

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

WEDBUSH SECURITIES INC.,  
(CRD No. 877),

Respondent.

Disciplinary Proceeding  
No. 2012034934301

Hearing Officer—LOM

**EXTENDED HEARING PANEL  
DECISION**

August 27, 2015

**Respondent submitted incomplete and inaccurate blue sheets to the SEC in willful violation of Securities Exchange Act Section 17(a) and SEC Rules 17a-4(j) and 17a-25, along with FINRA Rule 2010 (First Cause of Action).**

**Respondent also submitted incomplete and inaccurate blue sheets to FINRA in violation of FINRA Rules 8211, 8213, and 2010 (Second Cause of Action).**

**Respondent failed to have in place an audit system providing for accountability regarding inputting of records in willful violation of Securities Exchange Act Section 17(a), SEC Rule 17a-4(f)(3)(v), and FINRA Rule 2010 (Third Cause of Action).**

**Respondent also failed to establish and maintain a supervisory system and failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and rules in violation of NASD Rule 3010 and FINRA Rule 2010 (Fourth Cause of Action).**

**For the misconduct charged in the First and Second Causes of Action, in the aggregate, Respondent is fined \$850,000. For the misconduct charged in the Third and Fourth Causes of Action, in the aggregate, Respondent is fined \$150,000. Because the Firm is found to have committed violations of the**

**federal securities laws and regulations willfully, it is subject to a statutory disqualification. The Firm is also ordered to pay costs.**

### **Appearances**

Michael M. Smith, Esq. and Philip J. Berkowitz, Esq., representing Complainant.

Eric Segall, Esq. and John L. Erikson, Jr., Esq., Wedbush Securities Inc., representing Respondent.

## **I. INTRODUCTION**

The Financial Industry Regulatory Authority (“FINRA”)<sup>1</sup> and the United States Securities and Exchange Commission (“SEC”) regularly request trade data from securities broker-dealers to assist them in fulfilling their enforcement and regulatory mandates. Such information is critical to the regulators in investigating potential insider trading, market manipulation, and other market abuses. Broker-dealers are required to respond to such requests completely and accurately. The requests and responses are commonly referred to as “blue sheets,” but they are made by electronic means.

FINRA’s Department of Enforcement (“Enforcement”) filed a Complaint against Respondent, Wedbush Securities Inc. (“Wedbush” or the “Firm”), charging that it had submitted hundreds of blue sheets to the SEC and FINRA that were incomplete and inaccurate because they were missing millions of trades, in violation of federal securities laws and regulations and FINRA rules. In addition, Enforcement charges that the Firm failed to have in place an adequate audit system providing accountability for the information entered into its blue sheet responses, in violation of federal securities law and regulation, and failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with the applicable securities laws and regulations, in violation of FINRA rules. Enforcement charges that the Firm’s violations of the federal securities laws and regulations were willful.

It is undisputed that the Firm submitted 816 blue sheet responses between April 1, 2012, and December 31, 2013, (the “relevant period”) that were not complete and accurate when they were originally submitted, and those responses constituted approximately 16% of the total blue sheet responses submitted by the Firm during that period. When the Firm corrected the deficient blue sheet responses (some more than a year after the original incomplete and inaccurate

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<sup>1</sup> FINRA is responsible for regulatory oversight of securities firms and associated persons who do business with the public. It was formed in July 2007 by the consolidation of NASD and the regulatory arm of the New York Stock Exchange. FINRA is developing a new “Consolidated Rulebook” of FINRA Rules that includes NASD Rules. The first phase of the new Consolidated Rulebook became effective on December 15, 2008. See FINRA Regulatory Notice 08-57 (Oct. 2008), <http://www.finra.org/industry/notices/08-57>. Because this proceeding was brought after the new Consolidated Rulebook became effective, FINRA’s Procedural Rules apply. The applicable Conduct Rules are those that existed when the conduct at issue occurred. FINRA’s Rules (including NASD Rules) are available at [www.finra.org/industry/finra-rules](http://www.finra.org/industry/finra-rules). References here to FINRA include references to NASD.

submissions), it became apparent that Wedbush had failed to report more than 5.6 million transactions in its original blue sheet submissions.

The Firm was ignorant of the defects in its blue sheet submissions because it had no system for auditing the information entered into its blue sheet responses to provide for accountability. Nor did the Firm have any supervisory system or written supervisory procedures for supervising the submission of the Firm's blue sheets. If the Firm had simply spot-checked its submissions, it would have discovered many of the problems discussed here.

The seriousness of the misconduct and whether it was willful are the main issues. The Firm argues that it eventually filed complete and accurate blue sheets—it just filed them late. It minimizes the significance of the deficiencies in its blue sheets, argues that errors are unavoidable, and maintains that only a minor sanction should be imposed.

As discussed below, the Extended Hearing Panel finds that the violations were egregious and that the Firm acted willfully. The record reveals the Firm's lack of concern for, understanding of, and meaningful attention to its blue sheet responsibilities. The circumstances, including the failure to have any systems for checking the information entered into its blue sheets or supervising the creation and submission of them, compel the Panel to conclude that the violations of the federal securities laws and regulations were willful. In light of the Firm's extensive disciplinary history, including a prior problem with its blue sheet submissions, the Extended Hearing Panel concludes that stringent sanctions are required.

The Extended Hearing Panel imposes a fine totaling \$1 million (\$850,000 in the aggregate for the violations charged in the First and Second Causes of Action; and \$150,000 in the aggregate for the violations charged in the Third and Fourth Causes of Action). Because the Extended Hearing Panel finds, as charged in the First and Third Causes of Actions, that the Firm violated federal securities laws and regulations willfully, the Firm is statutorily disqualified. The Extended Hearing Panel also imposes hearing costs.

## **II. FACTS**

### **A. Background**

#### **(1) Hearing**

The hearing took place for five days on March 9-13, 2015. The record includes

testimony,<sup>2</sup> exhibits,<sup>3</sup> and stipulations.<sup>4</sup> Post-hearing briefing concluded on May 5, 2015.<sup>5</sup> This decision is based on careful consideration of the entire record.

## (2) Jurisdiction

Wedbush is a Los Angeles-based broker-dealer that has been registered with FINRA since 1955.<sup>6</sup> FINRA has jurisdiction to bring this proceeding against the Firm under Article IV, Section 6 of FINRA's By-Laws.

## (3) Respondent

During the relevant period, the Firm had approximately 900 employees in approximately 100 branch offices<sup>7</sup> and was "one of the top ten liquidity providers" on the various stock exchanges.<sup>8</sup> For at least a portion of the period, Wedbush "was consistently ranked as one of the five largest firms by trading volume on NASDAQ."<sup>9</sup>

During the relevant period, Wedbush had four primary revenue-producing lines of business: retail (brokerage and wealth management); capital markets (proprietary trading, investment banking and public finance); treasury (which produced revenue through stock loans);

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<sup>2</sup> The following persons testified at the hearing: Eric Segall ("Segall"), the Firm's senior vice president and co-chief compliance officer; Vincent Moy ("Moy"), the other co-chief compliance officer; David Bennett ("Bennett"), a FINRA regulatory analyst with the Office of Fraud Detection and Market Intelligence; Rosario Braisted ("Braisted"), a blue sheet manager with FINRA's Office of Fraud Detection and Market Intelligence; Ranganathan Rajagopal ("Rajagopal"), a director of technology with FINRA; Ron Yeager ("Yeager"), a programmer and manager of systems development for the Firm; Sherry Tejada ("Tejada"), a business conduct examiner for the Firm; Prashant Shah ("Shah"), the Firm's director of clearing technology.

References to the hearing transcript are cited here as "Hearing Tr.," with a parenthetical for the last name of the witness whose testimony is cited and the page number of the transcript. Thus, testimony of one of the Firm's co-chief compliance officers is cited "Hearing Tr. (Segall) 46-50."

<sup>3</sup> Complainant's exhibits are referred to here with the prefix "CX" and an identifying number. Respondent's exhibits are referred to with the prefix "RX" and an identifying number.

<sup>4</sup> The Parties agreed on two sets of stipulations: Joint Stipulations Of Relevant And Undisputed Facts, filed on January 16, 2015 (referred to here as "Jt. Stip."); and Amended Joint Stipulations Relating To Blue Sheet Requests And Responses filed on March 9, 2015 (the amended stipulations are referred to here as "Second Jt. Stip."). References to the stipulations will include the appropriate abbreviation and paragraph number, as in "Jt. Stip. ¶ 14" or "Second Jt. Stip. ¶ 1."

<sup>5</sup> The Parties filed opening briefs on April 21 and April 22, 2015, entitled as follows: Department Of Enforcement's Post-Hearing Brief ("Enf. PH Br."); Respondent Wedbush Securities Inc.'s Post-Hearing Brief ("Resp. PH Br."). The Parties filed simultaneous reply briefs on May 5, 2015, entitled as follows: Department Of Enforcement's Post-Hearing Reply Brief ("Enf. Reply"); Respondent Wedbush Securities Inc.'s Reply to Complainant's Post-Hearing Brief ("Resp. Reply").

<sup>6</sup> CX-35, at 2; CX-39, at 22.

<sup>7</sup> Hearing Tr. (Segall) 63; CX-39, at 22.

<sup>8</sup> Hearing Tr. (Segall) 63.

<sup>9</sup> Hearing Tr. (Segall) 63; CX-39, at 22.

and correspondent services.<sup>10</sup> The blue sheet problems are primarily related to the Firm's correspondent services, offered through its "correspondent services division."

The Firm's correspondent services division provided general clearing services for broker-dealer clients (introducing brokers) and "sponsored access" services to some customers. Sponsored access customers were allowed to send orders directly to the markets using a Wedbush market participant identifier ("MPID").<sup>11</sup> To the market, a trade by a sponsored access customer would be recognized as connected to Wedbush, but the true identity of the trader would be concealed. Wedbush referred to some of its sponsored access clients as "flip" clients, because the Firm would "flip" their trades out for ultimate settlement to wherever the clients actually custodied their assets.<sup>12</sup> During the relevant period, the bulk of the trades that cleared through the Firm came from the correspondent services division.<sup>13</sup>

The Firm's business conduct department is its compliance department. During the first six months of the relevant period, Eric Segall was the chief compliance officer. In October 2012, Vincent Moy became co-chief of compliance with Segall. Moy also took over responsibility for managing the day-to-day function of the business conduct department.<sup>14</sup> Segall and Moy and their department have responsibility for responding to blue sheet requests and maintaining a record of requests and responses.<sup>15</sup> Segall and Moy supervise the staff who produce the Firm's blue sheets.<sup>16</sup>

The Firm also embeds some compliance functions within its business departments. For example, responding to a regulatory request for information pursuant to FINRA Rule 8210 could be handled by a person located in the correspondent services department.<sup>17</sup>

#### **(4) Blue Sheets Generally**

Federal securities laws and FINRA rules require that broker-dealers submit trade data, commonly known as "blue sheets," to the SEC and FINRA electronically upon request.<sup>18</sup> Blue sheets provide regulators with critical information about transactions, including the name of the account owner, the nature of the transaction (whether it was a buy, sale, or short sale), and the

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<sup>10</sup> Hearing Tr. (Segall) 58-62.

<sup>11</sup> Hearing Tr. (Segall) 59-61.

<sup>12</sup> The flip clients also were sometimes referred to as "layoff" clients. Hearing Tr. (Yeager) 878; Hearing Tr. (Tejeda) 892.

<sup>13</sup> Hearing Tr. (Segall) 138.

<sup>14</sup> Hearing Tr. (Segall) 46-49; Hearing Tr. (Moy) 351-53.

<sup>15</sup> Hearing Tr. (Segall) 68-69; Hearing Tr. (Moy) 533, 594-95.

<sup>16</sup> Hearing Tr. (Tejeda) 893.

<sup>17</sup> Hearing Tr. (Segall) 53-54, 320-21; Hearing Tr. (Moy) 354.

<sup>18</sup> Second Jt. Stip. ¶ 1.

price at which the transaction occurred.<sup>19</sup> A firm's response to a blue sheet inquiry is generally due 10 business-days from the date it is received.<sup>20</sup>

The information provided in a blue sheet is essential to a regulator's ability to discharge its enforcement and regulatory mandates.<sup>21</sup> The failure of a broker-dealer to provide complete, accurate, and timely blue sheets in response to a regulatory request can impact the regulator's ability to perform its obligations, undermine the integrity of its investigations and examinations, and ultimately interfere with its ability to protect investors.<sup>22</sup>

In particular, blue sheets provide information that enables investigators to identify persons involved in suspicious trading. The identification of such traders is critical to understanding the potential connections among traders, insiders, and others. It would not be possible for FINRA to conduct an insider trading investigation without the information from the blue sheets. Even if a firm provides the missing data months later, the original omission of the information could affect a regulatory investigation, complicating the collection of evidence of wrongdoing and wasting scarce resources. It may simply be too late for the missing information to play a meaningful role in an investigation.<sup>23</sup>

#### **(5) Wedbush's Blue Sheet Systems**

In order to understand the nature and extent of the problems with the Firm's blue sheets, and the reasons they occurred, it is useful first to have a little information on Wedbush's particular blue sheet systems.

Up until 2007, Wedbush relied on outside vendors to hold the trading information it needed for blue sheets. In response to a blue sheet request, the Firm would pull its data from a vendor's system and prepare it for submission to the regulator. To the extent Wedbush needed information regarding trading by its sponsored access clients, however, it had to request that information from those clients. Wedbush found that depending on clients to respond timely was an impediment to ensuring that its own responses to regulators were timely.<sup>24</sup> The process of assembling and packaging the information to submit in response to a blue sheet request from a regulator was mostly manual.<sup>25</sup>

On April 9, 2007, as discussed below in connection with Wedbush's disciplinary history, the New York Stock Exchange ("NYSE") issued a board decision sanctioning Wedbush for

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<sup>19</sup> Second Jt. Stip. ¶ 2.

<sup>20</sup> CX-24, at 3; Hearing Tr. (Braisted) 693; Hearing Tr. (Tejeda) 917.

<sup>21</sup> Second Jt. Stip. ¶ 3.

<sup>22</sup> Second Jt. Stip. ¶ 4.

<sup>23</sup> Hearing Tr. (Bennett) 643-45.

<sup>24</sup> CX-17, at 14.

<sup>25</sup> Hearing Tr. (Segall) 266-68, 335-36.

submitting at least 22 inaccurate blue sheets and failing to establish and maintain appropriate systems and procedures for complying with blue sheet reporting requirements. Among other things, the NYSE decision required Wedbush to hire a consultant and undertake to make improvements in its process for creating blue sheets.<sup>26</sup>

As instructed by the NYSE, the Firm hired a consultant. He concluded, among other things, that the degree to which Wedbush processed blue sheets manually was unsustainable and recommended that the Firm automate its systems for collecting and processing information.<sup>27</sup>

In early 2008, the Firm's IT department began working to set up a system for receiving daily uploads of its clients trading data. The Firm intended its new system to be able to pull the information it needed for a blue sheet without waiting for clients to respond. The Firm also was redesigning its systems because of new regulatory requirements.<sup>28</sup>

In April 2012, the beginning of the relevant period, Wedbush's system was generally more automated than before. Its correspondent firms provided daily downloads of blue sheet data regarding their transactions. Some correspondent firm clients sent their information to the same system that the Firm used for its retail customers and its own proprietary trading, the Firm's Thomson Reuters Beta System ("Beta System"). Other correspondent firm clients, generally those with sponsored access to the markets (the flip clients), sent their data to a separate database system referred to as the Blue Sheet Generator.<sup>29</sup> Wedbush had 10 to 20 correspondent clients that were not on the Beta System (out of approximately 100 correspondent clients).<sup>30</sup>

Although more automated than before, the system implemented in April 2012 for generating blue sheet responses for sponsored access clients was still heavily manual and susceptible to error.<sup>31</sup> In responding to blue sheet requests from regulators, Wedbush primarily used the Beta System to collect and organize its response, cutting and pasting data relating to trades by sponsored access clients into the blue sheet file prepared using the Firm's Beta System.<sup>32</sup>

On November 30, 2012, Wedbush modified its blue sheet system again, but, even after that, Firm personnel still had to take a number of manual steps to complete the Firm's blue sheets for any trades made prior to November 30, 2012.<sup>33</sup> If the information sought straddled before

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<sup>26</sup> CX-15.

<sup>27</sup> CX-17, at 31.

<sup>28</sup> Hearing Tr. (Segall) 266-72, 292; RX-1.

<sup>29</sup> Hearing Tr. (Segall) 336-37.

<sup>30</sup> Hearing Tr. (Segall) 125, 321-23.

<sup>31</sup> Answer ¶ 25.

<sup>32</sup> Hearing Tr. (Segall) 123-24, 337-39; Hearing Tr. (Moy) 365-413; Hearing Tr. (Yeager) 836.

<sup>33</sup> Hearing Tr. (Segall) 109; Hearing Tr. (Moy) 370.

and after November 30, 2012, then the Firm had to use both the old and new systems to generate a complete response.<sup>34</sup>

Wedbush personnel who create and submit blue sheets have a 31-page set of desk procedures to guide them in the process. The desk procedures set out extensive manual manipulations that must be performed.<sup>35</sup> Moy called the desk procedures a “roadmap as to how to submit blue sheets.”<sup>36</sup>

The desk procedures are not supervisory procedures and do not contain any provisions for supervisory review or approval of blue sheets before they are submitted.<sup>37</sup> Nor do they contain any instructions for auditing or reviewing blue sheets before or after they are submitted to ensure accountability for the accuracy of the submissions.<sup>38</sup>

## **B. Deficient Blue Sheets (First and Second Causes of Action)**

The Extended Hearing Panel finds that the Firm submitted numerous incomplete and inaccurate blue sheets to the SEC and FINRA during the relevant period, depriving the regulators of information critical to their investigations and monitoring for market abuses. The errors arose from three different problems, but, ultimately, all the errors stemmed from the Firm’s lack of any coherent system of supervision, review, and quality control for the Firm’s blue sheets.

The Firm argues that it self-reported the vast majority of the blue sheet problems at issue in this proceeding, as though to suggest that the Firm was proactive in identifying issues with its blue sheets.<sup>39</sup> The suggestion that the Firm took the initiative in uncovering the problems at issue is false. Wedbush only identified most of the problems discussed here after FINRA staff inquiries led the Firm to investigate. None of the problems identified were because of any concerted effort by Wedbush to ensure the accuracy of its blue sheet responses to regulators.

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<sup>34</sup> Hearing Tr. (Segall) 109; Hearing Tr. (Moy) 431-33; JX-10.

<sup>35</sup> JX-7. Moy testified in detail regarding the manual aspects of producing a blue sheet. In order to generate a single blue sheet response, an analyst in Wedbush’s business conduct department had to perform numerous manual steps that included the following: renaming files from the Beta System; changing data in the header of the file created by the Beta System; inserting spaces in the data file produced by the Beta System; cutting and pasting data relating to trades by the sponsored access (flip) customers from the database for those customers’ trading into the blue sheet file prepared using the Firm’s Beta System; deleting unnecessary spaces from the bottom of the blue sheet trade data file; recalculating the number of lines of data in the blue sheet data and modifying the footer of the blue sheet response to reflect this calculation; and re-naming and re-saving the data file. Hearing Tr. (Moy) 371-79, 380, 397-400, 405-08.

<sup>36</sup> Hearing Tr. (Moy) 358.

<sup>37</sup> Hearing Tr. (Segall) 103-04; Hearing Tr. (Moy) 358-59.

<sup>38</sup> JX-7.

<sup>39</sup> Hearing Tr. (opening statement by counsel) 40; Resp. PH Br., at 2; Hearing Tr. (Moy) 594-95.



## (1) Correspondent Firm Problem

The Parties stipulated to the material facts relating to the “correspondent firm problem.”<sup>40</sup>

**FINRA inquiry.** On September 26, 2012, an investigator in FINRA’s Department of Market Regulation notified Wedbush that trade data for one of Wedbush’s correspondent firms was missing from the blue sheets that Wedbush had submitted on June 5, 2012, and the investigator asked for an explanation.<sup>41</sup> The correspondent firm was a sponsored access client named Vogue Capital Management Capital Fund (“Vogue”).<sup>42</sup>

**Firm investigation.** Wedbush began investigating and discovered that the problem with the June 5, 2012, blue sheet was not isolated. Its blue sheets were missing data for Vogue and for two more sponsored access clients, SG Americas Securities, LLC (“SG”) and Tradebot Systems, Inc. (“Tradebot”).<sup>43</sup> Wedbush filed a FINRA Rule 4530 disclosure on November 30, 2012. The Firm disclosed that between April 1, 2012, and October 30, 2012, no trades for Vogue, SG, or Tradebot were included in Wedbush’s blue sheet submissions. Wedbush said that it would provide the regulators with the information that should have been included.<sup>44</sup>

**Impact.** Due to the correspondent firm problem, Wedbush admits that it submitted 254 incomplete blue sheet responses to FINRA that omitted information about 17,609 trades. Wedbush also admits that it submitted 169 incomplete blue sheet responses to the SEC that omitted information about 31,466 trades.<sup>45</sup> From April through October 2012, the regulators received no trade data for the three sponsored access clients.

**Correction.** Wedbush finished submitting corrected blue sheets to the SEC in February 2013.<sup>46</sup> It then began submitting corrected blue sheets to FINRA in April 2013, and completed its submissions to FINRA that same month.<sup>47</sup> Thus, the corrected blue sheets relating to the correspondent firm problem were provided to the regulators four to 12 months after the inaccurate originals.

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<sup>40</sup> Jt. Stip. ¶¶ 5-16.

<sup>41</sup> Jt. Stip. ¶ 11; Hearing Tr. (Segall) 151-52; JX-1.

<sup>42</sup> JX-1; Hearing Tr. (Segall) 276-78.

<sup>43</sup> Hearing Tr. (Segall) 274-78; Hearing Tr. (Yeager) 801.

<sup>44</sup> JX-2. The Firm was required to file a Form 4530 pursuant to FINRA Rule 4530. The Rule requires a FINRA member to “promptly report to FINRA” when the member “has concluded or reasonably should have concluded” that the member has violated any securities-related laws, regulations or standards of conduct of a regulator or self-regulatory organization. Segall acknowledged that the Rule requires firms to disclose problems that are large enough to warrant reporting. Hearing Tr. (Segall) 155-56. Accordingly, once Wedbush concluded that it had previously submitted numerous incomplete and inaccurate blue sheets that did not comply with regulatory requirements, it had to disclose that information on a Form 4530.

<sup>45</sup> Jt. Stip. ¶ 15; Second Jt. Stip. ¶¶ 4-5; CX-7; CX-8; Hearing Tr. (Segall) 143-49.

<sup>46</sup> Jt. Stip. ¶¶ 16, 22; Hearing Tr. (Segall) 156-58.

<sup>47</sup> Jt. Stip. ¶ 16.

***Firm’s explanation.*** The Firm’s co-chief of compliance, Segall, testified that the problem arose because of two different mistakes. Wedbush’s technical operations department downloaded data for two returning customers, SG and Tradebot, to a Wedbush blue sheet system that was inactive, and it failed to download the data for a new customer, Vogue, to any Wedbush blue sheet system at all.<sup>48</sup> Segall attributed both mistakes to someone’s failure to “flip the switch” necessary to make sure the trades went into the blue sheet system. He did not know precisely what the failure was, but the Firm’s IT people had described it to him in such terms.<sup>49</sup> Segall testified that the error was made by someone in technical operations, which was part of the correspondent services department. No one in the business conduct department was involved.<sup>50</sup>

The Firm’s director of clearing technology, Shah, testified that IT was not notified or instructed to “turn on” the three firms for the blue sheet process. As a consequence, IT did not configure the system to pick up trade data for the three firms.<sup>51</sup> He was unaware of any testing by the Firm to check whether client trade data was making its way to the blue sheets.<sup>52</sup> Shah testified that if the Firm had tested whether the blue sheet system was receiving all the data it should have received from the three customers, the Firm would have discovered that it did not have the data.<sup>53</sup>

***Extended Hearing Panel’s findings.*** Although Segall, along with Moy, is ultimately responsible for the submission of accurate blue sheets to the regulators, he disclaims any responsibility for the correspondent firm problem. He views it as an IT or correspondent services department problem, not a business conduct problem. It is troubling that the person in charge of blue sheets takes no responsibility. The quality of the information in the blue sheets could have and should have been checked. If it had been, the correspondent firm problem would have been discovered before FINRA staff discovered it.

## **(2) Missing Header Problem**

The Parties also stipulated to the essential facts relating to the “missing header problem.”<sup>54</sup>

***FINRA’s system for receiving blue sheets requires headers.*** FINRA provides an internet-accessible portal known as the “Firm Gateway” through which firms can upload blue sheet data files. The files must be properly formatted to include, among other things, a “header.”

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<sup>48</sup> Hearing Tr. (Segall) 138-40, 144, 274-75.

<sup>49</sup> Hearing Tr. (Segall) 146, 274-75, 315-17, 323-25, 336-37, 443.

<sup>50</sup> Hearing Tr. (Segall) 323-25.

<sup>51</sup> Hearing Tr. (Shah) 930-32, 950-54, 958.

<sup>52</sup> Hearing Tr. (Shah) 959-62.

<sup>53</sup> Hearing Tr. (Shah) 963.

<sup>54</sup> Jt. Stip. ¶¶ 28-45.

The header includes important information such as the identity of the firm submitting the blue sheet data file, the identity of the regulator to which the file is being submitted, and the regulator's case number. Without the information contained in the header, FINRA's system cannot process the blue sheet data file.<sup>55</sup>

A FINRA director of technology explained that the Firm Gateway functions like a temporary staging area or temporary folder for a blue sheet submission, until the blue sheet is identified and automatically "picked up" by the appropriate system database. The identification of the filer, the regulator to which the blue sheet is addressed, and the regulator's case number are necessary for the blue sheet to be directed electronically to the right place. Without that information in a header, there is no way for FINRA's system to know where a blue sheet belongs. After ten days, any items that have not been identified and "picked up" are automatically deleted.<sup>56</sup>

***Firm submits blue sheets without headers.*** Prior to November 2012, the Firm "compressed" its large files, aggregating or summarizing trades. After November 2012, the Firm began submitting data with more detail and in larger files to comply with regulatory requirements to provide information about each trade separately. When the Firm tried to submit large blue sheet files, the Firm's system would "time out." Moy testified that his staff reported the problem to him, and he asked IT for a solution.<sup>57</sup>

Moy testified that he knew that a header should have been on each file,<sup>58</sup> and the desk procedures for creating and submitting blue sheets specify that each file must have a header and a footer.<sup>59</sup> But the business conduct department played no role in supervising the process of breaking up the files and gave no advice to IT about the placement of headers on each of the smaller files.<sup>60</sup> Moy insisted that the Firm's technology people were "very well versed with blue sheets" and did not need his guidance.<sup>61</sup>

Without input from the business conduct department, an IT person broke down the files into smaller units without giving each smaller file the required header.<sup>62</sup> The business conduct

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<sup>55</sup> Jt. Stip. ¶¶ 28-31.

<sup>56</sup> Hearing Tr. (Rajagopal) 744-45, 748-51, 764-65.

<sup>57</sup> Hearing Tr. (Moy) 490, 499. Segall explained that the concept behind compression is to take all of a customer's buys and all of a customer's sells on a given day and put them into one total purchase and one total sale with an average price. Hearing Tr. (Segall) 208-09. Segall volunteered that the Firm was compressing files even though it was not supposed to do that. Hearing Tr. (Segall) 208-13. Braisted, the FINRA blue sheet manager, testified that compression was a summary of trades with similar characteristics, and that, at least from September 2005 onward, compression was not allowed for blue sheet reporting. Hearing Tr. (Braisted) 708-09; CX-24.

<sup>58</sup> Hearing Tr. (Moy) 496.

<sup>59</sup> Hearing Tr. (Tejeda) 911-12; JX-9, at 26.

<sup>60</sup> Hearing Tr. (Moy) 488-89.

<sup>61</sup> Hearing Tr. (Moy) 494-95.

<sup>62</sup> Hearing Tr. (Yeager) 852-53, 857.

department did not ask him to run any tests to see whether they were accepted by FINRA's system and did not ask him to review the files to see that they were in a proper format to submit to FINRA.<sup>63</sup>

FINRA's Firm Gateway successfully processed only the initial data file in a series because it was the only one with a header.<sup>64</sup>

***Discovery of missing header problem.*** In late May 2013, the Firm inadvertently became aware of the missing header problem. A Firm employee in the business conduct department, Sherry Tejada, was acting as the backup for the person who was usually responsible for preparing and submitting blue sheets. She happened to check some blue sheet files that she had submitted to see whether they registered in the Firm Gateway as having been submitted. In doing so, she discovered that only the first in a series of files registered as submitted. Then she randomly checked several files and saw that only the first in a series of files had the header that she expected to see.<sup>65</sup> Tejada identified the problem merely by looking at a text file.<sup>66</sup> She needed no special tools.<sup>67</sup>

Around the same time, FINRA staff in the Office of Fraud Detection and Market Intelligence ("OFDMI") noticed multiple discrepancies between the share volumes reported by Wedbush in its blue sheets and share volumes shown in the corresponding volume concentration reports.<sup>68</sup> On June 13, 2013, the staff issued a FINRA Rule 8210 request to the Firm regarding both the correspondent firm problem and the missing header problem (then called the "incorrect period issue").<sup>69</sup> The Rule 8210 request asked for information regarding approximately 36 specific blue sheets from late 2012 through April-May 2013.<sup>70</sup> The staff and the Firm engaged in correspondence regarding those discrepancies through late July 2013.<sup>71</sup>

On July 5, 2013, Wedbush filed a formal disclosure pursuant to FINRA Rule 4530. The Firm reported that from November 30, 2012, to June 4, 2013, some of its blue sheet submissions to FINRA's Firm Gateway electronic portal did not have headers and were not received by the

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<sup>63</sup> Hearing Tr. (Yeager) 856-57.

<sup>64</sup> Jt. Stip. ¶¶ 34, 36-38; Hearing Tr. (Moy) 495-96.

<sup>65</sup> Hearing Tr. (Tejada) 892-93, 896-901; Hearing Tr. (Moy) 501-08.

<sup>66</sup> Hearing Tr. (Tejada) 917-18.

<sup>67</sup> Jt. Stip. ¶¶ 39-41; CX-2, at 5; CX-19; Hearing Tr. (Tejada) 896-901.

<sup>68</sup> Hearing Tr. (Bennett) 656-57.

<sup>69</sup> Jt. Stip. ¶ 42; CX-1.

<sup>70</sup> CX-1, at 4.

<sup>71</sup> CX-1; CX-2; CX-3; Hearing Tr. (Bennett) 657-60.

regulators.<sup>72</sup> Essentially, for six months, the Firm had submitted blue sheets in an improper format that made it impossible for regulators to review the information.

**Correction.** The Firm finished submitting corrected blue sheets to the SEC and FINRA in July 2013.

**Impact.** Due to the missing header problem, between November 2012 and June 2013, the Firm submitted over 50 blue sheets to the SEC that were missing data files. The missing data files contained more than 4.4 million transactions. During that same period, the Firm submitted 49 blue sheets to FINRA that were missing data files, which files contained more than 1.2 million transactions.<sup>73</sup>

**Firm's explanation.** The Firm's senior compliance personnel persisted in blaming FINRA for the Firm's difficulties with the submission of large files. Segall testified that the problem with big files was the fault of FINRA's Firm Gateway system. Segall called it "FINRA's system fail."<sup>74</sup> He said that FINRA's system had a 10-megabyte limitation on the size of files. He claimed that he had that understanding from a conversation with an attorney in FINRA's Department of Market Regulation, but admitted that the conversation was "[y]ears before."<sup>75</sup>

Testimony of FINRA staff established that there was in fact no such limitation on the size of files accepted by FINRA's system at the time of the events at issue, although a firm might have trouble uploading files to the Firm Gateway due to limitations of its own systems, such as a slow browser speed or limited computer capacity.<sup>76</sup> Further, undercutting Segall's testimony regarding a supposed 10-megabyte limitation on files accepted by the Firm Gateway, Wedbush itself uploaded at least one large file of 14 to 15 megabytes to the Firm Gateway system during the relevant period, in December 2012.<sup>77</sup>

**Extended Hearing Panel's findings.** The missing header problem largely stemmed from the failure of the Firm's business conduct department to exercise due diligence in investigating and resolving the Firm's issues with submitting large files to FINRA. There is no evidence that the Firm's compliance personnel consulted with anyone at FINRA during the relevant period about the difficulties the Firm was having with submitting large files to the Firm Gateway, although FINRA staff responsible for managing the Firm Gateway provided customer support to assist firms with any problems uploading to the system.<sup>78</sup> Nor is there any evidence that

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<sup>72</sup> JX-5.

<sup>73</sup> Jt. Stip. ¶ 44; Second Jt. Stip. ¶¶ 36, 49; CX-21; CX-22.

<sup>74</sup> Hearing Tr. (Segall) 72.

<sup>75</sup> Hearing Tr. (Segall) 209-10.

<sup>76</sup> Hearing Tr. (Rajagopal) 746-48, 753-56, 763-64.

<sup>77</sup> Hearing Tr. (Rajagopal) 765-67; CX-25.

<sup>78</sup> Hearing Tr. (Rajagopal) 746-48, 753-56, 763-64.

Wedbush investigated the use of one of the two alternative systems for submitting blue sheets. Those alternatives have no size limit for the files submitted and would have eliminated any problems related to the technical capacity of the Firm's own system.<sup>79</sup>

The Firm's business conduct department also failed to exercise any oversight over the process of breaking down large files into smaller units to make sure that the files were formatted properly. Nor did the department follow any process for auditing its submissions to be sure that they were received by FINRA. The fact that Tejada so easily discovered the problem by spot checking her work indicates that anyone who checked could have learned that the files were not formatted correctly.

The Firm's senior compliance personnel asserted repeatedly that supervision was unnecessary and that the blame for the problem lay with FINRA. The denial of any need for supervision and the blame-shifting both manifest a purposeful unwillingness to investigate and solve underlying issues.

### **(3) Truncated CUSIP Problem**

The Parties stipulated to the key facts relating to the "truncated CUSIP problem."<sup>80</sup>

***FINRA inquiry.*** On December 18, 2013, a FINRA Blue Sheets Coordinator, emailed Wedbush regarding a blue sheet that Wedbush had submitted on October 2, 2013. The Coordinator asked for an explanation of a discrepancy. The blue sheet reported a lower trade volume for Wedbush and its customers than Wedbush's separately reported total volume in the particular security.

Wedbush resubmitted the file with the previously missing information on December 24, 2013. The Firm explained that its customer had submitted the underlying information with only a portion of the normal nine-digit CUSIP number and Wedbush's systems did not note the error.<sup>81</sup> The Extended Hearing Panel notes that a missing digit could be the explanation for an isolated incident.

***Firm's discovery of larger problem.*** It turned out that the truncated CUSIP problem was not limited to the blue sheet identified by FINRA staff as defective. On March 6, 2014, Wedbush filed another Rule 4530 disclosure relating to blue sheets. It disclosed that for over a year, from November 30, 2012, through December 31, 2013, its blue sheet submissions were missing all the data relating to Vogue, one of its sponsored access clients.

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<sup>79</sup> Hearing Tr. (Rajagopal) 744-46, 756-57, 762-64.

<sup>80</sup> Jt. Stip. ¶¶ 17-27.

<sup>81</sup> JX-4.

**Impact.** As a result of the truncated CUSIP problem, over the course of six months Wedbush failed to report 111,463 Vogue trades.<sup>82</sup> In fact, between the firm correspondent problem and the truncated CUSIP problem, Wedbush failed to report any trade data at all for Vogue, a high frequency trader, for a year and a half. From April 2012 to November 2012, there was no Vogue data in the Firm’s blue sheet database because of the correspondent firm problem, and from November 2012 through December 31, 2013, there was no Vogue data in the blue sheets even though the data was in the database because of the truncated CUSIP problem.

By the time that the Firm provided the corrections, later in March,<sup>83</sup> some of the trade data had been missing for more than a year.

**Firm’s explanation.** In 2012 and 2013, the Firm compiled information for its blue sheet responses to regulatory inquiries by searching its trade data using the applicable security’s nine-digit CUSIP.<sup>84</sup> Because one of the Firm’s sponsored access clients, Vogue, provided its data with only a partial CUSIP for each security that it traded—only eight characters, instead of nine—Wedbush’s system did not identify Vogue’s trades as responsive to regulatory requests.<sup>85</sup> The Firm verified that the CUSIP field was populated with some information when it received the trade data from Vogue, but it did not check the quality of the information received.<sup>86</sup>

**Extended Hearing Panel findings.** The Firm essentially shielded Vogue’s trading through Wedbush from regulatory scrutiny for a year and a half. The Firm’s compliance failure is serious and inexcusable.

### **C. Lack Of Audit Procedures Providing For Accountability (Third Cause Of Action)**

The Extended Hearing Panel finds that, during the relevant period, Wedbush had no audit system providing for accountability for the accuracy of the information entered into its blue sheets. Its procedures before, during, and after the creation and submission of its blue sheets were insufficient to qualify as an audit system or to provide for accountability.

Prior to the creation of a blue sheet, the only validation of information related to the raw data in its databases. The Firm checked the volume of correspondent firm trades in its blue sheet database against the executions reported in the National Securities Clearing Corporation (“NSCC”) files to see whether the volumes matched. If they did not, that might mean that files were missing. The Firm also verified when information came in from correspondent firms that

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<sup>82</sup> Jt. Stip. ¶ 26.

<sup>83</sup> Jt. Stip. ¶ 27; JX-4.

<sup>84</sup> A CUSIP is a nine-character identifier: the first six characters identify the issuer; the next two identify the type of security (equity or debt); and the last character is an automatically generated “check digit” that confirms the accuracy of the previous eight characters. Jt. Stip. ¶¶ 17-18.

<sup>85</sup> Jt. Stip. ¶¶ 19-21; Hearing Tr. (Segall) 285-86, 458-59; Hearing Tr. (Yeager) 871-75.

<sup>86</sup> Hearing Tr. (Yeager) 871; JX-3.

the CUSIP data field was not empty. Essentially, the Firm checked that it was receiving into its database what appeared to be the right amount of data and that there was information populating the CUSIP field.

After the creation of a blue sheet and before submission, the Firm did not have any process for checking the information in the blue sheet. When Segall was asked: “[W]hat systems or procedures did the [F]irm have in place to check for [human] errors” in the creation of a blue sheet response, he testified, “Honestly, the only procedure you have for that is double-check your work. Make sure that what you got back actually matches what you should have been inputting.”<sup>87</sup> Its director of clearing technology, Shah, confirmed that Wedbush had no process for validating the records in an actual blue sheet file.<sup>88</sup> The Parties stipulated that during the relevant period and at least until May 15, 2014, Wedbush had no audit system to validate its blue sheets after they were created.<sup>89</sup>

There was some evidence of a spot check after blue sheets were submitted, but it did not amount to an audit providing for accountability. Segall, testified that a staff person in the business conduct department did a review of “whatever amount [of blue sheets] that she chose to pull” once a quarter.<sup>90</sup> He thought that there used to be a written record documenting that review but he could not explain why FINRA staff received no evidence of such a review in response to Rule 8210 requests.<sup>91</sup>

Even if someone in the business conduct department did examine a few blue sheets after their submission once each quarter, there was no evidence that Wedbush had guidelines for how many blue sheets should be sampled or how they should be selected, or guidelines on what to look for when examining them, or instructions on what to do about discrepancies, or documentation of any such process. The Firm’s purported review was only “whatever” the staff person decided to do on an ad hoc basis in a given quarter.

#### **D. Wedbush’s Lack Of Supervisory Systems And Procedures (Fourth Cause Of Action)**

From April 1, 2012, to December 31, 2013, the Firm’s WSPs with regard to blue sheets said the following:

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<sup>87</sup> Hearing Tr. (Segall) 333.

<sup>88</sup> Hearing Tr. (Shah) 968-69. The Firm ran some checks on the data within its databases, but not on the information in the blue sheets. Hearing Tr. (Segall) 129-32, 134, 153; Jt. Stip. ¶¶ 46-49.

<sup>89</sup> Jt. Stip. ¶¶ 48-49; Hearing Tr. (Segall) 154, 158-59.

<sup>90</sup> Hearing Tr. (Segall) 135. The consultant’s report had described a process at the Firm by which a single blue sheet would be selected each quarter for verification. The focus of that task was to make sure that short sales were being reported accurately. CX-17; Hearing Tr. (Segall) 161-62.

<sup>91</sup> Hearing Tr. (Segall) 136-37.



Regulators may request information regarding client or [Wedbush] transactions as part of their ongoing market surveillance activities. Information is transmitted electronically through the Electronic Blue Sheet (EBS) system.

Business Conduct [the Firm's name for its compliance department] is responsible for responding to [blue sheet] requests and retaining records of requests and responses submitted.<sup>92</sup>

These three sentences are the entirety of the Firm's WSPs that related to blue sheets. The first sentence says that regulators may request information. The second sentence says that information is transmitted electronically. The third sentence says that the business conduct department is responsible for responding and retaining records of requests and responses submitted.

Both Segall and Moy acknowledged that the WSPs do not detail what is required to supervise the blue sheets.<sup>93</sup> They testified, however, that it is unnecessary for the WSPs to specify any procedures for supervising the Firm's blue sheet submissions. Segall testified, "It's not easy to prepare [blue sheets] improperly, because the system creates them. So it's not a whole lot to do improperly."<sup>94</sup> Segall repeatedly said that the people who were preparing the blue sheets had done it for years and knew what they were doing. "I didn't have to take any steps to supervise the preparation [of blue sheets]...[T]he actual preparation is done by people that have been doing it for years, and they're perfectly capable of creating a blue sheet and transmitting it. It's not a real complicated process."<sup>95</sup> Moy similarly testified that the staff is well-trained and knows what it is doing.<sup>96</sup>

The Firm did not update its WSPs after the discovery of any of the problems at issue here.<sup>97</sup> It did modify its desk procedures after the problems involved in this proceeding came to light.<sup>98</sup> Both Segall and Moy acknowledged, however, that the desk procedures only contain instructions on how to process blue sheets; the desk procedures are not supervisory procedures.<sup>99</sup>

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<sup>92</sup> JX-6, at 2. The Firm had desk procedures for how to submit blue sheets, but these contain no supervisory procedures. Hearing Tr. (Moy) 358-59.

<sup>93</sup> Hearing Tr. (Segall) 113-15; Hearing Tr. (Moy) 359-61.

<sup>94</sup> Hearing Tr. (Segall) 117.

<sup>95</sup> Hearing Tr. (Segall) 116-17.

<sup>96</sup> Hearing Tr. (Moy) 361.

<sup>97</sup> Hearing Tr. (Moy) 484.

<sup>98</sup> Hearing Tr. (Moy) 567-68, 588-89; JX-2; CX-4.

<sup>99</sup> Hearing Tr. (Segall) 103-04; Hearing Tr. (Moy) 358-59.

The Firm provided for no supervisory review or approval of blue sheets after they were created and before they were submitted. Segall testified that it would be impossible to review blue sheets manually and that the Firm had no automated review process.<sup>100</sup>

The consultant hired by Wedbush as a result of its prior disciplinary history concerning blue sheets (discussed below) had recommended that there be a prior approval procedure before submitting blue sheets. The consultant wrote in his report that the business conduct department should establish a system that would enable it “to view and print the blue sheet for accuracy, verification and, *once approved*, submit the file.”<sup>101</sup> The consultant further recommended that the blue sheet file be viewable as sent to regulators, and in a more easy-to-read and understandable format.<sup>102</sup>

Segall testified that the consultant had recommended only that the Firm *be able* to view and print blue sheets for accuracy—not that the Firm should actually print blue sheets and review them.<sup>103</sup> This parsing of the consultant’s recommendations reflects an attitude of disdain for the accuracy of the Firm’s submissions. It also suggests that improvements in the Firm’s systems are more for “show” than use.<sup>104</sup>

When the recommendation for printing, reviewing, and approving blue sheets was called to Segall’s attention at the hearing, he dismissed it as not a “good” recommendation.<sup>105</sup> This comment reveals the Firm’s disinterest in taking the initiative to improve the accuracy of its blue sheets. Tejada found the missing header problem by simply double checking whether her submissions were recorded as submissions in FINRA’s Firm Gateway system, and then reviewing the text files. This undercuts Segall’s claim that it is impossible to improve the accuracy of the Firm’s blue sheets by some simple review procedures.

The Extended Hearing Panel finds that during the relevant period the Firm had no reasonably designed supervisory system relating to its submission of blue sheets, and that the Firm’s WSPs failed to establish reasonable procedures for supervising the its blue sheets and documenting such supervision.

### **E. Impact Of Wedbush’s Misconduct**

Wedbush’s failure to submit complete and accurate blue sheets when they were initially due actually had an impact on at least one FINRA investigation. In that case the information that

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<sup>100</sup> Hearing Tr. (Segall) 134-35.

<sup>101</sup> CX-17, at 15 (emphasis supplied); Hearing Tr. (Segall) 294.

<sup>102</sup> Hearing Tr. (Segall) 89-90.

<sup>103</sup> Hearing Tr. (Segall) 134-36.

<sup>104</sup> Hearing Tr. (Segall) 134-35.

<sup>105</sup> Hearing Tr. (Segall) 136.

Wedbush provided in corrected blue sheets revealed suspicious trading by an individual who had not been identified previously as involved in potential wrongdoing.<sup>106</sup>

FINRA staff discovered this negative impact on an investigation from reviewing several dozen of Wedbush's corrected blue sheets. The staff did not review all 816 corrected blue sheets because it would have been difficult and time consuming to do.<sup>107</sup> Accordingly, other regulatory investigations may have been affected by Wedbush's failure to provide all the information requested in its original submissions.

The Firm denies that its deficient blue sheets had any impact.<sup>108</sup> The Extended Hearing Panel finds that denial further evidence of Wedbush's willful blindness to its responsibilities for blue sheet reporting and to the harm that may result from the submission of inaccurate blue sheets.

#### **F. Wedbush's Disciplinary History Relating To Deficient Blue Sheets**

On April 9, 2007, the NYSE issued a board decision concerning Wedbush and its blue sheets. The board decision concluded that Wedbush had submitted at least 22 inaccurate blue sheets and had failed to establish and maintain appropriate systems and procedures for complying with blue sheet reporting requirements. In connection with that proceeding, Wedbush was fined \$200,000 and required to retain an outside consultant to review and make recommendations concerning the adequacy of its legal and compliance resources, including its controls and procedures for supervising blue sheet responses.<sup>109</sup>

The problem was that Wedbush had failed to report short sales accurately. The Firm blamed the problem on the vendors it was using to assist it in generating and submitting its blue sheet responses, which made programming errors that caused the Firm to report some short sales as long positions.<sup>110</sup>

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<sup>106</sup> Hearing Tr. (Bennett) 646, 652-54.

<sup>107</sup> Hearing Tr. (Bennett) 655.

<sup>108</sup> Segall's testimony revealed his lack of concern about the impact of the Firm's incomplete and inaccurate blue sheets. He testified, "I was aware that it [the deficient blue sheets] could impact [the regulator's ability to discharge its obligations], but in this case it shouldn't have." Hearing Tr. (Segall) 71. He reiterated, "I was aware [the deficient blue sheets] could [have an impact], but I don't believe it did in this situation." Hearing Tr. (Segall) 74. With respect to the missing header problem, which involved 5.6 million unreported trades, Segall claimed that FINRA staff had sufficient information elsewhere from which it could have pieced together the identity of the traders. Hearing Tr. (Segall) 70-73.

<sup>109</sup> CX-15.

<sup>110</sup> CX-15, at 5-6.

The NYSE board declared that reliance on a third party vendor does not relieve the Firm of its duty to comply with the applicable rules and laws.<sup>111</sup> The NYSE board decision also did not mince words as to the serious nature of Wedbush's failure to meet its blue sheet

responsibilities. It said,

[T]he record below, ... includes ample evidence ... that Wedbush's responses to requests for Blue Sheet information were inexcusably inadequate, inept, dilatory and systemically deficient.<sup>112</sup>

The NYSE board further noted that "we were alarmed at the apparent ineptitude that characterized [Wedbush's] handling of its Blue Sheet problem."<sup>113</sup> It found that Wedbush had failed to devote sufficient resources to detecting and solving the inaccurate reporting to regulators, with the result that the Firm was dilatory in addressing the issue. The NYSE board found the delay to be unacceptable.<sup>114</sup>

### **G. Wedbush's Other Disciplinary History**

In the past 10 years alone, the Firm has been fined approximately \$2 million by FINRA, NASD, and NASDAQ in 16 separate disciplinary actions and settlements involving supervision failures.<sup>115</sup> Enforcement offered evidence of 15 cases in the past 5 years alone in which the Firm was sanctioned for supervisory violations,<sup>116</sup> and 12 cases in which the Firm was sanctioned for violations relating to the production of incomplete, inaccurate or late information to its regulators.<sup>117</sup>

Enforcement points out in post-hearing briefing that in April 2013 Wedbush settled a FINRA disciplinary proceeding involving charges that the Firm had failed to produce information and records in response to FINRA Rule 8210 requests in a timely and complete manner. In connection with that settlement, the Firm accepted a fine of \$75,000. The Firm also accepted findings that it (through Segall) had failed to establish and maintain a supervisory system, and to establish, maintain, and enforce WSPs reasonably designed to comply FINRA Rule 8210 and its NASD predecessor.<sup>118</sup> The failure to have a supervisory system and adequate

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<sup>111</sup> CX-15, at 6.

<sup>112</sup> CX-15, at 2.

<sup>113</sup> CX-15, at 7-8.

<sup>114</sup> CX-15, at 8.

<sup>115</sup> CX-34, at 31 (appeal pending).

<sup>116</sup> CX-34; CX-36; CX-43; CX-44; CX-45.

<sup>117</sup> CX-34; CX-36; CX-39; CX-43; CX-45; CX-52; CX-55; CX-57; CX-60; CX-61.

<sup>118</sup> Enf. PH Br., at 31 and n.158; CX-56.

WSPs for supervising Rule 8210 responses was found to be a violation of NASD Rule 3010,<sup>119</sup> one of the same Rules that the Firm is charged with violating here.

## **H. Wedbush's Ability To Pay**

Enforcement has requested a total fine of \$1 million.<sup>120</sup> Segall testified that a \$1 million fine would “be a significant hit to the firm’s liquidity and ability to pay.”<sup>121</sup>

## **I. Lack Of Accountability And Concern For Compliance Obligations**

The Extended Hearing Panel is troubled by the lack of accountability for Wedbush’s blue sheets. The Firm’s co-chiefs of compliance take no responsibility for the Firm’s blue sheet problems and shift blame elsewhere. They absolve themselves of responsibility for two problems (the correspondent firm problem and the truncated CUSIP problem) by saying that they do not supervise IT or the correspondent services department. As to the third problem (the missing header problem) they take credit for Tejada’s accidental discovery of the problem and chide FINRA for failing to catch it before the Firm did.<sup>122</sup>

The Extended Hearing Panel is similarly troubled by attitudes casting doubt on the Firm’s commitment to comply with its reporting obligations. One of the Firm’s chief compliance officers, Segall, dismissed the impact of the Firm’s incomplete and inaccurate blue sheets on regulatory investigations and shifted much of the blame for problems to the regulators. He testified that the missing header problem “never would have happened but for FINRA’s system fail.”<sup>123</sup> But, as discussed above, there was no FINRA system fail.

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<sup>119</sup> CX-56, at 38.

<sup>120</sup> Enf. PH Br., at 34.

<sup>121</sup> Hearing Tr. (Segall) 302.

<sup>122</sup> Resp. PH Br., at 14-15; Hearing Tr. (Segall) 192-195; Hearing Tr. (Moy) 441-45.

The lack of accountability was manifest in the circular quality of some of the testimony. Segall and Moy testified that IT was responsible for many of the problems and that questions about why the Firm had not discovered the problems before were better addressed to IT. IT personnel testified that they simply followed instructions and nobody in business conduct had directed them to do something different. Hearing Tr. (Segall) 315-16, 323-24, 328-29; Hearing Tr. (Moy) 441-46; Hearing Tr. (Yeager) 867-68; Hearing Tr. (Shah) 930, 932, 950-54.

Wedbush embeds some compliance functions within its business departments, which exacerbates the lack of accountability. During the relevant period, compliance did not have an oversight role throughout the organization. Some compliance personnel reported instead to business management in their division. Hearing Tr. (Segall) 320-21. This created confusion regarding supervision. For example, the co-chief compliance officers contradicted each other in their testimony about lines of reporting for compliance. Segall testified that CF was a senior vice president in the correspondent services department who had both operations and business conduct responsibility. Although she had some compliance responsibilities, including responsibility for responding to FINRA requests pursuant to Rule 8210, and Segall had responsibility for Rule 8210 requests, he testified that she did not report to him in any way. Hearing Tr. (Segall) 53-54. In contrast, Moy testified that CF reported to Segall when he managed the business conduct department and that she reported to Moy once he took over management of the department. Hearing Tr. (Moy) 354.

<sup>123</sup> Hearing Tr. (Segall) 72.

### III. VIOLATIONS

Wedbush committed the violations of federal securities laws and regulations and the violations of FINRA Rules alleged in the Complaint. The only significant issue is whether its violations of the federal securities laws and regulations alleged in the First and Third Causes of Action were willful, which would give rise to a statutory disqualification. Willfulness is separately addressed below.

#### A. First Cause Of Action

The First Cause of Action alleges that Wedbush submitted incomplete and inaccurate blue sheets to the SEC in willful violation of Securities Exchange Act Section 17(a) and SEC Rules 17a-4(j) and 17a-25, along with FINRA Rule 2010. Section 17(a) and Rule 17a-4(j) require broker-dealers to preserve certain records and to furnish to a “representative of the Commission”—in this case, FINRA—a “complete” copy of any records required to be preserved by the Rule or any other records that are subject to examination and requested by the representative of the Commission. Rule 17a-25 specifies that upon request broker-dealers must submit information electronically.<sup>124</sup>

Wedbush committed the violations alleged. The Firm submitted incomplete and inaccurate blue sheets to the SEC in violation of the specified law and regulations. As discussed above, due to the correspondent firm problem, between April and October 2012, the Firm submitted 169 incomplete blue sheet responses to the SEC, omitting any information regarding 31,466 trades. Due to the missing header problem, between November 2012 and June 2013, it submitted more than 50 incomplete blue sheets to the SEC, omitting any information regarding 4.4 million transactions. Due to the truncated CUSIP problem, between November 2012 and December 2013, the Firm submitted 161 incomplete blue sheets to the SEC. A total of 111,463 transactions were missing from blue sheets submitted to the SEC and FINRA because of the truncated CUSIP problem.

The Firm’s argument that its blue sheets were merely “tardy” because it eventually submitted corrected blue sheets is unavailing. Regulators are entitled to timely receipt of complete and accurate blue sheets.<sup>125</sup> The argument fails to acknowledge the need for timely information to pursue investigations of potential insider trading and market abuse. Stale

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<sup>124</sup> Each Cause of Action also alleges a violation of FINRA Rule 2010. That Rule is the self-regulatory organization’s requirement that members and associated persons conduct business in accord with high standards of commercial honor and just and equitable principles of trade. It is well-established that a violation of the securities laws and regulations or FINRA’s Rules is also a violation of FINRA Rule 2010. *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at \*42 (June 29, 2007). Because the Hearing Panel finds that the Firm committed the substantive violations alleged in each Cause of Action, the Hearing Panel finds that the Firm also violated FINRA Rule 2010. Rule 2010 will not be further discussed here.

<sup>125</sup> CX-24 (NASD Notice to Members 05-58, Intermarket Surveillance Group Requires Validation of Electronic Blue Sheet Submissions at 3 (Sept. 2005) (“In general, blue sheet submissions are to be received by a requesting organization within ten (10) business days following the date of the request for such information.... Incomplete submissions do not fulfill a member’s or member organization’s obligation to make timely submissions.”).

information may be no better than no information, if it is provided too late to assist in a regulatory investigation.

## **B. Second Cause Of Action**

The Second Cause of Action alleges that Wedbush's submission of incomplete and inaccurate blue sheets to FINRA violated FINRA Rules 8211, 8213, and 2010. FINRA Rules 8211 and 8213 require that when FINRA requests information about any transaction (whether on an exchange or off) the trade data shall be provided in whatever automated format FINRA may prescribe.

Wedbush committed the violations alleged. As discussed above, due to the correspondent firm problem, between April and October 2012, it submitted 254 incomplete blue sheet responses to FINRA, omitting any information regarding 17,609 trades. Due to the missing header problem, between November 2012 and June 2013, it submitted more than 49 incomplete blue sheets to FINRA, omitting any information regarding 1.2 million transactions. Due to the truncated CUSIP problem, between November 2012 and December 2013, the Firm submitted 125 incomplete blue sheets to FINRA.

## **C. Third Cause Of Action**

The Third Cause of Action alleges that Wedbush violated Securities Exchange Act Section 17(a), SEC Rule 17a-4(f)(3)(v), and FINRA Rule 2010. Rule 17a-4(f)(3)(v) provides that a member must have in place "an audit system providing for accountability regarding inputting of records." It further specifies that the results of such an audit system must be preserved and available for examination of the self-regulatory organization of which the broker-dealer is a member.

Wedbush committed the violations alleged. As discussed above, the Firm had no audit system in place providing accountability for the information entered into its blue sheets. The lack of accountability was manifest from the testimony at the hearing. The two co-chiefs of compliance referred the Extended Hearing Panel to IT witnesses for explanations as though compliance was not involved in ensuring that the information in the blue sheets was complete and accurate. The Firm's IT staff made it plain that they did what they were asked to do and no more. They did not know what was required for the filing of blue sheets that complied with the applicable laws and regulations. Furthermore, the senior compliance personnel instituted no procedures for checking the entry of information in the blue sheets before submission, and any quarterly review of the blue sheets after submission was purely ad hoc.

## **D. Fourth Cause Of Action**

The Fourth Cause of Action alleges that Wedbush violated NASD Rule 3010 and FINRA Rule 2010. NASD Rule 3010(a) requires member firms to "establish and maintain a system to supervise" the activities of its registered and associated persons that is "reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD

Rules.” NASD Rule 3010(b) further requires member firms to “establish, maintain, and enforce written procedures to supervise the types of business in which it engages,” and the activities of its registered and associated persons that is “reasonably designed to achieve compliance” with applicable securities laws and regulations, and with the applicable FINRA and NASD Rules.

Broadly speaking, WSPs are a written set of policies and procedures that every broker-dealer firm is required to create, maintain, and update, and to which every broker-dealer is required to adhere. WSPs describe concrete steps that must be taken to supervise activities and identify who is responsible for doing so. They also set up a system of documentation for those activities.<sup>126</sup> It is fundamental that a firm “must have detailed written policies and procedures addressing each area of its operations, with specific steps that are to be taken to assure compliance with applicable laws and firm policies.”<sup>127</sup> A firm’s WSPs “should be comprehensive, covering all areas of activities, products and governing legal requirements, and leaving no gaps in supervision and internal control.”<sup>128</sup>

Firms are well aware of the requirement for detailed, concrete WSPs. FINRA’s predecessor, NASD, issued guidance long ago making that clear. The guidance instructs that a firm’s WSPs “should include a description of the controls and procedures used by the firm to deter and detect misconduct and improper activity.” The WSPs “should also identify the specific personnel who perform the various supervisory functions.”<sup>129</sup>

Wedbush committed the violations alleged. The Firm’s WSPs say nothing about supervision of blue sheets. They say only that the business conduct department is responsible for responding to requests and retaining records of the requests and responses. Without question, the WSPs were not reasonably designed to achieve compliance with the applicable requirements. The WSPs failed to meet the requirements of NASD Rule 3010.

### **E. Willfulness**

Whether Wedbush willfully engaged in the misconduct proven in connection with the First and Third Causes of Action is a critical issue because Wedbush is subject to statutory disqualification if those violations were willful.<sup>130</sup> Article III, Section 3 of FINRA’s By-Laws provides that no member shall continue as a member if it becomes subject to disqualification. Article III, Section 4 of FINRA’s By-Laws states that a member is subject to disqualification if the member is subject to one of the disqualifying events listed in Section 3(a)(39) of the

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<sup>126</sup> *Dep’t of Enforcement v. Ranni*, No. 20080117243, 2012 FINRA Discip. LEXIS 6, at \*15-16 (OHO Mar. 9, 2012).

<sup>127</sup> Clifford E. Kirsch (ed.), *Broker-Dealer Regulation* (2d ed.), ¶ 6:7.3 at 6-28.

<sup>128</sup> *Id.* at 6-29.

<sup>129</sup> NASD Notice to Members 98-96, 1998 NASD LEXIS 121, at \*6 (Dec. 1998).

<sup>130</sup> *Dep’t of Enforcement v. Merrimac Corporate Securities, Inc.*, No. 2007007151101, 2010 FINRA Discip. LEXIS 41, at \*55 n.48 (OHO Dec. 8, 2010), *aff’d*, 2012 FINRA Discip. LEXIS 43, at \*38 (Board of Governors May 2, 2012) (recordkeeping violation was willful even if firm was attempting to comply with rules).



Securities Exchange Act. One of the disqualifying events listed in Section 3(a)(39) is a finding by a self-regulatory organization such as FINRA that a violation of the federal securities laws was willful. Under Article III, Section 3(d) of FINRA's By-Laws, if a member is subject to statutory disqualification, it must seek permission to remain in the securities industry. FINRA Rules in the 9520 and 9550 Series set forth procedures for seeking that permission.

The Firm argues that it did not act willfully because it did not know that it was submitting incomplete and inaccurate blue sheets. It asserts that the Firm intended the SEC and FINRA to receive the information it submitted and for the information to be complete. It says that it did not know that FINRA had no system to tie files together if they did not have headers, and it did not know that it was missing data due to the correspondent firm and truncated CUSIP problems.<sup>131</sup>

The Firm's argument is incorrect. Willfulness does not require intent to commit misconduct or knowledge of committing an error.

In the context of securities law violations, the definition of willfulness is broad. It has been long held that "willfully" means intentionally committing the act that constitutes the violation, not intentionally committing the violation.<sup>132</sup> Violations of provisions that promote accurate disclosure by securities professionals in order to maintain a high level of business ethics in the securities industry are willful where a person knows what he is doing.<sup>133</sup> "[A]s used in the federal securities laws, 'willful' means something other than involving 'deliberate or reckless disregard of a regulatory requirement.'"<sup>134</sup>

In this case, Enforcement proved more than that the Firm voluntarily engaged in the acts that constituted the violations. Enforcement actually proved that Wedbush acted in reckless disregard of regulatory requirements. The Firm chose to do without any audit or supervisory systems to reasonably ensure that its blue sheets were complete and accurate and to provide accountability for the submissions. It did so despite the risks that its blue sheets would not be complete and accurate and despite the importance of blue sheets to regulators. The Firm's co-chief compliance officers believed that it was impractical and unnecessary to implement any supervisory procedures or an audit system. They purposefully instituted no system for checking the accuracy of the information submitted in the blue sheets or to provide for accountability.

The absence of any audit or supervisory systems was particularly willful in light of the consultant's recommendation that Wedbush adopt procedures that would allow for the printing, review, and *approval* of blue sheets before submission to regulators. The persons ultimately responsible for the blue sheets, Segall and Moy, ignored that recommendation. As discussed

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<sup>131</sup> Resp. PH Br., at 17; Resp. Reply, at 9-10.

<sup>132</sup> *Mathis v. SEC*, 671 F.3d 210, (2d Cir. 2012); *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965); *Leaddog Capital Markets, LLC*, Initial Decisions Release No. 468, 2012 SEC LEXIS 2918, \*38-39 (Sept. 4, 2012) (collecting cases).

<sup>133</sup> *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at \*41 and n.51 (Nov. 9, 2012).

<sup>134</sup> *Next Financial Group, Inc.*, Initial Decision Release No. 349, 2008 SEC LEXIS 1393, at \*59-60 (June 18, 2008).

above, when it was called to Segall’s attention at the hearing he dismissed it as not a “good” recommendation.

That Wedbush could have and should have done more to ensure the accuracy of its blue sheet responses is obvious. The record established that some simple spot-checking would have uncovered many of the problems at issue.

The failure to submit complete and accurate blue sheets to the SEC in violation of Section 17(a) of the Securities Exchange Act and SEC Rules 17a-4(j) and 17a-25, as alleged in the First Cause of Action, was willful in light of all of the circumstances. The failure to have an audit system providing for accountability in violation of Section 17(a) and SEC Rule 17a-4(f)(3)(v), as alleged in the Third Cause of Action, was also willful for the same reasons.

## **IV. SANCTIONS**

### **A. Extended Hearing Panel’s Conclusions**

Enforcement recommends a total fine of \$1 million—\$850,000 for submitting inaccurate and incomplete blue sheets (First and Second Causes of Action) and \$150,000 for failing to have in place adequate audit and supervisory systems and procedures for blue sheet reporting.<sup>135</sup> The Extended Hearing Panel concludes that the total fine is well within the applicable FINRA Sanction Guidelines, for the reasons discussed below.

In the Extended Hearing Panel’s view an even larger fine would be appropriate for Wedbush’s failure to have in place adequate audit and supervisory systems and procedures. The total absence of meaningful oversight and quality control created a complete lack of accountability at the Firm. Essentially there was a vacuum where there should have been focused attention and active management. That vacuum resulted in multiple information reporting failures on a grand scale. The violations were egregious. However, in light of the finding of willfulness, which triggers additional issues for Wedbush going forward, the Extended Hearing Panel adopts Enforcement’s recommendation without increasing the fine.

### **B. Sanction Guidelines And Analysis**

Adjudicators in FINRA disciplinary proceedings look to FINRA’s Sanction Guidelines (“Guidelines”) in considering the appropriate sanction for a violation.<sup>136</sup> The Guidelines contain recommendations for sanctions for many specific violations, depending on the circumstances and any mitigating or aggravating factors. The Guidelines also contain General Principles and overarching Principal Considerations that are applicable in all cases.<sup>137</sup> The Guidelines are intended to be applied with attention to the regulatory mission of FINRA—to protect investors

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<sup>135</sup> Enf. PH Br., at 34.

<sup>136</sup> FINRA Sanction Guidelines (2015) (“Guidelines”), <http://www.finra.org/industry/sanction-guidelines>.

<sup>137</sup> Guidelines at 2-7.

and strengthen market integrity.<sup>138</sup> They are intended to be remedial and to deter the respondent and others from similar misconduct in the future.<sup>139</sup>

Ultimately, however, adjudicators must do what they believe is right in the circumstances of the particular case. The Guidelines “do not prescribe fixed sanctions.”<sup>140</sup> They are “not intended to be absolute.”<sup>141</sup>

### **(1) Guidelines For Incomplete And Inaccurate Blue Sheets**

The Guidelines specifically recommend a range of fines for a failure to respond in a timely and accurate manner to a regulatory request for automated submission of trading data.<sup>142</sup> These Guidelines apply to the misconduct charged in the First Cause of Action, the Firm’s failure to submit complete and accurate blue sheets to FINRA in violation of FINRA Rules 8211, 8213, and 2010.

The Guidelines provide for a fine of \$100 per day when the automated filing is 10 to 15 days late, and a fine of \$500 per day when a filing is 16 to 30 days late. The Guidelines suggest that when an automated submission is more than 30 calendar days late it should be treated as a violation of FINRA Rule 8210. The Guidelines also indicate that if a firm has a history of more than four violations of the Rules relating to automated submission of trading data, FINRA Rules 8211 and 8213, then a subsequent incomplete or inaccurate submission may be alleged and treated as a violation of Rule 8210.<sup>143</sup>

If the failure to make an automated submission timely and complete is treated as a Rule 8210 violation, the range of possible sanctions for each individual failure increases. A failure to respond timely is subject to a fine of \$2,500 to \$37,000. A partial but incomplete response is subject to a fine of \$10,000 to \$73,000.<sup>144</sup>

In this case, many of Wedbush’s incomplete and inaccurate blue sheets were not corrected until months after they were originally due. Enforcement argues that we should treat all the incomplete and inaccurate blue sheets the Firm submitted to FINRA all as having been only 30 days late. On that basis, Enforcement calculates that the Guidelines would warrant a fine

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<sup>138</sup> Guidelines at 1, Overview.

<sup>139</sup> Guidelines at 2, General Principle 1.

<sup>140</sup> Guidelines at 1, Overview.

<sup>141</sup> *Id.* and at 3.

<sup>142</sup> Guidelines at 75.

<sup>143</sup> Guidelines at 75 and n.1.

<sup>144</sup> Guidelines at 33.

of \$6.42 million.<sup>145</sup> Enforcement does not take into account the much larger fines that might be applied pursuant to Rule 8210 where the Firm submitted corrected blue sheets more than 30 days late.

FINRA's Guidelines do not specifically address the failure to submit timely and complete information to the SEC upon request. But, as Enforcement argues, the Guidelines for violations of FINRA Rules 8211 and 8213 are the most analogous and appropriate to apply. Applying the same 30-day formula to the incomplete blue sheets submitted to the SEC, Enforcement estimates that the fine would be \$5.82 million.<sup>146</sup>

Thus, according to Enforcement's calculations, a total fine of \$12.24 million would be well within reason under the Guidelines, without making any adjustments for what Enforcement argues is the egregious quality of the misconduct. By contrast, an \$850,000 fine for all the blue sheet violations is light. It amounts to little more than \$1,000 for each of the 816 deficient blue sheets.

## **(2) Guidelines For Deficient Audit And Supervisory Systems And Procedures**

For deficient supervisory procedures in violation of NASD Rule 3010, the Guidelines recommend a fine of \$1,000 to \$25,000.<sup>147</sup> The Guidelines do not address violations of the SEC Rule requiring an audit system providing for accountability for blue sheets, but the Guidelines for the similar violation of NASD Rule 3010 are appropriate. Enforcement additionally suggests that the Guidelines for recordkeeping violations are also appropriate. They provide for a fine of \$1,000 to \$15,000 in the ordinary case and a fine ranging from \$10,000 to \$146,000 in an egregious case. The Guidelines further provide that in an egregious case a firm might be suspended for up to two years or expelled.<sup>148</sup>

Enforcement treats the lack of adequate audit and supervisory systems and procedures as an egregious violation. It also asserts that Wedbush's disciplinary history shows that more stringent sanctions are necessary to deter future misconduct. Enforcement requests a \$150,000 fine for these violations.

### **C. Aggravating Factors**

Some of the aggravating factors discussed here are more relevant to one violation or the other, but they all contribute to the overall conclusion that the misconduct at issue here occurred

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<sup>145</sup> Enforcement calculates that Wedbush submitted approximately 428 inaccurate and incomplete blue sheets to FINRA, most of which were not corrected until several months after they were due. If a \$500 fine is imposed for each day that each FINRA blue sheet was out of compliance, then the total would be \$6.42 million (428 blue sheets × 30 days × \$500 per day = \$6,420,000).

<sup>146</sup> Enforcement calculates that the Firm submitted approximately 388 inaccurate and incomplete blue sheets to the SEC. A \$500 fine per day applied to each for 30 days yields a fine of \$5,820,000.

<sup>147</sup> Guidelines at 104.

<sup>148</sup> Guidelines at 29.

because the Firm paid scant attention to its blue sheet reporting responsibilities. After consideration of the aggravating factors and potential mitigating factors, the Extended Hearing Panel concludes that the violations here were egregious.

*Acceptance of responsibility and voluntary correction prior to regulatory intervention.*<sup>149</sup> It is aggravating that Wedbush accepted no responsibility for the faulty blue sheets it submitted to the SEC and FINRA, even after regulatory intervention. The Firm persisted in claiming that the missing header problem was FINRA's fault—something that was untrue. It also persisted in characterizing itself as proactive in reporting and correcting its faulty blue sheets—which was also untrue.

Furthermore, the Firm's senior management in charge of blue sheets disclaimed responsibility for errors in its blue sheets because they did not supervise IT or the correspondent services department. Wedbush did not connect its lack of an audit system providing for accountability or its lack of WSPs reasonably designed to ensure compliance with its blue sheet responsibilities to the Firm's submission of hundreds of incomplete and inaccurate blue sheets. There is no evidence that the Firm understands the nature and scope of its blue sheet responsibilities.

As for corrective action, even after regulatory intervention Wedbush has done nothing to address the root problem. It represents that it has addressed the particular problems identified (it now makes sure that there are nine digits in the CUSIP field, for example, and now puts headers on all its files for submission). However, it has made no changes to its WSPs. Its senior compliance personnel reflect no understanding of the need for systems of auditing and supervising that will provide for accountability in the Firm's blue sheet reporting.

The Extended Hearing Panel notes with dismay the attitude of Segall and Moy, who were responsible for supervising the Firm's process for creating and submitting blue sheets—both denied that supervision was necessary. Segall testified that he did not have to take any steps to supervise the preparation of blue sheets because the people who were preparing them had been doing the work for years and did not need supervision. The facts of this case prove otherwise.

Wedbush denies that it is indifferent to its regulatory obligations.<sup>150</sup> It cites in support complimentary statements made by the consultant who was hired as a result of the NYSE board decision. Among other things, for example, the consultant wrote in his report that the Firm's supervisory and compliance systems are reasonably designed to detect and prevent violations of federal, FINRA, and state securities laws. Those remarks, of course, do not bind the Extended Hearing Panel. They are, in any event, irrelevant here because they were made before the events at issue here and do not address the misconduct that is the subject of this Complaint.

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<sup>149</sup> Guidelines at 6, Principal Considerations 2 and 3.

<sup>150</sup> Resp. Reply, at 4.

The Firm portrays its submission of hundreds of incomplete and inaccurate blue sheets as a matter of understandable mistakes that the Firm did not anticipate.<sup>151</sup> It characterizes the mistakes as “easily” made “by earnest people trying hard.”<sup>152</sup> It maintains that Enforcement is unreasonably seeking an impossible level of perfection, because “no system could be fully automated.”<sup>153</sup>

The Extended Hearing Panel rejects these contentions. It concludes that the Firm profoundly misunderstands the nature and importance of its blue sheet responsibilities.

***Pattern, aberration, number, character of misconduct.***<sup>154</sup> Wedbush engaged in a pattern of misconduct over a lengthy period of time (a year and a half). It is aggravating that the Firm submitted hundreds of faulty blue sheets and that they were faulty for multiple reasons. The misconduct was far from an aberration. Rather, it was an ingrained way of doing business. Those in charge of blue sheet reporting did nothing to ensure the accuracy of the information provided to regulators or to establish systems and procedures that would provide accountability for the Firm’s reporting to regulators.

The Extended Hearing Panel rejects Wedbush’s characterization of the violations as “isolated.”<sup>155</sup> That is wrong. The problems at issue affected 16% of the Firm’s blue sheets during the relevant period and resulted in a failure to disclose to regulators more than 5.6 million trades.

***Disciplinary history.*** The Guidelines specify that disciplinary sanctions should be more severe for recidivists. This is because an important objective of the disciplinary process is to deter and prevent future misconduct. A recidivist has already demonstrated that less stringent sanctions were insufficient to accomplish that objective. The Guidelines recommend escalating sanctions on recidivists, increasing their severity.<sup>156</sup>

As the SEC has noted, “FINRA routinely considers an applicant’s disciplinary history in determining the appropriate sanctions.”<sup>157</sup> There are a number of reasons for doing so. Disciplinary history may assist “in determining the likelihood of the respondent’s repeating the misconduct and assessing sanctions that are in the public interest.”<sup>158</sup> The SEC has said, “We have long recognized that prior disciplinary history . . . provides evidence of whether an

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<sup>151</sup> Resp. PH Br., at 2.

<sup>152</sup> Resp. PH Br., at 11.

<sup>153</sup> Resp. PH Br., at 13.

<sup>154</sup> Guidelines at 6-7, Principal Considerations 8, 9, 16, 18.

<sup>155</sup> Resp. Reply, at 2.

<sup>156</sup> Guidelines at 2.

<sup>157</sup> *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 SEC LEXIS 1699, at \*47 and n.83 (June 14, 2013).

<sup>158</sup> *Dist. Bus. Conduct Comm. v. Blitstein*, No. C3A910113, 1992 NASD Discip. LEXIS 29, at \*13 n.4 (NAC Oct. 19, 1992).

applicant's misconduct is isolated, the sincerity of the applicant's assurance that he will not commit future violations and/or the egregiousness of the applicant's misconduct."<sup>159</sup> Disciplinary history includes settlements with the SEC or FINRA of similar charges.<sup>160</sup>

Wedbush's disciplinary history is a particularly aggravating factor here. That history is not only extensive but some of it is directly related to the misconduct found in this case.

In the last ten years, Wedbush has been involved in numerous disciplinary proceedings and subject to approximately \$2 million in fines. In the past 5 years the Firm has been sanctioned in 12 cases for violations relating to the production of incomplete, inaccurate or late information to its regulators. In 2007, the NYSE fined the Firm \$200,000 and required it to hire a consultant to review and make recommendations regarding its controls and procedures for supervising blue sheets. The NYSE found that the Firm failed to establish and maintain appropriate systems and procedures for supervision and control of its blue sheet reporting. As discussed above, the NYSE expressly found that Wedbush's approach to blue sheet reporting was "inexcusably inadequate, inept, dilatory and systemically deficient."<sup>161</sup>

The Extended Hearing Panel in this matter concludes that the Firm's lack of audit and supervisory systems for blue sheets five years after the NYSE decision manifests a continuing inexcusable and inept approach to blue sheet reporting.

#### **D. Potential Mitigating Factors**

*Assertion that Wedbush self-reported problems.* Wedbush claims that FINRA staff brought only two erroneous blue sheets to the Firm's attention, and the Firm should be credited with identifying the other 814 inaccurate blue sheets at issue. As discussed above in connection with the chronology of events giving rise to the proceeding, this characterization of the Firm's discovery and reporting of the inaccurate blue sheets is false. The Firm only discovered the problems with its blue sheets when FINRA staff first identified potential problems and, with respect to the missing headers, by accident. The Firm filed Rule 4530 disclosures because it was required to do so. Doing what is required is not a mitigating factor.<sup>162</sup>

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<sup>159</sup> *Plunkett*, 2013 SEC LEXIS 1699, at \*47 and n.82. See also *Midas Sec. LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at \*66-67 (Jan. 20, 2012) (importance of prior disciplinary history has been long recognized); *In re Investment Planning, Inc.*, Exchange Act Release No. 32687, 51 S.E.C. 592, at \*19 (July 28, 1993) ("disquieting disciplinary history" justified imposing more severe sanctions on respondent).

<sup>160</sup> A settlement of prior charges involving similar conduct could bear on whether the respondent engaged in knowing or reckless misconduct the second time. Cf. *In re William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, \*101 (July 2, 2013) (disciplinary history put respondent on notice that his conduct was not proper and was relevant to his knowing or reckless conduct).

<sup>161</sup> CX-15 at 2.

<sup>162</sup> Cf. *Dep't of Enforcement v. McCune*, No. 2011027993301, 2015 FINRA Discip. LEXIS 22, at \*23 (July 27, 2015) ("an associated person should not be rewarded for acting in accordance with his duties as a securities professional").

***Assertion that no one was harmed.*** The Guidelines provide that the existence, nature and extent of injury should be considered in determining sanctions.<sup>163</sup> The Firm claims that no one was harmed by its submission of deficient blue sheets.<sup>164</sup> The Firm is incorrect. The Firm's incomplete and inaccurate blue sheets deprived regulators of information they needed to investigate potential insider trading and other market abuses. While it is impossible to determine the extent to which regulatory investigations were hampered, there is evidence that at least one specific investigation was affected. Potentially, many investigations were deprived of useful information regarding wrongdoing. The investing public as a whole is harmed by the Firm's misconduct.

***Inability to pay.*** The Guidelines require adjudicators to consider a respondent's *bona fide* inability to pay when imposing a fine. The burden is on the respondent to raise the issue and to provide evidence of the alleged inability to pay.<sup>165</sup>

Segall testified that a fine as substantial as \$1 million would create difficulties. Without more, there is an insufficient basis for reduction of the fine here. Furthermore, the Guidelines specifically provide that adjudicators are not required to adjust monetary sanctions on the basis of a firm's required minimum net capital.<sup>166</sup> We understand that to mean that a fine need not be adjusted simply to allow a firm to continue in business. Similarly, we are not required to decrease the fine here simply to diminish the financial burden to the Firm.

In fact, the Guidelines specifically provide, "Sanctions should be more than a cost of doing business."<sup>167</sup> The Extended Hearing Panel believes that the fine here must reflect its judgment regarding the egregious and willful nature of the violations. It would fly in the face of FINRA's mission to protect investors and strengthen market integrity to decrease the fine to accommodate the wrongdoer's financial needs. Doing so would simply permit the Firm to treat FINRA's fines as a cost of doing business.

***Assertion that requested sanctions are disproportionate and punitive.*** The Guidelines specify that adjudicators should consider a firm's size with a view toward ensuring that the sanctions imposed are remedial and not punitive.<sup>168</sup> Wedbush suggests that the requested fine of \$1 million is excessive and punitive on its face.<sup>169</sup> The record contains no evidence to support this assertion. Even if there were, the Extended Hearing Panel concludes that the finding of willfulness and the totality of the circumstances justify the size of the fine. The Guidelines provide that with respect to willful misconduct adjudicators may determine, in light of the

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<sup>163</sup> Guidelines at 6, Principal Consideration 11.

<sup>164</sup> Resp. PH Br., at 18.

<sup>165</sup> Guidelines at 5, General Principle 8.

<sup>166</sup> Guidelines at 5, General Principle 8.

<sup>167</sup> Guidelines at 2.

<sup>168</sup> Guidelines at 2, General Principle 1.

<sup>169</sup> Resp. PH Br., at 17-18; Resp. Reply, at 5-9.



totality of the circumstances, that small size will not be considered in connection with sanctions.<sup>170</sup>

### **E. Aggregation Of Violations For Purposes Of Sanctions**

The Guidelines provide for the aggregation or batching of violations for the purpose of determining sanctions.<sup>171</sup> The Extended Hearing Panel believes it appropriate to aggregate the sanctions for the deficient blue sheets submitted to the SEC and FINRA because the violations involve the same misconduct. The Extended Hearing Panel aggregates the sanctions for the failure to have either an audit system or a supervisory system with WSPs reasonably designed to achieve compliance because the violations are similar in character.<sup>172</sup>

## **V. ORDER**

For submitting 816 incomplete and inaccurate blue sheets to the SEC in willful violation of the Securities Exchange Act Section 17(a), SEC Rules 17a-4(j) and 17a-25, and FINRA Rule 2010, (First Cause of Action), and for submitting incomplete and inaccurate blue sheets to FINRA in violation of the Securities Exchange Act Section 17a-4(f)(3)(v) and FINRA Rule 2010 (Second Cause of Action), Respondent Wedbush Securities Inc. is fined in the aggregate \$850,000.

For failing to have in place an audit system providing for accountability regarding inputting of records in willful violation of Securities Exchange Act Section 17(a), SEC Rule 17a-4(f)(3)(v), and FINRA Rule 2010 (Third Cause of Action), and for failing to establish and maintain a supervisory system and failing to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and rules in violation of NASD Rule 3010 and FINRA Rule 2010 (Fourth Cause of Action), Respondent Wedbush Securities Inc. is fined in the aggregate \$150,000.

Wedbush Securities Inc. is subject to a statutory disqualification for its willful violations of federal securities laws and regulations.

The Firm is also ordered to pay costs, which amount to \$9,085.21, including a \$750 administrative fee and the cost of the transcript. The fines and assessed costs shall be due on a

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<sup>170</sup> Guidelines at 2 n.2.

<sup>171</sup> Guidelines at 4, General Principle 4.

<sup>172</sup> The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

date set by FINRA, but not sooner than thirty days after this decision becomes FINRA's final disciplinary action in this proceeding.

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Lucinda O. McConathy  
Hearing Officer  
For the Extended Hearing Panel