

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013035340001**

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

RE: Cobra Trading, Inc., Respondent
Member Firm
CRD No. 132078

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Cobra Trading, Inc. ("Cobra", "Respondent" or "Firm") is a broker-dealer that registered with FINRA and the SEC on December 17, 2004. Cobra is also registered with 51 states and territories. Cobra provides direct market access to its customers and is headquartered in Allen, Texas.

RELEVANT DISCIPLINARY HISTORY

On October 17, 2011, FINRA issued a Letter of Acceptance, Waiver and Consent (No. 2008012205501), in which Cobra was censured and fined \$8,500 for violating SEC Rule 203(b)(1) of Regulation SHO in that on numerous occasions, Cobra accepted a short sale order or effected a short sale for its own account without: (1) borrowing the security or entering into a borrowing arrangement; or (2) having reasonable grounds to believe the security could be borrowed; and (3) documenting compliance with Reg. SHO.

OVERVIEW

From January 6, 2009 through September 3, 2013 (“Relevant Time Period”), Cobra had various failures related to the implementation of its Anti-Money Laundering (“AML”) procedures. More specifically, Cobra failed to adequately: (1) implement AML policies and procedures reasonably expected to detect and cause the reporting of suspicious transactions; and (2) implement an adequate Customer Identification Program (“CIP”) for new accounts. In addition, Cobra moved customer transactions into the firm’s exempt error account so that the Firm’s customers could avoid additional margin assessed by Cobra’s clearing firm on individual securities. As a result of the foregoing, Cobra violated NASD Rule 3011 (for the period before January 1, 2010), FINRA Rule 3310 (for the period on or after January 1, 2010), and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

1. AML Suspicious Activity Monitoring Failures

a. Failure to Detect and Investigate Red Flags

FINRA Rule 3310(a), formerly NASD Rule 3011(a), requires members to “[e]stablish and implement policies and procedures that can reasonably be expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder.”

FINRA issued Notice to Members 02-21 on April 10, 2002. In Notice to Members 02-21, FINRA set forth a non-exhaustive list of 25 AML red flags, which are indicative of potentially suspicious activity, including the following:

- 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 history.
- 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).

In Notice to Members 02-47, FINRA reminded members of their obligation to detect AML “red flags” and to report suspicious activity, where appropriate, by filing a suspicious activity report (“SAR”).

During the Relevant Time Period, Cobra's AML compliance program required the Firm to monitor, investigate and report, where appropriate, suspicious activity. Cobra, however, failed to adequately monitor and investigate activity in certain of its customers' accounts by not addressing specific account activity that raised AML red flags under the AML written supervisory procedures ("WSPs") that should have required further due diligence. For example, Cobra's WSPs noted, among several others, the following AML red flags:

- Wire transfers to/from financial secrecy havens or high-risk geographic locations without an apparent business reason;
- Customers engaging in prearranged or other non-competitive trading, including wash or cross trades of illiquid securities;
- Customers opening multiple accounts with the same beneficial owners or controlling parties for no apparent business reason;
- Funds being deposited for purchase of a long-term investment followed shortly by a request to liquidate the position and transfer the proceeds out of the account;
- Customer transactions including the pattern of receiving stock in physical form or the incoming transfer of shares, selling the position, and wiring out proceeds; and
- Customers providing unusual or suspicious identification documents that cannot be readily verified.

Cobra failed to identify and conduct further due diligence on the potentially suspicious activity identified above while conducting transactional reviews in its customers' accounts. As examples, the Firm failed to identify certain activities and conduct further due diligence on its customers and the subject transactions, which would have revealed the following: (1) negative news articles concerning a customer's role in securities fraud charges filed in 2009 by the SEC against the customer who was rapidly liquidating low priced securities at Cobra and transferring the proceeds offshore; (2) wire transfers to a financial secrecy or a high-risk geographic location without an apparent business reason; (3) deposited funds for purchase of a long-term investment followed shortly by a transfer of investment proceeds to an offshore account; (4) a customer who had been convicted of, *inter alia*, securities fraud, opening joint accounts when release conditions only permitted the opening of an individual account; and (5) short selling activity in the account of a customer who was previously associated with a firm that FINRA fined \$1 million for illegal short sales.

b. Inadequate Trade-Based Surveillances

From May through October 2011, Cobra failed to adequately monitor manipulative activity, including wash trades. Wash trades are transactions in a security that involve no change in the beneficial ownership of the security that is

intended to produce the false appearance of trading. During the Relevant Time Period, Cobra had 3,169 transactions that occurred in the same security and in the same (or related) accounts at the same time and execution price. According to Cobra's WSPs, the firm was required to review all daily transactions to identify manipulative activity, including wash trades. Cobra, however, failed to adequately detect and investigate this potentially suspicious activity, and report it on a SAR, if appropriate.

During the Relevant Time Period, Cobra also received a number of exception reports generated by its clearing firm to help monitor for suspicious activity. Cobra, however, did not adequately investigate the activity identified in the exception reports. Cobra also failed to adequately document its investigations as required by its WSPs. Specifically, there was no evidence of a substantive review of the potentially suspicious activity. In addition, Cobra relied on its annual independent AML test to monitor for suspicious activity. Cobra, however, cannot rely on the annual independent test for its obligation to conduct on-going monitoring of suspicious activity.

Moreover, during the Relevant Time Period, Cobra's AML WSPs required that each customer account be assigned a risk-ranking in order for the Firm to apply additional monitoring to its higher-risk customer accounts. While customer risk-ranking is not mandated under the Bank Secrecy Act and its implementing regulations, the Firm included this process in its procedures, and then failed to follow that procedure at on-boarding and when monitoring accounts on a going-forward basis.

As a result of the foregoing, Cobra violated NASD Rule 3011(a) (for the period before January 1, 2010), FINRA Rule 3310(a) (for the period on or after January 1, 2010) and FINRA Rule 2010.

2. CIP Failures

On April 30, 2003, the Department of the Treasury and the SEC jointly issued a final rule to implement section 326 of the PATRIOT Act. Section 326 requires broker-dealers to implement written CIP procedures to: (1) verify the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintain records of the information used to verify the person's identity; and (3) determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations. The CIP should contain procedures that describe the documentary and non-documentary methods that firms will use for identity verification.

FINRA Rule 3310(b), formerly NASD Rule 3011(b), requires FINRA members to establish and implement procedures "reasonably designed to achieve compliance with the Bank Secrecy Act" and implementing regulations, including procedures concerning the identification and verification of account holders. The implementing regulations require member firms to establish risk based CIP for

verifying a customer's identity. The CIP must be tailored to the firm's business, including the firm's customer base, to ensure that the firm has a reasonable basis for knowing its customers.

Cobra failed to implement CIP procedures reasonably designed to verify its customers' identities. When Cobra's CIP review revealed inconsistent identifying information, the Firm did not employ reasonable procedures to address those inconsistencies to form a reasonable belief that it knew the true identity of the customer.

As a result of the foregoing, Cobra violated NASD Rule 3011(b) (for the period before January 1, 2010), FINRA Rule 3310(b) (for the period on or after January 1, 2010) and FINRA Rule 2010.

3. Failure to Adhere to High Standards of Commercial Honor and Just and Equitable Principles of Trade

FINRA Rule 2010 requires members and associated persons, in the conduct of their business, to "observe high standards of commercial honor and just and equitable principles of trade."

On February 27, 2001, the SEC approved amendments to NASD Rule 2520 relating to margin requirements for day traders. The amendments became effective on September 28, 2001. The amendments were designed to address the intraday risks associated with day trading in customer accounts, and required that equity and maintenance margin be deposited and maintained in customer accounts that engaged in pattern day trading in amounts sufficient to support the risks associated with their trading activities. On December 2, 2010, FINRA converted NASD Rule 2520 to FINRA Rule 4210.

FINRA Rule 4210, formerly NASD Rule 2520, among other things, places minimum requirements for customer accounts that qualify as pattern day trader accounts. To qualify as a pattern day trader account, a customer has to execute four or more day trades within five business days and the number of day trades has to exceed six percent of the customer's total trades within a five business day period. Pattern day traders are prohibited from effecting transactions in excess of their day trading buying power, defined as the equity in a customer's account at the close of business the previous day, less any maintenance margin, multiplied by four for equity securities. Also, pattern day traders have to maintain a minimum equity balance of \$25,000 in their account. When the equity in a customer's account is not sufficient to meet the day trading requirements, additional cash or securities have to be received into the account to meet any deficiency within five business days of the trade date. Until the pattern day trader meets the special maintenance margin call: (1) the account has to be margined based on the cost of all the day trades made during the day; (2) the customer's day-trading buying power is limited to the equity in the customer's account at the

close of business the previous business day, less the required maintenance margin, multiplied by two (instead of four); and (3) firms are prohibited from utilizing the “time and tick” method for calculating margin. If a pattern day trader fails to meet the special maintenance margin call within five business days, the account is further restricted to trading only on a cash-available basis for 90 days or until the call is met.

FINRA Rule 4210(d) requires members to establish their own procedures to: (1) review limits and types of credit extended to all customers; (2) formulate their own margin requirements; and (3) review the need for instituting higher margin requirements and collateral deposits than are required by the rule for individual securities or customer accounts.

During the Relevant Time Period, Cobra provided a third party direct access trading platform that serviced pattern day traders. Cobra had a clearing agreement with a clearing firm to clear all of Cobra’s trades and to provide margin to Cobra’s customers. Cobra’s clearing firm set the margin requirements and monitored the accounts daily, calculated the pattern day traders’ buying power, and issued special maintenance margin calls. Also, Cobra’s clearing firm assessed additional margin on individual securities pursuant to FINRA Rule 4210(d). Pursuant to this rule, Cobra’s clearing firm established a policy that assessed an additional margin that increased the initial margin requirement for certain securities from 25% to 100%. The third party trading platform used by Cobra was unable to recognize the clearing firm’s additional margin assessments. Cobra’s clearing firm published and provided to Cobra a list of the securities in which the clearing firm assessed an additional margin. Cobra reviewed the reports provided by its clearing firm to see if any of the pattern day trading accounts traded securities that were subject to the additional margin assessed by the clearing firm. If so, Cobra moved those securities transactions from the pattern day trading customer’s account into Cobra’s exempt error account. Because Cobra moved the securities transactions identified by the clearing firm as requiring additional margin to an exempt error account, the pattern day traders were not subject to the additional margin assessed by Cobra’s clearing firm.

If Cobra had not moved the above-described transactions to its exempt error account, the pattern day trader would have been subject to the additional margin assessed by the clearing firm, which would have led to a special maintenance margin call requiring the pattern day trader to deposit additional cash or securities into the account to meet any deficiency within five business days of the trade date. The account would be restricted unless and until the pattern day trader met the special maintenance margin call. If the pattern day trader failed to meet the special maintenance margin call within five business days, the trader would have been further restricted to trading only on a cash-available basis for 90 days or until the special maintenance margin call was met.

By circumventing NASD Rule 2520 (for the period before December 2, 2010)

and FINRA Rule 4210 (for the period on or after December 2, 2010) in the foregoing manner, Cobra violated FINRA Rule 2010.

- B. Respondent also consents to the imposition of the following sanctions:

Cobra shall be censured and fined \$150,000.

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

Respondent 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

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against 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, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions

regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

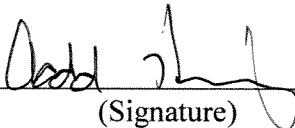
Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (“ODA”), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent’s permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent’s: (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. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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 Respondent 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 Respondent to submit it.

12/11/14
Date

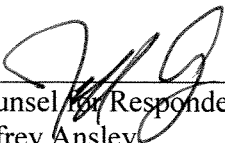
Cobra Trading Inc., Respondent

By: 
(Signature)

Name: Chad Hessing
(Print Name)

Title: President

Reviewed by:

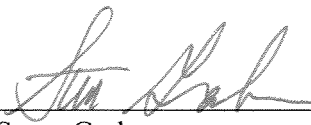


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Accepted by FINRA:

2/17/2015
Date

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



Steve Graham
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