

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007007331401**

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

RE: Donnelly Penman & Partners,
(CRD No. 104448)

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, Donnelly Penman & Partners ("Member") 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 the Member alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Member 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

Donnelly Penman & Partners became a member of FINRA, and became registered with the Securities and Exchange Commission (SEC) on January 5, 2001. The Member conducts a general securities business on a fully disclosed basis. The Member's membership with FINRA and registration with the SEC remain currently in effect. The Member has no history of disciplinary action.

OVERVIEW

In December 2005, the Member was cautioned for failing to conduct an independent test of the Member's Anti-Money Laundering ("AML") Program. Despite this notice, the Member failed to conduct and evidence an independent test of the Member's AML Program from 2006 to May 2007. In addition, from April 5 to April 30, 2007, the Member received 31 checks from its customers, and placed them in a locked drawer at the Member's offices. In doing so, the Member

improperly held customers' funds in violation of SEC Rule 15c3-3 and its Membership Agreement. The Member also failed to apply with FINRA to amend its Membership Agreement thirty days prior to making a material change in its business operations, and therefore violated NASD Rule 1017. Finally, the Member failed to keep a checks received and dispersed blotter, in violation of SEC Rule 17a-3.

FACTS AND VIOLATIVE CONDUCT

Failure to Conduct and Evidence an Independent Test of the AML Program NASD Conduct Rules 2110, 3011, and IM-3011-1

1. NASD Conduct Rule 3011, which became effective on April 24, 2002, required NASD members to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act, 31 U.S.C. §5311, *et seq.*, and the regulations promulgated thereunder. NASD Conduct Rule 3011(c) requires that member firms have independent testing for compliance with the AML Rules on an annual basis or every two years depending on the member firm's business. NASD issued Notice to Members 02-21 in April 2002 to notify NASD members of this requirement. NASD reiterated this requirement in subsequent Notices to Members 02-47 (August 2002), 02-50 (August 2002), 02-78 (November 2002), 02-80 (December 2002), and 03-34 (June 2003).
2. On December 6, 2005, the Member was issued a Letter of Caution, which included FINRA staff's determination that the Member failed to provide evidence of the completion of independent testing of an Anti-Money Laundering Compliance Program for 2003 and 2004. The Member responded to the Letter of Caution by letter dated December 19, 2005. In that letter, the Member stated that it did not have a specific Anti-Money Laundering program in place for those years given the nature of its business. The Member also stated that it did not receive or hold customer funds at any point in time. The letter concluded by stating that, "In light of the NASD comment though, we will have written evidence on a going forward basis showing that we have performed independent testing of anti-money laundering compliance."
3. Despite the requirement that the Member monitor compliance with the requirements of the Bank Secrecy Act, 31 U.S.C. §5311, *et seq.*, and the regulations promulgated thereunder, and despite the notifications from FINRA as described above, the Member failed to conduct and evidence an independent test of its Anti-Money Laundering Program from January 2006 to May 1, 2007.

4. Such acts, practices and conduct constitute separate and distinct violations of NASD Conduct Rules 2110, 3011 and IM-3011-1 by the Member.

**Improperly Holding Customer Funds
in Violation of the Customer Protection Rule
SEC Rule 15c-3-3, and NASD Conduct Rule 2110**

5. In January 2006, the Member began offering shares of the Donnelly Penman Financial Services Fund ("Donnelly Fund"). The Fund was classified as a Regulation D offering, exempt from registration under Rule 506, and was considered a best efforts offering. From April 5 to April 30, 2007, the Member received a total of 31 checks made payable to it "as Escrow Agent" for the Donnelly Fund, or directly to the Member, which totaled \$825,843.75. After the checks were received by the Member, they were placed in a drawer. The drawer was locked and the checks were held in that drawer until the monthly "closing date" arrived, which was the date the checks were deposited in an account for the Donnelly Fund. For the checks received during the month of April, 2007, the closing date was May 1, 2007. From the time the Member received the checks until the closing date, the Member was deemed to be holding customer funds.
6. SEC Rule 15c-3-3 ("The Customer Protection Rule") requires that broker/dealers, which receive customers' funds or securities, open and maintain an account with a bank entitled "Special Reserve Bank Account for the Exclusive Benefit of Customers" ("Reserve Bank Account"). The Reserve Bank Account must be separate from any other bank account of the broker/dealer. The account shall hold customers' deposits of cash and/or qualified securities in amounts computed according to a Reserve Formula Computation ("the Formula").¹ The Customer Protection Rule also requires that broker/dealers make a computation pursuant to the Formula any time that funds are withdrawn from the Reserve Bank Account, or on a monthly basis, to ensure that there are sufficient funds in the account to pay customers if the broker/dealer must liquidate.

¹ The Customer Protection Rule created requirements that were aimed at protecting customers' funds and securities from broker/dealer misuse and ensuring that these assets would be available for distribution in the event of the broker/dealer's failure. The Customer Protection Rule's possession or control requirements were designed to protect customers' securities by ensuring that the broker/dealer either had possession of customers' fully paid and excess margin securities or kept them in a good control location. In addition, the Customer Protection Rule ensures that customers' funds are protected and available to pay customers if the broker/dealer must liquidate, by requiring the broker/dealer to compute the amount of funds that must be segregated from its operations in the Reserve Bank Account. The bank, which agrees to open the Reserve Bank Account for the broker/dealer and hold the customers' funds and/or securities, must agree that it will not attach the deposits in the Reserve Bank Account if the broker/dealer defaults on any loans from that bank.

7. From April 5 to April 30, 2007, the Member did not make any computations of the amounts that should have been held in a Reserve Bank Account using the Formula.
8. By placing the customers' checks in a drawer, rather than in a Reserve Bank Account, and by failing to perform any reserve calculations regarding the checks that the Member held, the Member violated SEC Rule 15c3-3 and NASD Conduct Rule 2110.

**Failure to Abide By the Membership Agreement and Failure to File a
Request to Change Its Membership Agreement
NASD Rules 1017 and 2110**

9. On December 29, 2003, the Member entered into a Membership Agreement with FINRA. Under the terms of the Membership Agreement, the Member agreed that it will not hold customer funds or safekeep customer securities. The Membership Agreement was signed by its President and Chief Compliance Officer.
10. Pursuant to NASD Rule 1017, member firms are required to file an application for an approval of a material change in business operations at least 30 days prior to such change. Under NASD Rule 1011, a material change in business operations includes adding business activities that require a higher minimum net capital under SEC Rule 15c3-1.
11. From April 5 to May 1, 2007, the Member accepted 32¹ checks from customers, 13 of which were made payable to the Member, the Member failed to abide by the terms of its Membership Agreement, in violation of NASD Conduct Rule 2110.
12. In addition, the Member did not request a change in its Membership Agreement prior to accepting 32 customer checks from April 5 to May 1, 2007. The acceptance and holding of customer checks increased the Member's minimum required net capital level under SEC Rule 15c3-1 from \$100,000, as stated in the Membership Agreement, to \$250,000. The Member violated NASD Rule 1017 by engaging in business activities that required a higher minimum net capital level under SEC Rule 15c3-1, while failing to request an approval for the change in its Membership Agreement with FINRA staff.

¹ The Member accepted a check on May 1, 2007, which was not included in paragraphs 5 through 8 referenced above. The check that the Member received on May 1, 2007 was made payable to the Member, rather than to the Donnelly Fund.

Failure to Maintain a Checks Received and Disbursed Blotter
SEC Rule 17a-3, and NASD Conduct Rules 2110 and 3110(a)

13. SEC Rule 17a-3(a)(1) requires that all broker/dealers make and keep current, among other things, a blotter containing an itemized daily record of all receipts and disbursements of cash and all other debits and credits.
14. From April 5 to May 1, 2007, the Member received a total of 32 checks made payable to the Member "as Escrow Agent" for the Donnelly Fund, or directly to the Member, which totaled \$825,843.75, but failed to create a blotter which showed the dates that the checks were received by the Member, in violation of SEC Rule 17a-3, and NASD Rules 2110 and 3110(a), by the Member.

- B. The Member also consents to the imposition of the sanctions of a censure and a \$17,500 fine.

The Member agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment(s) are due and payable. The Member has submitted an Election of Payment form showing the method by which the Member proposes to pay the fine imposed.

The Member specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

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

II.

WAIVER OF PROCEDURAL RIGHTS

The Member 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 it;
- 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, the Member 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.

The Member 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

The Member 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 the Member; and
- C. If accepted:
 - 1. this AWC will become part of the Member's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about its 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. The Member 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. The Member 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 the Member's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The Member may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Member 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.

The Member certifies that a duly authorized representative has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it 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, have been made to induce the Member to submit it.

7/25/08
Date

Donnelly Penman & Partners

C. Kirk Haggarty
By Managing Director
Its C. Kirk Haggarty

Reviewed by:

Regal L. [Signature]
Counsel for the Member

Accepted by FINRA:

5/19/08
Date

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

Richard S. Schultz
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