

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090196601**

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

RE: Southwest Securities, Inc., Respondent
CRD 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, NYSE Euronext and the Securities Investor Protection Corporation ("SIPC"), 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, investment banking, capital management services, and execution and clearing for correspondent customers.

RELEVANT DISCIPLINARY HISTORY

The Firm has previously been disciplined for violations of Rules pertaining to supervision and supervisory procedures, including the following:

- On September 18, 2002, FINRA accepted a Letter of Acceptance, Waiver and Consent (No. C05020047) in which the firm was censured and fined \$25,000 in

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part for its failure to enforce its written supervisory procedures with regard to processing customer Letters of Authorization and for its *"failure to reflect in its written supervisory procedures its procedures to address the setting of trading parameters for correspondent firms and the monitoring of correspondent transactions away from the firm,"* [emphasis added] in violation of NASD Rules 2110 and 3010(b).

OVERVIEW

During the period January 2008 through August 2009 (the "Relevant Period"), Southwest had supervisory and operational deficiencies with respect to its Clearing Services Department ("Clearing Services"), Correspondent Review Committee (the "Review Committee"), and risk management practices for its clearing correspondents. The deficiencies in Southwest's Clearing Services included, among other things, failure to have written supervisory and operational systems and procedures, failure to have adequate written job descriptions and perform adequate job training, failure to perform adequate due diligence and/or risk assessment with respect to prospective correspondents, and failure to have procedures for the escalation of significant events involving correspondents. The deficiencies with respect to Southwest's Review Committee included, among other things, failure to have written policies and procedures for the Review Committee, and failure by the Review Committee to perform adequate due diligence and/or risk assessment with respect to prospective correspondents. Southwest failed to have adequate systems and procedures to identify and manage certain risks associated with its correspondent relationships and the trading of those correspondents, and therefore failed to adequately assess and manage the risks associated with its correspondents, both at the initiation of such a relationship and on a continuing basis thereafter. Among other things, the Firm failed to be aware of the broker-dealers with which it had a correspondent relationship, and failed to notify NSCC and the NASDAQ Risk Management system of the termination of correspondent relationships and therefore effectively terminate its clearing liability; prematurely accepted clearing liability for a correspondent by notifying NSCC it was prepared to clear for the correspondent when in fact it was not so prepared; failed to recognize its correspondents' ability to trade away from it based on the correspondents' exchange memberships, agreements and arrangements; and failed to be aware of external procedures and establish internal procedures to terminate on an intra-day basis a correspondent relationship and therefore the correspondent's ability to trade. The Firm failed to have procedures to establish and failed to establish reasonable NASDAQ Automated Confirmation of Transactions ("ACT") Risk Management limits, and failed to have procedures for monitoring and responding to NASDAQ ACT Risk Management Alerts.

In part, as a result of the above mentioned procedural, due diligence, and other deficiencies and violative behaviors, in or about June 2009, the Firm entered into a correspondent relationship with C Securities, Inc. ("C Securities") without having performed adequate due diligence regarding GC, the owner of C Securities, and/or C Securities. The correspondent relationship established permitted C Securities to enter and execute trades away from the Firm, to the extent C Securities had agreements with exchanges and market centers that enabled it to do so. In late July 2009, despite significant aspects of the correspondent relationship such as how the Firm

would obtain information regarding C Securities' transactions and the pricing of the clearing services having not been established, the Firm prematurely notified NSCC that it was prepared to start clearing for C Securities. In so doing, Southwest enabled C Securities to access the securities markets, since C Securities had no other clearing arrangement, before Southwest was prepared to begin performing clearing services for C Securities. Thus enabled, C Securities, on August 3, 2009, without even a trading account or trading deposit having been established at the Firm, purchased 30,000 shares of a NYSE listed stock at a cost of \$445,200 and sold those shares for \$451,788. On August 3, 2009, NASDAQ ACT Risk Management Alerts notified the Firm of C Securities' trading in excess of the \$100,000 threshold set by the Firm, but the Firm failed to timely respond to such alerts or terminate its clearing relationship with C Securities on that trading day. On August 6, 2009, after C Securities established a trading account at the Firm and made a trading deposit, C Securities engaged in further trading even though the Firm had still not established a method to receive the information necessary for the Firm to clear its trades. Again, the Firm failed to timely and adequately respond to NASDAQ ACT Risk Management Alerts and failed to take immediate action to end C Securities' ability to trade. C Securities' second day of trading resulted in an unsecured loss in its account at the Firm in excess of \$6.3 million.

As a result, the Firm violated NASD Rules 3010(a) and (b), NASD Rule 2110, and FINRA Rule 2010.¹

FACTS AND VIOLATIVE CONDUCT

"Clearing" broker/dealers or "clearing firms" are larger broker-dealers that undertake on behalf of smaller broker-dealers, who for themselves and/or their clients perform certain functions with respect to publicly traded securities, such as: maintaining account documentation, carrying customer accounts, handling order flow and trade executions, paying and receiving funds, receiving and delivering securities, safekeeping securities, segregating customer funds, expediting the settlement of trades, processing account statements, and reporting activity.

Clearing firms ensure that transactions are made efficiently, and transmit information to and from both sides of the purchase and sale and the clearing corporation. Clearing firms are regulated with respect to requirements regarding maintenance of capital and the carrying of securities positions. The association of a small broker-dealer with a clearing firm provides the small broker-dealer with support, technology and credibility as a trading counterparty.

As the clearing firm for approximately 200 correspondent broker-dealers, Southwest provided a range of services and performed varied functions, and had financial responsibility to settle and clear the transactions of its correspondents.

C Securities and GC

During the Relevant Period, GC was the sole owner and employee of C Securities, a FINRA-regulated broker-dealer, which he formed in 1996. From June 2004 through May 2009, C Securities' trades were cleared by another FINRA-regulated broker dealer. GC contacted the

¹ See FINRA Regulatory Notice 08-57, which describes certain changes to FINRA's rules including the change of NASD Rule 2110 to FINRA Rule 2010, effective December 15, 2008.

Firm unsolicited in or about early April 2009 and C Securities and Southwest began negotiating a correspondent relationship. GC sought a clearing agreement by which C Securities would have the ability to enter and execute trades away from Southwest and provide transaction information for clearing purposes at the end of the trading day. C Securities sought to provide Southwest with only total numbers for the transactions it effected in a security on each side of the market each day (ex. bought 10,000 XYZ for total cost \$100,000, sold 10,000 XYZ for total proceeds \$105,000 regardless of how many individual executions made up the 10,000 share per-side totals) and it would be charged only \$10 per side of each security regardless of the number of actual orders and/or executions or the share size or dollar value of its transactions. Southwest did not agree to C Securities' desired pricing structure or to receive such limited transaction information and required C Securities to provide it with information regarding each execution. C Securities later agreed to provide detailed trade data at the end of each trading day. Despite this agreement however, no final process was ever established for C Securities to transmit such detailed transaction data to the Firm. While C Securities and the Firm executed a clearing agreement, they never resolved a dispute regarding how the pricing terms would be implemented.

The Firm did not have written procedures with regard to due diligence to be performed regarding potential correspondent clearing clients; rather, it required the potential client to fill out a questionnaire and supply certain documentation, and used a checklist of documents and information to be obtained from the potential client. Although the Firm's personnel had discretion to omit information from the checklist because of the lack of procedures, there was no method of ensuring that such omission or deviations were reasonable and appropriate.

One item of documentation on the checklist was the three most recent months of the potential clearing client's trading records. The Firm failed to obtain these trading records from C Securities. Instead, C Securities provided only one month of trading records, the most-recent month ended at the time it made its application to the Firm. The one month of trading records provided only the total per-side positions, not individual executions. Nonetheless, some of the total per-side transactions were in excess of \$30 million. Southwest should have investigated further the size of C Securities' intra-day trading positions in determining whether to enter into a clearing relationship with C Securities.

A principal purpose of the Review Committee was to evaluate and accept or reject potential correspondents. The Review Committee and other Southwest employees, including three members of Clearing Services, met in June 2009 to review C Securities' application. The documents provided to the Review Committee for consideration in connection with its review of C Securities' application included the one month of trading records which showed daily total per-side transactions of up to \$30-\$40 million, and the projected annual revenue of \$48,000 to the Firm to be derived from the relationship.

With respect to C Securities' application, the Review Committee failed to focus on several important matters. Most significantly, a review of the one month of trading information that GC provided would have enabled the Review Committee to learn that C Securities sometimes traded total per-side positions with a value in excess of \$30 million on a single day. Thus, Southwest could have – and should have – been aware of the dollar and share volume of trading that this

proposed correspondent had done in the recent past, and should have considered the risk management implications of his trading practices.

Despite having the information in its possession and being alerted to the share volume and dollar levels of C Securities' recent trading, Clearing Services did not inquire further regarding C Securities' trading history.

Despite being presented with potentially problematic trading information at a Review Committee meeting on June 23, 2009, the Review Committee approved C Securities as a correspondent at that meeting. Shortly thereafter, Southwest and C Securities executed a Clearing Agreement and C Securities funded its initial clearing deposit of \$100,000.

The process of on-boarding C Securities as a correspondent continued through the end of July 2009. During the on-boarding process GC expressed increasing frustration at being unable to trade. In late July 2009, GC inquired again when he could begin trading. At this time, however, the Firm and C Securities were still working out two remaining issues of the clearing arrangement: the method for receiving the information necessary to clear and settle C Securities' executed trades and the implementation of the pricing terms under the clearing agreement.

Although these issues were unresolved on July 27, 2009, the Firm sent a notification letter to NSCC to advise it that Southwest would begin clearing for C Securities, effective immediately. Southwest committed itself to take on this clearing responsibility even while these significant issues regarding the clearing arrangement remained open. As a result of Southwest's premature notice to NSCC, C Securities was able to execute trades with counterparties, including trades on the NASDAQ exchange, and report trades through ACT or to the Trade Reporting Facility ("TRF") even though Southwest was not ready to accept and clear trades.

The NASDAQ ACT Risk Management system allows clearing firms to establish gross dollar threshold limits for purchases and sales for their correspondents. When a correspondent's single trade and/or cumulative trading on one side of the market exceeds 70%, and then again 100% of the clearing firm established limit, the ACT Risk Management System notifies the clearing firm by sending an "Alert" by email (an "ACT Alert"). The ACT Alert is issued with respect to the correspondent's cumulative trading, encompassing all trades in all venues. No additional ACT Alerts are sent once the daily limit has been exceeded. In the case of C Securities, the Firm had set a limit of \$100,000 for buying, and \$100,000 for selling. With respect to trades reported to the TRF, the ACT Alert gives the clearing firm the opportunity to accept or decline to clear the trade within 15 minutes of the notification. With respect to trades which the clearing firm may decline to clear, the clearing firm may set a default that all such trades should be permitted to proceed or declined in the event the correspondent should fail to timely respond. The Firm had established that all such trades by its correspondents should proceed in the event it failed to timely respond.

C Securities' account consisted almost exclusively of day trading and therefore was subject to the day trader margin calculation which allows intraday leverage of 4-to-1 times maintenance excess. At the beginning of the day on Monday, August 3, 2009, C Securities had no funds on deposit at the Firm for trading purposes and only a \$100,000 clearing deposit. That day, at

approximately 11:39 a.m., a Clearing Services employee received an ACT Alert that a correspondent had breached a pre-established trading limit. Shortly thereafter, the Firm determined the ACT Alert involved C Securities. The Firm contacted GC, who verbally reported that he had traded shares of an NYSE listed stock via his NASDAQ terminal and that Southwest would be receiving the trades for clearing. At the end of the trading day, C Securities manually provided transaction details to Southwest, which Southwest subsequently used to clear the trades. The transaction details revealed that C Securities had bought 30,000 shares, and sold 30,000 shares, of the NYSE listed stock in 86 total transactions. C Securities incurred a profit on the transactions of approximately \$6,600.

Despite C Securities having traded prior to the Firm giving it permission to do so, prior to the establishment and funding of a trading account, prior to the establishment of a final process for transmission of C Securities' trading data to the Firm, and prior to the resolution of the issue of pricing terms under the clearing agreement, the Firm failed to take action to prevent C Securities from doing any trading after August 3, 2009. Instead, on August 4, the Firm opened a trading account for C Securities, used that account to record and settle the trades executed on August 3, 2009, and accepted a deposit from C Securities of \$2.9 million to fund C Securities' trading account.

Early in the trading day on August 6, 2009, Southwest received near-simultaneous ACT Alerts that C Securities had reached, respectively, its 70% and 100% sell-side threshold trading limits. A second set of near-simultaneous ACT Alerts regarding C Securities' purchase activity in the same stock were received by the Firm approximately 15 minutes later. The Firm failed to use the information contained in both sets of ACT Alerts to react in a timely manner. Due to the Firm's failure to provide NASDAQ ACT Risk Management with contact parties for ACT Alerts, NASDAQ ACT Risk Management directed all the alerts to a single Clearing Services employee who was on vacation on August 6, 2009. Although he was checking his email from home, and received the ACT Alert via email, he did not react timely to either set of ACT Alerts. When the Firm did inquire, it determined that the alerts related to C Securities' trading in a NYSE-listed stock. The Firm began monitoring C Securities' trading on NASDAQ on a real-time basis through the ACT system, and made repeated attempts to contact GC. GC continued to trade throughout the day. By late morning, the Firm determined that it needed to withdraw as the clearing firm for C Securities.

The Firm failed to be aware on August 6, 2009 of the procedure to terminate, on an intra-day basis, its responsibility as the clearing firm for a particular correspondent and therefore the correspondent's ability to trade. The termination of its status as a correspondent's clearing firm could have been accomplished through telephone communications. As a result of the Firm's failure to immediately take action to terminate its clearing relationship with C Securities and therefore C Securities' continued ability to trade when it deemed C Securities' trading to be excessive and uncontrollable, C Securities was able to continue trading and Southwest remained responsible to settle and clear the trades which C Securities continued to effect throughout the day.

Throughout the day on August 6, C Securities sold short 20,312,511 shares of a NYSE-listed stock at an average price of \$22.35, for a total dollar amount of \$454,095,852. C Securities

bought 17,846,079 shares of the same stock at an average price of \$22.27, for a total dollar amount of \$397,459,412. Thus, C Securities finished the day with a short position of 2,466,432 shares in this single stock.

The following morning, the Firm issued a margin call to C Securities for \$25 million, and purchased shares to close the short position. Upon closing the position and crediting the \$2.9 million that was in the C Securities account, the C Securities account had an unsecured debit balance of \$6,355,947.

Deficiencies in the Clearing Services Department

During the Relevant Period, it was the function of the Firm's Clearing Services department to establish new correspondent relationships for the Firm. Salespersons in Clearing Services identified potential correspondents, performed initial due diligence regarding the potential correspondent, and compiled data regarding the correspondent for presentation to management of Clearing Services. If management of Clearing Services determined that the correspondent was a desirable candidate, it presented the correspondent to the Review Committee. If the Review Committee approved the potential correspondent, a Clearing Services employee worked with the new correspondent to "on board" the correspondent as a clearing services client of the Firm.

Lack of Operational and Escalation Policies and Procedures

The Firm failed to have written operational policies and procedures for certain Clearing Services functions relating to, among other things, due diligence, on boarding of new correspondents, and risk management. Clearing Services employees were not informed as to how and/or when they were to go about performing certain of their job functions. Although the Firm used a checklist of tasks to be performed and documents to be obtained as part of the on boarding and due diligence processes, the Firm did not require that all the items on the checklist be performed or obtained, and did not have procedures to inform its personnel as to when it might be appropriate to omit a task or information or otherwise deviate from the checklist. As the result, in the case of C Securities, two of the three most recent months of trading statements were not obtained. In addition, the checklist did not address the order in which tasks were to be completed. As a result, in the case of C Securities, the Firm sent a letter to NSCC accepting clearing responsibility for C Securities' trading, as well as firm-wide email announcing C Securities as a new correspondent of the Firm, before the two outstanding issues regarding transaction data and pricing were resolved.

The Firm did not have procedures for the escalation of issues relating to a potential or current correspondent to senior management of the Firm or anyone outside of Clearing Services, other than such escalation that may have occurred incidentally through the Review Committee process. As a result, issues regarding potential correspondents, such as the concern expressed by a Clearing Services employee who noticed the high volume of trading on the one month of statements C Securities provided, were not addressed. Also, issues regarding current correspondents, such as C Securities' trading on August 3, 2009, were not brought to the attention of anyone outside the Clearing Services department so that a coordinated response could be formulated and carried out.

Lack of Adequate Job Descriptions and Training

During the Relevant Period, the Firm failed to have adequate written descriptions of the job functions or responsibilities of any of its Clearing Services employees and at least one of the Clearing Services employees involved in the C Securities incident was never provided with his job description by the Firm. Further, the Firm failed to provide Clearing Services employees with any formal training specific to the operation of the clearing business.

As a result, Clearing Services employees did not have a clear understanding of certain individual functions and/or responsibilities, and functions which should have been performed were not, based on misunderstanding as to which Clearing Service employee was responsible to perform that function.

Lack of Due Diligence in Clearing Services

The Firm did not have written policies and procedures setting forth documents and/or information which Clearing Services employees were required to obtain from potential correspondents for due diligence purposes. Instead, there was only a checklist which served, in practice, as a guideline. The items of documentation and/or information set forth on the checklist were not all obtained for each potential correspondent without justification for their omission.

Deficiencies in the Review Committee

Lack of Written Policies and Procedures for the Review Committee

During the Relevant Period the Firm did not have written policies and procedures for the composition or the function of the Review Committee. There were no designated mandatory participants in a Review Committee meeting, and there was no quorum requirement to constitute a meeting of the Review Committee. Further, there was no requirement that the Review Committee members be provided with information regarding potential correspondents in advance of the meeting at which the potential correspondent was considered for approval. The documents and information collected by Clearing Services regarding potential correspondents were only made available to the Review Committee at the Review Committee meetings. In some cases, Review Committee members were only provided with an email summary describing the potential correspondents a few hours prior to the meeting at which they would be discussed.

In addition, the Review Committee had no established written criteria that committee members were to use in determining the acceptability of a potential correspondent or in assessing the risks posed to the Firm by the correspondent's business.

Review Committee Failure to Perform Adequate Risk Assessment

Given the limited information provided to the Review Committee, the format in which it was presented and the limited time available for its consideration, no adequate risk assessment could have been or was conducted. The Review Committee's failure to receive or consider any

information regarding the potential risks of establishing a correspondent relationship with a new entity is just one example of the Firm's failure to be aware of, assess and deal with the risks associated with its Clearing Services business. The Review Committee considered only one month of trading information for C Securities, instead of three months as suggested by the checklist. Moreover, the information that was provided should have caused the Review Committee to inquire further into C Securities' trading patterns in determining whether to establish a correspondent relationship.

In investigating the C Securities' situation, the following other deficiencies at the Firm were discovered.

Lack of Risk Assessment and Management

Failure to Identify Correspondents

In August 2009, the Firm did not have an accurate list of its correspondents. The Firm's list of its correspondents was incorrect in that it did not contain all the correspondents for which the Firm currently had clearing responsibility. In addition, the Firm had terminated its correspondent relationship with many correspondents but had failed to provide notice of the terminations to NSCC. As a result, the NSCC never was able to inform its participants that Southwest was no longer the actual clearing firm for those correspondents and counterparties to trades with those correspondents were not aware that Southwest was not prepared to make and/or receive delivery of funds and/or securities for those former correspondents.

Failure to Assess and Manage Risk of Correspondent Qualified Special Representative Agreements ("QSRs") and Correspondent Clearing Arrangements ("9A/9Bs")

QSRs and 9A/9Bs allow correspondents to enter and execute transactions away from their clearing firm, which transactions the clearing firm is nevertheless responsible to settle and clear. The clearing firm is not aware of these transactions until the end of the trading day.

In August 2009, the Firm was not aware which of its correspondents had the ability to execute trades away from the Firm pursuant to QSRs and 9A/9B Agreements which trades the Firm would be obligated to settle and clear. The Firm failed to monitor which correspondents were actually executing trades away from the Firm pursuant to these agreements. By failing to recognize its exposure to trading under such agreements, the Firm failed to recognize and assess the full extent of its financial obligations and risks associated with its correspondent relationships.

Failure to Recognize Correspondents' Ability to Trade Away and Exchange Memberships

The Firm failed to recognize that any correspondent with an Equity Market Participant Identifier could execute transactions away from it and/or that those trades could be reported to the TRF without the Firm's prior knowledge and that the Firm had clearing and settlement responsibility for those trades.

The Firm did not know which of its correspondents had NASDAQ or other exchange direct execution capability and the full extent of the correspondents' exchange memberships. Further, the Firm failed to recognize that its clearing responsibility extended to all equity transactions effected by its correspondents regardless of where and how such transactions were affected.

Providing Untimely Notice to NSCC

By notifying NSCC that the Firm was prepared to accept clearing and settlement responsibility for C Securities, before the Firm had completed all the steps of its on boarding process and resolved issues regarding billing and trade data uploading, the Firm accepted unnecessary risk that C Securities might begin trading immediately. In addition, the Firm failed to timely notify NSCC of the termination of correspondent relationships.

Failure to Establish Reasonable ACT Trade Reporting Limits

The Firm had no policies or procedures for the establishment of ACT Risk Management Limits for new correspondents, for monitoring the adequacy of such limits for existing correspondents, and for making changes to such reporting limits.

Clearing Services had no procedures to seek input and/or review from any other department of the Firm when establishing such limits, and did not do so. The Firm had no procedures for changing correspondent limits and sometimes decided to raise the limits in order to decrease the frequency with which it received alerts regarding its correspondents because it did not want to be burdened with reviewing and responding to such alerts. In some cases changes to correspondent limits were made without adequate deliberation. In August 2009, the Firm was unaware of and had not documented the ACT Risk Management Limits for each correspondent.

The Firm failed to establish meaningful ACT Risk Management Limits for many of its correspondent firms individually and for all its correspondents cumulatively. As a result of the C Securities incident, and prior to the commencement of FINRA's investigation, the Firm obtained from the ACT Risk Management system the Firm's ACT Alert limits as they existed as of August 13, 2009 for its correspondents, and reviewed those limits. A review of those limits indicated that the level at which ACT Alerts would be triggered for 50 correspondents were set at \$999,999,999 each for "Total Buying Power" and "Total Selling Power." As to certain of these correspondents, such limits were not appropriate. As a result, the Firm's correspondents could have executed billions of dollars in trades each day without triggering an ACT Alert as to these position limits.

Failure to Implement Procedures for Response to ACT Alerts and Failure to Respond to ACT Alerts

The Firm failed to implement procedures for identifying the personnel responsible for receiving and responding to ACT Alerts. In addition, the Firm failed to timely respond to such Alerts.

Southwest failed to designate any employees to receive and respond to ACT Alerts. Nonetheless, ACT Alerts were sent to the Firm e-mail address of a single Clearing Services

employee. Neither this Clearing Services employee nor any other Clearing Services or other Firm employee had been adequately trained with regard to ACT Alerts or informed as to its functionality. Neither the Clearing Services employee to whom the ACT alerts were sent, nor any other Firm employee routinely responded to ACT alerts on a timely basis, if at all. The Firm also lacked procedures describing the steps to be taken by such personnel in responding to an Act Alert.

Failure to Be Aware of External Procedures and Establish Internal Procedures to Terminate on an Intra-day Basis a Correspondent Clearing Relationship

The Firm failed to be aware that procedures existed which would allow it to terminate, on an intraday basis, its clearing relationship with a correspondent at NSCC and the various exchanges including NASDAQ. Such notice to the NASDAQ and various exchanges prevents the correspondent from entering any further trades in those venues, prevents trades to which the correspondent was a counter-party from being reported to the TRF, and would allow the Firm to terminate its financial responsibility for the correspondent's trading once the termination was given effect at NSCC.

Failure to Supervise

NASD Rule 3010 requires member firms to establish and maintain a system, including written procedures, to supervise the activities of its employee, which is reasonably designed to achieve compliance with applicable securities laws and regulations.

NASD Rule 2110 required, and FINRA Rule 2010 requires that "a member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."

During the Relevant Period, the Firm lacked written operational or supervisory procedures for certain Clearing Services functions relating to, among other things, due diligence, on boarding of new correspondents and risk management. In addition, the Firm lacked written procedures for the composition or function of the Review Committee. Further, the Firm had no policies and procedures for maintaining current information regarding its correspondents, including those correspondents' ability to trade away from the Firm, establishing and monitoring ACT Risk Management Limits, responding to ACT Alerts, recognizing and monitoring the risks associated with correspondent relationships, or terminating correspondent relationships and providing notice of such to NSCC.

The Firm failed to provide its Clearing Services Department personnel with adequate training and instruction with regard to the on-boarding of correspondents and the performance of due diligence with respect to potential correspondents. The Firm failed to provide its Review Committee with adequate direction and information to meaningfully assess potential correspondents, including but not limited to the risks associated with such correspondents. In addition, the Firm failed to manage the risks associated with its correspondent clearing business in that it failed to be aware of and maintain currently essential information regarding its correspondents, failed to establish reasonable ACT Trade Reporting Limits and utilize ACT

Alerts, and failed to be aware of the means by which it could terminate its clearing relationship and thereby terminate the correspondent's access to exchanges and the TRF on an intra-day basis.

Southwest thereby violated NASD Rules 3010 and 2110 and FINRA Rule 2010.

Other Factors

In determining the appropriate sanction, FINRA took into account that the Firm performed an internal audit which began immediately after the Firm became aware of C Securities trading on August 6, 2009 and shared the results of the audit with FINRA. The Firm updated its ACT Risk Management limits to lower the thresholds at which ACT Alerts would be triggered, increased the number of employees receiving ACT Risk Management Alerts, and implemented mandatory training, conducted by NASDAQ staff, for such employees as to the use of the ACT Risk Management System, and particularly as to the process for terminating a correspondent relationship on an intra-day basis. In addition, the Firm and its outside counsel provided substantial assistance to FINRA staff during the investigation.

- B. The Firm also consents to the imposition of the following sanctions:
- a. A censure;
 - b. A fine in the amount of \$650,000, and
 - c. An undertaking: (1) to designate a risk management officer within Southwest Securities, Inc. whose primary responsibility shall be identification and management of the risks associated with the Firm's Correspondent Clearing Services business; and (2) within 30 business days of notification of acceptance of this AWC, a registered principal of the Firm shall submit to Donald C. Sullivan, FINRA Department of Enforcement, 14 Wall Street, 14th Floor, New York, New York 10005, a signed, dated letter, giving the following information: (a) a reference to this matter; (b) a representation that the Firm has designated the above-referenced risk management officer; (c) the name of that person, and the date the person began that role; (d) a representation that the firm has revised its written supervisory and operational procedures to address the deficiencies described herein; and (e) the date(s) the revised procedures were implemented.

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 imposed in this matter.

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

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 it;
- 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 me; 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 it;
 - 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.

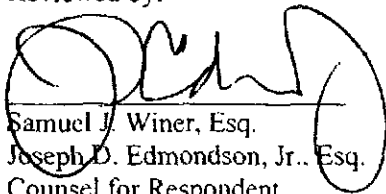
February 09, 2011
Date:

Southwest Securities, Inc.

By:

James A. Winder
Vice President
General Counsel

Reviewed by:


Samuel J. Winer, Esq.
Joseph D. Edmondson, Jr., Esq.
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Washington, DC 20007-5109
202-672-5528

Accepted by FINRA:

February 16, 2011
Date

Susan Light

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