

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

GEORGE REILLY
(CRD No. 1523041),

Respondent.

Disciplinary Proceeding
No. 2006006518904

Hearing Officer—MAD

DEFAULT DECISION

November 5, 2009

Respondent violated Conduct Rules 3010 and 2110 by (i) failing to establish, maintain, and enforce an adequate supervisory system and procedures, and (ii) failing to adequately supervise two registered representatives and the trading and market making at his firm. He also violated Conduct Rules 3011 and 2110 by (i) failing to develop and implement an AML program reasonably designed to achieve and monitor his firm's compliance with applicable AML laws, rules, and regulations, and (ii) failing to detect and report suspicious money movements and trading activity. For these violations, Respondent is suspended in all principal capacities for two years and fined a total of \$50,000.

Appearances

Peter Schlossman, Senior Counsel, Washington, DC, for the Department of Enforcement.

No appearance by or on behalf of George Reilly.

DECISION

I. Introduction

On June 30, 2009, the Department of Enforcement ("Enforcement") filed the attached Complaint in this disciplinary proceeding against Respondent George Reilly ("Reilly"). The First Cause of the Complaint charges that Reilly violated Conduct Rules 3010 and 2110 by: (1) failing to establish, maintain, and enforce a reasonable supervisory system and procedures, and (2)

failing to supervise two registered representatives, and the trading and market making at his firm. The Second Cause of the Complaint charges that Reilly violated Conduct Rules 3011 and 2110 by: (1) failing to establish and implement a reasonable anti-money laundering (“AML”) program, and (2) failing to detect and report suspicious money movements and trading.¹

Reilly did not answer or otherwise respond to the Complaint. Consequently, on September 14, 2009, Enforcement filed a Motion for Entry of Default Decision (“Default Motion”), supported by the Declaration of Peter Schlossman, Esq. (“Schlossman Decl.”) and four exhibits. Respondent did not file a response to the Default Motion.²

II. Jurisdiction

Reilly began his career in the securities industry in 1988.³ From June 1988 until December 2000, Reilly was registered and associated with a series of FINRA member firms. Between December 4, 2000, and December 12, 2007, Reilly worked at Chicago Investment Group, LLC (“CIG” or “Firm”). At CIG, he was registered as a General Securities Representative and a General Securities Principal, as well as several other capacities.⁴ On December 17, 2007, CIG filed a Uniform Termination Notice for Securities Industry Registration (“Form U5”), indicating that Reilly’s employment had been terminated on December 12, 2007.⁵

¹ As of July 30, 2007, NASD consolidated with the member regulation and enforcement functions of NYSE Regulation and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD. Following consolidation, FINRA began developing a new FINRA Consolidated Rulebook. The first phase of the new consolidated rules became effective on December 15, 2008, including certain conduct rules and procedural rules. *See* Regulatory Notice 08-57 (Oct. 2008). This decision refers to and relies on the NASD Conduct Rules that were in effect at the time of Respondent’s alleged misconduct. The applicable rules are available at www.finra.org/rules.

² The factual determinations in this decision are based on the allegations of the attached Complaint, which are deemed admitted, as well as additional materials filed by Enforcement.

³ CE-1, at 2.

⁴ Schlossman Decl. ¶ 4; CE-1, at 2.

⁵ Schlossman Decl. ¶ 5; CE-2.

Although Reilly has not been associated with a FINRA member since December 12, 2007, he remains subject to FINRA's jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because (1) the Complaint was filed within two years following the termination of his last registration with a FINRA member, and (2) the Complaint charges him with misconduct committed while he was associated with a FINRA member firm.⁶

III. Origin of the Investigation

Enforcement's investigation of Reilly originated from a referral from FINRA's Member Regulation Department as a result of its examination of CIG. Upon receipt of that referral, Enforcement investigated CIG, Reilly, and other firm employees to determine if CIG was involved in price manipulation of an OTC Bulletin Board ("OTCBB") stock. In addition, Enforcement investigated for possible supervisory and AML violations. At the conclusion of its investigation, Enforcement filed the Complaint in this proceeding.

IV. Respondent's Default

The Hearing Officer finds that Reilly defaulted by failing to answer or otherwise respond to the Complaint within the time required by Procedural Rule 9215. Enforcement's Default Motion, supporting declaration, and exhibits show that Enforcement properly served Reilly with the Complaint and the First and Second Notices of Complaint in accordance with Procedural Rule 9134(b)(1). Accordingly, pursuant to Procedural Rules 9215(f) and 9269(a)(2), the Hearing Officer deems the allegations in the attached Complaint admitted and grants Enforcement's Default Motion.

⁶ Article V, Sec. 4(a), FINRA By-Laws, available at www.finra.org/rules (then follow "FINRA Manual" hyperlink to "Corporate Organization: By-Laws").

V. Findings of Fact and Conclusions of Law

A. Respondent's Supervisory Responsibilities

Reilly worked at CIG's headquarters in Chicago, Illinois.⁷ He was CIG's President from 2004 until his termination in December 2007. He was also the Chief Compliance Officer from 2003 through December 2006, and the AML officer from 2002 through July 2006. In these roles, his supervisory responsibilities included establishing and maintaining CIG's supervisory system, including its written procedures, and establishing and implementing its AML compliance program.⁸ In addition, Reilly was CIG's designated principal responsible for trading and market making and the designated supervisor of Paul Benz ("Benz"), a broker working out of his home in New Jersey, and Darren White ("White"), a trader working out of his home in California.⁹

B. Supervisory Violations

1. Legal Standard

Conduct Rule 3010(a) requires that FINRA members "establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [FINRA]."¹⁰ The supervisory system must be tailored specifically to the member's business and must address the activities of all of its registered representatives and associated persons.¹¹

Conduct Rule 3010(b) requires that a member "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities

⁷ Schlossman Decl. ¶ 14.

⁸ Schlossman Decl. ¶¶ 14, 16.

⁹ Schlossman Decl. ¶ 14.

¹⁰ NASD Conduct Rule 3010(a).

¹¹ NASD Notice to Members ("NTM") 99-45, 1999 NASD LEXIS 20, at *5 (June 1999).

of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of [FINRA].”¹² “Whether a particular supervisory system or set of written procedures is in fact ‘reasonably designed to achieve compliance’ depends on the facts and circumstances of each case.”¹³

A violation of Conduct Rule 3010 also is a violation of Conduct Rule 2110, which requires member firms to observe high standards of commercial honor and just and equitable principles of trade.¹⁴

2. Inadequate System and Procedures

In the First Cause of the Complaint, Enforcement alleges that Reilly failed to establish and maintain a supervisory system and procedures reasonably designed to achieve CIG’s compliance with applicable laws, rules, and regulations. Enforcement alleges that CIG’s supervisory system and procedures were deficient in several respects. First, the Firm did not have an adequate system for supervising its market making activities. Reilly, as the Firm’s designated principal responsible for trading and market making, supervised the Firm’s trading activities by conducting a daily review of the Firm’s trade blotter.¹⁵ The Firm had no other method to collect and report trade data in order to detect patterns of suspicious or improper trading.¹⁶ Second, the supervisory system was not reasonably designed to enable Reilly to supervise the activities of Benz and White, two registered representatives located on opposite sides of the country and a

¹² NASD Conduct Rule 3010(b).

¹³ *In re Kresge*, 2007 SEC LEXIS 1407, at *27 (June 29, 2007) (quoting *La Jolla Capital Corp.*, 54 S.E.C. 275, 281 & n.15 (1999)).

¹⁴ *Kresge*, 2007 SEC LEXIS 1407, at *42.

¹⁵ Schlossman Decl. ¶ 14.

¹⁶ *Id.*

significant distance from Reilly. Third, during most of the review period, the written supervisory procedures did not contain any procedures for market making. When the written supervisory procedures were revised in late 2006 to include market making procedures, they still failed to provide reasonable guidance on how to detect and prevent market manipulation.¹⁷

3. Failure to Supervise

The Complaint alleges that between April 24 and October 31, 2006, Benz and White engaged in manipulative trading of South Texas Oil Company stock ("STXX"), a thinly traded OTCBB stock. The trading occurred in two accounts: Benz's corporate customer's account and one of CIG's proprietary trading accounts. Benz directed White to execute agency transactions for his corporate customer's account and make a market in STXX at CIG, both of which caused the STXX share price to increase.¹⁸ For example, between April 24 and August 28, 2006, the corporate account transactions, primarily purchases, constituted approximately one-third of the total market activity in STXX, and the share price increased from \$.30 to \$1.94. Further, between August 29 and October 31, 2006, when CIG was an active market maker in STXX, responsible for over one-third of the total volume, the closing price increased from \$.35 to \$4.05, a gain of over 1,000 %.¹⁹ During this same period, Benz's corporate customer's account alternated between buying and selling STXX, often buying the shares back at a higher price.²⁰ These sales and repurchases occurred while the corporate account maintained a significant position of STXX shares.²¹

¹⁷ Schlossman Decl. ¶ 14.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

The First Cause of the Complaint alleges that Reilly failed to fulfill his supervisory responsibilities. First, he failed to reasonably supervise Benz and White. He had minimal contact with them, and did not review their customers' account statements.²² Second, Reilly failed to properly supervise the market making and trading at CIG.

Enforcement identified several "red flags" relating to Benz's trading in his corporate customer's account and White's market making in the STXX security at CIG that Reilly failed to detect.²³ First, the nature of Benz's STXX trading on behalf of his corporate customer should have prompted Reilly to investigate. The corporate account was responsible for a large percentage of the total volume in STXX between April and October 2006.²⁴ The trading was suspicious because the corporate account was buying and selling similarly sized blocks of STXX, while simultaneously holding a large number of STXX shares in reserve.²⁵ In addition, the STXX repurchases were frequently at higher prices.²⁶ Second, White's market making in STXX should have alerted Reilly to potential problems. For example, during the first two days of the STXX market making, CIG was at the inside bid 95% of the time and was responsible for over 80% of the total volume.²⁷ From August 29 through October 31, 2006, CIG was at the inside bid 52% of the time and the share price of STXX increased from \$1.90 to \$4.05.²⁸ Third, there were overlapping relationships between control personnel for the corporate account, South Texas

²² Schlossman Decl. ¶ 14.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

Oil Company, and a hedge fund with which South Texas Oil Company had entered into a subscription agreement.²⁹

The Hearing Officer finds that Reilly failed to establish and maintain a reasonable supervisory system, as required by Conduct Rule 3010(a), and failed to establish, maintain, and enforce written supervisory procedures, as required by Conduct Rule 3010(b). He also violated Conduct Rule 3010(a) by failing to adequately supervise Benz and White, and the market making and trading at CIG. The Hearing Officer further finds that Reilly thereby violated Conduct Rule 2110, which requires associated persons to “observe high standards of commercial honor and just and equitable principles of trade.”

C. Anti-Money Laundering Violations

1. Legal Standard

Conduct Rule 3011 requires each member firm to “develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the firm’s compliance with the requirements of the Bank Secrecy Act [(“BSA”)]... , and the implementing regulations promulgated thereunder by the Department of the Treasury [(“Treasury”)].” Further, Conduct Rule 3011(a) requires each member to establish and implement policies and procedures “that can be reasonably expected to detect and cause the reporting of” suspicious activity and transactions.

Notice to Members (“NTM”) 02-21, which provides guidance to member firms concerning AML compliance programs, emphasizes each firm’s duty to detect red flags and, if a

²⁹ Approximately ten months prior to the trading activity discussed above, South Texas Oil Company entered into a subscription agreement with a hedge fund. One of the authorized users of the corporate account was a director of the hedge fund. He took a majority interest in South Texas Oil Company during the same time that the corporate account was responsible for a large portion of STXX’s monthly trading. The corporate account, the hedge fund, and South Texas Oil Company all shared the same attorney, who was responsible for wiring funds between his escrow account and the corporate account. Further, Benz’s brother was the controlling manager and Chairman of the hedge fund. Schlossman Decl. ¶ 14.

firm detects any, to “perform additional due diligence before proceeding with the transaction.”³⁰ NTM 02-47,³¹ which sets forth the provisions of the final AML rule for suspicious transaction reporting promulgated by Treasury for the securities industry, advises broker-dealers of their duty to file a Suspicious Activity Report (“SAR”) form for certain suspicious transactions occurring after December 30, 2002. The SAR form indicates 20 “Type[s] of suspicious activity” that broker-dealers must report, including “Market manipulation,” “Prearranged or other non-competitive trading,” “Securities fraud,” “Significant wire or other transactions without economic purpose,” and “Wash or other fictitious trading.”

2. Deficient Anti-Money Laundering Program

In the Second Cause of the Complaint, Enforcement alleges that Reilly failed to develop and implement an AML compliance program reasonably designed to detect suspicious transactions as required under the BSA. Enforcement also alleges that Reilly failed to detect suspicious money movements and trading activity in Benz’s corporate customer’s account, investigate the activity, and make the appropriate SAR filing.

CIG’s AML procedures were not tailored to its business. While CIG made a market in STXX, its AML procedures did not address market making activities.³² In addition, CIG’s AML program lacked procedures on monitoring and preventing money laundering. The program did not explain what additional due diligence or follow-up would be required if a money laundering “red flag” was detected, or when a SAR must be filed.³³

³⁰ NASD NTM 02-21, 2002 NASD LEXIS 24, at *37 (Apr. 2002).

³¹ NASD NTM 02-47, 2002 NASD LEXIS 59 (Aug. 2002).

³² Schlossman Decl. ¶ 16.

³³ *Id.*

Reilly also failed to track or monitor suspicious money movements and patterns of trading. For example, Reilly failed to detect and investigate the suspicious nature of the transactions in Benz's corporate customer's account.³⁴ While CIG's AML procedures require further investigation for suspicious transactions equal to or greater than \$5,000,³⁵ Reilly failed to conduct any investigation of such transactions, including wire transfers, in the corporate account.

The Hearing Officer finds the allegations of the Second Cause of the Complaint sufficient to establish that Reilly violated Conduct Rules 3011 and 2110 by: (1) failing to establish and implement an AML program reasonably designed to achieve and monitor CIG's compliance with its obligations under the BSA and related Treasury regulations, and (2) failing to detect and report the suspicious money movements and trading activity in the corporate customer's account.

VI. Sanctions

A. Supervision Violations

The Hearing Officer considered the FINRA Sanction Guidelines ("Guidelines") principal considerations and the specific considerations for each violation in deciding upon the appropriate sanctions in this case. The Guidelines for failing to supervise recommend, in egregious cases, suspending the responsible individual in any or all capacities for up to two years or imposing a bar. The Guidelines further recommend the imposition of a fine between \$5,000 and \$50,000.³⁶ The Guidelines for deficient supervisory procedures recommend a fine between \$1,000 and \$25,000, and, in egregious cases, suspending the responsible individual in any or all capacities for up to one year.³⁷

³⁴ Schlossman Decl. ¶ 16.

³⁵ *Id.*

³⁶ FINRA Sanction Guidelines 108 (2007), available at www.finra.org/sanctionguidelines.

³⁷ *Id.* at 109.

The Hearing Officer concludes that Reilly should be suspended for two years in all principal capacities and fined \$30,000 for: (1) his failure to implement a reasonable supervisory system and procedures, and (2) his failure to adequately supervise Benz and White, and the trading and market making at CIG. The record sufficiently demonstrated a number of "red flags" concerning the STXX trading in Benz's corporate customer's account and White's market making in STXX, which Reilly ignored. In addition, the Hearing Officer has taken into consideration that Reilly permitted Benz and White to work out of their home offices without adequate oversight. Reilly's minimal supervision of Benz and White enabled them to engage in manipulative trading of STXX. Finally, the Hearing Officer has considered Reilly's relevant disciplinary history. In June 2008, Reilly was fined \$20,000, jointly and severally with his firm, and required to re-qualify as a general securities principal for failing to establish, maintain, and enforce an adequate supervisory system and procedures regarding the activities of a registered representative under a special supervisory plan.

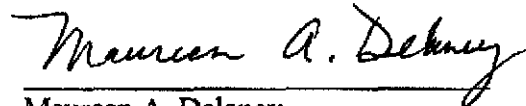
B. AML Violation

The Guidelines do not specifically address violations of Conduct Rule 3011. However, in substance, the rules requiring firms to implement written AML procedures are supervisory requirements. Accordingly, the Hearing Officer has considered the guidelines for supervisory violations, stated above, in determining the appropriate remedial sanction in this case.

CIG failed to monitor and report suspicious money movements and trading activity. In addition, the deficiencies in CIG's AML procedures - lack of tailoring to CIG's business, lack of procedures addressing market making, lack of procedures on how to monitor and prevent money laundering, and lack of procedures regarding when a SAR must be filed - are significant. Accordingly, the Hearing Officer will fine Reilly \$20,000 for this violation.

VII. Order

George Reilly violated Conduct Rules 3010 and 2110 for: (1) his failure to establish, maintain, and enforce a reasonable supervisory system and procedures, and (2) his failure to adequately supervise Benz and White, and the trading and market making at CIG as alleged in the First Cause of the Complaint. He also violated Conduct Rules 3011 and 2110 for: (1) his failure to develop and implement an AML program reasonably designed to achieve and monitor CIG's compliance with applicable AML laws, rules, and regulations, and (2) his failure to detect and report suspicious money movements and trading activity, as alleged in the Second Cause of the Complaint. For these violations, Reilly is suspended in all principal capacities for two years and fined a total of \$50,000 (\$30,000 for the supervision violations under the First Cause of the Complaint and \$20,000 for the failure to implement and enforce an adequate AML compliance program under the Second Cause of the Complaint). If this Default Decision becomes the final disciplinary action of FINRA, Reilly's suspension shall begin on December 7, 2009, and end at the close of business on December 6, 2011, and the fine shall be due and payable if and when he re-enters the securities industry.



Maureen A. Delaney
Hearing Officer

Copies to:

George Reilly (via FedEx, next day delivery, and first-class mail)
Peter Schlossman, Esq. (via electronic and first-class mail)
David R. Sonnenberg, Esq. (via electronic mail)