used to analyze for potential manipulation, there was no written guidance establishing such a procedure, and, if there were a procedure performed to see if there was a pattern of trading, there was no written record memorializing review. [62] Lek implicitly admitted that the Firm's informal, real-time monitoring was insufficient in the Firm's fast-paced electronic trading environment. He testified that "in the old days" they could monitor for wash sales by comparing customer execution quantity, execution time, and price. However, as Lek testified, when they started observing thousands of orders within a single second they realized they needed a new system for wash trades surveillance.[63]

In fact, there was evidence that the Firm failed to identify at least one instance of attempted manipulative trading by a DTI trader. Prior to market opening, a trader in one of the DTI subaccounts placed an order in Goldman Sachs stock and then cancelled it and replaced it with a larger order, which he again cancelled and replaced with a still larger order. By repeatedly placing an order and then cancelling and replacing it, the trader evaded Dimension's size limit for DTI's orders. Each increment was within DTI's limit and was permitted, but the accumulated total order eventually exceeded DTI's size limit. After the problem was discovered, Dimension learned that the trader had intended to affect the opening price by repeatedly entering, cancelling,

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[61] Hearing Tr. (Lek) 1461-66. Lek testified that the filters prevented potential manipulation violations by blocking orders that were too large, or exceeded the customer's credit limit, or were after a particular cut-off time. Hearing Tr. (Lek) 1461-66. He called exception reports a "second best" option for identifying problems. Hearing Tr. (Lek) 1466.

[62] Hearing Tr. (Lek) 1575-77.

[63] Hearing Tr. (Lek) 1447-48, 1474. Lek spoke of thousands of orders per second. Other evidence indicated that the firm processed hundreds of trades per minute. Regardless of the exact figures, the Hearing Panel finds that the Firm's systems processed more orders in a minute than could be thoroughly and reliably reviewed manually in real-time, as the Firm was attempting to do in the early part of the Review Period.

and replacing orders. Dimension discussed the Goldman trading with Lek.[64] Dimension modified its software to prevent the problem from arising again, but there were other problem trades that occurred before Dimension became aware of the problem and fixed it.[65]

Because the Goldman trading did not exceed the Firm's own credit or size limits for DTI, the Firm did not itself flag that trading as any kind of problem.[66] The Firm learned of the problem afterward, either due to regulatory inquiries or through discussions with Dimension.

2. The Firm's Practices After Summer 2009

The Goldman pre-open orders sparked regulatory interest. NYSE Regulation contacted the Firm in June 2009 about the entry of large orders in three securities, including Goldman, and the cancellation of those orders just prior to market open. NYSE Regulation contacted the Firm several more times about similar conduct through November 2009.[67]

The Firm contended that the regulator's concerns were not warranted.[68] However, at the same time, the Firm pressed Dimension, the introducing broker, to make sure that there was not another attempt at manipulating the opening price[69] and began to develop new exception reports,

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[64] Hearing Tr. (Lek) 421-24. There was no evidence of when the discussion between Dimension's principal, Potter, and Lek took place. Lek testified that he discussed the Goldman trading with Potter, and Potter told him the trader had circumvented Dimension's controls. Lek said he did not remember whether Potter told him that the trader had admitted to placing the large orders in an effort to influence the opening cross. Hearing Tr. (Lek) 421-24. Farrell-Starbuck testified that she did not recall learning that a trader had placed large orders in an attempt to influence the opening cross. Hearing Tr. 289-90.

[65] Hearing Tr. (Potter) 1175-82, 1193-1202, 1227-32; Hearing Tr. (Lek) 417-25; CX-4 at 3; CX-17.

[66] Hearing Tr. (Lek) 1462.

[67] Hearing Tr. (Posharow) 664-66, 672-86.

[68] Hearing Tr. (Lek) 445-50.

[69] Hearing Tr. (Farrell-Starbuck) 210-18; CX-19; CX-20; CX-21; CX-43.

including exception reports for potential wash sales, pre-market cancellations of orders, and marking the close.[70]

Wash Trades. The first new exception report was a wash trade report that the Firm implemented in August 2009. At first, the Firm ran the report at the DTI customer level, but the report flagged hundreds of potential wash trades. The Firm concluded that many of those trades were false positives, and therefore the Firm modified the wash trade report to capture only potential wash trades by individual subaccounts. Thereafter, the number of reported potential wash trades shrank dramatically.[71]

The Firm ran the wash trade report daily, after the market close, and Farrell-Starbuck tried to review it every day. The Firm sent the report to Dimension, the introducing broker, automatically. Farrell-Starbuck testified that she looked for potential coordination across subaccounts. Although Farrell-Starbuck might send an initial email concerning an issue to Dimension, the introducing broker, she would often follow up by telephone. Her initial emails were retained in the Firm's systems, but Farrell-Starbuck kept no record of her telephone conversations or of her other follow up. She did not notate the trades discussed in her records and did not request that Dimension keep a record. She did not recall writing down or creating a record of any of her discussions with Dimension.[72]

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[70] Hearing Tr. (Farrell-Starbuck) 201-02.

[71] Hearing Tr. (Farrell-Starbuck) 160-71; Hearing Tr. (Lek) 1506-12. The Firm did not track trading by traders working for the same limited partner to see if they were trading on opposite sides of the same stock at the same time. It only tracked trading either at the DTI or subaccount levels. Hearing Tr. (Lek) 1520. Lek testified that the Firm did not have the ability to track by limited partner. Hearing Tr. (Lek) 1602-03.

[72] Hearing Tr. (Farrell-Starbuck) 160-61, 174-79, 181-85; RX-541 at 2-3. Farrell-Starbuck testified that she began to keep some kind of log and procedures to document her reviews and actions in escalating issues. Hearing Tr. (Farrell-Starbuck) 274, 317-19. The log placed in evidence began with an entry on February 17, 2010. RX-706.

If Dimension represented that none of the flagged trades were wash trades, Farrell-Starbuck accepted that statement. She knew that Dimension was developing its own report to identify potential associated subaccounts, and she recalled asking for more information about that in order to make the Firm's report more meaningful.[73]

According to Lek, Dimension did ultimately develop its own wash sale report and it was better than the Firm's. Lek said that Dimension had the necessary information to know whether a party on one side of a trade was related to a party on the other side of the trade.[74] The Firm did not know where the traders for the various subaccounts were located, whether they were working together, or whether they were sharing ideas. Lek did have conversations with Dimension's principal, Potter, about who might be working together in conjunction with analyzing potential wash sales.[75] However, the Firm did not contact DTI, or its traders directly to investigate any trading.[76]

<u>Pre-Market Cancelled Orders</u>. The Firm implemented a pre-market cancel exception report on October 20, 2009, in response to regulatory inquiries.[77] The regulatory inquiries arose after an investigation of a DTI trader's pattern of pre-market cancellations. Farrell-Starbuck testified that she discovered a pattern of pre-market cancels in a DTI trading account and asked Dimension about it. The Firm relied on Dimension to investigate the trading, which was its standard practice with all its introducing brokers. Dimension reported that the trading was inappropriate. Farrell-Starbuck sought to stop the inappropriate trading but she had to ask

[73] Hearing Tr. (Farrell-Starbuck) 174-85; RX-541 at 2-3.

[74] Hearing Tr. (Lek) 438-42.

[75] Hearing Tr. (Lek) 383-85.

[76] Hearing Tr. (Farrell-Starbuck) 173-74.

[77] Hearing Tr. (Farrell-Starbuck) 210; CX-16.

Dimension repeatedly from sometime in June through early October 2009 what was being done to stop it.[78]

Lek testified that he analyzed the Firm's pre-market cancel exception report to see whether the pre-market cancellations looked like normal business.[79] Lek looked at what the general volume was, how much the trader traded, if the trader eventually bought the stock, and other trades that might be relevant.[80] He also would look at Dimension as a whole to see how much of its total large pre-market orders were cancelled versus executed. He saw that approximately 55% of DTI's orders were cancelled and 45% were executed on opening, which was a smaller ratio than for all of Lek's customers combined.[81] Lek explained that market circumstances had to be considered in evaluating whether the cancellations were because of some adverse or favorable market move.[82]

Marking The Close. The Firm implemented an exception report in March 2010 for marking the close.[83] The report identifies orders placed late in the day that moved the market in the direction of the order and therefore could change the price at which the stock closed.[84] Lek testified that he reviews the report every day. He dismisses a trade if he finds that the trader has

[78] Hearing Tr. (Farrell-Starbuck) 187-219; CX-9; CX-16; CX-19; CX-21; CX-43. A FINRA examiner testified that market makers had complained and triggered an investigation relating to the entry and cancellation of large orders prior to the open. When NYSE staff reached out to Potter at Dimension regarding some of the trading through the Firm, Potter responded that one trader had admitted to trying to influence the opening cross for Goldman stock. He said that the trader was fired. Hearing Tr. (Posharow) 676-83; CX-17; CX-18.

[79] Hearing Tr. (Lek) 1486-87.

[80] Hearing Tr. (Lek) 1487-88.

[81] Hearing Tr. (Lek) 1488.

[82] Hearing Tr. (Lek) 1488-89.

[83] Hearing Tr. (stipulation) 1612.

[84] Hearing Tr. (Lek) 1496-97.

no position in the stock, because he does not think a person without a position has an incentive to mark the close.[85]

3. The Firm's AML Manual And WSPs

Respondents contend that both the AML manual and the WSPs must be considered in evaluating the Firm's AML program. Accordingly, the Hearing Panel examined both.

During the Review Period, the Firm's AML manual contained little guidance with regard to manipulative trading that might require the filing of a SAR. Rather, the AML manual focused on money movement issues.[86] Lek testified, "Our AML procedures concentrate on money laundering and things surrounding money."[87] Lek's testimony strongly suggests that he sees money movement as the real AML concern. He emphasized in his testimony that the Firm does not accept third-party transfers into customer accounts[88] and asserted that it would "muck up" the AML manual if it were to include information regarding potentially manipulative trading.[89] He asserted that the inclusion of manipulative trading in the AML manual would make the AML procedures "less clear, and our employees less likely to focus on very specific anti-money laundering issues."[90] Only two of the forty-five red flags for AML and SAR reporting listed in the AML manual relate to securities transactions in any way.[91]

[85] Hearing Tr. (Lek) 1497-98.

[86] Hearing Tr. (Lek) 1411, 1419-20; CX-5; CX-6.

[87] Hearing Tr. (Lek) 1541.

[88] Hearing Tr. (Lek) 1419-20, 1428-31.

[89] Hearing Tr. (Lek) 1420.

[90] Hearing Tr. (Lek) 1420.

[91] CX-5 at 16-20; CX-6 at 11-17, 42-46.

The Firm's AML manual was not tailored to the Firm's business. It did not address the high-speed electronic trading services offered by the Firm. The AML manual was purchased "off-the-shelf" and, according to Lek, was "enhanced" by the application of the small firm template provided by FINRA.[92] But the small firm template is only a generalized tool to assist in the development of an AML program—not a mechanism for tailoring the Firm's AML program to its business.[93]

The Firm's WSPs, unlike the AML manual, identified pre-arranged trading, wash trading, churning, parking securities, orders at the open or close, and other activities as prohibited transactions.[94] During most of the Review Period, however, the WSPs gave no guidance as to what should be done if such transactions were identified or who would take action. Toward the end of the Review Period, in July 2010, a paragraph was added to the WSPs indicating that "Compliance" reviews potential wash trades, investigates, and documents its actions.[95] Even with that addition, the WSPs did not establish any connection between the identification of prohibited trading and the process for investigating and determining whether to file a SAR.[96]

[92] Hearing Tr. (Lek) 1410-11.

[93] Lek testified that the AML manual was also "enhanced" at the recommendation of the Firm's AML auditor. Hearing Tr. (Lek) 1410-11. However, there was no evidence that the auditor ever suggested changes relating to the high-frequency trading services provided by the Firm or the surveillance and reporting of suspicious trading activity. RX-543; RX-544; RX-545; RX-546.

[94] Hearing Tr. (Lek) 1411-22; RX-505 at 201-04; RX-506 at 208-211.

[95] CX-506 at section 9.33.6, p. 209.

[96] CX-506 at section 9.33, pp. 208-11 (listing prohibited transactions).

The WSPs, like the AML manual, were not tailored to the Firm's business. The WSPs contained a substantial amount of boilerplate that had little relevance to the Firm's business,[97] while saying very little about the high-speed trading environment at the Firm. The Firm purchased the WSPs from a vendor, and Lek admits that the Firm did not edit the WSPs significantly.[98]

Lek's testimony demonstrated that he thinks any distinction between the Firm's AML manual and its WSPs is meaningless in the context of a small firm such as his. He testified, "It didn't matter if someone brought a suspicious activity to me because it involved suspicious money movements or suspicious trading, they both got brought to my attention, and I made no distinction whether I thought this was a potential anti-money laundering violation or a potential manipulative activity, they're both investigated."[99]

Lek's testimony also conveyed a sense that he had concluded that it does not much matter what is in the WSPs, because, ultimately, all significant issues must be brought to him to resolve. He said, "The written supervisory procedures are not a description of exactly what in a 20-man firm everybody should do other than call Sam. That's – that's the general thing, let Sam know."[100]

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[97] For example, the WSPs provided that a record of review for prohibited transactions should be made by initials on a branch manager's log, but the Firm has no branch manager's log. The WSPs also listed churning as a potential problem to be monitored, but the Firm's business does not give rise to much risk of churning. Hearing Tr. (Lek) 1543-45.

[98] Hearing Tr. (Lek) 1593.

[99] Hearing Tr. (Lek) 1421. *See also* Hearing Tr. (Lek) 1565-67.

[100] Hearing Tr. (Lek) 1547. *See also* Hearing Tr. (Lek) 1566 ("[T]hey all know to come and bring it [any prearranged trading] to my attention."); 1567 (He did not add red flags for potentially manipulative trading to the Firm's AML procedures "[b]ecause we already had procedures to surveil for potentially manipulative trading. And I am both the anti-money laundering compliance officer and the chief compliance officer, so if an employee brings something to my attention, they don't say, 'Sam, are you wearing your AML hat right now or your CCO hat right now?' Either way, it's brought to me and I follow up on it.").

4. Evaluations Of The Firm's AML Program

As it is required to do under FINRA Rule 3310(c), the Firm hired an independent consultant to examine its AML program each year. From 2007 through 2013, that person was Frank Calimano, who testified on behalf of Respondents.

Calimano started his own consulting practice in 2004 after nearly forty years in the financial services industry, mostly in compliance positions.[101] He stopped serving in a compliance officer capacity in August 2002,[102] not long after the Patriot Act became law and AML issues "really mushroomed."[103] He keeps up with AML issues by attending conferences and studying.[104] He is not a certified anti-money laundering specialist.[105] No attempt was made at the hearing to qualify him as an AML expert.

Currently, in addition to providing services as what is sometimes referred to as a "rent-a-FinOp," Calimano does fifteen to twenty AML audits each year.[106] Each year that he audited the Firm's AML program, Calimano concluded that the program had no material deficiencies and was operating within financial services industry and government standards.[107] However, each report qualified that opinion, stating that a more "comprehensive" regulatory examination might uncover other deficiencies.[108]

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[101] Hearing Tr. (Calimano) 1250-58.

[102] Hearing Tr. (Calimano) 1290.

[103] Hearing Tr. (Calimano) 1258. The Patriot Act is officially titled "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001."

[104] Hearing Tr. (Calimano) 1258-59.

[105] Hearing Tr. (Calimano) 1291.

[106] Hearing Tr. (Calimano) 1257, 1260.

[107] Hearing Tr. (Calimano) 1273, 1278-82; RX-543; RX-544; RX-545; RX-546.

[108] Hearing Tr. (Calimano) 1283-85.

Although Calimano testified to a number of procedures that he generally performed in conducting an AML audit,[109] and he said that it generally took five to six weeks to complete an AML audit,[110] it is plain that his audit of Lek's Firm was not "comprehensive." The Firm paid Calimano between $1,000 and $2,000 for his AML report each year.[111] The report largely consisted of repeated boilerplate and did not address unique aspects of the Firm's business, such as the rapid-fire electronic trading environment.[112] Later reports took no notice of whether recommendations made in earlier reports were adopted and might simply repeat a recommendation.[113] Although Lek was the Chief Compliance Officer, and Calimano kept records of his interviews with other persons at the Firm in two of his audits, there is no record that Calimano spoke with Lek. Calimano testified that he might have spoken to Lek.[114]

Calimano's conclusion that the Firm's AML program had no material deficiencies also was inconsistent with his testimony at the hearing about one of the critical requirements for a sound AML program. In his 2007-2008 report, he noted that although the AML compliance officer reviewed emails and instant messages, the Firm did not have any documentation or proof of that review process. His failure to label this a material deficiency is inconsistent with his

[109] Hearing Tr. (Calimano) 1260-63.

[110] Hearing Tr. (Calimano) 1262-63.

[111] Hearing Tr. (Calimano) 1287.

[112] RX-543; RX-544; RX-545; RX-546.

[113] For example, Calimano recommended in one report that the AML procedure manual should include a procedure for protecting empoyees who reported suspected compliance violations from retaliation. The recommendation was not adopted and the following year Calimano's report simply repeated the identical recommendation without comment. Hearing Tr. (Calimano) 1297-98. Similarly, recommendations as to national securities letters, general customer due diligence and due diligence for correspondent accounts of foreign financial institutions were repeated from one audit report to the next without comment. Hearing Tr. (Calimano) 1299-1304.

[114] Hearing Tr. (Calimano) 1269-70.

testimony that he thinks that "everything you review should be noted somehow, whether it's on the document itself or whether you keep a log, a daily log of what you did."[115]

Furthermore, in later audit reports, Calimano made no suggestions regarding documentation,[116] even though, as Lek and Farrell-Starbuck testified, neither of these compliance officers was documenting work done to review and investigate potentially manipulative trading.[117] Lek made plain at the hearing that he did not think it reasonable to require documentation of what the Firm did to investigate a potential pattern of manipulation. He asserted that if he kept a record of every time he ran a query to investigate he would "never get through the day."[118]

Enforcement's AML expert testified that by 2008 software for automating surveillance had become less expensive and firms were using such tools.[119] In evaluating the Firm's AML program, she said that the Firm was technologically advanced and that she would have expected to see an automated system for surveillance with red flags crafted to the Firm's products and services.[120] She termed the period in which the Firm had no specific transaction monitoring reports a "complete failure."[121] She testified that the Firm's written procedures were not

[115] Hearing Tr. (Calimano) 1271.

[116] Hearing Tr. (Calimano) 1274-79.

[117] Hearing Tr. (Lek) 1512-15. Later in the Review Period, Farrell-Starbuck did begin keeping log of her activities in reviewing the pre-market cancel exception report. Hearing Tr. (Farrell-Starbuck) 274-75; RX-706.

[118] Hearing Tr. (Lek) 1514-15.

[119] Hearing Tr. (Fox) 897-98. Enforcement's AML expert was qualified as an expert at the hearing. She runs her own company providing AML consulting services. She was originally trained as an accountant, but starting in 2002 she moved from finance-related activity into compliance and designed an AML program for a securities broker-dealer. Since 2008, she has written numerous articles on AML compliance for securities broker-dealers, including the AML responsibilities of clearing brokers. She also has spoken before industry groups and regulators on AML issues and is active in AML professional networks. Hearing Tr. (Fox) 882-86.

[120] Hearing Tr. (Fox) 891-92.

[121] Hearing Tr. (Fox) 914.

consistent with industry standards.[122] By 2008, the industry was including in its AML procedures specific red flags for securities-related activity, not just money movement and banking red flags.[123]

Enforcement's AML expert did not find the exception reports that Respondents developed sufficient to satisfy the AML requirements. This is because Respondents' exception reports by themselves were not identified as AML reports and there was no clear direction on how the reports were to be used to effect the AML program. The exception reports did not create an understanding of how to use them for purposes of AML compliance.[124]

Enforcement's AML expert also emphasized the need to create a record of any investigative process undertaken for AML purposes, noting that a pattern can be missed if there is no documentation.[125] She further explained that the SAR reporting process has certain deadlines. To comply with those deadlines, it is necessary both to provide written guidance as to what to do and when, and then, when an issue arises, to document what you did and when you did it.[126] Documentation, she said, could be simple; even dropping something into an electronic file could suffice.[127] She criticized the Firm's AML program for a lack of documentation creating an investigative process and a lack of work product memorializing the performance of an investigation. She said that an AML program with no evidence of execution is not a solid

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[122] Hearing Tr. (Fox) 911.

[123] Hearing Tr. (Fox) 911-12.

[124] Hearing Tr. (Fox) 980-82, 989-91.

[125] Hearing Tr. (Fox) 893-94.

[126] Hearing Tr. (Fox) 893-94.

[127] Hearing Tr. (Fox) 894.

program.[128] She concluded that the Firm's AML procedures during the Review Period were incomplete and not properly implemented.[129]

Even Calimano, who testified on Respondents' behalf, declined to say that manual monitoring of some 500 trades per minute for manipulation was effective. He stopped short of calling it ineffective, however, responding only that it could be improved. He agreed with Enforcement's expert that a firm needs to tailor its AML program to its business model,[130] and he voiced the view that whatever was done as an AML review should be documented.[131]

F. The Firm's DTI Portfolio Margining

The Firm extended margin credit to DTI on the entire DTI portfolio. It did not extend margin credit to the subaccounts or individual traders or limited partners.[132] There was one set of documents establishing portfolio margining and that was for DTI only.[133] Accordingly, the Firm did not conduct separate surveillance of the subaccounts for risk management or margin credit purposes.[134]

The Firm extended margin credit to all the DTI accounts in the aggregate because it understood DTI to be the beneficial owner of all the DTI accounts.[135] The only entity that was

[128] Hearing Tr. (Fox) 944-45.

[129] Hearing Tr. (Fox) 908.

[130] Hearing Tr. (Calimano) 1295-97.

[131] Hearing Tr. (Calimano) 1270-72.

[132] Hearing Tr. (Lek) 443.

[133] Hearing Tr. (Lek) 443-44, 1354-56.

[134] Hearing Tr. (Lek) 1371-72.

[135] Hearing Tr. (Lek) 443-44, 452, 454-55. Lek acknowledged that the limited partners of DTI might share an economic interest in the profits and losses of the partnership. He also acknowledged that most of DTI's traders were day traders and that there are special margin rules for day traders. But, in his mind, DTI as a whole was the day trader. Hearing Tr. (Lek) 444.

responsible for payment if there was a margin call was DTI.[136] Respondents understood that DTI funded all the subaccounts[137] and that the traders were only employees or independent contractors.[138] Lek testified that he understood that the assets in the DTI accounts belonged exclusively to DTI.[139] The subaccounts were established to allow DTI to monitor the performance of the traders in the various subaccounts.[140] As discussed above, the Firm's staff compared the structure of DTI to that of a hedge fund, noting that the Firm would deal with the fund as its customer, not the traders.[141] Lek also compared the structure of DTI to a hedge fund, saying that he would interact with the hedge fund customer, not the traders or limited partners of the hedge fund.[142]

The Firm's understanding of DTI was based on what Respondents learned about DTI in opening the account and in Lek's continuing discussions with Dimension, the introducing broker

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[136] Hearing Tr. (Lek) 1337; CX-7.

[137] Hearing Tr. (Lek) 395-96.

[138] Hearing Tr. (Lek) 395-96. Lek's testimony in this regard was confusing. He also testified that some traders might pool their contribution to DTI and could have a limited partnership interest in DTI. Hearing Tr. (Lek) 397-400. He wrote a letter to FINRA staff indicating that he was investigating suspected wash orders to determine whether some of the DTI traders were working together and had a shared "beneficial interest." At the hearing, Lek termed that a "poor word choice." Hearing Tr. (Lek) 405-10; CX-12. It was not clear what Lek meant by "poor word choice," but the record is that Lek believed that DTI owned and controlled the DTI subaccounts, even though particular traders might be working together or sharing an interest in a common strategy or subaccount.

[139] Hearing Tr. (Lek) 1334-36.

[140] Hearing Tr. (Farrell-Starbuck) 144-45, 221-23.

[141] Respondents' expert on margin analysis opined that the Firm's provision of margin to DTI was consistent with industry custom and practice. Hearing Tr. (Pfalzer) 1631-32. He explained that it is typical to permit a customer to access information on its subaccounts but to aggregate the parent and subaccounts for purposes of margining. Running reports at a subaccount level does not change anyone's understanding of who is the beneficial owner of an account. Hearing Tr. (Pfalzer) 1639-43. What is important, he said, is to know who the client is and who is responsible if you ask for your money in a margin call. Hearing Tr. (Pfalzer) 1643-44.

[142] Hearing Tr. (Lek) 467-71.

that brought DTI to the Firm.[143] Lek emphasized how important it is for him to know who the beneficial owner of an account is. He explained that it is his money that is "on the line" with margin, and that he would want to know to whom he was lending money. In this case, Lek said, DTI was the only beneficial owner.[144]

G. Regulatory Concerns With The Firm's DTI Portfolio Margining And Lek's Response

The Complaint alleges that three red flags put Respondents on inquiry notice that DTI was not the sole beneficial owner of all the DTI subaccounts and required Respondents to investigate: (i) a February 1, 2010 letter from FINRA staff mandating that Respondents stop providing portfolio margining to DTI as a single entity;[145] (ii) an April 2010 Regulatory Notice (Regulatory Notice 10-18) indicating that the existence of multiple subaccounts is a red flag (among others) requiring investigation of whether the subaccounts are actually separate beneficial owners;[146] and (iii) a second letter from the staff dated April 27, 2010, apparently modifying the staff's original mandate, since the second letter no longer required Respondents to treat each subaccount as a separate customer.[147] The second letter required Respondents to investigate the beneficial ownership of the DTI subaccounts and satisfy themselves as to the beneficial ownership of each.

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[143] Hearing Tr. (Farrell-Starbuck) 224-27 (Farrell-Starbuck conducted Know-Your-Customer diligence on DTI); Hearing Tr. (Lek) 384-87 (Lek had various conversations with Potter, the Dimension principal, in analyzing whether there might be collusion with wash sales and from time to time Lek obtained information regarding individual traders for purposes of checking for criminal background and OFAC information).

[144] Hearing Tr. (Lek) 492-94, 1354-55.

[145] Hearing Tr. (Lek) 445-448; CX-30. This letter suggested that Respondents were aggregating DTI subaccounts under separate tax identification numbers. At the hearing, Lek explained that DTI was a separate legal entity even if its limited partners had their own tax identification numbers. He said that the Firm was not aggregating the subaccounts by tax identification numbers. Hearing Tr. (Lek) 500-01.

[146] Hearing Tr. (Lek) 449; CX-34.

[147] Hearing Tr. (Lek) 449-51; CX-31.

Pursuant to FINRA Rule 8210, the second letter also requested a report on what Respondents did in conducting the investigation and their findings.[148]

Respondents' counsel replied to each of the staff's letters on Respondents' behalf.[149] Counsel's response to the first letter explained how the staff's view was incorrect.[150] Counsel's response to the second letter was, in Lek's view, the report requested by the second letter.[151] Lek also testified that he conducted some additional investigation in response to the regulatory concerns and satisfied himself that DTI was the sole beneficial owner of the accounts.[152] He was emphatic that he conducted the inquiry and that DTI was the beneficial owner of all the accounts.[153]

However, after the second letter, Lek began a process of eliminating the subaccounts from the Firm's systems. Lek said that he wanted to eliminate any misimpression created by the subaccounts that they were individual customers.[154] The elimination of the subaccounts was ongoing toward the end of the Review Period, in September 2010, when Farrell-Starbuck left the Firm.[155]

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[148] Hearing Tr. (Lek) 449-51; CX-31. The Complaint does not allege a failure to comply with Rule 8210.

[149] Hearing Tr. (Lek) 445-59. There was testimony regarding the letters from Lek's counsel but the letters themselves are not in evidence. Hearing Tr. (Lek) 449-59.

[150] Hearing Tr. (Lek) 446.

[151] Hearing Tr. (Lek) 450.

[152] Hearing Tr. (Lek) 1350-51, 1354.

[153] Hearing Tr. (Lek) 454-55, 1354.

[154] Hearing Tr. (Lek) 1379.

[155] Hearing Tr. (Farrell-Starbuck) 143; Hearing Tr. (Lek) 451.

H. The Hearing Panel Rejects Certain Arguments By Both Parties

The Hearing Panel rejects both Enforcement's interpretation of certain facts as red flags and Respondents' assertion that other facts are insignificant.

1. Enforcement's Arguments

Enforcement asserted that certain trading by DTI traders was so strongly suggestive of wash trades that Lek's investigation of the trading by making inquiries to Dimension was deficient. A FINRA examiner urged that Lek and the Firm should have contacted traders directly regarding the orders he identified as red flags. The FINRA examiner justified this idea by saying, "Why not?"[156]

The examiner's suggestion, however, runs contrary to testimony regarding custom and practice in the industry. Enforcement's AML expert testified that even if the introducing broker is not cooperative, it still would not be industry practice for a clearing broker to contact the suspect customer directly.[157] She explained that you must be cautious about interacting with the customer who may be a potential violator, because a SAR must be kept confidential and it is a felony to "tip" someone.[158]

The FINRA examiner also testified that Respondents' AML program missed red flags of potential wash sales (not actual manipulative trading but potential manipulative trading that required investigation). But Respondents' expert on securities trading and manipulation cast doubt on the examiner's analysis. The Hearing Panel finds that the examiner's testimony does not support the claim that the Firm's AML program was inadequate.

[156] Hearing Tr. (Park) 832-34.

[157] Hearing Tr. (Fox) 1074-75.

[158] Hearing Tr. (Fox) 1074-78.

The FINRA examiner analyzed some of the trading by two groups of DTI subaccounts and created an exhibit to reflect his analysis. The examiner chose a one-minute time frame for his analysis. He identified numerous instances where traders within a group entered buy and sell orders at the same price within one minute of each other. He labelled these orders as red flags indicating a potential pre-arranged trade.[159]

The examiner's analysis, however, was incomplete. The examiner did not look at executions and did not know whether any of the trades were already executed by the time others were entered. He admitted that if orders were executed at different times or different prices then they would not be wash trades.[160] In the high-speed environment where orders are entered and filled in fractions of a minute, some of the orders may have already been executed before others were entered.

The examiner's choice of a one-minute time frame also appeared inappropriate in the context of the high-frequency trading in which the traders engaged. The examiner justified choosing the one-minute interval by saying that in his own view one minute is a relatively short period of time.[161] In contrast, Respondents' expert on securities trading and manipulation testified that in the high-volume, high-speed trading environment at the Firm, a one minute window was too wide to analyze for cross-trades.[162]

Respondents' expert further testified that there was nothing inherently manipulative about trades by the same party in the same security on opposite sides of the market, even if there is no

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[159] Hearing Tr. (Park) 703-14; CX-7; CX-45; CX-46.

[160] Hearing Tr. (Park) 744-51.

[161] Hearing Tr. (Park) 789-91, 803-04.

[162] Hearing Tr. (Mayhew) 1704-05.

change in beneficial ownership. He explained that two traders working for the same company might accidentally cross in the market without communicating with one another because they were working on different trading strategies in different places. As a result, the trading would be no different than if they were working for different companies. The two trades would not convey false or misleading information.[163] Accordingly, such "self-trades" by themselves could not be presumed to be manipulative.

Respondents' expert also testified that he calculated the maximum volume of trades that might have crossed for each stock and then compared that to daily trading volume for the day to come up with the percentage of trading that day represented by the potentially manipulated trades. He discovered that the volume of potentially manipulated trading was so low that it did not constitute a red flag. The average was about half of 1% of daily trading volume. Eighty-seven percent of the time it was less than 1%, and 99% of time it was less than 5%.[164]

The testimony of Respondents' expert puts a different perspective on the information available to Lek and whether it constituted a red flag that required more than an inquiry to the introducing broker. If the introducing broker's response was not satisfactory or raised concerns, then further investigation would be required. But the evidence did not show that the trading alone was enough to require Respondents to do more.

2. Respondents' Arguments

Respondents expressed certain views that the Hearing Panel rejects. Lek asserted, for example, that orders that were entered and cancelled prior to the opening of the market cannot

[163] Hearing Tr. (Mayhew) 1686-89.

[164] Hearing Tr. (Pfalzer) 1697-1700.

affect the market.[165] A fact witness expressed the view that "spoofing" (the entry and cancellation of orders never intended to be executed) is not a problem.[166] To accept such assertions would mean that the entire process of pre-market bids and offers was meaningless and that market participants engage in it for no reason. This defies common sense. Rather, the Hearing Panel concludes that the pre-market open activity is a process of on-going price discovery and information about the market's appetite for particular securities that can have an influence on pricing when the market opens.

Lek also asserted that his Firm's identification of the subaccounts was meaningless to DTI and that his Firm's eventual elimination of the subaccounts was irrelevant to DTI.[167] That assertion is undercut by the fact that Respondents tracked the trading by individual subaccounts in order to enable DTI to track the performance of different traders and strategies in the different subaccounts. The assertion is further undermined by testimony that it is typical in the industry to set up subaccounts to track performance.[168]

Such assertions by Lek, which on their face are not credible, damaged his credibility generally. However, the Hearing Panel does not find his credibility so damaged as to reject it in its entirety. The Hearing Panel rejects Lek's opinions, but believes his factual testimony regarding what he and his staff did in setting up the DTI account, monitoring the trading, and establishing and modifying exception reports. The Hearing Panel also believes his testimony that

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165 Hearing Tr. (Lek) 482-83, 1495.

166 Hearing Tr. (Potter) 1206-07.

167 Hearing Tr. (Lek) 366-71.

168 Hearing Tr. (Potter) 1110-11; Hearing Tr. (Pfalzer) 1623-32, 1639-43.

he investigated the beneficial ownership of the subaccounts and satisfied himself that DTI was the only owner.

III. CONCLUSIONS OF LAW

A. Count I – Firm Failed To Establish And Implement Reasonable AML Policies And Procedures

1. AML And FINRA Rule Requirements

FINRA Rule 3310 requires each member to develop and implement a written AML program "reasonably designed" to achieve and monitor the member's compliance with the Bank Secrecy Act (31 U.S.C. 5311, *et seq*.) and implementing regulations promulgated by the Department of the Treasury. Subsection (a) of FINRA Rule 3310 requires that, at a minimum, a FINRA member establish and implement policies and procedures that can be "reasonably expected" to detect and cause the reporting of transactions in accord with the requirements of a particular subsection of the Bank Secrecy Act, 31 U.S.C. 5318(g), and its implementing regulations. Whether a particular supervisory program or set of procedures is in fact "reasonably designed to achieve compliance" depends on the particular facts and circumstances.[169]

The relevant implementing regulation, promulgated in 2002, governs the reporting of suspicious transactions. It provides: "Every broker or dealer in securities within the United States . . . shall file with FinCEN [the Financial Crimes Enforcement Network] . . . a report of any suspicious transaction relevant to a possible violation of law or regulation."[170]

[169] *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007) (whether supervisory procedures are reasonably designed depends on particular facts and circumstances); *Dep't of Enforcement v. Stonegate Partners, LLC*, Complaint No. E112005002003, 2008 FINRA Discip. LEXIS 26, *21 at n.10 (OHO May 15, 2008) (same).

[170] 31 C.F.R. § 103.19(a)(1).

The implementing regulation is not limited to the improper movement of money and assets. It covers suspicious transactions that may relate more broadly to "violation of any law or regulation."[171]

Concurrent with its adoption of NASD Rule 3011 in April 2002 (the forerunner of FINRA 3310), FINRA issued a Notice To Members, NTM 02-21, reminding broker-dealer firms of their AML responsibilities. NTM 02-21 explains that a broker-dealer "must develop internal policies, procedures, and controls to ensure compliance with the AML laws." NTM 02-21 further explains that those AML compliance procedures and controls must be documented, stating: "As with any supervisory procedure, the firm must establish and implement controls and written procedures that explain the procedures that must be followed, the person responsible for carrying out such procedures, how frequently such procedures must be performed, and how compliance with the procedures should be documented and tested." NTM 02-21 expresses a preference for the use of automated systems to assist in monitoring trading and cautions that if a manual system is used to monitor customer accounts it must provide for the review of a sufficient amount of account activity to allow the member firm to identify patterns of activity that make no economic sense. NTM 02-21 specifically instructs on-line firms to consider conducting computerized surveillance.

NTM 02-21 makes clear that a firm's AML program must be tailored to its particular circumstances. It says, "To be effective, those [AML] procedures must reflect the firm's business model and customer base." It also specifically states that an AML compliance program is not a "one-size-fits-all" requirement.

A FINRA Notice to Members issued in August 2002, NTM 02-47, sets forth the final AML rules promulgated by the Department of the Treasury for the securities industry. NTM 02-

[171] *Id*.

47 advises broker-dealers of their duty to file a suspicious activity report ("SAR-SF") for any suspicious transactions.

The form SAR-SF identifies twenty categories of suspicious activity that "must be reported," including market manipulation, pre-arranged or other non-competitive trading, securities fraud, and wash or other fictitious trading. There is also a category for "other" to encompass the broad range of potentially illegal and improper conduct in the securities and financial services industry.[172]

The SAR-SF also contains specific instructions to securities broker-dealers. A broker-dealer is required to file a report of a transaction (either effected or attempted) if it involves at least $5,000 and the broker-dealer "knows, suspects, or has reason to suspect" that the transaction or a pattern of transactions falls within one of the categories of itemized improper transactions. Among the itemized improper transactions is any transaction that "[h]as no business or apparent lawful purpose," if, after examining the available facts, the broker-dealer knows of no reasonable explanation. The instructions set a timetable for reporting. A SAR should be filed within 30 calendar days from initial detection, or, if more time is required to identify a suspect, no later than 60 calendar days after detecting the facts constituting the basis for the report.[173]

2. The Firm's AML Program Was Inadequate

During the Review Period, the Firm's AML program was not reasonably designed to achieve compliance with its AML responsibilities and the applicable SAR reporting requirements. Nor did the Firm adequately implement its AML program.

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[172] CX-28.

[173] CX-29 at 1.

Until summer 2009, the Firm relied on ad hoc, manual review of its customers' trading as roughly 500 trades per minute came across the staff's computer screens. Identification of patterns of potential market manipulation in this fast-moving environment was difficult, if not impossible. Enforcement proved at least one instance where the Firm failed to identify conduct intended to manipulate the market—the pre-open orders and cancellations in Goldman stock. Enforcement's expert testified that the cost of software to enable better surveillance had decreased to the point that it was reasonable to expect that a technologically advanced firm like Lek's would have some automated systems for monitoring trading. Even Lek implicitly conceded that the manual system was no longer effective when the Firm was processing hundreds of trades per minute. The inadequacy of the system was exacerbated by the lack of any guidance in the Firm's AML manual and WSPs as to the connection between potential manipulative trading and the Firm's duty to file a SAR in certain circumstances.

Although in the summer of 2009 the Firm started to add some automated exception reports to its system of surveillance for potentially manipulative trading, its AML program was still inadequate. The exception reports generated lists of trades. Beyond creating a list, the Firm did not institute any particular procedures for investigating the items identified in the exception reports or for determining whether to file a SAR. Enforcement's AML expert testified that merely generating a list of potentially suspect trades does not satisfy the AML requirements. For most of the Review Period, the Firm also did not document any AML review or investigation that may have been performed. Both Enforcement's AML expert and Respondents' AML auditor testified that documentation is required for a sound AML program.

Accordingly, during the Review Period the Firm did not establish and implement an adequate AML program.

B. Count II – Portfolio Margining Claim Dismissed

1. Rules Allegedly Violated

The Second Cause of Action charges that Lek and his Firm violated NASD Rule 3010 (now superseded by FINRA Rule 3010). NASD Rule 3010(a) requires a member firm to establish and maintain a system to supervise the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws, regulations, and NASD (now FINRA) rules. NASD Rule 3010(b) requires a member firm to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of its associated persons. NASD Rule 3010(b) requires that written supervisory procedures set forth the supervisory system established by the member pursuant to NASD Rule 3010(a).

The Second Cause of Action additionally charges that the alleged misconduct violated NASD Rule 2110 and its successor, FINRA Rule 2010. These are identical versions of an ethical rule requiring a member to "observe high standards of commercial honor and just and equitable principles of trade." It is well established that whenever another violation of law or rule is found, the ethical rule is also violated.[174]

2. Insufficiency Of The Evidence

The Complaint alleges that the Firm failed to investigate the "true nature" of the ownership of the subaccounts, despite being notified of red flags suggesting that DTI and its subaccounts had different beneficial owners. The Complaint does not charge that Respondents actually violated

[174] Violations of law and FINRA Rules have long been held inconsistent with the standards of ethical conduct required by FINRA Rule 2010 (and its identical predecessor, NASD Rule 2110). *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 182 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966). FINRA Rule 2010 is a broad ethical proscription that requires members of the securities industry to conduct themselves with integrity, fairness, and honesty. *See, e.g.*, *Heath v. SEC*, 586 F.3d 122, 131-39 (2d Cir. 2009).

the portfolio margining rule, and Enforcement did not prove that any of the DTI subaccounts were beneficially owned by anyone other than DTI. Thus, the "true nature" of the ownership of the subaccounts cannot be determined.[175]

The Complaint does not point to a flaw in Respondents' supervisory system and procedures for initially establishing portfolio margining for DTI. Rather, it alleges that Respondents failed to respond appropriately to the two letters from the staff regarding the DTI subaccounts and Regulatory Notice 10-18 setting forth factors that should cause a broker-dealer to investigate the beneficial ownership of subaccounts.

The Hearing Panel concludes that the evidence is insufficient to determine that Respondents failed to employ reasonable supervisory systems and procedures in response to the two letters and Regulatory Notice 10-18. Lek testified that he did further investigate the beneficial ownership of the DTI subaccounts in response, and that he satisfied himself, as the second letter required, that DTI was the beneficial owner of the accounts. He testified that this action was documented. He also responded to each staff letter through counsel.

The record contains no evidence, however, as to the nature of Lek's investigation or the basis for Lek's conclusion. Enforcement argues that Respondents' failure to offer into evidence any documentation of the investigation shows that if Lek conducted further investigation what he did was insufficient. Enforcement also argues that Lek's decision to eliminate the subaccounts from the Firm's systems demonstrates that he intended *not* to gather additional information regarding beneficial ownership of those accounts.[176]

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[175] The Hearing Panel recognizes that a determination that a respondent has violated NASD's supervisory rule is not dependent on a finding of an underlying violation. *E.g.*, *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *34 n.27 (Dec. 19, 2008). However, the degree of certainty as to the underlying violation is relevant to assessing the reasonableness of Lek's conclusion that DTI was the beneficial owner of the subaccounts.

[176] Hearing Tr. (closing argument) 1806-09.

While there are reasons to be skeptical of the thoroughness of Lek's additional investigation, there is not enough evidence in the record to reach a reasoned conclusion in that regard. Because Enforcement has the burden of proving by a preponderance of the evidence the charge in the Second Cause of Action, the claim must be dismissed.

IV. SANCTIONS

In considering the appropriate sanction for a violation, adjudicators in FINRA disciplinary proceedings look to FINRA's Sanction Guidelines. The Sanction Guidelines contain recommendations for sanctions for many specific violations, depending on the circumstances. They also contain General Principles and overarching Principal Considerations, which are applicable in all cases. The Sanction Guidelines are intended to be applied with attention to the regulatory mission of FINRA—to protect investors and strengthen market integrity.[177]

There are no specific Sanction Guidelines applicable to the violation here, the failure to establish and implement an adequate AML program. The National Adjudicatory Council ("NAC") has treated deficient written supervisory procedures as an analogous violation and applied the Sanction Guidelines for that type of violation to a case of deficient AML procedures.[178] Other Hearing Panels have done likewise.[179] The Hearing Panel in this case also looks to the Sanction Guidelines for deficient written supervisory procedures as an analogous violation.

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[177] FINRA Sanction Guidelines (2011) ("Sanction Guidelines"), available at http://www.finra.org/sanctionguidelines. *See* Sanction Guidelines, Overview, 1.

[178] *Dep't of Enforcement v. Domestic Sec., Inc.*, Complaint No. 2005001819101, 2008 FINRA Discip. LEXIS 44 (NAC Oct. 2, 2008).

[179] *Dep't of Enforcement v. AIS Fin., Inc.*, Complaint No. 2008012169101, 2011 FINRA Discip. LEXIS 24, at *39 (OHO Mar. 3, 2011); *Dep't of Enforcement v. Sterne, Agee & Leach, Inc.*, Complaint No. E052005007501, 2010 FINRA Discip. LEXIS 18, at 73 (OHO Mar. 5, 2010).

For the analogous violation, the Sanction Guidelines recommend a monetary sanction in a range of $1,000 to $25,000. The Sanction Guidelines specify that in egregious cases adjudicators should consider suspending the firm as to any or all relevant activities or functions for up to thirty business days or until the deficiencies are corrected to conform to the requirements. In connection with a failure to have appropriate procedures in place, the Sanction Guidelines suggest considering whether the deficiency allowed violative conduct to occur or to escape detection and whether the deficiency made it difficult to determine who was responsible for specific areas of compliance.[180]

Looking first to the recommendations specific to this kind of violation, the Hearing Panel finds that the violation was serious. Although Lek touted his Firm's systems as very advanced, Enforcement's AML expert testified that the industry was employing software tools to assist in the detection of AML violations during the period that the Firm was still relying on ad hoc, manual surveillance. Even after developing automated exception reports to identify potential problems, the Firm did not develop procedures for using them and did not document its use of the exception reports. Lek's testimony conveyed the sense that, although the Firm did improve its surveillance for potentially manipulative trading during the Review Period, the Firm did not fully embrace the need to develop a coherent AML program for investigating and reporting suspicious trading. The Firm continued to use an AML manual that did not discuss how the Firm should detect and investigate suspicious trading, and that provided no guidance as to the process for determining in a timely fashion whether to report suspect trading with a SAR. The WSPs that Lek argued were sufficient for AML purposes did not link AML concerns or SAR reporting to the prohibited activities discussed elsewhere in the WSPs. Given that the WSPs were over 200 pages and

[180] Sanction Guidelines 104.

covered many different topics, it is unreasonable to expect a reader to make that connection without more guidance. Finally, during the Review Period, the need to document any AML reviews was largely ignored by Lek and his staff.

The Hearing Panel further finds that there was evidence that the deficiencies in the Firm's AML program *may* have allowed violative conduct to occur or escape detection.[181] In at least one instance, there was proof that the Firm's system did not identify orders and cancellations intended to manipulate the pre-open market for Goldman stock.

Even though, ultimately, all important issues at the Firm were "escalated" to Lek, the lack of documentation still made it difficult to determine who was responsible for specific actions relating to SAR reporting. There was no documentation of the duties delegated to Farrell-Starbuck.

Lek's testimony highlighted two problems with the Firm's approach to its AML responsibilities. Both problems suggest that the sanctions here should be substantial in order to deter misconduct by the Firm in the future. The problems reveal a fundamental lack of understanding of, or resistance to, the need to articulate procedures and to document AML reviews and decision-making.

First, Lek's testimony showed that the Firm did not dedicate sufficient thought or resources to its AML program. On the one hand, Lek testified that the Firm is small and everyone knows to come to him about anything suspicious. On the other hand, he asserted that he did not have time to document everything that he considered. It is not satisfactory, however, to declare that responsibility rests with a person who does not have time to document any AML review done.

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[181] Enforcement did not attempt to prove that any violative conduct actually occurred because of the deficiencies in Lek's AML policies and procedures, and Lek put on evidence to explain that some of the conduct that Enforcement portrayed as suspicious was less likely to be a potential violation than it first appeared.

If the person has insufficient time, then other resources must be mobilized. To establish and implement an adequate AML program for detecting, investigating, and reporting suspicious transactions, a firm must document the procedures and the persons responsible for carrying them out. Then a firm must document the steps taken in performing those tasks. Both Enforcement's AML expert and the Firm's AML auditor agreed that a reasonable AML program requires documentation.

Second, although the Firm began to improve its AML detection procedures by creating new exception reports, Lek's testimony shows that the Firm still did not understand its fundamental AML responsibilities. It still did not create any clear connection between the exception reports and the Firm's performance of its AML responsibilities.

In determining what sanctions would be remedial, the Hearing Panel considered the Firm's efforts to improve its AML program. There was limited evidence that the Firm has continued to evolve and improve its AML compliance program. Lek testified, for example, that the Firm is now memorializing some of its activities in reviewing for suspicious trading.[182] However, no determination can be made here about the efficacy of current procedures.

The Hearing Panel concludes that the Firm (the only Respondent charged with the AML violation) should be censured and fined $100,000. Although the fine exceeds the maximum set forth in the Sanction Guidelines for the analogous violation, the Hearing Panel concludes that it is necessary to impose the larger fine in order to achieve the goal of deterring such misconduct by the Firm and others in the future. The Firm's misconduct occurred over an extended period of time, was only modified at the prompting of FINRA staff, and even when modified did not fully address the problems with the Firm's AML program. Through Lek, the Firm demonstrated a

[182] Hearing Tr. (Lek) 1575-77, 1580-82.

disregard for its AML responsibilities. The misconduct stemmed from inattention and the failure to devote sufficient resources to the design and implementation of the Firm's AML program. The fine must be sufficient to impress upon the Firm the importance of its AML responsibilities and to cause it to develop, implement and maintain procedures suitably tailored to its business.[183]

V. ORDER

For failing to establish and implement anti-money laundering policies and procedures that were reasonably designed to achieve compliance with the Bank Secrecy Act and its implementing regulations, in violation of NASD Conduct Rules 3011(a) and 2110 and FINRA Rules 3310(a) and 2010, as alleged in the First Cause of Action, Lek Securities Corporation is censured, fined \$100,000, and ordered to pay costs. The costs are in the amount of \$14776.34, which includes a \$750 administrative fee and the cost of the transcript.[184] The fine and assessed costs shall be due on a date set by FINRA, but not sooner than thirty days after this decision becomes FINRA's final disciplinary action in this proceeding.

Lucinda O. McConathy
Hearing Officer
For the Hearing Panel

[183] The Hearing Panel rejects Enforcement's request for a fine of \$300,000. The proposed fine is an extraordinary departure upward from the maximum specified in the Sanction Guidelines for the analogous violation. Enforcement failed to justify why such a sharp departure from the Sanction Guidelines would be warranted.

[184] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.