

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2005002670701**

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REGISTRATION & DISCLOSURE

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Person Financial Services, Inc.
Member Firm
CRD No. 25866

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, Person Financial Services, Inc. ("Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

During all periods mentioned herein, Respondent was a registered broker dealer with the Securities and Exchange Commission and a member of the FINRA, whose registration and membership remain in effect. The firm's relevant disciplinary history for the past five years consists of the following:

On June 20, 2003, FINRA accepted an AWC (Case No. C06030011) whereby the firm was censured, fined \$25,000.00 and ordered to retain an independent outside consultant to conduct a review of, and prepare a written report and make recommendations as to the adequacy of the firm's supervisory and compliance policies and procedures and its system for applying such procedures, for failing to establish and maintain a

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supervisory system reasonably designed to address the processing of letters of authorization received from two of its correspondent firms, and including but not limited to the establishment and maintenance of written procedures as to the processing of letters of authorization, all in violation of NASD Conduct Rules 2110, 3010(a), and 3010(b).

On October 6, 2005, FINRA accepted an AWC (Case No. C06050007) whereby the firm was censured and fined \$50,000 for failing to adequately fund its reserve account in violation of SEC Rule 15c3-3 and NASD Conduct Rule 2110, and for failing to timely file reports of foreign bank and financial accounts in violation of NASD Conduct Rules 2110 and 3011.

OVERVIEW

From July 1, 2003 to June 30, 2005, Respondent Penson Financial Services, Inc. permitted customers to purchase and sell securities in a series of transactions without requiring full cash payment for each securities purchase. Respondent improperly permitted the use of unsettled proceeds of securities sold as payment for subsequent securities purchases, and then allowed the securities purchased to be sold without requiring full cash payment.

THE APPLICATION OF REGULATION T TO CASH ACCOUNTS.

Under Regulation T, securities may only be purchased in a cash account if the customer has sufficient funds in the account to pay for all purchases, independent of the sale proceeds to be received from the sale of those securities.¹ In order to comply with Regulation T, a customer must have funds for the purchase in the account or must deliver a check for full payment of the purchase transaction to the broker-dealer by settlement date.

Section 7(c) of the Exchange Act provides, in relevant part, as follows:

It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer - on any security (other than an exempted security) ... in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System ... shall prescribe.

¹ See *Fed. Res. Staff Op.*, 2 *Federal Reserve Regulatory Services*, Part 5-616.11 (May 27, 1994).

Section 220.8(a)(1)-(2) of Regulation T, promulgated by the Board of Governors of the Federal Reserve System provides, in relevant part, as follows:

(a) *Permissible Transactions.* In a cash account, a creditor, may:

- (1) Buy for or sell to any customer any security or other asset if:
 - (i) There are sufficient funds in the account; or
 - (ii) The creditor accepts in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment.
- (2) Buy from or sell for any customer any security or other asset if:
 - (i) The security is held in the account; or
 - (ii) The creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account

In Federal Reserve Staff Opinion, 5-616.18,¹ the Board staff reiterated that the practice of permitting cash account customers to use the proceeds of unsettled sale transactions to fund subsequent purchase transactions violates Regulation T. Specifically, in May 2003, the Board staff addressed a situation in which a customer sells stock A on Day 1, buys stock B on Day 2, sells stock B on Day 3, and then buys and sells stock C on Day 5. The fact pattern assumed the following: (1) each of the purchases was less than the value of the account; (2) stock A had been fully paid-for; and (3) a three-day settlement process applied. The Board staff stated that Regulation T permits two methods for paying for a securities purchase in a cash account: (1) a customer who has sufficient funds in the account on trade date may purchase securities and sell them at any time; and (2) a customer who does not have sufficient funds in the account on trade date may purchase securities only with the understanding that such securities will not be sold until they are paid in full. However, the Board staff emphasized that sale proceeds that had not yet been received do not constitute "sufficient funds." Consequently, under the facts presented, the Board staff stated that the sale of stock B on Day 3 should have put the creditor on notice that the customer may have engaged in an impermissible transaction, because stock B was purchased with the proceeds of the sale of stock A, and the sale of stock A would not settle until Day 4. In that same regard, the sale of stock C on Day 5 was similarly impermissible because it was purchased with unsettled funds from the sale of stock B. The Board reiterated that this interpretation did not set forth a new legal

¹*Fed. Res. Staff Op., 2 Federal Reserve Regulatory Services*, Part 5-616.18 (May 12, 2003).

proposition: "For over 50 years, Regulation T has required customers to pay for securities purchased in a cash account before selling them."

THE VIOLATIONS

During the period from July 1, 2003 to June 30, 2005, Respondent Penson Financial Services, Inc. permitted the improper trading in up to 75,000 transactions, resulting in violations of Regulation T for (i) sale of securities without full cash payment having been made by the customer; or (ii) the use of proceeds from unsettled sale transactions as payment for subsequent transactions; or (iii) the failure to properly restrict accounts from trading subsequent to the trading activity described prior.

Respondent charged a clearing fee to the introducing broker for each market order during the relevant time period. Consequently, Respondent received revenue due to the foregoing misconduct.

The foregoing acts, practices and conduct constitute separate and distinct violations of Regulation T and NASD Conduct Rule 2110 by Respondent Penson Financial Services, Inc.

During the period from June 2006 through July 2006, Respondent Penson Financial Services, Inc. violated Section 220.8 of Regulation T for the following reasons:

- (b) Respondent failed to obtain a Regulation T extension request with regard to forty-three transactions in twenty-two customer cash accounts;
- (c) Respondent failed to obtain payment by the Regulation T date for eight transactions in eight customer cash accounts;
- (d) with regard to three transactions in three customer cash accounts, Respondent accepted payment into the customers' margin accounts to cover purchases in their cash accounts; however, debit balances remained in the customers' cash accounts and Respondent failed to obtain a Regulation T extension request for such accounts;
- (e) with regard to three transactions in three customer accounts, Respondent filed a Regulation T extension request; however, it accepted payment after the extension due date;
- (f) with regard to one transaction in one customer's account, Respondent obtained a Regulation T extension request and sold the customer's securities before the extension due date; however, it allowed this customer to make an additional purchase during the ninety-day freeze

period.

The foregoing acts, practices and conduct constitute separate and distinct violations of Regulation T and NASD Conduct Rule 2110 by Respondent Penson Financial Services, Inc.

B. Respondent also consents to the imposition of the following sanctions:

A censure and monetary fine of \$500,000 against Respondent Penson Financial Services, Inc.

In addition, Respondent Penson Financial Services, Inc. shall comply with the following undertakings within the time periods specified (unless otherwise extended by FINRA staff in writing upon good cause shown and upon receipt of a timely request from Respondent).

1. Assessment of Current Supervisory System, Policies and Procedures. Within 30 days of acceptance of this AWC, Respondent Penson Financial Services, Inc. shall retain, at its sole expense, an independent outside consultant ("Consultant"), not unacceptable to FINRA, to: (a) to conduct an assessment, applying AICPA consulting standards, of the effectiveness of Respondent's current supervisory system, policies and procedures (written and otherwise) and related controls relating to Respondent's compliance with those sections of Regulation T that are the subject of this disciplinary action; and (b) prepare a written report ("Consultant's Report") summarizing its findings and recommendations. The Consultant's report shall describe the method and scope of the assessment, and include any appropriate recommendations to improve Respondent's system, policies and procedures regarding Respondent's compliance with Regulation T. Respondent shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client privilege or other doctrine or privilege to prevent the Consultant from transmitting any information, reports or documents to FINRA.
2. Delivery of Consultant's Report. No later than 90 days after acceptance of this AWC, Consultant shall submit to FINRA a copy of the Consultant's Report.
3. Certification re: Consultant's Report. No later than 60 days after the date of the Consultant's Report, an officer of Respondent shall certify in writing to FINRA staff that Respondent has implemented all recommendations set forth in the Consultant's Report, or has engaged in a process that will result in the implementation of any such recommendations within 90 days of the date of such certification. To the extent that Respondent elects not to implement any of the Consultant's Report recommendations, Respondent's

officer shall include in the firm's written response a detailed explanation outlining Respondent's reasons for not implementing Consultant's recommendations and any alternate procedures adopted to accomplish the same purpose of such recommendation.

4. Semi-Annual Regulation T Assessments for 18 Months. Respondent shall engage its Consultant to (a) conduct, for each of the next three six month periods beginning the month following the date of the certification of the Consultant's Report, an assessment (each, a "Semi-Annual Regulation T Assessment") of Respondent's implementation of the recommendations in the current Consultant's Report or further recommendations made by the Consultant; and (b) prepare a written assessment report ("Semi-Annual Regulation T Consultant's Report") summarizing its findings and any further recommendations. Each Semi-Annual Regulation T Consultant's Report shall describe the method and scope of the assessment, and make any appropriate recommendations to improve Respondent's system, policies and procedures regarding Regulation T. Within 60 days after the end of each respective six month period, Respondent shall deliver to FINRA a copy of each Semi-Annual Regulation T Consultant's Report.
5. Certification re: Semi-Annual Regulation T Audits. No later than 60 days after submission to FINRA of each Semi-Annual Regulation T Consultant's Report, the Chief Executive Officer and the Executive Vice President of Respondent shall certify, in writing, to FINRA that (i) such officers have reviewed Respondent's Semi-Annual Regulation T Consultant's Report, and (ii) Respondent has implemented all recommendations set forth therein, or has engaged in a process that will result in the implementation of any such recommendations within 90 days of the date of such certification.
6. Officer Certification Regarding Regulation T System and Procedures. Within nine months of notice of acceptance of this AWC, the Chief Executive Officer and Executive Vice President of Respondent, or such other persons as are acceptable to FINRA, shall certify in writing to FINRA that the firm has established a system and procedures reasonably designed to achieve compliance with Regulation T.
7. Period of Engagement. Respondent shall require the Consultant to enter into a written agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any other employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any firm with which the Consultant is affiliated in performing his or her duties pursuant to this AWC shall not, without prior written consent of FINRA staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with

Respondent or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

Respondent specifically and voluntarily waives any right to claim that Respondent is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter. Respondent has submitted an Election of Payment form showing the method by which Respondent proposes to pay the fine imposed.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against Respondent;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-3; and
 - 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement.

This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

Respondent certifies that Respondent has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Respondent to submit it.

Penson Financial Services, Inc.

12/6/07
Date

By: Philip A. Pendergraft

Name: PHILIP A. PENDERGRAFT

Title: EXEC. VICE PRESIDENT

Reviewed by:

Robert Mendelson
Attorney Name
Counsel for Respondent

Firm Name Morgan, Lewis & Bockius LLP
Address 101 Park Ave
City/State/Zip NY NY 10178
Phone Number 212 309 6000

Accepted by FINRA:

12/7/2007
Date

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

George C. McGuigan, Jr.
George C. McGuigan, Jr.
Regional Counsel
FINRA Department of Enforcement

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