

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2009016264701**

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

RE: Callaway Financial Services, Inc.
Respondent Member
BD No. 104003

Corey N. Callaway
General Securities Principal
CRD No. 1279194

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondents Callaway Financial Services, Inc. ("Callaway Financial") and Corey N. Callaway ("Callaway") submit 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 Respondents alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondents hereby accept and consent, 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

Callaway Financial Services, Inc.

Callaway Financial became registered with FINRA on August 22, 2000. The firm is a general securities firm with two locations and four registered persons.

Corey N. Callaway

Callaway has been in the securities industry since 1984, when he became employed by a FINRA member firm. He became registered as a general securities representative in 1987. Callaway also holds FINRA registrations as a general securities principal, financial and operations principal, and municipal securities principal. After working for several other FINRA member firms, he has been associated with Callaway Financial since April 26, 2000 and serves as its president, chief compliance officer, financial and operations principal, and anti-money laundering ("AML") officer.

OVERVIEW

During the period from March 2005 to December 2007, Callaway Financial, acting through Callaway, failed to establish and implement an adequate AML compliance program, in violation of NASD Rules 3011(a) and (b) and 2110.

FACTS AND VIOLATIVE CONDUCT

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 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." FINRA *Notice to Members* ("NtM") 02-21 and NtM 02-47 emphasize members' duties to detect "red flags" and, if detected, to perform additional due diligence before proceeding with a suspicious transaction.

Additionally, a broker-dealer should tailor its AML program to fit its business. In developing an appropriate AML program, a broker-dealer should consider factors such as

¹ 31 C.F.R. §103.19(a)(1) (2002).

² NASD Rule 3011 (FINRA Rule 3310 as of January 1, 2010).

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).

its size, location, business activities, the types of accounts it maintains, and the types of transactions in which its customers engage.⁵

During the relevant period, Callaway Financial's AML program required it to monitor for potentially suspicious activity and AML "red flags," investigate potentially suspicious activity, and report suspicious activity by filing a SAR-SF as appropriate. During this same time period, Callaway Financial's written AML procedures identified a non-exhaustive list of AML "red flags," including, without limitation, the following:

- The customer wishes to engage in transactions that lack business sense or apparent investment strategy, or are inconsistent with the customer's stated business strategy;
- The customer (or a person publicly associated with the customer) has a questionable background or is the subject of news reports indicating possible criminal, civil, or regulatory violations;
- The customer's account has unexplained or sudden extensive wire activity, especially in accounts that had little or no previous activity;
- The customer, for no apparent reason or in conjunction with other red flags, engages in transactions involving certain types of securities, such as penny stocks, Regulation S stocks, and bearer bonds, which although legitimate, have been used in connection with fraudulent schemes and money laundering activity. (Such transactions may warrant further due diligence to ensure the legitimacy of the customer's activity.); and
- The customer maintains multiple accounts, or maintains accounts in the names of family members or corporate entities, for no apparent business purpose or other purpose.

Throughout the same time period, the firm's written AML program required Callaway to monitor for potentially suspicious activity and AML "red flags," investigate potentially suspicious activity, and report suspicious activity by filing a SAR-SF as appropriate. However, Callaway Financial and Callaway failed to adequately implement or enforce the firm's AML program and to otherwise comply with their AML obligations, as they did not document any identification or review of numerous transactions to determine if they were in fact suspicious and were required to be reported on a SAR-SF.

In addition, Callaway Financial's AML program required that the firm either conduct automated monitoring with exception reports provided by Callaway Financial's clearing firm or "manually monitor a sufficient amount of account activity to permit identification of patterns of unusual size, volume, pattern or type of transactions, . . . or any of the 'red flags'" included in the written AML program. Callaway Financial and Callaway did neither. The firm's AML program further provides that "[t]he AML Compliance [Officer] will be responsible for this monitoring, will document when and how it is carried out, and will report suspicious activities to the appropriate authorities." Callaway

⁵ See NLM 02-22 at 4.

Financial and Callaway did not document such review and did not report what were clearly suspicious activities.

For example, Callaway and Callaway Financial learned that a customer, had a criminal record, yet made no inquiry into the nature of the crimes. Minimal effort would have revealed that the customer had been convicted of racketeering, fraud, securities fraud, grand theft and lending practice violations, and that he had been disbarred as a lawyer. This knowledge should have caused Callaway and Callaway Financial to give heightened scrutiny to all future activity in the accounts, which included the following.

There was extensive activity involving penny stocks and low-priced stocks where shares were delivered into the account, quickly sold, and the proceeds wired to bank accounts belonging to the customer. The penny stock deposits and liquidations and the extensive wire transfers of funds out of the customer's accounts were red flags that the firm and Callaway failed to either detect or investigate. Callaway Financial and Callaway also failed to inquire into the specifics of the customer's business, even as they were facilitating the removal of restricted legends from the shares purportedly given to the customer for his work. Notably, the firm did not ask for, and the customer did not provide, an explanation of why the customer had accounts in the names of multiple corporate entities that were receiving shares of the same restricted stocks.

Such acts, practices, and conduct constitute separate and distinct violations of NASD Rules 3011(a) and (b) and 2110 by Callaway Financial and Callaway.

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

Callaway Financial is censured and fined \$40,000.⁶

Corey N. Callaway is suspended from association with any FINRA member firm in a principal capacity for two months and fined \$10,000.

Respondents agree to pay the monetary sanctions upon notice that this AWC has been accepted and that such payment is due and payable. Respondents have submitted Election of Payment forms showing the method by which they propose to pay the fines imposed.

Respondents specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

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

⁶ Pursuant to the General Principles applicable to all Sanction Determinations contained in the Sanction Guidelines, FINRA imposed a lower fine in this case after it considered, among other things, the firm's revenues and financial resources. See NIM 06-55.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondents specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against them;
- 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, Respondents specifically and voluntarily waive any right to claim bias or prejudice 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.

Respondents further specifically and voluntarily waive 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

Respondents understand 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 them; and
- C. If accepted:
 - 1. This AWC will become part of their permanent disciplinary record 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 their disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the

subject matter thereof in accordance with FINRA Rule 8310 and FINRA Rule 8313; and

4. Respondents 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. Respondents 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 Respondents' rights to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Respondents may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondents 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.

Callaway certifies that he has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that he 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 him to submit it.

The undersigned, on behalf of Callaway Financial, certifies that he is duly authorized to act on Callaway Financial'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 Callaway Financial 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 Callaway Financial to submit it.

Callaway Financial Services, Inc.

5-10-11
Date

By: [Signature]
Corey N. Callaway, President

5-10-11
Date

By: [Signature]
Corey N. Callaway

Accepted by FINRA:

May 17, 2011
Date

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

Rebecca L. Burnaugh (md)
Rebecca L. Burnaugh
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FINRA, Department of Enforcement
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