

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

Highland Financial, Ltd. (CRD No. 25896),

and

Gordon D. Smith (CRD No. 2006592),

Respondents.

DISCIPLINARY PROCEEDING
No. 2011025591601

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Respondent Highland Financial, Ltd., acting through Respondent Gordon D. Smith, failed to file timely a Currency Transaction Report (CTR) upon receipt from a customer of two cash deposits totaling \$39,780 and \$103,440, respectively. Moreover, on both occasions, Smith engaged in illegal “structuring” by depositing the currency he had received into multiple accounts at multiple financial institutions on multiple days in amounts of \$10,000 or less for the purpose of causing the financial institutions to fail to file a CTR. Smith deposited some of the cash into Highland’s operating account and also into an account owned by HRE, a non-FINRA member entity that he controlled. By depositing customer funds into those two accounts, Highland and Smith commingled the customer’s funds with the firm’s funds and with

HRE's funds, consequently misusing the customer's funds. Highland also failed to develop and implement a written anti-money laundering (AML) program reasonably designed to ensure the Firm's compliance with the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*). Among other things, Highland failed to monitor, detect, and investigate suspicious transactions and determine whether to file a Suspicious Activity Report (SAR) in the face of multiple "red flags" involving the firm's receipt of cash from the customer and Smith's subsequent deposits of the cash. By virtue of such conduct, Highland willfully violated Section 17(a) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 17a-8 thereunder and violated FINRA Rule 3310(a), and Highland and Smith violated FINRA Rules 2150(a) and 2010.

RESPONDENTS AND JURISDICTION

2. Highland has been a FINRA member since April 1990. Its only office is in Johnstown, Pennsylvania. The firm is primarily engaged in sales of mutual funds on a wire order basis. It has no clearing agreement with another member firm. At all times relevant to this Complaint, Highland employed three registered persons, but only Smith was registered as a principal (the firm operated under a waiver that FINRA had granted it from the requirement to have two registered principals). Moreover, the firm claimed and operated under the exemption from Exchange Act Rule 15c3-3 (titled, "Customer Protection – Reserves and Custody of Securities") provided by Rule 15c3-3(k)(2)(i).
3. In November 1989, Smith first became registered with FINRA as a General Securities Representative. From April 1990 to the present, he has been registered with FINRA through Highland as a General Securities Representative and as a General Securities

Principal. At all times relevant to this Complaint, Smith was Highland's President, Chief Compliance Officer and Anti-Money Laundering Compliance Officer (AMLCO).

FACTS¹

Smith and Highland Receive About \$39,780 In Cash for Investment and Fail to File a CTR; Smith Engages in "Structuring" Currency Deposits

4. As of July 20, 2011, AE was an existing customer of Highland and had previously purchased securities through the firm. Smith was AE's securities account representative at Highland. AE was about 67 years old and a widow. Her mother lived with her.
5. On July 20, 2011, AE called Smith and told him, in substance, that she had found about \$40,000 in cash in her house that her mother had been holding for many years. AE asked Smith to assist her in depositing the money, claiming in substance that she could not deposit it herself because she could not leave her house with her mother for the amount of time it would take to go to her (AE's) bank, deposit the money and return. Smith agreed to meet AE, and he met her that day at a fast food restaurant located about midway between Highland's office and where AE lived. AE suggested the specific location.
6. On July 20, 2011, Smith received about \$39,780 in cash from AE. When given to him, some of the money was inside of socks and some was bound by rubber bands or paper wrappers. All of the money so collected was given to Smith inside a paper bag. In giving him the money, AE intended for Smith to deposit the funds and purchase

¹ In most instances, dates and monetary amounts used in this Complaint are stated without any prefatory word or term such as approximately or "about." Nevertheless, when any date or amount of money is used without any qualification, it is intended to encompass a minor or insignificant deviation that may be revealed by evidence introduced at the hearing.

securities in her account at Highland. Smith gave AE a receipt that reflected he had received \$40,000 from her. He retained a duplicate copy of the receipt for the firm's records. Smith later wrote the actual amount that he had received from AE on Highland's retained copy of the receipt.

7. After receiving the currency from AE, Smith went to a branch of STC, the financial institution at which Highland maintained an account titled, "Highland Financial, Ltd Special Account FBO Customers" (STC Account). Highland used this account to comply with the exemption it claimed under Exchange Act Rule 15c3-3.
8. Smith entered the STC branch without any money, leaving it in his car, and spoke with a manager (or an assistant manager), telling her that he had cash to deposit. That person informed him that if he deposited over \$10,000 of cash, STC would be required to file a report with the federal government, but that if he deposited \$10,000 or less, STC would not have to report the deposit to the government.
9. After speaking with the manager, Smith went to his car, called AE and told her in substance about the requirement that a bank report a deposit of cash exceeding \$10,000 to the IRS. AE expressed concern to Smith about such a report being filed with the IRS with respect to her cash and about the possibility that she would receive an inquiry from the IRS, telling Smith she would not know what to tell the IRS if the agency were to question her about the money. Smith, either at AE's request or making an independent decision based on the concerns AE expressed to him, decided to deposit the cash so as to prevent any bank from filing a report with the U.S. government. More specifically, Smith intentionally decided to make multiple

deposits of \$10,000 or less at multiple banks over multiple days so as to cause the banks to fail to file CTRs. Depositing cash in that manner is known as “structuring.”

10. After the call with AE ended, Smith obtained some of the currency AE had given him, re-entered the STC branch and deposited \$9,500 of the cash he had received from AE into the STC Account.
11. Subsequently on July 20, 2011, Smith went to a branch of FSB, the financial institution at which Highland maintained its operating account (FSB Account). At FSB, Smith also learned that FSB did not have to report a currency deposit of \$10,000 or less per day to the government.
12. On July 20, 2011, Smith deposited \$9,520 of the cash he had received from AE into the FSB Account.
13. On either July 20 or July 21, 2011, Smith made a second deposit to the STC Account of cash that he had received from AE on July 20. The amount deposited was \$8,000. The July 2011 statement for the STC Account showed that the deposit occurred on July 21.
14. On July 21, 2011, Smith deposited \$7,760 of the cash he had received from AE into the FSB Account.
15. On July 22, 2011, Smith made a final deposit of currency he had received from AE on July 20, depositing \$5,000 into the STC Account.
16. On July 26, 2011, Smith caused a check to be prepared and issued against the FSB Account payable to Highland in the amount of \$17,280, and he deposited it or caused it to be deposited to the STC Account that day. The purpose of the \$17,280 check

was to transfer to the STC Account funds belonging to AE that Smith had put in the FSB Account.

17. On about July 26, 2011, Smith caused the currency he had received from AE on July 20 totaling about \$39,780 to be invested in securities for AE and a sibling. Specifically, he caused the money (less about \$1,094 paid to Highland as commissions) to be invested in about eight mutual funds within the same fund family.

Smith and Highland Receive an Additional \$103,440 in Cash from AE for Investment and Fail to File a CTR; Smith Again Engages in Structuring Currency Deposits

18. On or about August 16, 2011, AE called Smith and told him that she and her brother, who was visiting, had found more cash that her mother had been holding in her home for many years. AE asked Smith to assist her in depositing the money and investing it. That day (August 16), Smith met AE and her brother at the same fast food restaurant where AE had previously given him cash.
19. On August 16, 2011, Smith received from AE and her brother about \$103,440 in cash. As before, some of the money was inside of socks and some was bound by rubber bands or paper wrappers. All of the money so collected was given to Smith inside a paper bag. The money was given to Smith to be deposited and used to purchase securities in an account at Highland of which they were joint owners. This time, Smith did not provide AE and/or her brother a receipt.² Smith told AE he was going to deposit the money the way he had before, meaning that he was going to engage in “structuring,” depositing the cash in amounts of \$10,000 or less at multiple

² In the ensuing paragraphs, the allegations refer to the money that Smith received on August 16 as being received from AE alone.

banks on multiple days so as to cause the banks at which he deposited the cash to fail to file a report with the U.S. government.

20. That day (August 16), Smith went to a branch of STC and deposited \$9,090 of the cash he had received from AE into the STC Account.
21. On August 17, 2011, Smith deposited \$9,700 of the cash he had received from AE on August 16 into the STC Account and he deposited \$9,700 of it into the FSB Account.
22. On August 18, 2011, Smith deposited \$9,900 of the cash he had received from AE on August 16 into the STC Account and he deposited \$9,250 of it into the FSB Account.
23. Also on August 18, 2011, Smith deposited \$9,200 of the cash he had received from AE on August 16 into a third bank account, specifically a bank account maintained by HRE at MLB (MLB Account).
24. Smith owned about 50% of HRE. He was the President of HRE and he controlled the MLB Account. HRE owned the building in which Highland maintained its office.
25. On August 19, 2011 (a Friday), Smith deposited \$10,000 of the cash he had received from AE on August 16 into the STC Account and he deposited \$9,900 of the cash into the MLB Account.
26. Also on August 19, 2011, Smith made two separate deposits of cash that he had received from AE on August 16 into the FSB Account, each in the amount of \$10,000. The second \$10,000 deposit was made together with four unrelated checks that totaled \$4,343.65 and thus the cash was part of a deposit that totaled \$14,343.65.
27. In making the second \$10,000 deposit of cash belonging to AE, Smith knew that after a certain time of day FSB recorded and posted any deposit made to a bank customer's account as if it had occurred on the next business day. Smith made the

first deposit to the FSB Account on August 19 before the designated time of day; he deliberately made the second \$10,000 deposit to the FSB Account *after* the designated time of day when FSB recorded and posted a deposit as if it had occurred on the next business day so that the second \$10,000 deposit of cash would be recorded and posted as having occurred on a different day than the first deposit. In fact, the August 2011 month-end account statement for the FSB Account reflected that the \$14,343.65 deposit Smith made to the account occurred on August 22, 2011 – instead of August 19.

28. On about August 19, 2011, Smith deposited, or caused to be deposited, to the STC Account an \$8,562 check, dated that day, drawn against the MLB Account and made payable to “Highland Financial.” Smith had caused that check to be prepared and issued. The purpose of the \$8,562 check was to transfer to the STC Account funds belonging to AE that Smith had put in the MLB Account. The \$8,562 check was deposited to the STC Account at the same time that Smith deposited \$10,000 of AE’s cash to the STC Account and was part of a deposit that totaled \$35,562.
29. On about August 19, 2011, Smith deposited or caused to be deposited to the STC Account, a \$17,000 check drawn against the FSB Account dated August 17 and made payable to “Highland Financial, Ltd.” Smith had caused that check to be prepared and issued. The purpose of the \$17,000 check was to transfer to the STC Account funds belonging to AE that Smith had put in the FSB Account. The \$17,000 check was deposited to the STC Account at the same time that Smith deposited \$10,000 of AE’s currency to the STC Account and was also part of the deposit that totaled \$35,562.

30. On August 22, 2011, Smith deposited \$6,700 of the cash he had received from AE on August 16 into the STC Account.
31. On August 22, 2011, Smith deposited, or caused to be deposited, to the STC Account a \$10,538 check drawn against the MLB Account dated August 22 in the amount of \$10,538 payable to Highland. Smith had caused that check to be prepared and issued. The purpose of the \$10,538 check was to transfer to the STC Account funds belonging to AE that Smith had put in the MLB Account. The \$10,538 check was deposited to the STC Account at the same time that Smith deposited \$6,700 of AE's currency into the STC Account and was part of a deposit that totaled \$39,188.
32. On August 22, 2011, Smith deposited, or caused to be deposited, to the STC Account a \$21,950 check drawn against the FSB Account and made payable to Highland. Smith had caused that check to be prepared and issued. The purpose of the \$21,950 check was to transfer to the STC Account funds belonging to AE that he had put in the FSB Account. The \$21,950 check was deposited to the STC Account at the same time that Smith deposited \$6,700 of AE's currency into the STC Account and was also part of the deposit that totaled \$39,188.
33. On or about August 25, 2011, Smith caused the funds he had received from AE on August 16 totaling about \$103,440 to be invested in securities for AE and her two siblings. Specifically, he caused the money (less about \$4,100 paid to Highland as commissions) to be invested in about eight mutual funds within two fund families.
34. In September 2011, FINRA staff conducting an examination of Highland discovered evidence of the cash receipts and deposits discussed in the preceding paragraphs and alerted Smith to rule violations arising from this activity.

35. On about October 25, 2011, Highland finally filed two separate CTRs reporting the receipt of \$39,780 in currency from AE on July 20, 2011 and reporting the receipt of \$103,440 in currency from AE on August 16, 2011.

FIRST CAUSE OF ACTION

Failure to File CTRs Timely (Highland and Smith) (Exchange Act Section 17(a) and Rule 17a-8 and FINRA Rule 2010)

36. The Department realleges and incorporates by reference paragraphs 1 through 35 above.
37. At all times relevant herein, under applicable provisions of the Bank Secrecy Act of 1970 (BSA), U.S.C. Section 5311 *et seq.*,³ and under applicable provisions of the implementing regulations promulgated thereunder (which at the times relevant herein were contained in Chapter X under Title 31 of the Code of Federal Regulations), financial institutions (as defined in the BSA, U.S.C. Section 5312) were required to file a CTR with the U.S. Treasury Department reporting any receipt of currency exceeding \$10,000. At all times relevant herein, Highland was a financial institution under Section 5312(a)(2) of the BSA.
38. Under the BSA and implementing regulations, a financial institution as defined was required at all times relevant herein to file a CTR within 15 days after receiving more than \$10,000 of currency.⁴
39. At all times relevant herein, Exchange Act Rule 17a-8 required every registered broker or dealer that was subject to the requirements of the BSA to comply with the reporting, recordkeeping and record retention requirements of Chapter X of Title 31

³ The BSA is also known as the Currency and Foreign Transactions Reporting Act of 1970.

⁴ 31 CFR Chapter X Section 1010.306(a)(1).

of the Code of Federal Regulations. Pursuant to Rule 17a-8, Highland was required to file a CTR with the U.S. Treasury Department reporting any receipt of currency exceeding \$10,000.

40. After Smith received \$39,780 in cash from AE on July 20, 2011, Highland, acting through Smith, failed to file within 15 days after receiving the currency a CTR reporting the receipt of the currency. In fact, Highland did not file a CTR reporting the receipt of the currency from AE on July 20 until October 25, 2011.
41. After Smith received \$103,440 in cash from AE on August 16, 2011, Highland, acting through Smith, failed to file within 15 days after receiving the currency a CTR reporting the receipt of the currency. In fact, Highland did not file a CTR reporting the receipt of currency from AE on August 16 until October 25, 2011.
42. At all relevant times, Smith knew or reasonably should have known that Highland was required to file, and that as Highland's President, sole principal and designated AMLCO, he was required to cause Highland to file, a CTR reporting any receipt of more than \$10,000 in currency. Indeed, Highland's AML procedures in effect at the time stated the firm would file a CTR for currency transactions that exceeded \$10,000.
43. By virtue of such conduct, Highland willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 promulgated thereunder, and Highland and Smith violated FINRA Rule 2010.

SECOND CAUSE OF ACTION

Structuring Cash Deposits (Smith)
(FINRA Rule 2010)

44. The Department realleges and incorporates by reference paragraphs 1 through 43 above.
45. At all times relevant herein, STC, FSB and MLB were financial institutions under Section 5312(a)(2)(A) of the BSA.
46. At all times relevant herein, Title 31 of the Code of Federal Regulations, Chapter X (31 CFR Chapter X), Section 1010.314 titled "Structured Transactions" provided that no person shall, for the purpose of evading the reporting requirements under the regulations: cause or attempt to cause a domestic financial institution to fail to file a report required by the regulations; or, structuring (as defined under the regulations) or assist in structuring or attempt to structure any transaction with one or more domestic financial institutions. Structuring was defined in 31 CFR Chapter X Section 1010.11(xx).
47. From July 20 to July 22, 2011 and with respect to the \$39,780 in cash he received from AE, Smith engaged in illegal structuring by depositing the currency he had received into multiple accounts (the STC Account and the FSB Account) on multiple days, all such deposits consisting of less than \$10,000 for the purpose of evading the reporting requirements under 31 CFR Chapter X. Smith acted to evade the reporting requirements under 31 CFR Chapter X in that he acted with the purpose of precluding STC and FSB from filing, and/or intended to cause STC and FSB to fail to file, a CTR reporting a receipt of currency that exceeded \$10,000.

48. From August 16 to August 22, 2011 and with respect to the \$103,440 in cash he received from AE, Smith engaged in illegal structuring by depositing the currency he had received into multiple accounts (the STC Account, the FSB Account and the MLB Account) on multiple days, all such deposits consisting of \$10,000 or less, for the purpose of evading the reporting requirements under 31 CFR Chapter X. Smith acted to evade the reporting requirements under 31 CFR Chapter X in that he acted with the purpose of precluding STC, FSB and MLB from filing, and/or intended to cause STC, FSB and MLB to fail to file, a CTR reporting a receipt of currency that exceeded \$10,000.
49. Smith knew or should have known that structuring was illegal under Federal law and in contravention of applicable securities rules and regulations. Indeed, Highland's AML procedures in effect at the time, which designated Smith as the firm's AMLCO, cited as a red flag of possible money laundering that a customer engages in transactions involving cash that "appear to be structured to avoid the \$10,000 government reporting requirements." In addition, the firm's AML Compliance Procedures stated that the firm would file a suspicious activity report if it suspected, or had reason to suspect, that a transaction was designed to evade "any requirements of the BSA regulations." The deposits of currency Smith made at STC, FSB and MLB were designed to evade requirements of the BSA regulations.
50. By virtue of such conduct, Smith violated FINRA Rule 2010.

THIRD CAUSE OF ACTION

Commingling Customer Funds with Non-Customer Funds (Highland and Smith) (FINRA Rules 2150(a) and 2010)

51. The Department realleges and incorporates by reference paragraphs 1 through 50 above.
52. The currency Highland received from AE on July 20, 2011 and on August 16, 2011 could only properly be held in the STC Account, the account Highland had established for the benefit of customers pursuant to its exemption from Exchange Act Rule 15c3-3.
53. Instead, from about July 20, 2011, to about July 26, 2011, Highland, acting through Smith, held funds belonging to AE in the FSB Account.
54. From about August 17, 2011, to about August 22, 2011, Highland, acting through Smith, held funds belonging to AE in the FSB account.
55. From about August 18, 2011, to about August 22, 2011, Highland, acting through Smith, held funds belonging to AE in the MLB Account.
56. By holding funds belonging to AE in the FSB and MLB Accounts, Highland, acting through Smith, commingled AE's funds with the firm's funds and with the funds of HRE, respectively, and subjected AE's funds to unwarranted risks including the risks associated with the firm's and HRE's businesses.
57. The foregoing instances when Highland, acting through Smith, commingled AE's funds with firm funds in the FSB Account and with HRE funds in the MLB Account constituted distinct improper uses of AE's funds.
58. By virtue of such conduct, Highland and Smith violated FINRA Rules 2150(a) and 2010.

FOURTH CAUSE OF ACTION

Failure to Implement Procedures to Report Suspicious Transactions (Highland) (FINRA Rules 3310(a) and 2010)

59. The Department realleges and incorporates by reference paragraphs 1 through 58 above.

60. On July 2, 2002, the United States Department of the Treasury issued the implementing regulation, 31 CFR § 103.19(a)(1), which is now contained in 31 CFR Chapter X §1023.32(a)(1), providing that, with respect to any transaction after December 31, 2002, “[e]very broker or dealer in securities within the United States . . . shall file with FinCEN . . . a report of any suspicious transaction relevant to a possible violation of law or regulation.” 31 CFR Chapter X §1023.32(a)(2) specifically provides:

A transaction requires reporting . . . if it is conducted or attempted by, at, or through a broker-dealer, it involves or aggregates funds or other assets of at least \$5,000, and the broker-dealer knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):

- (i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation;
- (ii) Is designed, whether through structuring or other means, to evade any requirements of this part or any other regulations promulgated under the Bank Secrecy Act . . . ;
- (iii) Has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction after examining the available

facts, including the background and possible purpose of the transaction; or

- (iv) Involves use of the broker-dealer to facilitate criminal activity.

61. FINRA Rule 3310(a) (previously NASD Conduct Rules 3011(a)) mandates that member firms establish and implement policies and procedures that can reasonably be expected to detect and cause the reporting of suspicious transactions. In addition, FINRA emphasized in Notice to Members 02-47 each firm's duty to detect relevant red flags and, if it detects any, to perform additional due diligence to determine whether a SAR should be filed.
62. Highland's written AML procedures required the AMLCO to monitor account activity to permit identification of possible suspicious activity and to report suspicious activities to appropriate authorities. In this regard, the Firm's procedures identified a non-exclusive list of various possible red flags, including the following four:
- a. The customer exhibits unusual concern about the firm's compliance with government reporting requirements;
 - b. The customer wishes to engage in transactions that lack business sense;
 - c. The customer asks for exemptions from the firm's policies relating to the deposit of cash or cash equivalents; and
 - d. The customer engages in transactions involving cash or cash equivalents or other monetary instruments that appear to be structured to avoid the \$10,000 government reporting requirements.

As further detailed below, Highland failed to monitor, detect and investigate suspicious transactions and determine whether to file a SAR in response to these red flags, and others, relevant to the two instances when it received cash from AE and Smith engaged in structuring in depositing the cash.

63. Highland's procedures mandated the filing of a SAR upon the detection of such activity as follows:

We will file a SAR for any account activity (including deposits and transfers) conducted or attempted through our firm involving \$5,000 or more where we know, suspect or have reason to suspect: * * * 2) the transaction is designed to evade any requirement of the BSA regulations.

Smith's conduct detailed in the First Cause of Action was designed to evade a reporting requirement of the BSA.

64. From July 20, 2011 through at least September 2011, Highland failed to monitor, detect and investigate suspicious transactions and determine whether to file a SAR in response to multiple red flags relevant to AE's account, including certain red flags specifically cited in the Firm's own written AML procedures. Those multiple red flags included the following:

- a. the circumstances attendant to AE's delivery of the cash to Smith;
- b. the concerns AE expressed about possibly being questioned by the IRS concerning the cash;
- c. AE's desire to have the cash deposited so as to prevent any report from being filed with the government authorities; and
- d. Smith's structuring of cash deposits as alleged in the First Cause of Action above.

65. By failing to monitor, detect and investigate suspicious transactions and determine whether to file a SAR with respect to multiple red flags relevant to AE's account, Highland violated FINRA Rules 3310(a) and 2010.

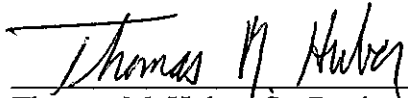
RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Respondents committed the violations charged and alleged herein;
- B. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed;
- C. order that Respondents bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330; and
- D. make specific findings that Highland willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 promulgated thereunder.

FINRA DEPARTMENT OF ENFORCEMENT

Date: July19, 2012



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