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**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2008011615801**

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

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

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Penson Financial Services, Inc. ("Penson," "Firm" or "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 Penson 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

Penson is located in Dallas, Texas and has been a FINRA member firm since November 11, 1990. Penson provides execution, clearing, custody, and settlement of securities transactions to approximately 250 correspondent firms. Penson employs approximately 413 associated personnel and 90 registered personnel.

RELEVANT DISCIPLINARY HISTORY

On December 10, 2007, FINRA accepted an AWC (Case No. 2005002670701) whereby the Firm was censured, fined \$500,000 and required to retain an independent outside consultant for permitting customers to purchase and sell securities without requiring full cash payment for each securities purchase in violation of Regulation T and NASD Rule 2110.

On September 27, 2007, FINRA accepted an AWC (Case No. E062005013001) whereby the Firm was censured and fined \$20,000 for permitting, without the customers' consent, the

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hypothecation of customers' securities positions under circumstances that permitted the commingling of these securities positions with non-customer securities positions in order to collateralize bank loans in violation of SEC Rules 8C-1 and 15C2-1 and NASD Conduct Rule 2110.

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 Rule 2110, and for failing to timely file reports of foreign bank and financial accounts in violation of NASD Rules 2110 and 3011.

OVERVIEW

From October 1, 2003 through May 31, 2008, Penson violated NASD Rules 3011 and 2110 and MSRB Rule G-41 by failing to adequately implement its AML compliance program. In addition, from March 31, 2007 through May 31, 2008, Penson violated NASD Rules 3150 and 2110 by failing to report required information to INSITE accurately. Furthermore, from March 31, 2007 through May 31, 2008, Penson violated NASD Rule 2110, by failing to keep accurate books and records regarding the age and actual amount of unsecured deficits in the accounts of its correspondent firms and failing to provide the age and/or the actual amount of certain unsecured deficits to its correspondent firms.

FACTS AND VIOLATIVE CONDUCT

AML VIOLATIONS

In July 2002, the Department of Treasury issued regulations requiring suspicious transaction reporting for broker-dealers.¹ Consequently, since 2002, broker-dealers have been required by FINRA to, among other things,

- (a) Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder;
- (b) Establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder.²

A firm's AML procedures must address a number of areas including monitoring transactions to report suspicious activity where appropriate. For example, when potentially suspicious activity that warrants investigation is identified, a firm must initiate a review of that activity promptly and complete its review within a reasonable period of time.³ Firms are required to file a Form

¹ 31 C.F.R. §103.19(a)(1) (2002).

² FINRA Rule 3011; see also FINRA Notice to Members ("NtM") 02-21, at 5.

SAR-SF ("SAR-SF") with Treasury's Financial Crimes Enforcement Network reporting "any suspicious transaction relevant to a possible violation of law or regulation."⁴

It is not necessary for a broker-dealer to prove that a customer has engaged in illegal activity or to have actual knowledge of illicit or unlawful trading by a customer; rather, it is sufficient that the broker-dealer have reason to suspect that a transaction or series of transactions involve unlawful activity or lack an apparent lawful purpose. The Treasury also has advised broker-dealers to determine whether activity raises suspicions by monitoring for various "red flags." *NiM 02-21* and *NiM 02-47* emphasize members' duties to detect "red flags" and, if detected, to perform additional due diligence before proceeding with a suspicious transaction.

Broker-dealers should tailor their AML program to fit their business. In developing an appropriate AML program, a broker-dealer should consider factors such as its size, location, business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.⁵ When tailoring their supervisory procedures and systems to the business conducted, FINRA has instructed member firms to consider the technological environment in which they operate.⁶

Although there is no requirement for firms to utilize automated transaction monitoring systems, FINRA has provided guidance to clearing firms, such as Penson, to the effect that in order to "assist introducing brokers and, more importantly to satisfy their own obligations under federal law, clearing firms should establish both automated systems to detect suspicious activity and procedures to share AML information and responsibilities with introducing brokers, consistent with the Money Laundering Abatement Act."⁷

Penson Failed to Establish and Implement an Adequate AML Compliance Program

From October 1, 2003 through May 31, 2008 (the "review period"), Penson failed to adequately establish and implement its AML compliance program. Throughout most of the review period, Penson had an inadequate system for detecting, reviewing and reporting suspicious activity. Through at least the end of 2006, for example, the system relied on a limited number of employees to conduct primarily manual reviews, despite the fact that at the time the Firm cleared hundreds of thousands of trades per day for over 200 correspondent firms. Specifically, until the end of 2006, either one or two individuals were responsible for reviewing approximately two dozen different AML exception reports for suspicious activity. Certain of these reports were thousands of pages in length. Penson's failure to allocate sufficient resources to the Firm's AML compliance program resulted in, at times, inadequate and untimely reviews. Given the limited

³ See The SAR Activity Review, Issue 10 (May 2006).

⁴ 67 Fed. Reg. 44048 (July 1, 2002). See also, 31 C.F.R. §103.19(a)(1) (2002).

⁵ *NiM 02-21*, at 4.

⁶ *NiM 99-45*, at 2.

⁷ *NiM 02-21*, at 15.

resources allocated to conduct these reviews, at times these exception reports were not consistently reviewed or, in some instances, reviewed at all.

Additionally, from the start of the review period to the end of 2007, the criteria used to generate the Firm's AML exception reports were not appropriately risk-based and did not identify or account for higher-risk customers and activities, including but not limited to, risks involving: (1) high-risk geographic locations (e.g., tax havens); (2) certain financial products such as penny stock deposits and liquidations; and (3) certain types of accounts such as international financial institutions. Given the deficiencies in the Firm's risk based program and the Firm's failure to consistently review them throughout this portion of the review period, Penson was unable to adequately monitor for suspicious activity.

Furthermore, throughout much of the review period, from an AML perspective, the Firm did not regularly review penny stock deposits and liquidations, and the Firm also permitted customers to disburse funds out of certain accounts with check writing features without adequate AML review. Although employees in Penson's compliance department identified the inability to review checking activity as early as January 2004, and Penson's internal audits of its AML program that were conducted in May 2006 and June 2007 identified that, from an AML perspective, the Firm failed to review fund disbursements from accounts that had check writing features, Penson did not begin reviewing such activity until December 2007. At that time, Penson incorporated into its automated systems the tracking of these money movements.

Starting in 2007 and continuing through the end of the review period, the Firm committed additional resources to improving its AML compliance by restructuring its AML compliance department and increasing staffing. Additionally, in December 2007, Penson implemented a sophisticated automated system to assist the Firm in the detecting, reviewing and reporting suspicious activity.

However, although these enhancements have assisted the Firm in identifying suspicious activity for review, in certain instances as the updated automated system was implemented, the Firm failed to conduct *timely* investigations of activity identified by the automated system as potentially suspicious. In this regard, staff's review revealed approximately 129 instances in which suspicious activity had been flagged for review by the Firm's automated system, but the Firm failed to promptly commence a review of these activities or to complete its review within a reasonable period of time. Certain of these instances remained open for more than 90 days and, in some instances, without the Firm's review. For example, in January 2008, the Firm identified a corporate account whose principal had been charged by the SEC with securities laws violations and who, through Penson, was conducting multiple third party wires between multiple corporate accounts. Although this activity was flagged for review in January 2008, as of the end of the review period, the Firm had not conducted an investigation into this matter or determined whether or not to file a SAR-SF. Ultimately, in March 2009 the firm filed a SAR-SF regarding this activity.

Penson's AML Training Program was Deficient

NASD Rule 3011(e) requires member firms to provide AML training to appropriate firm personnel. *NiM* 02-21 emphasizes that member firms should scrutinize their operations to determine if there are certain employees who may need additional or specialized training due to their duties and responsibilities. Furthermore, as detailed in *NiM* 02-21, employees in Compliance, Margin, and Corporate Security may need more comprehensive training, and the firm should train these employees or have these employees receive the appropriate instruction to ensure compliance with the Money Laundering Abatement Act.

During the review period, although Penson administered a general AML training program, it failed to provide specialized or enhanced AML training to employees that had greater exposure to financial transactions (e.g., wire transactions and journal activity) of its correspondent firms' customers. Additionally, in certain instances, Penson failed to document the AML training that it provided to its employees, as required by its own AML procedures.

Penson Failed to Assess the AML Risks of Certain of its Correspondent Accounts for Foreign Financial Institutions

Section 312 of the Money Laundering Abatement Act requires broker-dealers to assess the money laundering risks presented by correspondent accounts for foreign financial institutions based upon a consideration of certain relevant factors, as appropriate to the particular jurisdiction, customer, and account.

At various times from March 31, 2007 through May 31, 2008, Penson failed to adequately assess the money laundering risks presented by two of the Firm's eleven correspondent accounts for foreign financial institutions as required by Section 312 of the Money Laundering Abatement Act, 31 C.F.R. 103.176, NASD Conduct Rule 3011(a) and (b) and MSRB Rule G-41.

Penson's Written AML Procedures were Deficient

At various times during the review period, Penson's written AML procedures were deficient in that they failed to address how the Firm would: (1) identify its correspondent accounts for foreign financial institutions; (2) document the assessment of money laundering risks presented by each foreign financial institution; and (3) utilize the automated system it had implemented into its AML program.

Notably, the Firm's 2007 independent test included recommendations to amend the Firm's written AML procedures to address the Firm's use of an automated system to assist its personnel in conducting AML reviews and also recommended a number of other amendments to the Firm's written AML procedures. As of April 2008, the Firm's written AML procedures still had not been updated. By failing to timely address these deficiencies, Penson did not establish or implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder.

As a result of all of the foregoing conduct, Penson violated Section 312 of the Money Laundering Abatement Act, NASD Conduct Rule 3011(a), (b) and (c) and MSRB Rule G-41.

INSITE REPORTING VIOLATIONS

From March 31, 2007, through May 31, 2008, Penson failed to report required information to INSITE accurately. Specifically, Penson reported inaccurate INSITE data for at least eight variables: unsecured customer debits, margin debits in customer accounts, aged initial margin calls, short interest dollar value, exchange equity transaction dollar value, exchange equity sales commissions, as-of trades and cancelled trades, dating back to at least June 29, 2007. Most notably, Penson inaccurately reported unsecured debits to INSITE for most of its correspondent firms whose customers had such debits. Further, a review of the data integrity testing, which the Firm performed on its INSITE reporting, revealed numerous instances where the reportable unsecured debit balances for a correspondent firm were not reported; in one instance a correspondent firm's unsecured debit balance reached as high as \$1.7 million, and Penson reported no unsecured debits to INSITE.

As a result of all of the foregoing conduct, Penson violated NASD Conduct Rules 3150 and 2110.

PENSON'S FAILURE TO PROVIDE REQUIRED INFORMATION TO ITS CORRESPONDENT FIRMS

SEC Rule 15c3-1(c)(2)(iv)(B) specifies the circumstances in which a clearing firm must take a charge to its net capital for unsecured or partly secured debits. Further, the SEC staff has stated that deficits in unsecured and partly secured introduced accounts shall be deducted by the carrying broker-dealer and the introducing broker-dealer when the clearing agreement states that such deficits are the liability of the introducing broker-dealer. The introducing broker-dealer must deduct the charge on the day after it becomes a charge to the carrying broker and the SEC staff has instructed carrying broker-dealers to advise the introducing broker-dealer in writing on a daily basis of all such deficits to be charged.⁸

NIM 05-38 emphasizes that clearing firms must review their operations to ensure that they have policies and procedures in place to comply with the SEC's staff's guidance, which does not permit any delay in passing on the deficit and requires that the clearing firm must advise the introducing broker-dealer in writing on a daily basis of all such deficits; including the age of the deficit and the actual amount of the charge to net capital. Penson's clearing agreements state that the introducing broker-dealers are responsible for all customer deficits; therefore, the firm and its introducing broker-dealers must comply with the conditions of SEC Rule 15c3-1(c)(2)(iv)(B).

From March 31, 2007 through May 31, 2008, Penson provided its introducing broker-dealers with a daily unsecured Negative Equity Report. However, the Negative Equity Report did not explicitly include the age of the deficit and/or the actual amount that the introducing firm should charge to its net capital.

As a result of all of the foregoing conduct, Penson violated NASD Conduct Rule 2110.

⁸ See SEC Staff Interpretation Letter to NYSE; No. 88-14, August 1988.

- B. Respondents also consent to the imposition of the following sanctions:

Respondent Penson is censured and fined \$450,000.

An undertaking by Respondent Penson to have all personnel employed in the Firm's AML compliance department register for, within 60 days of the date of issuance of this AWC, sixteen hours of training concerning anti-money laundering, in a program that is acceptable to FINRA. The Firm shall provide FINRA with evidence of the registrations within ten days of registration. The Firm's personnel shall then attend and complete such training within six months of the issuance of this AWC, and shall provide FINRA with evidence that they have completed such training within ten days of completion of the training program.

Respondent agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fines imposed.

Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

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 Complaint issued specifying the allegations against them;
- 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, 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 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

Respondent understands that:

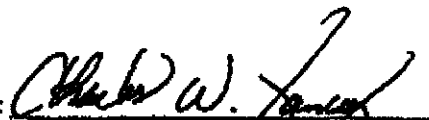
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. This AWC will become part of Respondent's permanent disciplinary records and may be considered in any future actions brought by FINRA or any other regulator against them;
 - 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary records;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; 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 rights 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 understand that they 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 Penson, certifies that he is duly authorized to act on Penson's 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 Penson 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 Penson to submit it.

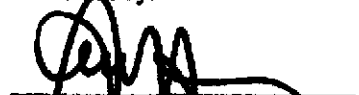
Penson Financial Services, Inc.

By:


Charles W. Yancey, President and CEO

10/12/09
Date

Reviewed by:


Ivan P. Harris, Esq.
Counsel for Respondent
Morgan, Lewis & Bockius LLP
5300 Wachovia Financial Center
200 South Biscayne Boulevard
Miami, FL 33131-2339

Accepted by FINRA:

12/14/09
Date

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

David B. Klafter, Esq.
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CORRECTIVE ACTION STATEMENT

Penson Financial Services, Inc.

In connection with their consideration of the attached Letter of Acceptance, Waiver and Consent ("AWC"), Penson Financial Services, Inc. ("Penson" or the "Firm") requests that the Office of Disciplinary Affairs and the National Adjudicatory Council take into account certain corrective actions already taken by the Firm with regard to its Anti-Money Laundering ("AML") compliance program.

As noted in the attached AWC, beginning in 2007, Penson undertook various enhancements to its AML compliance program, with specific emphasis on the Firm's ability to detect and report potentially suspicious activity. Among other things, since 2007, Penson has:

1. Substantially increased the level of staffing dedicated to AML surveillance within the Firm's compliance department. Penson also hired a dedicated AML Chief Compliance Officer to oversee its AML program.
2. Purchased and implemented a sophisticated, fully-automated AML surveillance system that monitors for suspicious activity. Penson has further employed outside consultants to assist with the design and implementation of this automated system, which has been fully operational since the first quarter of 2008.

Penson is committed to achieving compliance with all applicable rules and regulations regarding AML compliance and suspicious activity reporting. The Firm believes that the corrective steps it has taken will enable it to fully comply with applicable requirements in the future.