

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011029074302**

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

RE: Charles Schwab & Co., Inc., Respondent
CRD No. 5393

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Charles Schwab & Co., Inc. ("Schwab") 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 Schwab alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Schwab 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

Charles Schwab & Co., Inc. (CRD # 5393) is headquartered in San Francisco, California and has been a FINRA member since October, 1970. Schwab has approximately 350 branch offices and approximately 4,400 registered representatives.

OVERVIEW

This matter involves the failure of Schwab to implement policies and procedures that were reasonably designed to detect and cause the reporting of suspicious wire transactions. This failure allowed \$96 million in funds stolen from a U.S. financial services firm to be deposited into three newly-opened accounts at Schwab without an inquiry into the incoming wire transactions and without any alert being generated by the firm's AML systems.

This failure occurred because Schwab's Anti-Money Laundering process did not designate three accounts as related and because the thresholds for commencing an inquiry into potentially suspicious incoming wire transactions such as these were

inadequate. Because the accounts were not recognized as related, Schwab did not detect or investigate potentially suspicious incoming wire transactions in three accounts to determine whether they should be reported on a suspicious activity report.

By failing to implement policies and procedures that were reasonably designed to detect and cause the reporting of suspicious incoming wire transactions, Schwab violated FINRA Rules 3310(a) and 2010.

FACTS AND VIOLATIVE CONDUCT

Facts

EC Delivered \$96 Million in Stolen Funds from her Employer to Accounts at Schwab

Between late July and early August 2011, EC became a new Schwab customer and through an independent investment advisor opened accounts with the firm. The accounts at issue were a charitable gift account, an account for a revocable trust, and an account for a limited liability corporation. EC stated on two of the new account applications that she was an employee of CSS, a U.S. financial services firm.

Between August 3 and 15, 2011, EC sent four wire transfers totaling \$96 million from an account owned by CSS to three newly opened accounts at Schwab.¹ The wire transfer instructions from CSS noted that the source of the money for the wire transfers was a corporate account in CSS's name. EC had initiated the wire transfers from her employer's account using account access she had gained through fraudulent means.² No one at Schwab commenced an inquiry into the incoming wire transactions. EC invested some of the funds in a variety of investments including mutual funds and money market funds and did not make any withdrawals prior to the detection of her theft.

Schwab's AML Program

As part of its overall AML program, the firm utilized a computer system to surveil accounts and transactions for potentially suspicious activity. Schwab's computer system operated using numerous "scenarios" that generated alerts of potentially suspicious activity. Under the firm's AML system, if the computer system produced a certain number of alerts within a particular timeframe, the

¹ The individual wires were in the amounts of \$10 million, \$21 million, \$30 million, and \$35 million.

² In April 2012, as a result of the fraudulent wire transfers described in this AWC, the U.S. Attorney charged EC with one count of wire fraud in violation of 18 U.S.C. § 1343. EC thereafter pled guilty and was sentenced to a 63-month prison term.

results were transmitted to a Schwab analyst to conduct an investigation for possible AML escalation.

One of the "scenarios" was the "Incoming Electronic Transactions" scenario. This scenario addressed instances where related accounts received incoming electronic transactions, provided the incoming electronic transactions met certain pre-established thresholds during a look-back period. Schwab set thresholds for the number of incoming electronic transactions; the dollar amount of the incoming transactions; and the number of alerts which would cause an analyst to investigate the accounts or transactions.

Schwab's Incoming Electronic Transactions scenario failed to generate any alerts for the incoming wire transactions and the incoming wire transactions were not escalated for further investigation. This was due to two deficiencies in the system. First, even though the new account documentation for the three accounts showed that EC was associated with the accounts, Schwab's process for determining whether accounts were related (known as "householding") did not designate the accounts as related. As a result, no AML alert was generated by the system, even though the incoming wire transactions would have met the thresholds to generate an alert if the three accounts had been considered related.

Second, Schwab's system did not generate an alert for large dollar deposits into newly-opened accounts. Thus, the system did not generate any alerts for the three newly-opened accounts based on the size of the individual incoming wire transfers, which ranged from \$10 million to \$35 million, or for the aggregate amount of the wires, which was \$96 million.

Furthermore, even if the system had generated an alert, under Schwab's system the incoming wires in EC's accounts would not have generated a sufficient number of alerts for the activity to be escalated for review by an analyst. For these reasons, EC's incoming wire transactions were never referred to an analyst for further inquiry into their source or circumstances. Consequently, Schwab did not investigate the \$96 million in wires sent by EC to determine whether to report them as suspicious for AML purposes.

On or about August 19, 2011, CSS informed Schwab that the funds in the accounts were stolen. On the same day, Schwab froze the accounts and subsequently returned the funds to CSS, minus approximately \$126,000 in losses incurred on investments made in the accounts.

Violations

Schwab Violated FINRA Rules 3310(a) and 2010

FINRA Rule 3310(a) requires that member firms must, at a minimum, "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."

Among the types of transactions that must be reported by broker-dealers are: (1) Transactions that may derive from or facilitate illegal or criminal activity; (2) Transactions that have no business or apparent lawful purpose or are not the sort in which the particular customer would normally be expected to engage; and (3) Where 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.

In developing an 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.¹ Two FINRA Notices to Members ("NTM"), 02-21 and 02-47, emphasize a member's duty to detect "red flags" and, if detected, to "perform additional due diligence before proceeding with the transaction."

As described above, Schwab failed to implement policies and procedures that could reasonably have been expected to detect and cause the reporting of suspicious activity. Because Schwab's householding process did not designate EC's accounts as related, its AML system failed to recognize that the incoming wire activity in the accounts was related. Schwab's system also failed to consider the large dollar amounts of any of the wires, or of the wires in the aggregate, for AML purposes. Because of these deficiencies, EC's transactions were not referred to an analyst for further inquiry into the circumstances of the transactions. Schwab thus failed to detect and report, where appropriate, suspicious activity in EC's accounts.

By failing to implement policies and procedures that were reasonably designed to detect and cause the reporting of suspicious wire transactions, Schwab violated FINRA Rule 3310(a) and FINRA Rule 2010.

B. Schwab also consents to the imposition of the following sanctions:

1. A censure; and
2. A fine in the amount of \$175,000.

Schwab further agrees to comply with the following undertaking: Schwab shall conduct a comprehensive review of the adequacy of its AML policies, systems, procedures (written or otherwise), and training with respect to detecting and reporting suspicious incoming wire transactions. Within one hundred eighty days of the issuance of a Notice of Acceptance of this AWC, an officer of the firm shall certify in writing to FINRA's Department of Enforcement that (i) the firm has engaged in the comprehensive review described above; and (ii) as of the date

¹ See Notice to Members 02-21 at 4.

of the certification, the firm has in place policies and procedures to address and correct the violations described in this AWC. The certification shall be accompanied by a description of the review undertaken pursuant to this undertaking. In addition, at the time the certification is provided, Schwab will provide the Department of Enforcement with a copy of its procedures relating to compliance with FINRA Rule 3310. The Department of Enforcement may, upon a showing of good cause and its sole discretion, extend the time for compliance with this provision.

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

Schwab specifically and voluntarily waives any right to claim that the firm 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

Schwab 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, Schwab specifically and voluntarily waive 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.

Schwab 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.

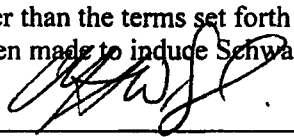
OTHER MATTERS

Schwab 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 Schwab; and
- C. If accepted:
 - 1. this AWC will become part of Schwab's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Schwab;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about my 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. Schwab 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. Schwab 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 Schwab's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Schwab may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Schwab 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 Schwab 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 Schwab to submit it.

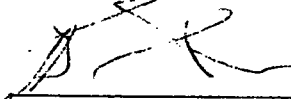
12/16/2013
Date (mm/dd/yyyy)


Respondent

Charles Schwab & Co., Inc.

By CHRISTOPHER W. CUZZUCOLI

Reviewed by:

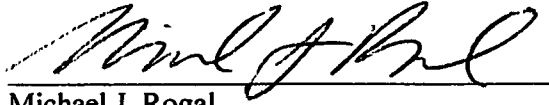


George Simon
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Chicago, IL 60654
312.832.4554

Accepted by FINRA:

12/18/2013
Date

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

A handwritten signature in black ink, appearing to read "Michael J. Rogal", written over a horizontal line.

Michael J. Rogal
Senior Counsel
FINRA Department of Enforcement
15200 Omega Drive
3rd Floor
Rockville, MD 20850-3241