

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20070095085**

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

RE: Southwest Securities, Inc., Respondent
BD No. 6220

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Southwest Securities, Inc. ("Southwest" or the "Firm") 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 Southwest alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Southwest 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

Southwest, a member of FINRA and NYSE Euronext, is a registered broker-dealer and investment advisor headquartered in Dallas, Texas and is a wholly-owned subsidiary of SWS Group, Inc. The Firm has approximately 42 branch offices, and employs approximately 300 registered and 630 non-registered persons. The Firm engages in a nationwide securities business, and its business activities include, among other things, retail brokerage, investment banking, capital management services, securities lending and execution, and clearing for correspondent customers.

RELEVANT DISCIPLINARY HISTORY

The Firm previously has been disciplined on several occasions, including the following:

In September 2008, the Firm consented to a censure and a \$75,000 fine for failing to develop and implement a written anti-money laundering program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act. The Firm's conduct violated NASD Rules 3011 and 2110 and MSRB Rule G-41 (AWC No. 20050028955).

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In June 2008, the Firm consented to a censure and a \$45,000 fine for failures regarding trade reporting, and for related supervisory failures. The Firm's conduct violated NASD Rules 2110, 3010(a) and 6230 and Exchange Act Rule 10b-10(a)(2) (AWC No. 20070071677).

In March 2008, the Firm consented to a censure and a \$67,500 fine for failures related to order tickets and trade reporting, and for related supervisory failures. The Firm's conduct violated NASD Rules 2110, 2320, 3110, 6230 and MSRB Rules G-14, G-17 and G-27, and Exchange Act Rules 17a-3 and 17a-4 (AWC No. 20050000962).

OVERVIEW

In 2007, the Division of Member Firm Regulation of the New York Stock Exchange conducted examinations of Southwest's financial and operational procedures (the "FINOP examination") and its sales practice procedures and supervisory standards. These examinations were conducted jointly with NASD and the National Futures Association. In 2008, FINRA conducted the Firm's FINOP examination. The 2007 and 2008 FINOP examinations included review of the Firm's compliance with Rule 15c3-3 under the Securities and Exchange Act of 1934 ("Exchange Act"). In general, Rule 15c3-3 requires that a broker-dealer promptly obtain and maintain possession or control of customer securities. The purpose of Rule 15c3-3 is to protect customer assets from being used improperly by a broker-dealer to fund its business operations. Interpretations of Rule 15c3-3's provisions have been issued by the Securities and Exchange Commission and published by FINRA to assist firms in complying with the rule. Certain interpretations of Rule 15c3-3 applied to this matter and are discussed below.

The 2007 and 2008 FINOP examinations disclosed that the Firm had deficits in certain securities. A securities deficit position constitutes shares of securities in customer accounts over which the Firm should have possession or control but does not. Deficits in securities can occur in the normal course of the business operations of a broker-dealer. Regardless of how the deficits at issue occurred, Exchange Act Rule 15c3-3 required that Southwest take timely steps to eliminate them. Those steps included issuing notices to other firms to whom the Firm had loaned securities in which deficits occurred and requesting that the borrowing firms return a sufficient number of shares of those securities to cover the deficits; making attempts to borrow the securities and documenting those attempts; and/or buying the securities in the market.

As further discussed below, the Firm failed to take prompt and appropriate action to resolve securities deficits. The Firm, therefore, failed to comply with requirements concerning possession or control of securities and violated Exchange Act Rule 15c3-3 and NASD Rule 2110.

FACTS AND VIOLATIVE CONDUCT

Background

Exchange Act Rules 15c3-3(b) and (d) require that a broker-dealer promptly obtain and maintain physical possession or control of fully-paid securities and excess margin securities carried for the account of customers¹ and that the broker-dealer determine the quantity of such

¹ The terms "customer," "fully-paid securities," "excess margin securities," "securities carried for the account of a customer," among others, are defined in Exchange Act Rule 15c3-3(a).

securities not in its possession or control each business day. During the 2007 and 2008 FINOP examinations, the Firm did not promptly obtain possession or control of five securities in which it had deficits.

Securities Deficits in 2007 and 2008

The 2007 examination disclosed that the Firm had deficits in December 2006 and January 2007 in three NASDAQ-listed securities.

At the time the deficits occurred in two of the securities, W Corp. and MT Corp., the Firm had outstanding stock loans, meaning that it had loaned shares of those securities to other firms and the borrowers had not yet returned the securities to the Firm. On January 4, 2007, the Firm had a deficit of 5,130 shares in W Corp. On January 5, 2007, it issued a notice requesting that the borrower return 3,522 shares of W Corp. (i.e., a "stock loan recall notice"). On January 8, 2007, the Firm had a deficit of 3,704 shares in MT Corp. As of that date, the Firm had issued a stock loan recall notice requesting that the borrower return 3,500 shares of MT Corp. The notices in each instance were for fewer shares than the amounts of the existing deficits. The Firm did not issue additional stock loan recall notices to cover the deficits in each security. The deficits in W Corp. and MT Corp. were not eliminated until January 11, 2007 and January 16, 2007, respectively.

From December 26, 2006 to January 9, 2007, the Firm had a deficit in a third security, M Corp. At that time, the Firm did not have any outstanding loans of that security to other parties and was not required to issue stock loan recall notices. Nevertheless, the Firm was required to make continuing attempts to borrow shares of M Corp. while the deficit in that security persisted. The Firm produced documentation showing that it had attempted to borrow the security on December 26, 2006 and January 4, 2007. The Firm did not document whether it had attempted to borrow M Corp. shares on any other date during the period in which the deficit existed. As explained below, the Firm's two documented borrow attempts were inadequate to comply with possession or control requirements. The deficit in M Corp. was eliminated on January 10, 2007.

The 2008 examination disclosed that the Firm had deficits in December 2007 and January 2008 in two NYSE-listed securities, U Corp and C Corp. As described below, on three occasions when the Firm had deficits in those securities, it received shares of the securities and immediately delivered the securities to the National Securities Clearing Corporation's Continuous Net Settlement system ("CNS")² to resolve fails to deliver³ that involved shares of the securities in deficit. These actions, known as "turnaround deliveries," were permitted under Rule 15c3-3(b). However, in delivering borrowed shares to resolve fails to deliver in U Corp and

² "Continuous net settlement," or CNS, is an accounting system that summarizes and nets each participant's daily transactions in each issue, including open positions from previous days, to create a single long position or a single short position for the participant. The majority of equity trades in the United States are cleared and settled in CNS systems. CNS systems net the securities delivery obligations and payment obligations of all clearing corporation participants. Clearing corporations notify participants of their securities delivery and payment obligations each day. In addition, the clearing corporation guarantees the completion of all transactions and interposes itself as the counterparty to both sides of any transaction. See www.sec.gov/divisions/marketreg/mrclearing. The National Securities Clearing Corporation ("NSCC") is a subsidiary of the Depository Trust and Clearing Corporation.

³ A "fail to deliver" occurs when a broker-dealer acting as seller of securities does not deliver the securities to the counterparty by the settlement date of a transaction.

C Corp., the Firm was still required to promptly take steps to reduce or eliminate the existing deficits in those securities, but it did not.

On January 2, 2008, the Firm received 300 shares of U Corp. that it had borrowed from another party and on the same date, used the 300 shares to resolve a fail to deliver. At that time, the Firm had a deficit in this security of 4,992 shares. With the 4,992-share deficit still in existence, the Firm borrowed and received an additional 2,000 shares of U Corp. on January 2, 2008. That same day, the Firm used 1,876 of those shares to resolve a fail to deliver. The Firm did not borrow additional shares on January 2, 2008 to reduce or eliminate the U Corp. deficit. The deficit in U Corp. was eliminated on January 3, 2008.

On January 2, 2008, the Firm also borrowed and received 60,000 shares of C Corp. At that time, the Firm had a deficit of 15,263 shares in this security. On the same day, the Firm proceeded to use 57,857 shares to resolve a fail to deliver. The Firm did not borrow additional shares on January 2 and January 3, 2008 to reduce or eliminate the C Corp. deficit. The deficit in C Corp. was eliminated on January 4, 2008. Moreover, the Firm failed to document whether it had attempted to borrow securities or taken other appropriate action to obtain possession or control of C Corp. shares on December 28, 2007, when there was an existing deficit in that security.

Violations of Exchange Act Rule 15c3-3 and NASD Rule 2110

Exchange Act Rule 15c3-3(b) mandated that the Firm promptly obtain and maintain possession or control of customers' fully-paid and excess margin securities. Exchange Act Rule 15c3-3(d) required that the Firm be able to determine from its books and records the quantity of customer securities in its possession or control, as well as those securities not in its possession or control each business day. To comply with Rule 15c3-3(d), the Firm also needed to keep appropriate records of the actions it took to eliminate securities deficits, whether attempting to borrow securities, recalling loaned securities or making purchases of securities in the market (known as "buy-ins.")

Exchange Act Rule Interpretation 15c3-3(d)(1)/101, concerning "Securities Loans Recalls – Elective Procedure," spelled out the steps that the Firm needed to take in order not to violate the possession or control requirements of Rule 15c3-3, as those requirements related to deficits that arose in securities it had lent out. The Elective Procedures provided that once the Firm determined that it had a deficit in securities it had lent out, the Firm was required to: attempt to borrow the loaned securities; issue a stock loan recall notice to the borrower by 11:30 a.m. on the next business day if the Firm was not successful in its initial borrow attempts; and continue to attempt to borrow the loaned securities. If the deficit still existed four business days after the date on which the Firm had initially determined the existence of such deficit, the Firm then was required to send an additional recall notice to the borrower. The follow-up recall notice needed to state that the Firm would seek to buy-in the securities in which the deficit existed if such securities were not received by the following business day (i.e., the fifth business day after the initial determination of the deficit). Interpretation 15c3-3(d)(1)/101 made clear that the Firm was required to attempt to borrow the securities every day that the security continued to be needed to meet possession or control requirements. This Rule Interpretation applied to deficiencies found during the Firm's 2007 examination.

Exchange Act Rule Interpretation 15c3-3(b)(2)/01, concerning "Turnarounds-Allowability," provided that same day receipt and redelivery of a security received as a result of a settlement of a transaction was permitted, as long as the turnaround did not create or increase a deficit. Furthermore, under this Rule Interpretation, the Firm was required to "exercise due diligence to promptly obtain possession or control of fully-paid and excess margin [customer] securities, including the taking of other stops prescribed by the rule for reducing or eliminating any deficiency." This included promptly making attempts to borrow additional shares of securities in which the Firm had received shares and on the same day, delivered those shares to counterparties to resolve fails to deliver. This Rule Interpretation applied to deficiencies found during the Firm's 2008 examination.

As described above, on certain occasions in 2007 and 2008, the Firm had deficits in certain securities. In those instances, the Firm was required to take action to eliminate such deficits, including steps prescribed in Interpretation 15c3-3(d)(1)/101. Instead, the Firm failed to issue stock loan recall notices on a timely basis for a sufficient number of shares to cover the size of the deficits, and to make continuing stock borrow attempts during the existence of the deficits.

NASD Rule 2110 required that the Firm observe "high standards of commercial honor and just and equitable principles of trade." The Firm's failure to comply with Rule 15c3-3 as described above constituted a violation of NASD Rule 2110.

The Firm, therefore, violated Exchange Act Rule 15c3-3 and NASD Rule 2110.

B. The Firm also consents to the imposition of a censure and \$50,000 fine.

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

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

The Firm 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.

II. WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against the Firm;
- B. To be notified of the 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 Firm 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 Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA 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 Firm 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 FINRA 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 Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. The Firm 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 Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a

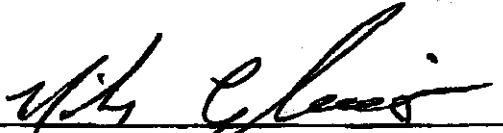
party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm 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 undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm 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 the Firm to submit it.

4-15-11

Date


Southwest Securities, Inc.

By: Mike Cogliano, CCO

Accepted by FINRA:

4/21/11

Date

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


Susan Light
Senior Vice President & Chief Counsel
FINRA Department of Enforcement
14 Wall Street, 14th floor
New York, NY 10005