BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. C.L. King & Associates, Inc. Albany, NY, and Gregg Alan Miller Albany, NY, Respondents.	DECISION Complaint No. 2014040476901 Dated: October 2, 2019

Firm failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to ensure compliance with the securities laws; firm and registered principal failed to establish and implement an anti-money laundering program reasonably designed to cause the detection and reporting of suspicious transactions; and firm and registered principal failed to conduct adequate due diligence and respond to red flags indicative of potential money laundering. Held, findings and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., John Luburic, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Christopher F. Robertson, Esq., Katherine R. Moskop, Esq.

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Decision

C.L. King & Associates, Inc. ("CLK") and Gregg Alan Miller appeal an Extended Hearing Panel ("Hearing Panel") decision. The Hearing Panel found that CLK negligently made material misrepresentations and failed to disclose material facts to sophisticated financial institutions that were issuers of debt securities with a survivor's option provision ("survivor bonds") when the firm submitted the redemption materials to the issuers for a CLK customer. The Hearing Panel also found that in connection with the redemption of these particular debt securities, CLK failed to establish and maintain a supervisory system, including written supervisory procedures ("WSPs"), reasonably designed to ensure that the firm complied with the securities laws.

Separate from the firm's survivor bond business line, CLK also sold penny stocks on behalf of two customers.[1] One of these customers was a bank based in Liechtenstein ("PL Bank"), which sold over 41 million shares of 40 penny stocks from June 2009 through April 2014, generating proceeds of $4.87 million. The second customer, ("ABC Corp."), sold more than 11 billion shares in 138 penny stocks from December 2012 to November 2013 and generated more than $14 million in proceeds. The Hearing Panel determined that CLK and the firm's anti-money laundering ("AML") compliance officer, Miller, failed to develop and implement an AML program reasonably designed to detect and report suspicious activity indicative of potential money laundering in connection with the firm's penny stock business, as required by the Bank Secrecy Act ("BSA"). Further, the Hearing Panel found that CLK and Miller failed to conduct adequate due diligence and respond to red flags regarding the trading activities of PL Bank.

For the foregoing misconduct, the Hearing Panel censured the firm and fined it a total of $750,000. The Hearing Panel also suspended Miller for six months as a principal, fined him a total of $20,000, and ordered that he requalify as a principal before again acting in that capacity.

After reviewing the record, we reverse the Hearing Panel's findings that CLK negligently made material misrepresentations and omitted to disclose material information to the issuers of debt securities. We otherwise affirm the Hearing Panel's findings of liability. We also modify the sanctions as set forth in detail below.

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[1] The term "penny stock" refers to a security "issued by a very small company that trades at less than $5 per share." http://www.sec.gov/answers/penny.htm; *see* SEC Rule 3a51-1, 17 C.F.R. § 240.3a51-1 (defining "penny stock").

I. Background

A. CLK

CLK has been a FINRA member since 1972. The firm's headquarters are in Albany, New York, with offices in New York City and Boston. During the relevant period, the firm employed between approximately 70 and 105 registered persons. CLK provides investment research, equity and fixed income trading, corporate finance, prime brokerage, and clearing services to institutional clients and other broker-dealers.

In 2007, CLK created the Prime Services Department to diversify the firm's "producing assets" and to boost its revenue by bringing in new customers that would use CLK's custodial trading and redemption services. The firm hired Jeffrey Maier to lead the Prime Services Department and introduce new clients to the firm. Maier worked in the firm's New York City office. Peter Bulger was the firm's chief operating officer and chief compliance officer at this time, and he supervised Maier from Albany. Maier introduced to the firm the customers who are at the center of this action: Donald F. Lathen and Lathen's hedge fund, Eden Arc Capital Partners, LP, and Eden Arc Capital Management, LLC (the investment adviser to the fund) (together, "Eden Arc"), PL Bank, and ABC Corp. CLK closed the Prime Services Department in September 2013.

B. Miller

Miller was CLK's compliance manager and AML compliance officer ("AMLCO") at all times relevant to this matter. CLK hired Miller in March 2000 in the operations department in Albany. He first registered with the firm in February 2001 as a general securities representative. Since then, he has maintained several other registrations, including general securities principal, options principal, equity trader limited representative, municipal securities principal, and research principal. The firm's WSPs named Miller as AMLCO and made him responsible for reviewing at least annually the firm's AML policies and procedures; reviewing new AML regulations; monitoring customer activities to reasonably detect and prevent money laundering activities; and developing and updating the firm's AML program.

At the time of the hearing in this matter, Miller continued to function as the firm's AMLCO, and in February 2015, he became the firm's chief compliance officer. In September 2017, the firm replaced Miller as chief compliance officer, but he remains registered with the firm in various capacities.

II. Procedural History

FINRA staff learned of CLK's involvement with Lathen's redemption of survivor bonds and CLK's penny stock activity during a 2013 on-site examination of the firm. The matter was referred to the Department of Enforcement ("Enforcement") for further action.

Enforcement filed a complaint against CLK and Miller on April 18, 2016. Cause one of the complaint alleges that CLK violated Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act") and FINRA Rule 2010 when it negligently made material misrepresentations and omissions to issuers of survivor bonds during the process of redeeming the bonds for Lathen. Enforcement embedded in cause one the allegation that CLK's "actions also constitute separate and distinct violations of FINRA Rule 2010." Cause two alleges that CLK failed to establish and implement a reasonable supervisory system, including WSPs, related to the firm's survivor bonds business, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.[2] Cause three alleges that CLK and Miller failed to establish and implement a reasonable AML program, including WSPs, designed to detect, investigate, and report potentially suspicious activity, particularly in light of the risks presented by the penny stock liquidations of PL Bank and ABC Corp., in violation of NASD Rule 3011(a) and FINRA Rules 3310(a) and 2010. Cause four alleges that CLK and Miller failed to conduct adequate due diligence and respond to red flags regarding the trading activity of PL Bank, a foreign financial institution, in violation of NASD Rule 3011(b) and FINRA Rules 3310(b) and 2010.

After a ten-day hearing, the Hearing Panel found the respondents liable for the misconduct Enforcement alleged in the complaint. For the violations of the Securities Act and FINRA Rule 2010 alleged in cause one, the Hearing Panel censured the firm and fined it $250,000. The Hearing Panel imposed an additional censure and fine of $50,000 for the supervision violations related to the firm's survivor bond business, as alleged in the complaint's second cause. For the firm's and Miller's AML-related violations alleged in cause three, the Hearing Panel censured the firm and fined it $400,000. The Hearing Panel suspended Miller for five months as a principal and fined him $15,000. For the firm's and Miller's failures to conduct adequate due diligence related to PL Bank, as required by the BSA, and as alleged in cause four, the Hearing Panel censured the firm and fined it $50,000. The Hearing Panel suspended Miller as a principal for an additional month and fined him $5,000. The Hearing Panel also ordered Miller to requalify as a principal before acting again in that capacity for his misconduct under both causes three and four.

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2 The conduct rules that apply are those in effect at the time of the relevant conduct.

III. Alleged Misrepresentations and Omissions and the Firm's Failure to Supervise Under Causes One and Two of the Complaint

Enforcement's first two causes of action against CLK concern the firm's activities related to Lathen's redemptions of survivor bonds. We set forth the facts, discuss the findings of violation, and address sanctions related to the firm's survivor bond activities in Part III.

A. Facts Related to the Firm's Survivor Bond Activities

1. Lathen and Eden Arc's Investment Strategy

Lathen is a seasoned investment banker who formerly was a managing director at Lehman Brothers and CitiGroup. In 2009, Lathen identified a novel strategy to profit from corporate bonds, notes, and market-linked certificates of deposit offered by sophisticated institutions, including Bank of America, Goldman Sachs Bank, General Electric Capital Corporation, Barclays Bank, JPMorgan Chase, Wells Fargo, CitiBank, and Deutsche Bank. Purchasers could redeem these investments early for par, the full principal amount prior to maturity, under a survivor's option provision if a joint owner died (i.e., the survivor bonds). Lathen's investment strategy involved purchasing these survivor bonds when they were trading at a discount either in the initial offering or on the secondary market and redeeming them at par, pursuant to the survivor's option provision.

Lathen founded EndCare, a marketing business to solicit terminally ill individuals to participate in his investment strategy. He located participants through referral relationships with hospices. The participants were already enrolled in hospice or had a life expectancy of less than six months as verified by a physician. In exchange for their participation, Lathen provided the terminally ill individual with an immediate payment of $10,000. Lathen would open a brokerage account with the participant as joint tenants with rights of survivorship. He then would buy survivor bonds for the account or transfer bonds to it that he held in other accounts. When the participant died, Lathen, as the survivor, would exercise the option on the bonds held in the account. Lathen initially purchased the survivor bonds with the terminally ill individuals using his own money. Lathen, in 2011, established the Eden Arc hedge fund as a financing vehicle to pursue his strategy on a larger scale.

Before opening a brokerage account in Lathen's and a participant's name, the participant signed a "Participant Agreement." Under the agreement, the participant agreed to become a nominal owner with Lathen of a brokerage account to be titled as a joint tenancy with right of survivorship. Upon the death of a participant, the rights to the account would vest solely with Lathen and not in the participant's estate. The Participant Agreement provided for the one-time cash payment of $10,000, which was payable after the account was opened and held securities. The Participant Agreements dated between January 5, 2012, and February 3, 2013, entitled the participant to "5% of the net profits in the [a]ccounts during the term of the joint tenancy, subject to a minimum of $10,000 [upfront payment] and a maximum of $15,000."[3] This version of the

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[3] The agreement further provided that, "in the event that Lathen . . . should predecease the Participant, Participant, or if applicable, Participant's estate hereby agrees to cooperate with

[Footnote continued on next page]

Participant Agreement prohibited a participant's pledging, borrowing against, or withdrawing funds without Lathen's permission. The Participant Agreements dated after February 3, 2013, provided that the joint tenant accounts would be pledged to secure a loan to Lathen "to cover the [$10,000] payment to Participant and to finance the purchase of the [i]nvestments." This revised version of the agreement removed the prohibition against participants' pledging, borrowing against, or withdrawing funds from the joint accounts and modified the provision regarding the disposition of assets in the event that Lathen predeceased the participant. If that occurred, the account would be liquidated to pay the outstanding balance on the loan described above and any remaining proceeds would go to the participant.

From January 2012 to March 2015, the period relevant to CLK's survivor bond activity, the Participant Agreements required participants to execute a power-of-attorney ("POA") designating Lathen as their attorney-in-fact and authorized Lathen to sign account-opening forms for the participants. The agreements were silent as to where Lathen would open the brokerage accounts. Lathen included the POAs with the new account application submitted to the applicable brokerage firm. The POAs also authorized Lathen, on behalf of the participants, to manage the brokerage accounts; "buy, sell, exchange convert, tender, trade, lend, and in any and every other way it sees fit to handle, dispose of, acquire, and deal in" securities; execute agreements relating to the accounts; and transfer money and securities into and out of the accounts. Lathen used the POAs to transfer survivor bonds between accounts.

Once a participant died, Lathen would exercise the survivor's option by filing a claim with the applicable brokerage firm to redeem the bonds at par value.

2. CLK Accepts Lathen as a Customer, Opens Accounts for Lathen, and Submits Redemption Requests

In fall 2011, an accounting firm that serviced one of CLK's largest clients introduced Lathen to Maier, the manager of CLK's Prime Services Department. Maier and Bulger had several meetings with Lathen during which he described his investment strategy. Maier previously had not heard of Lathen or his survivor bond investment strategy. Lathen emailed Maier the Eden Arc investor presentation and a list of Eden Arc's survivor bond holdings that totaled, in October 2011, over $19 million. Maier forwarded Lathen's email to Bulger and the firm's CFO, Robert Benton. Maier told them that Lathen had other accounts at another broker-dealer and Lathen was not satisfied with the high interest rate Eden Arc was paying on its debt balances. According to Maier, Lathen was "running $16 million in margin debt versus the bonds." Maier understood that CLK would profit from extending margin to Eden Arc, Lathen would not be trading much, and it "would take very little effort to handle this type of account." In a later email, Maier told Bulger and Benton that CLK's "earnings would come from the spread on the debt interest and the spread on the bonds that we buy for [Eden Arc] on the

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Investors or their designated agent to liquidate the Account(s). Once liquated, any funds contributed by Investors to the Accounts would be returned to them. The remaining value in the Account(s), if any, would then be divided 95% to Investors and 5% to Participant or their estate."

secondary market . . . [and] we should be able to make $200,000 [per month] on the relationship when you add in everything." CLK understood that Lathen's strategy was to redeem survivor bonds within three to six months after purchase.

CLK researched the survivor bond industry before approving the relationship with Lathen. Maier testified that a March 2010 Wall Street Journal article, which Eden Arc cited in its promotional materials, showed that others were using a survivor bond investment strategy and "gave [him] comfort." This article stated, "[l]egal and financial experts say there is nothing to prevent investors from buying these bonds with . . . a stranger who is terminally ill." It quoted an attorney who explained there was nothing in the prospectuses of survivor bonds that prohibited a stranger and terminally ill person from buying a survivor bond. The article further quoted a representative of AIG, a survivor bond issuer, who stated that the "bond's fine print doesn't prohibit such activity." Lathen also told CLK that Eden Arc's attorneys had reviewed extensively the survivor bond investment strategy, and they had determined it was legal. In addition, Lathen provided CLK with a legal opinion letter that discussed the joint tenancy agreement, which CLK's management reviewed before accepting Lathen's business. Lathen highlighted for CLK that there was no requirement in the survivor bond prospectuses that the surviving owner be related to the decedent. Bulger, however, was concerned about the participants, and the $10,000 payment to them. Lathen told Bulger that the $10,000 payment was "very meaningful" to the participants and these individuals were "very appreciative."

In addition, CLK's director of operations testified that he and Miller, prior to the firm agreeing to take on Lathen's business, discussed with BNY Mellon whether "there was anything unique about these [survivor bond] issues that they would require additional documentation." BNY Mellon represented to CLK that there was nothing "unique," but that not all issuers request the same documents when redeeming the survivor bonds. After this conversation, CLK understood that an issuer would request additional documentation from a broker-dealer if necessary and CLK would provide it.

On October 21, 2011, Maier informed Lathen that he had "reviewed your information with my group, and we are interested in taking the next steps with you." CLK formally approved the relationship with Eden Arc in November 2011. In January 2012, Lathen opened his first joint account with a participant at CLK. From January 2012 to October 28, 2013, CLK opened 36 accounts for Lathen and Eden Arc.[4]

Lathen completed the new account applications and submitted them to CLK. Lathen signed the applications for himself and as attorney-in-fact for the participants. Maier signed them as the firm's account executive, and Miller signed as principal. No one at CLK had any contact with the participants, and the firm did not send to the participants account statements or confirmations that would show transfers of assets into or out of the accounts.[5] Instead, CLK

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[4] Not all of the participants died while CLK custodied the Eden Arc accounts; thus, CLK did not submit redemptions for the survivor bonds held in these accounts.

[5] Bulger testified that the firm "never had any disagreements with the joint tenants."

addressed the account statements for the joint accounts to the participants and Lathen "c/o Eden Arc" at Eden Arc's business address. Because the participants gave Lathen sole discretion to manage the accounts through the POAs, the firm believed there was no need to send participants copies of account statements or confirmations, and Lathen requested that the firm send none. Moreover, none of the participants deposited any money into the joint accounts.

CLK submitted the first survivor bond redemption for Lathen in April 2012. Lathen directed staff in CLK's Prime Services Department on which documents to send to an issuer or issuer's payment agent to support a redemption request.[6] Lathen usually dealt with AB, who was Maier's assistant. AB had no prior experience redeeming survivor bonds, and her role in the redemptions was purely ministerial. Maier directed her to submit the redemption requests as Lathen directed, which is what she did.

The issuers or their agents received multiple requests from Lathen and Eden Arc acting on behalf of many different participants who had died. In most instances, AB prepared a cover letter from the firm to the issuer or agent stating that a "joint owner" of the referenced CLK account had died and to exercise the survivor's option with respect to certain bonds in the account. Lathen provided AB with a letter of authorization, copies of the participant's death certificate, and survivor's option election form, which Lathen had signed. CLK typically also provided the issuer or its agent with an affidavit of domicile for the participant, which Lathen had executed, and CLK account statements that listed Lathen and the participant and Eden Arc's address. CLK's operations department transmitted the paperwork to the issuer or its agent. CLK relied upon the issuers or their agents to request any additional information needed to redeem the survivor bonds.

In September 2012, CLK hired consultants to conduct a risk assessment of all areas of the firm. In November 2012, Miller emailed one of the consultants, DP, a copy of the EndCare brochure. After reviewing it, DP wrote to Miller and Bulger that he "would like to see the contract [Participant Agreement] that is signed." CLK obtained a sample Participant Agreement in December 2012. The firm's review of the sample Participant Agreement did not immediately prompt it to request additional Participant Agreements from Lathen for the joint accounts at CLK. The firm did not require Eden Arc to provide copies of the Participant Agreements for the relevant joint accounts until summer 2013, and prior to that, the firm had "very few" of them.[7] On June 10, 2013, AB emailed Eden Arc stating, "[g]oing forward we will need a participation

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[6] One payment agent, the Depository Trust & Clearing Corporation ("DTCC"), processed the majority of the survivor bond redemptions for Lathen. DTCC was the agent for Barclays, JPMorgan, CitiBank, MBIA, Societe Generale, and Wells Fargo, among others. BNY Mellon, another payment agent, also processed many survivor bond redemption requests that CLK submitted for Lathen. BNY Mellon was the agent for Bank of America, Countrywide Financial, General Electric, GMAC, and HSBC, among others. Goldman Sachs Bank ("Goldman Bank") used both DTCC and BNY Mellon for different redemptions.

[7] Bulger stated that the firm only had "one or two" of the Participant Agreements in June 2013.

agreement for each new account." Two months elapsed before CLK did anything further to obtain the Participant Agreements.

An August 2013 consultant's report discussed the risks to the firm from the Eden Arc business.[8] The report identified as a risk that the survivor bond "issuers could contest the validity of an Investment Advisor [Eden Arc] 'survivor' and contest the redemption provision." The report stated that the risk of the Eden Arc business to CLK "seemed tolerable" and [f]or people who need money in the late stages of life, the transaction is beneficial to the [participant]. From a public perception, however, it may be seen as exploiting a dying person for profit." The report concluded that "[t]he [participant] benefits by receiving cash, Eden Arc benefits by redeeming the bonds prior to maturity at par, CLK[] earns interest and the issuers assume a redemption rate so it likely has little impact on them."

On August 15, 2013, a compliance officer at Goldman Bank sent AB an email requesting additional information regarding redemption requests for three CLK accounts to enable the bank "to determine whether Mr. Lathen may elect to exercise a survivor's option." Among other items, Goldman Bank requested "[a]ny agreements between Mr. Lathen . . . with the other identified owner of each of the accounts." AB immediately forwarded Goldman Bank's email to Miller, Maier, and CLK's in-house counsel. The next day, AB sent Lathen's assistant an email following up on her June 10 request for the Participant Agreements. In the email, AB stated that CLK needed four specific Participant Agreements "ASAP" and that the firm would not open any more accounts for Lathen until it received "copies of all participant agreements."

On August 22, 2013, AB sent Goldman Bank the information that it requested, including the Participant Agreements. Thereafter, Goldman Bank denied the redemption requests. Goldman Bank concluded that none of the accounts for which CLK had submitted redemption requests were "bona fide joint tenant accounts, but rather were established exclusively to permit Mr. Lathen to acquire securities with survivor's benefits."

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[8] CLK revisited the joint tenancy issue throughout its ongoing relationship with Lathen when the firm engaged consultants to review the firm's risks. CLK believed that the firm's new account application was the "prevailing document" because Lathen opened the accounts as "joint tenants with right of survivorship." In the event that Lathen predeceased a participant, CLK understood it was obligated to transfer the assets of the joint account to the surviving participant. CLK's in-house counsel testified that if a party connected to Eden Arc challenged such a transfer, his advice was for the firm to file an "interpleader" action and "let the courts decide." CLK believed it did not have to provide a Participant Agreement unless an issuer asked for it because this was a third-party agreement between Lathen and a participant and "had nothing to do with" CLK. And as the firm gleaned from its discussions with BNY Mellon, an issuer would request any additional documentation it deemed necessary for redemption. Here, each request that CLK handled identified Lathen and Eden Arc as the redeemers on behalf of many deceased individuals with different names from different geographic areas. Each of these requests also prominently listed Lathen and Eden Arc's address and phone number. Lathen and Eden Arc's involvement in the redemptions was not unknown to the issuers or their agents.

In September 2013, Barclays contacted DTCC requesting additional information from CLK before approving two CLK survivor bond redemption requests. CLK thereafter provided the requested POAs and Participant Agreements to DTCC on behalf of Barclays. Barclays honored the redemption requests after receiving this information. From August 2013 through March 24, 2014, Barclays redeemed millions of dollars' worth of survivor bonds that Lathen and six participants held in CLK accounts.

Between January 2012 and March 2015, CLK executed redemption requests on behalf of Eden Arc and Lathen for approximately $62 million of survivor bond investments held in 26 accounts.[9] The largest joint account, between Lathen and CK, held 75 survivor bonds and generated approximately $14.2 million in redemptions for Lathen. The second largest account held approximately 80 bonds and generated approximately $8 million in redemptions.

The firm profited from Lathen and Eden Arc's business by providing margin and from the spread on the survivor bonds that CLK bought on their behalf in the secondary market. From 2012 through September 2013, CLK earned $1,162,396 from Lathen and Eden Arc's survivor bond business. Lathen and Eden Arc transferred their business to another broker-dealer late in 2013, but CLK continued to handle some redemptions of survivor bonds for Eden Arc until March 2015.[10]

3. SEC's Action Against Lathen and Eden Arc

On August 15, 2016, the SEC issued an order instituting administrative and cease-and-desist proceedings against Lathen and Eden Arc. In relevant part, the SEC's Division of Enforcement alleged that Lathen and Eden Arc violated Sections 17(a)(1), (a)(2), and (a)(3) of the Securities Act, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, when they knowingly, recklessly, or negligently made misrepresentations or omissions of material facts to the issuers of survivor bonds. The SEC alleged that Lathen made false statements to the issuers that he and the participants were "joint owners" and failed to disclose the Participant Agreements that he signed with the participants. The administrative law judge ("ALJ") dismissed the proceeding in its entirety.[11] *Donald F. ("Jay") Lathen, Jr.*, Initial

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[9] One participant, GB, had two joint accounts with Lathen for which CLK redeemed survivor bonds.

[10] Lathen sold approximately 100 survivor bonds that he held in his CLK accounts on the open market instead of submitting them for early redemption from the issuer pursuant to the survivor's option.

[11] After the hearing in this case, CLK submitted the ALJ's order to the Hearing Officer. We take judicial notice of the ALJ's order. FINRA Rule 9145(b); *cf. Am. Inv. Servs. Inc.*, 54 S.E.C. 1265, 1266 n.1 (2001) (noting the SEC may take notice of any material matter that is properly entitled to judicial notice by a federal district court, any matter in the public official records of the Commission, or any matter which is peculiarly within the knowledge of the Commission as an expert body). Although the ALJ's order is "not binding on this body," we acknowledge the overlapping nature of some of the issues relevant to CLK's submission of the redemption

[Footnote continued on next page]

Decisions Release No. 1161, 2017 SEC LEXIS 2509, at *3, *82, *137-38 (Aug. 16, 2017). The ALJ concluded that the SEC failed to prove that Lathen and Eden Arc had the requisite intent to violate the Securities Act or the Exchange Act. The ALJ declined to resolve the issue of whether the joint tenancies were valid, characterizing the issue as an "unsettled matter of New York law" and "speculative in this proceeding," in light of the dispositive conclusion that Lathen acted in good faith. *Id.* at *121.

In dismissing the action, the ALJ noted "[t]here is nothing necessarily illegal about using, or even exploiting, a contractual loophole . . . [or] about profiting from the death of the terminally ill, even if some might view it as unsavory." *Id.* at *137-38. This was "a novel investment strategy that was disclosed to investors, was profitable to them, and was dependent on a contractual loophole that has run its course." *Id.* at *1.

The ALJ found that, even assuming that the Participant Agreements would have been material to the issuers, Lathen and Eden Arc lacked intent to defraud. The ALJ expressly found that Lathen solicited extensive advice from counsel about the investment strategy.[12] Based upon that advice, Lathen reasonably believed that his investment strategy was legal, that the joint accounts were valid under New York law, and that he was not required to make further disclosures to the issuers. Lathen's attorneys advised him that he did not need to disclose the Participant Agreements to the issuers and to provide only what was required as a precondition to honor the redemption requests. Moreover, Lathen knew that some issuers continued to honor his redemptions even after learning about the Participant Agreements.[13] *Id.* at *132-33.

With respect to whether Lathen acted negligently for purposes of the alleged violations of Section 17(a)(2) and (3) of the Securities Act, the ALJ found that, by Lathen's solicitation of extensive legal advice about the novel strategy, he acted in "good faith" and that the SEC failed to establish the standard of care that Lathen's conduct may have contravened. The ALJ explained, "Lathen's attorneys advised him that he only needed to disclose to issuers what they explicitly specified in the offerings." And Lathen "acted with a good faith belief in pursuing a legal strategy; throughout his operation, he continued to honestly believe that he had created valid joint tenancies in consultation with his attorneys and that he did not need to disclose anything more to issuers." *Id.* at *136-37.

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materials on Lathen's behalf. *See Dep't of Mkt. Regulation v. Leighton*, Complaint No. CLG050021, 2010 FINRA Discip. LEXIS 3, at *33 n.13 (FINRA NAC Mar. 3, 2010).

[12] The ALJ noted that, from 2009 to the time of the SEC administrative hearing, Lathen engaged counsel from four different law firms to ensure that he acted lawfully related to the survivor bond redemptions. *Id.* at *39-40.

[13] Several issuers changed the language in their offering documents in response to Lathen and Eden Arc's redemptions. *Id.* at *57. For example, after Goldman Bank refused to redeem Lathen's requests, it began requiring a specific familial or legal relationship between joint account holders in order to redeem survivor bonds. *Id.* at *57-58.

The SEC did not appeal the ALJ's decision, and it therefore represents a final adjudication on the merits of the SEC's action against Lathen and Eden Arc.

B. Discussion of the Alleged Misrepresentations and Omissions

In this case, Enforcement alleged under cause one that CLK violated Sections 17(a)(2) and (3) of the Securities Act by making negligent misrepresentations and omissions to the issuers in connection with the redemption of survivor bonds on Lathen's behalf. Enforcement further alleged that this conduct constituted an independent violation of FINRA Rule 2010. Enforcement specifically alleged that CLK, when submitting redemption documents to issuers or their payment agents, misrepresented in the cover letters the status of a deceased participant as "joint owner" of the accounts with Lathen.[14] Enforcement averred that the participants were not beneficial owners of the accounts under New York law, and therefore these were not valid joint tenancies.[15] Enforcement further alleged that the firm made material omissions by failing to provide the issuers or their payment agents with copies of the Participant Agreements during the redemption process when CLK knew these agreements existed by December 2012.

The Hearing Panel found that, when CLK failed to provide the Participant Agreements to the issuers, the firm negligently omitted material information, and when the firm represented to the issuers during the redemption process that a participant was a joint owner of a survivor bond, CLK negligently made materially false statements, in violation of Section 17(a)(2) and (3). In addition, the Hearing Panel found that CLK's negligent misrepresentations constituted an independent violation of FINRA Rule 2010.[16] *See, e.g.*, *Dep't of Enforcement v. Pellegrino*, Complaint No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *14 n.13 (FINRA NAC Jan. 4, 2008) ("Negligent misrepresentations violate NASD Rule 2110."), *aff'd*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843 (Dec. 19, 2008). Because we disagree with the Hearing Panel's determination that Enforcement proved that CLK acted negligently, we reverse these findings of violation.

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[14] CLK's cover letter to issuers or their payment agents stated that a named participant, "a joint owner on internal account number[,] . . . has passed away. Please exercise the survivor's option with respect to the following bonds in the account." CLK also included Lathen and Eden Arc's cover letter addressed to the firm, which stated a named participant, "a joint owner on the above-referenced account, recently passed away. As the surviving joint owners on the account, we would like to exercise the survivor's option with respect to the following bonds in the account. Attached is the death certificate supporting this request." Lathen signed the cover letters and provided Eden Arc's name and contact information on the letterhead.

[15] Each Participant Agreement stated that it "shall be governed and construed as to its validity, interpretation and effect by the laws of the State of New York."

[16] FINRA Rule 2010 provides "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."

Securities Act Sections 17(a)(2) and (3) apply "in the offer or sale of any securities," and prohibit: obtaining money or property by means of any material misstatement of fact or statements that omit material facts (Section 17(a)(2)); or engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser (Section 17(a)(3)).[17] 15 U.S.C. § 77q(a). Sections 17(a)(2) and (3) do not require a showing of scienter; negligence is sufficient. *Aaron v. SEC*, 446 U.S. 680, 686-87 n.6 (1980).

Under the securities laws, those who make affirmative representations have an "ever-present duty not to mislead." *Basic Inc. v. Levinson*, 485 U.S. 224, 240 n.18 (1988). An omission is actionable under the securities laws when a person is under a duty to disclose. *See id.* at 239 n.17. A duty may arise when a statement is made that would otherwise be "inaccurate, incomplete, or misleading." *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015). Thus, Section 17(a) also prohibits "half-truths—literally true statements that create a materially misleading impression." *SEC v. Gabelli*, 653 F.3d 49, 57 (2d Cir. 2011), *rev'd on other grounds*, 568 U.S. 442 (2013). "[E]ven absent a duty to speak, a party who discloses material facts in connection with securities transactions assumes a duty to speak fully and truthfully on those subjects." *FindWhat Investor Grp. v. FindWhat.com*, 658 F.3d 1282, 1305 (11th Cir. 2011).

"Whether information is material 'depends on the significance the reasonable investor would place on the . . . information.'" *Dep't of Enforcement v. Akindemowo*, Complaint No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *32 (FINRA NAC Dec. 29, 2015) (quoting *Basic Inc.*, 485 U.S. at 240), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016). Likewise, whether a statement is misleading is judged from the point of view of an objective investor and determined based on the facts of a case. *Basic Inc.*, 485 U.S. at 238; *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

The Hearing Panel explained that the question of whether the CLK accounts were valid joint tenancies presents a novel issue under New York law. The Hearing Panel nevertheless found that the participants were not the beneficial owners of the assets in the joint accounts and therefore the accounts were not valid joint tenancies under New York law. The Hearing Panel found instead that these were "convenience accounts," which exist when a depositor does not intend to give a present beneficial interest in the assets of the account to the co-tenant. *See Fischedick v. Heitmann*, 699 N.Y.S.2d 508, 509 (App. Div. 2012) (rebutting presumption of joint

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[17] The Securities Act's definition of "security" includes a bond or a note. 15 U.S.C. § 77b(a)(1). The Securities Act also defines "sale" or "sell" to "include every contract of sale or disposition of a security or interest in a security[] for value." *Id.* § 77b(a)(3). CLK admits that the survivor bonds that Lathen and Eden Arc redeemed were securities.

For the federal securities laws, the transactions must also involve interstate commerce or the mails, or a national securities exchange. CLK used a means and instrumentality of interstate commerce when they communicated with the issuers or their agents via telephone or email, and the mails to send redemption packets. *See SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992).

tenancy when depositor did not intend to confer a "present beneficial interest" on other tenant or intend that the other tenant "acquire any ownership interest therein"); *In re Estate of Stalter*, 703 N.Y.S.2d 600, 602 (App. Div. 2000) (explaining the "key underlying issue" to determining whether a valid joint tenancy exists is the depositor's "intent at the time that the account bearing [the other party's] name was created"). The Hearing Panel found that Enforcement proved that Lathen did not intend to give the participants a beneficial interest in the assets held in the CLK accounts. *See In re Estate of Grancaric*, 936 N.Y.S.2d 723, 726 (App. Div. 2012) (shifting the burden to "the party challenging the title of the survivor, to establish—by clear and convincing evidence—. . . that the accounts were only opened as a matter of convenience and were never intended to be joint accounts").

Under the terms of the majority of the Participant Agreements, a participant was not entitled to the entire estate if Lathen predeceased the participant. Sixteen of the 26 Participant Agreements contained a provision that limited a surviving participant to five percent of the profits earned in the account, while the remaining 95 percent would go to Eden Arc. Eight others stated that the assets of the account were to be liquidated to repay a loan used to fund the $10,000 payment to the participant and to cover the costs of purchasing investments in the account. The remaining three agreements were silent and contained no provision directing the proceeds to Eden Arc or elsewhere if Lathen predeceased a participant. The Hearing Panel found that, on balance, the terms of the Participant Agreements demonstrated that the participants gave up ownership in the investments held in the accounts and were not true joint accounts. Lathen's investment strategy depended largely on the participants not getting the accounts through survivorship or using the funds.

The Hearing Panel further determined that the Participant Agreements contained material information that a reasonable issuer would want to know in order to determine whether a participant was a beneficial owner of the survivor bonds held in the CLK accounts at the time of death. According to the Hearing Panel, the Participant Agreements would have provided the issuers with notice of the relationship between Lathen and a participant in order to determine for itself whether to honor Lathen's redemption requests and altered the "total mix" of information available to the issuers. The two issuers in this case that requested and received the Participant Agreements from CLK came to different conclusions about honoring Lathen and Eden Arc's redemptions. After reviewing the Participant Agreements in September 2013, Goldman Bank refused to honor Lathen's redemption requests, determining that none of the accounts were "bona fide joint tenant accounts." In contrast, Barclays, after reviewing the agreements and speaking with CLK, redeemed millions of dollars of survivor bonds that Lathen held with six participants. Executives from two other issuers (Societe Generale and Gateway Bank of Florida) testified at the hearing that, had they known of the Participant Agreements, they would have questioned whether these were true joint accounts.

It is not necessary for our review of this case, however, to determine the validity of the joint tenancies under New York law or the materiality of the Participant Agreements to the issuers. Even if we were to agree with the Hearing Panel that the joint tenancies were invalid, and the Participant Agreements would have been material to these sophisticated issuers in assessing Lathen's and CLK's representations that a participant was a joint owner, we find that Enforcement did not prove by a preponderance of the evidence that CLK acted negligently when submitting the survivor bond redemption requests for Lathen. Therefore, Enforcement did not

prove that CLK violated Securities Act Section 17(a)(2) and (a)(3), or alternatively, FINRA Rule 2010 as a result of the alleged negligent misrepresentations or omissions.[18]

Negligent conduct under Sections 17(a)(2) and (a)(3) of the Securities Act is a failure "to use the degree of care and skill that a reasonable person of ordinary prudence and intelligence would be expected to exercise *in the situation*." *SEC v. True N. Fin. Corp.*, 909 F. Supp. 2d 1073, 1122 (D. Minn. 2012) (emphasis added). The Hearing Panel relied upon a general negligence standard used when a broker is recommending a security to a customer. We have stated that this "standard of care imposes a duty [on the broker] to take reasonable steps to become informed about a recommended security, and to do much more than rely unquestioningly on information an issuer provides." *Dep't of Enforcement v. Cantone*, Complaint No. 2013035130101, 2019 FINRA Discip. LEXIS 5, at *59-60 (FINRA NAC Jan. 16, 2019) (citing

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[18] We also note that the neither Enforcement nor the Hearing Panel addressed whether, for purposes of Section 17(a)(2), CLK "directly or indirectly" obtained "money or property" as a result of the alleged misrepresentations and omissions. CLK earned $1,162,396 from Lathen and Eden Arc's business between 2012 and September 2013 by providing margin and from the spread on the survivor bonds purchased in the secondary market. While CLK profited from Lathen and Eden Arc's business generally, Enforcement made no claims that CLK's earnings specifically were affected by the alleged misrepresentations or omissions when submitting the redemption paperwork to the issuers.

Courts have split on the issue of whether a respondent must personally gain money or property from the fraud in order to violate Section 17(a)(2). *Compare SEC v. Shapiro*, No. 15 Cv. 7045, 2018 U.S. Dist. LEXIS 93420, at *20 (S.D.N.Y. June 4, 2018) ("[I]t is sufficient under Section 17(a)(2) for the SEC to allege that [the defendant] obtained money or property for his employer while acting as its agent, or, alternatively, for the SEC to allege that [the defendant] personally obtained money indirectly from the fraud."), *and SEC v. AgFeed Indus.*, No. 3:14-cv-00663, 2016 U.S. Dist. LEXIS 194542, at *51-52 (M.D. Tenn. July 21, 2016) (finding it is sufficient to state a claim under Section 17(a)(2) that the complaint alleged that the defendant made false statements to investors in connection with company's efforts to raise money through its public offerings), *and SEC v. Stoker*, 865 F. Supp. 2d 457, 463 (S.D.N.Y. 2012) (holding that it would be sufficient for purposes of Section 17(a)(2) to show either that a defendant "personally obtained money indirectly from the fraud" or that he "obtained money or property for his employer while acting as its agent"), *with SEC v. Wey*, 246 F. Supp. 3d 894, 915 (S.D.N.Y. 2017) ("Thus, regardless of the manner of compensation, if the person would have earned the same fees or compensation regardless of whether the statement was false, a Section 17(a)(2) claim does not lie."), *and SEC v. Syron*, 934 F. Supp. 2d 609, 640 (S.D.N.Y. 2013) ("[The requirement that] the defendant personally gains money or property from the fraud is essential, for otherwise the defendant may have fraudulently induced the victim to part with money or property, but he has not obtained that money or property himself."); *and SEC v. Daifotis*, 2011 U.S. Dist. LEXIS 60226, at *27 (N.D. Cal. June 6, 2011) (requiring a showing under Section17(a)(2) that the defendant personally gained money or property from the alleged fraud). In light of our finding that Enforcement failed to prove negligence, it is unnecessary to resolve this issue.

Dep't of Enforcement v. Reynolds, Complaint No. CAF990018, 2001 NASD Discip. LEXIS 17, at *42-43 (NASD NAC June 25, 2001)), *appeal docketed*, SEC Admin. Proceeding No. 3-18999 (Feb. 14, 2019). This is not, however, a case of negligence where a broker recommends a security to a customer. *See, e.g.*, *Lathen*, 2017 SEC LEXIS 2509, at *135 ("Although 'reasonable prudence' and 'reasonable care' might be easy enough to measure in a garden-variety securities fraud case, this case is anything but simple."). Instead, this matter concerned CLK acting as Lathen's agent and involved a novel investment strategy that Lathen had vetted by multiple law firms, application of New York state law, and highly sophisticated issuers who exclusively controlled the parameters of the redemption requirements of their offerings, and some issuers' general awareness of an investment strategy similar to Lathen's that had been going on for more than two years before CLK submitted the first redemption.

Enforcement had the burden to identify the appropriate standard of care that CLK would be expected to exercise when submitting the redemption documents and needed to prove that CLK acted negligently under that standard. *See SEC v. Shanahan*, 646 F.3d 536, 546 (8th Cir. 2011); *see, e.g.*, *Del Mar Fin. Servs., Inc.*, Initial Decisions Release No. 188, 2001 SEC LEXIS 1737, at *106 (Aug. 14, 2001) ("There is an absence of precedent for charging a clearing broker with negligent antifraud violations. However, the expert testimony is useful in illuminating the standard of care."); *Richard Hoffman*, Initial Decisions Release No. 158, 2000 SEC LEXIS 105, at *76 (Jan. 27, 2007) ("To show negligence [under Sections 17(a)(2)-(3)], it must be shown that Hoffman failed to exercise a reasonable standard of care or competence of a registered representative. The record, however, is devoid of evidence concerning the standard of care that would apply. Nor is there any case precedent, and the Division has pointed to none, that provides guidance concerning the standard."). Enforcement has failed to meet that burden.

Enforcement has offered scant evidence with respect to the degree of care that an ordinarily careful broker-dealer would use under the same or similar circumstances as CLK did here. *See Shanahan*, 646 F.3d at 546 (holding that the SEC's failure to present sufficient evidence that defendant "violated an applicable standard of reasonable care was fatal to its case" under Sections 17(a)(2) and (3)); *cf. Shidler v. All Am. Life & Fin. Corp.*, 775 F.2d 917, 927 & n.14 (8th Cir. 1985) (upholding a finding that defendants were not negligent in soliciting proxies for a merger using a voting procedure later determined to violate an ambiguous Iowa statute). For example, Enforcement has offered no proof of CLK's duty when undertaking the administrative function of submitting the redemption paperwork while acting as an agent of a customer in an arm's length transaction; CLK's duty to investigate the validity of joint tenancy of an account under New York state law; CLK's duty to determine independently whether the documentation that Lathen provided to the issuers was sufficient to allow Lathen to exercise the survivor option; and CLK's duty to provide documentation to the issuers related to Lathan's side agreements with the participants. By way of analogy, courts routinely have dismissed fraud allegations against clearing brokers when performing administrative functions similar to CLK acting as the instrument for submitting the redemption paperwork related to the transactions orchestrated by Lathen. *Cf. Blech Sec. Litig.*, 961 F. Supp. 569, 584 (S.D.N.Y. 1997) (clearing firm not primarily liable for antifraud violations when its conduct is no more than the performance of routine clearing functions); *Blech Sec. Litig.*, 928 F. Supp. 1279, 1295-96 (S.D.N.Y. 1996) (no material omission even if clearing firm knew and failed to disclose a material fact because a clearing broker owes no duty of disclosure to introducing firm's customer); *Dillon v. Militano*, 731 F. Supp. 634, 636-39 (S.D.N.Y. 1990) (clearing broker performs clerical functions; not liable for introducing broker's fraud).

Moreover, there was some evidence of industry practices as they pertained to a reasonably prudent broker-dealer in CLK's position at the time. *See, e.g.*, *SEC v. GLT Dain Rauscher, Inc.*, 254 F.3d 852, 854 (9th Cir. 2001) ("We hold that the standard of care for an underwriter of municipal offerings is one of reasonable prudence, for which the industry standard is one factor to be considered, but it is not the determinative factor."). At least some issuers generally had known about this investment strategy since at least March 2010. As indicated by the March 2010 *Wall Street Journal* article that Maier referenced when discussing the firm's due diligence around the Eden Arc business, some issuers knew at that time about arrangements similar to Lathen's and nothing in the issuer's offering documents prohibited them. And Enforcement has offered no evidence that the offering documents for the survivor bonds at issue here required disclosure regarding side agreements between joint account holders and in connection with exercising a survivor's option.

We determine that Enforcement has not proven that CLK failed to exercise the degree of care that an ordinarily careful broker-dealer would use under the same or similar circumstances at the time. *See Shanahan*, 646 F.3d at 546; *True N. Fin. Corp.*, 909 F. Supp. 2d at 1122. We therefore disagree with the Hearing Panel's finding that Enforcement proved CLK was negligent when it acted as Lathen's agent to submit the redemption paperwork to these highly sophisticated issuers or their agents.

In addition, Enforcement did not prove that CLK "undertook a deceptive scheme or course of conduct that went beyond the misrepresentations" or omissions for purposes of violating Section 17(a)(3). *See Stoker*, 865 F. Supp. 2d at 467. A respondent may be liable under both Section 17(a)(2) and Section 17(a)(3) based on allegations stemming from the same set of facts, but only if the misrepresentations and omissions alleged are not the entirety of the misconduct that is already covered by Section 17(a)(2). *See id.* Enforcement has not proven that CLK engaged in such a scheme or course of conduct and did so with negligence.

We reverse the Hearing Panel's determination that CLK violated Securities Act Section 17(a)(2) and (a)(3) by making negligent misrepresentations or omissions and, alternatively, independently violated FINRA Rule 2010 through its negligent misrepresentations. The Hearing Panel did not explain why CLK's conduct independently violated FINRA Rule 2010, but regardless, Enforcement has not proven negligence.

C. Discussion of the Firm's Failure to Supervise Reasonably the Survivor Bond Business Line

While we decline to find that Enforcement proved the firm's actions related to its survivor bond business line violated the Securities Act and, in turn, FINRA Rule 2010, they were not without fault. Enforcement alleged in cause two of its complaint that CLK failed to establish and implement a reasonable supervisory system, including WSPs, to address the firm's survivor

bond business, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.[19] We affirm the Hearing Panel's findings that CLK violated these rules.

"Assuring proper supervision is a critical component of broker-dealer operations." *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007). Indeed, it is critical to the regulatory scheme because "[p]roper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and [FINRA] rules. It is also a critical component to ensuring investor protection." *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011). "[F]inal responsibility for proper supervision of a member's business rests with the member, and this supervision must be reasonable based on the particular facts of each case." *Dep't of Enforcement v. Wedbush Sec., Inc.*, Complaint No. 20070094044, 2014 FINRA Discip. LEXIS 40, at *35-36 (FINRA NAC Dec. 11, 2014), *aff'd*, 2016 SEC LEXIS 2794, *aff'd*, 719 F. App'x 724; *see also John A. Chepak*, 54 S.E.C. 502, 513 n.27 (2000) ("The standard of 'reasonable' supervision is determined based on the particular circumstances of each case."); *Reynolds & Co.*, 39 S.E.C. 902, 917 (1960) ("The duty of supervision cannot be avoided by pointing to the difficulties involved where facilities are expanding or by placing the blame upon inexperienced personnel . . . . These factors only increase the necessity for vigorous effort.").

NASD Rule 3010 and FINRA Rule 3110 require each member to establish and maintain a system, including WSPs, to supervise the activities of its associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules.[20] Under NASD Rule 3010(b) and FINRA Rule 3110(b), the firm must document these systems in the firm's WSPs, and the procedures must be tailored to the firm's business lines. NASD Interpretive Material ("IM") 3010-1; *see also* FINRA Rule 3110 Supplementary Material .12 ("Each member shall establish and maintain supervisory procedures that must take into consideration, among other things, . . . scope of business activities, [and] the nature and complexity of the products and services offered by the firm . . . ."); *Dep't of Enforcement v. Lek Sec. Corp.*, Complaint No. 2009020941801, 2016 FINRA Discip. LEXIS 63, at *36 (FINRA NAC Oct. 11, 2016) (finding boilerplate AML manual was not sufficiently tailored to the firm's business), *aff'd*, Exchange Act Release No. 82981, 2018 SEC LEXIS 830 (Apr. 2, 2018); *Dep't of Enforcement v. N. Woodward Fin. Corp.*, No. 2011028502101, 2016 FINRA Discip. LEXIS 35, at *27-28 (FINRA NAC July 19, 2016) (explaining that a firm's supervisory system must be

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[19] A violation of the supervision rules is a violation of FINRA Rule 2010. *See Wedbush Sec., Inc.*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794, at *15 n.11 (Aug. 12, 2016), *aff'd*, 719 F. App'x 724 (9th Cir. 2018).

[20] Because of the consolidation of the regulatory functions of NASD and NYSE Regulation into FINRA, and the development of a new consolidated FINRA rulebook, CLK was subject to both FINRA and NASD rules during the period at issue. As of December 1, 2014, FINRA Rule 3110 superseded NASD Rule 3010 without substantive change. *FINRA Regulatory Notice 14-10*, 2014 FINRA LEXIS 17 (Mar. 2014). NASD Rule 3010 applies to CLK's conduct before December 1, 2014, and FINRA Rule 3110 applies to CLK's conduct on or after December 1, 2014.

"tailored specifically to the member's business and must address the activities of all its registered representatives and associated persons").

When Lathen became a CLK customer, the firm had no experience with survivor bonds in general and Eden Arc's unique investment strategy in particular. Lathen and Eden Arc's business required CLK to open joint accounts on behalf of numerous participants and Lathen; purchase survivor bonds through these joint accounts or transfer survivor bonds among the various joint accounts, often on an expedited basis; facilitate redemptions of the survivor bonds on Lathen's behalf; and act as the liaison between Lathen, Eden Arc, the issuers or agents, and multiple departments within the firm such as Prime Services and operations. CLK ultimately redeemed $62 million in survivor bonds on Lathen's behalf. Nevertheless, CLK, had no system, including WSPs, to supervise this new business line. The firm's failure to create and implement supervisory procedures specific to the survivor bond business was unreasonable. *See Dep't of Enforcement v. William H. Murphy & Co.*, Complaint No. 2012030731802, 2018 FINRA Discip. LEXIS 24, at *53 (FINRA NAC Oct. 11, 2018) ("An adequate supervisory system must include written procedures tailored to the business lines the firm engages in."), *appeal docketed*, SEC Admin. Proceeding No. 3-18895 (Nov. 9, 2018).

CLK argues that it had reasonable procedures in place to "handle and monitor Eden Arc's business and redemption activity." The firm asserts that it "maintained procedures specifically regarding the redemptions of fixed income instruments, which applied to Eden Arc as well as C.L. King's clients in its [f]ixed income line of business." The firm's WSPs, however, do not address redemptions of fixed income instruments or anything pertinent to the survivor bond redemptions for Lathen and Eden Arc. The firm's director of operations testified that the firm had experience with bond redemptions generally, but acknowledged that the firm lacked specific experience with the survivor bond redemptions and none of its customers, other than Lathen, were engaging in the same business model. Maier, the head of the Prime Services, the primary department that oversaw Lathen's business, admitted that redeeming survivor bonds was more complex than the typical bond redemption that the firm handled, and he did not recall any firm procedures on how to supervise the redemption of these bonds.

In addition, we find that CLK failed to implement a supervisory system that was reasonably designed to ensure that the firm was not facilitating unlawful or unethical practices. The firm relied on AB, who was Maier's assistant and not a principal, to handle the Eden Arc business for the firm on a day-to-day basis, including obtaining the information from Lathen and providing it to the firm's operations department to submit the redemption requests to the issuers or agents. Maier directed her to submit the redemption requests as Lathen directed, which is what she did. AB, in turn, relied on the issuer or its agent to determine the requirements for redemption.

Maier did not review the account opening forms for Lathen's joint accounts with participants in any detail before signing them as the account representative nor did he review the redemption materials that AB collected. The firm notably did not receive copies of all of the Participant Agreements until August 2013, despite the fact it first opened accounts for Lathen and participants in early 2012. Obtaining and reviewing the Participant Agreements should have been an important component for the firm to determine whether opening these accounts and submitting redemptions was appropriate. Rather, Maier considered himself a "relationship

manager" and left it to AB and the firm's operations department to handle the survivor bond business properly.

The lack of any reasonable supervision around the Eden Arc business is particularly troublesome when reviewing the activity in the account the firm opened for Lathen and participant CK. CK's stepdaughter, DB, signed CK's Participant Agreement on her behalf as attorney-in-fact on May 30, 2013. The Participant Agreement provided that, to allow the participant time to exercise her right to cancel, Lathen would not countersign it for three days. Lathen nonetheless countersigned the same day (May 30), and then had his assistant email AB an application and POA that Lathen had signed to open a new account at CLK that afternoon.[21] Lathen's assistant stated he believed "this was a 'time is of the essence' situation." And it was. CK died the next morning on Friday, May 31, 2013, at 6:50 a.m. Later that day, at 4:41 p.m., AB emailed Lathen's assistant requesting documentation of DB's power-of-attorney. Lathen's assistant replied that he would send it the following Monday. Miller, who was the principal listed on the new account document, admitted in his hearing testimony that the documentation was not in order when he signed on May 31 because the firm did not have a copy of DB's power-of-attorney. The firm nonetheless opened the account on May 31 and reflected in CK's account that Lathen had purchased $3 million face value of a CitiBank survivor bond on that day. The firm also permitted Lathen to transfer into CK's account dozens of other survivor bonds, valued at more than $10 million, that Lathen held in other participants' accounts at CLK.[22] It appears, however, that CK had died before the transfers were effected.[23]

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[21] There were two other instances in the record when Lathen failed to wait three days before countersigning the Participant Agreement. In both of these instances in February 2013, Lathen countersigned the Participant Agreement and he or his assistant contacted CLK the same day to open a new joint account for Lathen and the participant. The firm was unaware that Lathen was doing this because it did not begin obtaining copies of the Participant Agreements until June 2013.

[22] Barclays and JPMorgan Chase issued the majority of the survivor bonds that Lathen transferred into CK's account.

[23] The timeline for the activity in CK's account is as follows: On May 24, 2013, CLK purchased $3 million of the CitiBank survivor bond and allocated that position to six different Lathen and Eden Arc accounts in equal $500,000 amounts. On May 30, 2013, at 4:10 p.m., Lathen emailed CLK's fixed income trader requesting that the firm allocate the $3 million CitiBank survivor bond in totality to CK's account. Lathen's assistant then sent an email to AB at 5:02 p.m. with the subject "Asset transfers" and attached a spreadsheet containing a listing of other securities to be journaled to CK's account. At 5:05 p.m., AB sent an email to CLK's operations department asking to "add in the trailer of the journal as of 5/29 or put in an as of date" if the journals could not be completed that day (May 30). On May 31, 2013, at 11:04 a.m., four hours after CK died, Lathen emailed CLK's fixed income trader, and copied AB, about the $3 million CitiBank survivor bond. Lathen stated, "[p]er our discussion, this will be handled as a journal with an effective date of yesterday." CK's May 2013 account statement for this transaction, however, reflects a *purchase* date of May 31, 2013, and an "as of" date in the description section of May 24, 2013. As noted above, the firm did not open CK's account until

[Footnote continued on next page]

Beginning in late June 2013, CLK began submitting the redemption documents to the agents of the issuers for the survivor bonds in Lathen and CK's account.[24] Lathen provided CLK with the redemption paperwork, including a copy of CK's death certificate, to submit to the issuers or agents on June 23, 2013. CLK sent redemption requests to the issuers or agents on behalf of Lathen and Eden Arc over the next few months despite CK's death certificate reflecting her death in the early morning likely prior to Lathen effecting the survivor bond transactions that he was submitting for redemption. By December 2013, the issuers or agents had redeemed all of the survivor bonds in CK's account except two Goldman Bank survivor bonds that Lathen later sold in the market. It was unreasonable for the firm to have no system or procedures in place to supervise the survivor bond business to ensure that the redemptions were appropriate.

We conclude that CLK violated NASD Rule 3010 and FINRA Rules 3110 and 2010 by failing to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with federal securities laws and FINRA rules in connection with the firm's survivor bonds business.

D. Sanctions for the Firm's Failure to Supervise the Survivor Bond Business Line

The Hearing Panel censured CLK and fined the firm $50,000 for its failure to supervise the survivor bond business. We affirm these sanctions.

In assessing sanctions for the respondents' violations, we consider the violation-specific Sanction Guidelines ("Guidelines") that are relevant to each respondent's misconduct and to the Principal Considerations in Determining Sanctions and General Principles that apply to all violations of FINRA rules. We have considered the Guidelines for failing to supervise and the separate Guidelines for deficient supervisory procedures. The Guidelines for failing to supervise recommend a fine of $5,000 to $73,000.[25] In egregious cases, they recommend suspending the firm with respect to any or all activities or functions for up to 30 business days.[26] The Guidelines also direct us to consider violation-specific considerations, including whether a respondent ignored "red flag" warnings that should have resulted in additional supervisory

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[cont'd]

May 31. The May 2013 account statement also reflects journals of the other survivor bond positions into CK's account with transaction dates of May 31 and as of dates of May 29.

[24] DTCC was the payment agent for all of the survivor bonds in CK's account with the exception of six.

[25] *FINRA Sanction Guidelines* 104 (Apr. 2017), http://www.finra.org/sites/default/files/2017_April_Sanction_Guidelines.pdf [hereinafter *Guidelines*].

[26] *Id.*

scrutiny; the nature, extent, size, and character of underlying misconduct; and the quality and degree of the firm's supervisory procedures and controls.[27]

The Guidelines for deficient written supervisory procedures recommend a fine between $1,000 and $37,000 and, in egregious cases, suspending the firm with respect to any and all activities or functions for up to 30 business days and thereafter until the procedures are amended to conform to the rule requirements.[28] The violation-specific considerations for deficient WSPs include whether the deficiencies allowed violative conduct to occur or escape detection, and whether the deficiencies made it difficult to determine who was responsible for specific areas of supervision or compliance.[29]

The firm implemented no supervisory structure and adopted no WSPs to oversee the survivor bond business line. No one at the firm had first-hand experience with Lathen and Eden Arc's unique investment strategy or the survivor bond business. The firm's failure to supervise reasonably this unique business line continued for an extended period and involved 36 separate accounts at CLK and the redemption of approximately $62 million in survivor bonds on behalf of Lathen and Eden Arc.[30] These redemptions involved 25 participants and hundreds of survivor bonds.[31]

The firm also did not have a written process for reviewing the redemption documents that it submitted, and did not obtain copies of the Participant Agreements in a timely manner that coincided with establishing the accounts for the participants and Lathen. Maier relied on AB (who relied on Lathen), the operations department, and the issuers. As we highlighted, the firm submitted for redemption millions of dollars in survivor bonds on Lathen's behalf in his account with CK after it appeared that CK had died before Lathen effected the survivor bond transactions in this account.

The firm also earned over $1 million from Lathen and Eden Arc's business; the firm, however, earned no money directly from submitting the redemptions.[32] We also acknowledge that the firm shut down the Prime Services Department in late 2013.

In determining the appropriate sanction for this cause of action, the Hearing Panel faulted the firm for failing to disclose and provide copies of the Participant Agreements to the issuers during the redemption process unless an issuer asked, which it found violated the Securities Act.

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27 *Id.*

28 *Id.* at 107.

29 *Id.*

30 *Id.* at 7, 8 (Principal Considerations Nos. 9, 17).

31 *Id.* at 7 (Principal Consideration No. 8).

32 *Id.* at 8 (Principal Consideration No. 16).

While we conclude that Enforcement did not prove that the firm violated the Securities Act, we determine that a censure and $50,000 fine remain the appropriate sanctions for the firm's supervisory failures related to the survivor bond business line.

IV. CLK's and Miller's Misconduct Under Causes Three and Four of the Complaint Related to the Firm's AML Program and Penny Stock Liquidations

Causes three and four of the complaint concern CLK's AML program and the firm's liquidations of penny stock. We set forth the facts, discuss the findings of violation, and address sanctions related to these causes in Part IV. Enforcement alleged in cause three that during the period June 2009 through April 2014, CLK and Miller failed to establish and implement a reasonable AML program, including WSPs, designed to detect, investigate, and report potentially suspicious activity, particularly in light of the risks presented by the penny stock liquidations of two customers, PL Bank and ABC Corp. Enforcement alleged in cause four that CLK and Miller failed to conduct adequate due diligence and respond to red flags regarding the trading activity of PL Bank. The Hearing Panel found that CLK and Miller engaged in the alleged misconduct, and we affirm these findings.

A. Facts

1. Swiss Broker-Dealer Introduces PL Bank to CLK

In 2007, Maier introduced CLK to a broker-dealer based in Switzerland ("Swiss BD"). Maier and the owner of the Swiss BD had worked together years earlier at the same U.S. broker-dealer. Maier represented to CLK's management that the Swiss BD's owner "worked with him over 8 years" and "both he and his accounts were first rate." According to Maier, the Swiss BD's business consisted mostly of trading mid- and large-cap U.S. equities "for foreign institutions who have been his accounts for 20+ years." Maier stated he knew "his book of business and never had any problems or concerns with [Swiss BD's owner] or his clients." When recommending that CLK take on this business, Maier predicted that the firm would "make between $50,000 to $100,000 with no strain on our group," and that he "like[d] [Swiss BD's owner] because he is careful, thorough, and easy to work with. His business hits right in our sweet spot." Maier expected Swiss BD's customers to place orders ranging in size from 500 to 2,000 shares in stocks trading at $20 to $80 per share. Maier represented that Swiss BD's clients "have passed all the OFAC and Patriot act requirements . . . and most of them are Swiss banks."

In the course of CLK's due diligence, Miller, the firm's AMLCO, "had a general conversation" with Swiss BD's owner to "make sure he's on top of AML." Neither CLK nor Miller, however, obtained any documentation from Swiss BD regarding its AML program or determined whether Swiss BD had a qualified compliance officer.[33]

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[33] The due diligence documentation that CLK collected included Swiss BD's then-current clearing agreement with another U.S. broker dealer, Swiss BD's audit and balance sheets for the prior two years, corporate registration documents, evidence of Swiss BD's authority to conduct a brokerage business, and the curriculum vitae of Swiss BD's owner.

In May 2007, CLK and Swiss BD entered into an agreement whereby CLK agreed to execute and clear transactions and carry accounts on a fully disclosed basis for Swiss BD and its customers. Under the agreement, CLK would receive 40 percent of the commissions that Swiss BD's customers paid for transactions executed through CLK. Swiss BD would determine those commission amounts. The agreement provided that Swiss BD would "develop, implement and enforce written AML policies and procedures . . . reasonably designed to ensure compliance with the requirements of the U.S. Laws and Rules relating to AML." The agreement directed that a qualified compliance officer was responsible for developing, implementing, and enforcing Swiss BD's AML program.

2. PL Bank Opens an Account at CLK and Begins Liquidating Penny Stocks

Two years later, in June 2009, CLK opened an account for PL Bank, a Swiss BD customer that was domiciled in Liechtenstein with its principal office in Switzerland. PL Bank was a new customer for Swiss BD. Maier testified that CLK was "comfortable" with PL Bank because it was a "major bank in Europe" and the firm found no negative information about it from regulators. Maier was the registered representative assigned to the account. PL Bank's securities were held in an account at another broker-dealer. CLK executed and cleared PL Bank's transactions on a "delivery versus payment/receive versus payment" (DVP/RVP) basis.

As soon as PL Bank established its account at CLK, it began using the account to liquidate penny stocks. The trading surprised CLK because the firm had expected PL Bank to trade mid- and large-cap stocks like other accounts that Swiss BD had introduced to the firm. Miller had no prior experience with penny stocks, but understood that trading penny stocks increased the firm's AML risk.

CLK erroneously believed that PL Bank was trading for its own account, when, in reality, it was acting on behalf of undisclosed subaccounts. The firm continued to act under that misconception even after one of its traders received an email from Swiss BD's owner in November 2011 that suggested a PL Bank customer was trading in the account. While Swiss BD's owner generally placed all of the PL Bank orders with CLK, in the November 2011 email, another person, ("FJ"), requested to sell shares in the PL Bank account. FJ requested to sell shares of Cloud Star Corporation (CLDS), a new stock with little trading history. Despite this unusual circumstance, CLK executed the trade without investigating FJ. Had the firm reviewed FJ's background, it would have learned that, in September 2006, the SEC had barred him for three years from serving in any supervisory capacity and ordered him to pay a $50,000 civil penalty because he failed to supervise a registered representative who had engaged in penny stock manipulation.[34] CLK ultimately discovered in March 2013 that the SEC had barred FJ after the firm received additional orders from him to sell CLDS in the PL Bank account.

On March 6, 2013, a CLK trader received an email from another broker-dealer, Knight Capital Americas LLC, that suggested PL Bank might be placing matched orders in CLDS.

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[34] In addition, FINRA had barred FJ in all capacities in April 2006 for allowing a statutorily disqualified person to be associated with a member and to engage in the securities business.

Knight asked CLK to confirm the legitimacy of the sell order. CLK's trader forwarded the email to Miller asking, "You guys ok with me responding . . . that it's a legitimate order?" Miller responded promptly, "Yes." Miller acknowledged, however, at the hearing that he had not heard of the term, "matched trading." But Miller testified that he understood that PL Bank was looking for buyers for its CLDS sell orders.[35] The firm took no action other than to tell Swiss BD this was inappropriate. On March 6 and 7, 2013, PL Bank's sales of CLDS constituted over 90 percent of the market volume.

A few days later, Maier emailed Swiss BD's owner that Knight had contacted CLK about the activity in PL Bank's account. Maier stated that "[t]he individual who . . . called the [CLK trading] desk when you were out was [FJ]," and asked "what role he plays with your account." Maier also attached FJ's BrokerCheck report, noting "as you can see he has a somewhat questionable past." In response, Swiss BD's owner confirmed that FJ had called CLK's trading desk, but that FJ was "NOT involved" in the CLDS trading about which Knight had inquired. Maier asked, "So we have one account for [PL Bank] . . . and they may be doing orders for different sub accounts at their institution?" Swiss BD's owner answered, "That's right." Other than tell Swiss BD's owner not to allow FJ to trade on behalf of PL Bank, the respondents did nothing further to determine whether PL Bank had customers who were accessing the U.S. financial system to trade securities or to enhance its monitoring of the PL Bank account.

From June 2009 through April 2014, CLK liquidated approximately 41.4 million shares of 40 penny stocks for PL Bank, which generated approximately $4.87 million in proceeds. The Hearing Panel found that CLK earned approximately $46,000 in commissions from selling penny stocks on PL Bank's behalf. Enforcement identified five of these penny stocks as bearing hallmarks of suspicious activity that CLK and Miller failed to identify: Green Star Alternative Energy, Inc. (GSAE), CLDS, Dethrone Royalty Holdings, Inc. (DRHC), Innocap, Inc. (INNO), and Southridge Enterprises, Inc. (SRGE). As discussed in detail in Part IV.B, we agree with the Hearing Panel that, despite a plethora of red flags, CLK and Miller failed to scrutinize PL Bank's liquidations of these stocks.

3. Maier Introduces CLK to ABC Corp.

In August 2012, Maier introduced ABC Corp. to CLK. Maier first met ABC Corp.'s owner through another broker-dealer where ABC had accounts. Maier had no prior knowledge of either ABC Corp. or its owner. ABC Corp. was utilizing multiple broker-dealers at the time and intended to consolidate its business in one broker-dealer.

Maier, together with Bulger and CLK's general counsel, met with ABC Corp.'s owner and attorney. ABC Corp. employed a law firm whose role was to ensure that the securities it deposited at broker-dealers would be in tradable form. Bulger and CLK's general counsel believed that ABC Corp.'s attorney was an authority on SEC Rule 144, who "knew all the

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[35] Swiss BD a few months earlier had asked CLK to execute a sale of two million shares of CLDS for $100,000 to a buyer PL Bank had located. CLK refused to execute the trade.

nuances" and was "on the ball as to Rule 144."[36] This law firm would provide CLK with a "Letter of Representation," stating that the firm may sell the securities pursuant to SEC Rule 144. After the meeting, ABC Corp.'s attorney wrote to Maier, "it was immediately obvious that both you and your firm could provide the expertise necessary to process the numerous transactions anticipated on a daily basis."[37]

Maier described ABC Corp. to CLK's new business committee as a "lender of last resort" to OTCBB and Pink Sheet companies that "weren't in a position to borrow money from other normal venues." ABC Corp. typically loaned a borrower $50,000 to $100,000, and in exchange, the borrower gave ABC Corp. a promissory note at eight percent interest that was convertible into the borrower's common stock. If a company could not repay the loan, the notes specified that the borrower would compensate ABC Corp. with the company's shares issued at a discount of between 35 and 50 percent from current market price.

Maier represented to the firm that ABC Corp. made approximately 50 loans per month and its annual securities sales totaled over $70 million. According to Maier, ABC Corp.'s owner would sell the shares when he "felt it was the right time" to do so in order to "pay himself back and hopefully make a profit." Maier expected that ABC Corp. would make approximately 250 deposits of securities per month, pay CLK "between 4-5% of the value of [each sell] order as commission," and the business would be "extremely profitable." ABC Corp. represented to Maier that it usually had 40 orders outstanding at one time. Maier requested that CLK's traders review ABC Corp.'s existing stock holdings. According to Maier, the traders identified "no issues or problems in handling sell orders in" ABC Corp.'s stock holdings and "they are comfortable with all of them." Maier also told the firm that ABC Corp. paid the other broker-dealers where it held accounts between $3 and $3.5 million in commissions in 2011.

While no other CLK customer engaged in a similar business model to ABC Corp., the firm believed "there is no real risk from a financial point of view" because CLK was "not extending credit" and "[a]ll securities in the portfolio are fully paid for."

4. CLK's Due Diligence of ABC Corp.

Before accepting ABC Corp.'s business, CLK prepared a due diligence package on the company and its owner. ABC Corp.'s owner provided Maier with information to complete CLK's internal due diligence questionnaire for new clients. ABC Corp. was incorporated in 2008. ABC Corp.'s owner was at one time a broker and registered in the Central Registration Depository ("CRD"®). CLK found no adverse information about ABC Corp. or its owner when conducting reference checks. Although Maier saw Internet posts describing ABC's owner as a

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[36] SEC Rule 144 of the Securities Act "provides an exemption and permits the public resale of restricted or control securities if a number of conditions are met, including how long the securities are held, the way in which they are sold, and the amount that can be sold at any one time." https://www.sec.gov/fast-answers/answersrule144htm.html.

[37] At some point, Bulger learned that this attorney was a relative of an ABC Corp. employee, but Bulger was not concerned about this relationship.

"toxic debt financier," he did not believe these were from a "verifiable source." Bulger, the firm's COO and CCO at the time, also saw the Internet posts. Maier asked ABC Corp.'s owner and his attorney about the allegations of toxic debt financing. The firm received "an answer that satisfied" it to move forward and had "no impact [on] the business [CLK was] looking at." Maier concluded that ABC Corp.'s business of loaning money and converting unpaid debt into penny stocks for liquidation was not a penny stock "scam," which to him involved a scheme to pump up a stock's price without any research and then dump the stock.

As part of the firm's due diligence, Bulger also reviewed the SEC's EDGAR system and found 700 corporate filings that mentioned ABC Corp. This fact demonstrated to him that ABC Corp. was not a new, fledgling business. Bulger had final approval for the firm and "was comfortable" accepting ABC Corp.'s business. Maier was the account's representative.

CLK found no regulatory actions or other formal proceedings against ABC Corp. or its owner, and it opened an account for ABC Corp. in November 2012. Soon after CLK accepted ABC Corp. as a customer, however, there was publicly available information that cast doubt on the validity of ABC Corp.'s business. In November 2012, ABC Corp. and its owner were named as defendants in a civil action filed in federal court. The amended complaint filed in January 2013 alleged that the defendants had engaged in a "massive 'pump and dump' scheme," in violation of Section 10(b) of the Exchange Act and Rule 10b-5, and sold unregistered securities in violation of Section 5 of the Securities Act.[38] CLK was not aware of this complaint.

At some point after CLK opened ABC Corp.'s account, the firm learned that the SEC had instituted cease and desist proceedings against ABC Corp.'s owner. In November 2013, ABC Corp.'s owner and his other companies entered into a Consent Order with the SEC to settle the cease and desist proceedings. The Consent Order reflected that the owner and his companies had violated Section 5 of the Securities Act by selling billions of unregistered and non-exempt shares of two penny stocks to the public. The defendants paid a total of $1.46 million in disgorgement, interest, and penalties.

5. CLK Institutes the SEC Rule 144 Checklist for ABC Corp.

From the outset, CLK understood that ABC Corp. would engage in numerous and frequent liquidations of unregistered penny stocks in certificate form pursuant to the safe harbor provisions in SEC Rule 144 of the Securities Act. Maier and Miller had little to no prior experience with such transactions. Although Maier had traded low priced securities, he had no direct experience selling securities pursuant to SEC Rule 144 and had never traded penny stocks. Miller's experience with penny stocks was limited to the liquidations in the PL Bank account.

At ABC Corp.'s request, CLK routed the majority of ABC Corp.'s sales transactions to another broker-dealer for execution. CLK believed that the other broker-dealer "had a strong reputation and vast experience in the low priced securities trading market." CLK determined

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[38] Enforcement set forth no evidence that the pump and dump scheme alleged in the civil complaint involved securities that ABC Corp. sold through CLK.

that using the other broker-dealer as an executing broker was "an important supplement to the Firm's plan for handling [ABC Corp.'s] business."

Miller recognized that, from an AML perspective, ABC Corp. was CLK's riskiest account. He believed, however, that CLK could negate that risk by becoming familiar with it. Miller, however, did not regard any of ABC's trading activity as suspicious because the firm had "expected" ABC to liquidate numerous penny stocks.

The evidence reflects that the firm's focus in accepting ABC Corp.'s business was not the AML risk associated with it, but SEC Rule 144 compliance. At Bulger's direction, the firm adopted a one-page ABC Corp. "Rule 144 Sales Due Diligence Checklist" ("Checklist") to document the Prime Service Department's due diligence efforts for each of ABC Corp.'s stock deposits. During the first three months ABC Corp. had its account at the firm, CLK's in-house counsel and Miller trained Maier and his assistant, AB, on what to look for to ensure that ABC Corp. provided all necessary documentation for its deposits. AB subsequently handled the "bulk" of the ABC Corp. day-to-day business, including the completion of the Checklists.

The Checklist required the Prime Services Department to list the name and contact information of the issuer whose stock ABC Corp. had deposited, whether the issuer was an SEC reporting company, the number of shares ABC Corp. had deposited, the number of outstanding shares, and a calculation of ABC Corp.'s percentage of the issuer's shares outstanding. If ABC Corp. deposited less than ten percent of the outstanding shares, the Checklist would note that ABC Corp. was not an affiliate or control person of the issuer. Bulger testified that while CLK "took a lot of great care" to ensure that ABC Corp. "didn't break the 10 percent" level, the firm did not know if ABC held shares elsewhere unless the transfer agent informed the firm. ABC Corp., however, made multiple deposits in tranches of an issuer's securities because it had multiple outstanding loans with the same issuer. These deposits, when combined, at times exceeded ten percent of the total shares outstanding.

The Checklist further directed the Prime Services Department to review the issuer's SEC filings and, if the issuer was not a reporting company, to obtain its recent financial statements. The Prime Services Department also identified where the stock was listed (OTCBB or Pink Sheets). The Checklist required that the Prime Services Department review the stock's prior five days of trading activity and "refer any suspicious activity to Prime Brokerage, Legal and Compliance," but it did not explain what sort of trading activity would be considered suspicious. Maier consulted with Miller and CLK's director of operations on what to look for before approving the deposits. CLK also relied on the legal opinion that ABC Corp. provided stating that each deposit satisfied the requirements of Rule 144. It typically took the Prime Services staff between 30 to 60 minutes per deposit to complete the Checklist.

The Checklist also required the Prime Services Department to conduct a "visceral Internet search" using the issuer's name "to determine whether the company has been subject to any investigations and/or claims of regulatory/legal issues such as market manipulation or possible sales/distribution violations." The Checklist directed reviewers to include a search of the "active message board" on the OTC Markets website. Miller testified that a "visceral" Internet search meant that the Prime Services Department ran "a general Internet search . . . just a regular Google search, or they used this OTCmarkets.com." Miller conceded that he did not "know exactly what they did" because he was not involved directly with the Checklist and

processing the stock deposits. Miller, nonetheless, testified that he provided training to the Prime Services Department "on what we need to do in order to check that box." At the hearing, he described the training: "[G]o on the Internet and find a website that you like that contains information about the securities. And if you see something suspicious, let me know. . . . I don't think I gave them specific examples. I may have said that I look at Yahoo Finance . . . . That's what it was." Miller directed that Prime Services review the issuer's previous day's trading and "if anything looks suspicious" to mention it to him, a supervisor, or compliance. Maier testified that either he or AB conducted the "visceral" search, which involved reviewing FactSet (a provider of financial information and financial software) and sites including Yahoo Finance and OTC Markets to review a stock's trading patterns over the prior week or two.

CLK did not document which websites the Prime Services Department reviewed. Rather, Prime Services staff merely checked the box indicating they had completed an Internet search. The Prime Services Department never discovered any negative information about the issuers whose stock ABC Corp. liquidated.

6. ABC Corp. Liquidates Billions of Shares of Penny Stocks

ABC Corp. deposited approximately 11.7 billion shares of 138 penny stock issuers during the year after ABC Corp. opened the account at CLK. ABC Corp. liquidated these shares through more than 2,000 transactions generating proceeds of more than $14.39 million. ABC Corp. regularly wire-transferred proceeds out of this account.[39] Enforcement identified in its complaint seven of these 138 stocks that bore hallmarks of suspicious activity: First Columbia Gold Corp. (FCGD), Alternative Energy Partners, Inc. (AEGY), Stakool, Inc. (STKO), SafeCode Drug Technologies, Inc. (SAFC), Medisafe 1 Technologies Corp. (MFTH), FastFunds Financial Corp. (FFFC), and IC Punch Media (PNCH). We agree with the Hearing Panel that there were conspicuous red flags related to these issuers that CLK and Miller failed to detect and scrutinize, which we discuss in Part IV.B.

Irrespective of these deposits and liquidations, the level of compensation that CLK had expected from ABC Corp.'s business never materialized. In April 2013, Maier wrote to ABC Corp.'s owner asking about the expected consolidation of all of ABC Corp.'s business with CLK. Despite the owner's repeated assurances that he would consolidate ABC Corp.'s business with CLK over the next month, the firm did not see any "meaningful increase in [ABC Corp.'s] business." By May 2013, ABC Corp. was not making the 250 deposits of securities per month that CLK had expected, and CLK was earning a fraction of the $3 million in commissions from the sell transactions that Maier had anticipated when pitching the business to the firm. Nevertheless, ABC Corp.'s business was not insignificant. CLK earned more than $574,000 in commissions on ABC's business during the 11 months it was a customer. CLK terminated its relationship with ABC Corp. by September 2013.

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[39] From February 11, 2013, through September 2013, ABC Corp. withdrew proceeds from its CLK account in 35 wire transfers, a rate of more than one transfer per week.

B. Discussion

CLK embarked on a new and unfamiliar business line for the firm when it began liquidating penny stocks for PL Bank in 2009. CLK magnified its AML risk because a foreign financial institution domiciled in Switzerland placed penny stock orders on behalf of another foreign financial institution domiciled in Liechtenstein. Then in 2012, CLK significantly increased its AML exposure when it accepted ABC Corp. as a customer and increased the volume of the firm's penny-stock-liquidation business. As discussed below, we find that CLK failed to establish and implement an AML program, including WSPs, reasonably designed to address the AML risks presented by its penny-stock liquidation business and failed to detect and act on red flags. The evidence further supports that the respondents failed to conduct adequate due diligence of PL Bank.

1. AML Requirements for All Broker-Dealers

Federal law and FINRA rules require all broker-dealers to have AML programs. In October 2001, Congress passed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("the PATRIOT Act"). Pub. L. No. 107-56, 115 Stat. 272 (2001). Title III of the PATRIOT Act imposes added obligations on broker-dealers under AML provisions and amendments to the BSA requirements. *See* 31 U.S.C. §§ 5311 *et seq*. Among other requirements, the PATRIOT Act requires that all broker-dealers establish and implement AML programs designed to achieve compliance with the BSA and the regulations thereunder, including the requirement that broker-dealers file SARs with FinCEN.[40] *See* 31 U.S.C. § 5318(h); 31 C.F.R. § 1023.210(a), (b). The SAR form applicable at the time to the securities industry identified 20 types of "suspicious activity" that broker-dealers are required to report to FinCEN, including "market manipulation," "prearranged or other non-competitive trading," "securities fraud," and "wash or other fictitious trading." *Lek*, 2018 SEC LEXIS 830, at *13.

In April 2002, the SEC approved NASD Rule 3011 setting forth the minimum standards required for each FINRA member firm's AML compliance program. *See Order Approving*

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[40] The Department of Treasury issued the implementing regulation with respect to the SAR requirement. The regulation provides, in part, that "[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 C.F.R. § 103.19(a)(1) (2010) (renumbered 31 C.F.R. § 1023.320(a)(1), effective March 1, 2011). The regulation further requires broker-dealers to report to FinCEN any transaction, alone or in the aggregate, that involves $5,000 in funds or assets and the broker-dealer knows, suspects, or has reason to suspect that the transaction: (1) involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity; (2) is designed to evade the requirements of the BSA; (3) has no business or apparent lawful purpose or is not the sort in which a particular customer would normally engage; or (4) involves the use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 103.19(a)(2) (renumbered 31 C.F.R. § 1023.320(a)(2)).

Proposed Rule Changes Relating to Anti-Money Laundering Compliance Programs, Exchange Act Release No. 45798, 2002 SEC LEXIS 1047 (Apr. 22, 2002). NASD Rule 3011 and FINRA Rule 3310 require FINRA members to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the BSA and its implementing regulations.[41] *See N. Woodward*, 2016 FINRA Discip. LEXIS 35, *29. These rules set forth the minimum requirements for an AML compliance program, including to "establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of" suspicious transactions; "establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the" BSA and its implementing regulations; provide independent testing by qualified persons of the AML program; designate and identify to FINRA an individual responsible for implementing and monitoring the AML program; and "provide ongoing training for appropriate personnel." NASD Rule 3011(a)-(e); FINRA Rule 3310(a)-(e).

2. FINRA Issued Extensive Guidance to Members on AML Compliance

FINRA has provided firms with explicit guidance concerning AML compliance obligations since 2002. *See NASD Notice to Members 02-21*, 2002 NASD LEXIS 24, at *17-20 (Apr. 2002). FINRA explained that a firm's AML procedures must be tailored to "reflect the firm's business model and customer base" and take into account factors such as the firm's "business activities, the types of accounts it maintains, and the types of transactions in which its customers engage." *Id.*; *see also Dep't of Enforcement v. Domestic Sec., Inc.*, Complaint No. 2005001819101, 2008 FINRA Discip. LEXIS 44, at *11 (FINRA NAC Oct. 2, 2008) (highlighting FINRA's extensive AML guidance). The obligation to develop and implement an AML compliance program "is not a 'one-size-fits-all' requirement." *NASD Notice to Members 02-21*, 2002 NASD LEXIS 24, at *55.

NASD Notice to Members 02-21 reminds member firms of their duty to detect and investigate red flags indicating potential money laundering and sets forth a non-exhaustive list of such red flags.[42] 2002 NASD LEXIS 24, at *37-42. Red flags requiring further inquiry include, without limitation, the questionable background of the customer and transactions involving speculative, low-priced stocks. *Id.* at *40. "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 . . . [that] have been used in connection with fraudulent schemes and money laundering." *Id.* FINRA further advised that "[a]ppropriate" red flags must be described in each firm's written AML procedures. *Id.* at *42. Once a firm identifies suspicious activity, it is

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[41] FINRA Rule 3310 supersedes NASD Rule 3011 and was adopted without substantive change, effective January 1, 2010. *See FINRA Regulatory Notice 09-60*, 2009 FINRA LEXIS 171 (Oct. 2009).

[42] The Notice to Members defines "money laundering" as "engaging in acts designed to conceal or disguise the true origin of criminally derived proceeds so that the unlawful proceeds appear to have derived from legitimate origins or constitute legitimate assets." 2002 NASD LEXIS 24, at *7.

required to file a SAR with FinCEN. *Id.* at *42-43; *see also NASD Notice to Members 02-47*, 2002 NASD LEXIS 59 (Aug. 2002).

Since issuing NASD Notice to Members 02-21, FINRA has alerted members periodically to AML-related risks associated with penny-stock activity and provided updated guidance on how to structure reasonable AML programs to address those risks. In March 2009, which was three months before CLK began liquidating penny stocks for PL Bank, FINRA issued a Regulatory and Examination Priorities Letter, in which it urged firms to "ensure that their AML policies and procedures are appropriately tailored to the firm's business model, risk profile and volume of transactions, particularly with regard to monitoring, detecting and reporting suspicious activity." The letter specifically addressed AML concerns relating to penny stocks:

> FINRA has found that firms that participated in unregistered securities distributions . . . may have ignored a number of red flags that may have triggered suspicious activity reporting requirements under the Bank Secrecy Act. Some of the potentially problematic trading has been in securities of issuers that were the subject of unsolicited promotional emails, or "spam," and by customers . . . who had questionable backgrounds or were the subject of news reports indicating possible criminal, civil or regulatory violations. These red flags demonstrate the importance of knowing your customer and conducting appropriate due diligence when red flags arise.[43]

In the 2010 Regulatory and Examination Priorities Letter, FINRA highlighted the then recently updated AML small-firm template. The template, FINRA noted, "includes new red flags related to securities transactions, deposits of physical certificates and penny stock companies," and it urged "[f]irms of all sizes [to] consider incorporating these red flags into their AML programs." The letter warned that "[f]irms using automated monitoring that does not focus on manipulative trading activity, or focuses only on suspicious trading accompanied by a suspicious money movement may not have adequate systems," and reminded firms of their obligation to "tailor their monitoring systems to their business and risk profile."[44]

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[43] 2009 Priorities Letter (Mar. 9, 2009), http://www.finra.org/industry/2009-exam-priorities-letter#4. In January 2009, FINRA also issued Regulatory Notice 09-05, which reminded firms of their obligation to determine whether unregistered securities are eligible for public sale. This notice advised firms of their responsibility to ensure that their AML compliance programs address red flags that may be associated with unregistered resales conducted through the firm, including the sale of restricted securities under SEC Rule 144. *FINRA Regulatory Notice 09-05*, 2009 FINRA LEXIS 7 (Jan. 2009).

[44] 2010 Priorities Letter (Mar. 1, 2010), https://www.finra.org/sites/default/files/Industry/p121004.pdf.

The updated small-firm template identified these red flags specific to penny-stocks:

- Company has no business, no revenues and no product.
- Company has experienced frequent or continuous changes in its business structure.
- Officers or insiders of the issuer are associated with multiple penny stock issuers.
- Company undergoes frequent material changes in business strategy or its line of business.
- Officers or insiders of the issuer have a history of securities violations.
- Company has not made disclosures in SEC or other regulatory filings.
- Company has been the subject of a prior trading suspension.[45]

In January 2012, FINRA again emphasized in its Regulatory and Examination Priorities Letter the susceptibility of penny stocks to fraud and manipulation. One of the areas of concern it identified was the risk that brokerage firms might facilitate unlawful distributions of unregistered securities by liquidating penny-stock holdings for customers. FINRA reminded firms that, "[a]s part of their [AML] responsibilities, member firms are obligated to monitor for suspicious activity and to file Suspicious Activity Reports where warranted."[46]

3. Respondents Failed to Tailor CLK's AML Program and to Detect and Investigate Red Flags Under Cause Three

Enforcement alleged in cause three that, during the period June 2009 through April 2014, CLK and Miller failed to establish and implement a reasonable AML program, including WSPs, designed to detect, investigate, and report potentially suspicious activity, particularly in light of the risks presented by the penny stock liquidations of PL Bank and ABC Corp. Despite FINRA's ongoing guidance, CLK and Miller specifically failed to tailor the firm's AML program to address its penny-stock liquidation business. Consequently, the respondents were ill equipped to detect and investigate red flags arising from PL Bank's and ABC Corp.'s penny-stock activity. By failing to establish and implement an AML program reasonably designed to detect and report suspicious transactions under the BSA, the respondents violated NASD Rule 3011(a) and FINRA Rules 3310(a) and 2010, as alleged under cause three of the complaint.

a. Inadequate AML Program

When PL Bank and ABC Corp. were liquidating penny stocks, CLK had in place AML procedures that directed Miller, as the AMLCO, to review at least annually the firm's AML policies and procedures, review new AML regulations, and engage in ongoing monitoring of activity at the firm that could involve AML-related risks. The firm's WSPs directed that Miller,

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[45] Updated Small Firm Template 34-35 (Jan. 1, 2010); 2018 Small Firm Template 39 (July 18, 2018) (including same red flags as 2010 update that signal possible money laundering), http://www.finra.org/industry/anti-money-laundering-template-small-firms.

[46] 2012 Priorities Letter (Jan. 31, 2012), https://www.finra.org/sites/default/files/Industry/p125492.pdf.

as the AMLCO, was responsible for developing and updating the firm's AML program and monitoring (or designating others to assist with monitoring) the activity of "customers to reasonably detect and prevent money laundering activities." These WSPs also provided Miller with guidance on SAR reporting obligations when CLK "knows, suspects, or has reason to suspect that the transaction (or pattern of transactions . . .)" fell into a certain categories.

While CLK's WSPs during the review period contained the red flags identified in NASD Notice to Members 02-21, Miller did not incorporate the penny-stock red flags enumerated in FINRA's 2010 revised template into CLK's AML procedures until June 30, 2013. As the AMLCO, Miller was responsible for updating the WSPs with these red flags, and he failed to perform AML "compliance functions for which he was directly responsible." *See Thaddeus J. North*, Exchange Act Release No. 84500, 2018 SEC LEXIS 3001, at *31 (Oct. 29, 2018), *appeal docketed*, No. 18-1341 (D.C. Cir. Dec. 27, 2018). Miller testified that a third-party vendor provided the firm with updates for its WSPs. Miller testified that "we do try to, you know, add information to the firm's WSPs on our own, but it looks like we had also missed the fact that the small firm's AML template was updated." The respondents assert their reliance on the third party to provide "updates based on new regulatory rules was reasonable and appropriate." Miller, however, admitted that he was responsible for maintaining the firm's AML compliance procedures as the AMLCO and it was his and the firm's responsibly, rather than a third party's, to ensure that the procedures were reasonably designed and tailored to the firm's business. The respondents also acknowledge that, by the time CLK's procedures were revised in June 2013 to include red flags designed for penny stock transactions that were in FINRA's updated small firm template, the "vast majority of the transactions challenged in FINRA's complaint had already occurred and [CLK] had decided to wind down the [Prime Services Department] business."

Miller admittedly lacked experience with the penny stock market, and the firm was surprised when PL Bank began liquidating penny stocks in its newly opened CLK account. Nonetheless, Miller did not undertake to tailor CLK's AML program to this new and risky line of business. Nor did he do so when CLK magnified its AML exposure by agreeing in November 2012 to liquidate penny stocks for ABC Corp.

As the Hearing Panel found, Miller's testimony reflects that he had little idea what to look for in assessing PL Bank's and ABC Corp.'s penny stock liquidations. He was unaware that the issuers of many of the stocks ABC Corp. liquidated were subject to going concern opinions, and he could not recall if he even knew at the time what the terms meant. He testified that, because CLK expected ABC Corp. to lend money to companies that had no business, revenues, and products, he did not consider those attributes potentially suspicious. He also did not consider it suspicious that trading in a stock spiked when ABC Corp. started selling it because "it was expected" and ABC Corp. was "effectively creating shares."

To find information about issuers, Miller "typically" relied on Yahoo Finance or Bloomberg to view activity in the stock "price wise." He first learned at the hearing that there are websites that aggregate information about penny-stock promotions. And as discussed below, Miller did not inquire into whether PL Bank was liquidating penny stocks for its own account or for the accounts of others. While Miller understood that selling penny stocks increased the firm's AML risk, the respondents failed to construct and execute an AML program tailored to the firm's business to mitigate those risks. Because the firm's procedures "were not tailored to the specific nature of its business, they were not reasonably designed to achieve compliance with the

BSA and its implementing regulations." *N. Woodward*, 2016 FINRA Discip. LEXIS 35, at *30-31; *see also Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2011027666902, 2017 FINRA Discip. LEXIS 16, at *40 (NAC May 26, 2017) (finding that firm failed to develop and implement AML procedures even though it had recently begun trading penny stocks), *aff'd in relevant part*, Exchange Act Release No. 86404, 2019 SEC LEXIS 1771 (July 17, 2019).

The respondents assert that they "created and followed extensive AML-related due diligence, monitoring, and supervisory policies and procedures applicable—and tailored—to" ABC Corp. and PL Bank. But their assertion is unsupported by the evidence. CLK's procedures did not address how to monitor for and detect suspicious penny stock activity. The respondents further claim they "revised and refined [CLK's] procedures to account for additional risk caused by [PL] Bank's increasing trades in penny stocks." But the evidence shows that the changes they identify were implemented for operational reasons and not to monitor for suspicious transactions involving penny stock trading. For example, they identify various reports that CLK routinely generated and routine reviews its supervisors conducted, but the evidence does not reflect that these reports and reviews enabled CLK to detect suspicious penny-stock activity. In practice, CLK reviewed trading in a stock only during the preceding five days. As a result, no one in the trading department ever elevated a concern about these sales to Miller. As the SEC has explained,

> [i]n addition to reporting individual suspicious transactions, broker-dealers are required to report any pattern of transactions of which the suspicious transaction is a part. The pattern-reporting requirement is intended to recognize the fact that a transaction may not always appear suspicious standing alone and that a broker-dealer may only be able to determine that a SAR must be filed after reviewing its records.

Lek, 2018 SEC LEXIS 830, at *19.

ABC Corp.'s liquidations never aroused the respondents' suspicions because they were consistent with ABC Corp.'s stated business model. The respondents highlight a daily report that "was particularly helpful in monitoring" that ABC Corp.'s ownership of outstanding shares "remained below the 10% threshold." ABC Corp., however, commonly deposited multiple tranches of stock of an issuer that, combined, exceeded ten percent of the total shares outstanding, but never at any one time. This practice of ensuring that ABC Corp. never deposited at any one time more than ten percent of an issuer's outstanding shares did not concern respondents because ABC Corp.'s owner "told us right up front that that's what he was doing, so it was expected."

The respondents also claim to have "created a comprehensive set of new [ABC Corp.]-specific due diligence and supervisory procedures that involved the trading, compliance, legal, and operations departments" (i.e., the Checklist). They nonetheless admittedly failed to tailor the firm's existing AML program to the increased penny stock liquidations by ABC Corp.'s business because Miller believed the firm already had appropriate AML procedures in place. Miller testified that there was no reason to do anything differently because the firm "can tell if a stock is acting out of character. They can tell just on the trading activity . . . and look for news . . . us[ing] Bloomberg." The evidence reflects that the firm adopted the procedures they identify to aid in SEC Rule 144 compliance and the procedures were inadequate for AML compliance. The

purpose of the Checklist, as the Hearing Panel accurately described it, "was primarily to ensure that the paperwork ABC Corp. submitted was complete and technically compliant with Rule 144. It was a routinized 'check-the-box' procedure that failed to detect any suspicious trading activity." The Checklist did not address issues in the context of AML concerns. Indeed, the plethora of red flags that the firm and Miller failed to detect reflects the inefficacy of CLK's AML program.

b. Failure to Detect and Investigate Red Flags

Enforcement identified 12 penny stocks that CLK liquidated for PL Bank and ABC Corp. that bore classic hallmarks of suspicious penny-stock activity. These red flags include (1) PL Bank and ABC Corp. sold large volumes of shares through their CLK accounts; (2) PL Bank and ABC Corp. earned significant proceeds from these penny stock sales; (3) issuers had little or no revenues or business operations; (4) issuers underwent recent name or business changes; (5) issuers were subject to promotional campaigns that aligned with PL Bank's and ABC Corp.'s liquidations; and (6) persons associated with certain issuers had a history of securities-related misconduct. PL Bank's and ABC Corp.'s trading was suspicious and should have caused the respondents to engage in additional due diligence into this trading. Information about these stocks was publicly available, but respondents failed to detect and investigate any of these red flags. We agree with the Hearing Panel that the respondents' failure to adopt a reasonable AML program impeded their ability to detect and investigate these red flags.

i. ABC Corp.'s Sales

a. AEGY

AEGY claimed to be "involved in the alternative energy sector." In May 2013, AEGY announced in press releases that it changed its business. The company announced it was acquiring an online payment system that facilitated purchases of medical marijuana. AEGY also explained in another May 2013 press release that the recent high volume of trading in AEGY stock was the result of issuing over 120 million shares to ABC Corp. from convertible promissory notes.

AEGY had 209,619,640 shares outstanding as of December 12, 2012. From December 28, 2012, through June 21, 2013, ABC Corp. deposited approximately 395,872,013 shares through 18 stock deposits into its CLK account. ABC Corp. sold over 395 million shares of AEGY by late June 2013. ABC Corp. liquidated its position in AEGY in 29 trades, which generated proceeds of approximately $710,000 despite the issuer having minimal revenues in the four years since its inception and an accumulated deficit of more than $7.2 million. On 27 of the 29 days that CLK liquidated ABC Corp.'s AEGY stock, these sales accounted for over 20 percent of the total market volume. On six of these days, ABC Corp.'s sales accounted for over 40 percent of the total market volume.

b. FCGD

FCGD changed its name in 2010 and described itself as an "exploratory stage enterprise" that was "devoting all of its present efforts in securing and establishing a new business." In the Form 10-Q for the period ending September 30, 2012, FCGD described that the "focus of its

business and operations is on the development of our mineral property interests on properties located in the western United States" and that it was looking for other opportunities in other locations, including Colombia and Bolivia.

In the Form 10-Q for the period ending September 30, 2012, FCGD disclosed that it had an accumulated deficit of nearly $19 million. In the Form 10-K for the period ending December 31, 2012, FCGD disclosed that it had no full-time employees and its officers did not devote their services full-time to the company. FCGD's only source of capital in 2011 and 2012 was from issuing a total of $130,000 in convertible notes to ABC Corp.

From December 21, 2012, to August 23, 2013, ABC Corp. deposited approximately 30,649,033 shares of FCGD into its CLK account. On April 24, 2013, multiple websites were promoting FCGD. The Penny Stock General website said FCGD is "our momentum play today" and is "on momo alert." Penny Stock General further stated, "FCGD – Today's Big Alert!" and "our new pick is FCGD!," that "this is one momentum play you do not want to miss out on!" Another website, Stock Market Watch, stated about FCGD, "This is the major announcement that you have been waiting for. We expect this play to kick up in a major way, due to the awareness campaign that we have established." Stock Market Watch also stated, "I am very excited this morning. We have a hot new momo play on tap that we think could reap members nice rewards." On the same day, trading volume in FCGD rose to 168 million shares and ABC Corp. sold 5,883,333 of its FCGD shares, generating proceeds of over $31,000.[47]

Between January 2, 2013, and August 23, 2013, ABC Corp. liquidated its position in FCGD in five trades, generating approximately $44,204 in proceeds. On four of the five days that ABC Corp. sold FCGD, its sales represented over 30 percent of total market volume in the stock. On three of the five days, ABC Corp.'s sales of FCGD represented over 40 percent of total market volume.

c. MFTH and SAFC

SAFC and MFTH described themselves as developing and marketing a device and software that would ensure that medical professionals administer medication to patients in correct dosages. Both issuers reported in periodic filings that, in November 2012, they entered into a licensing agreement granting SAFC the nonexclusive right and license to manufacture and market MFTH's technology.

SAFC's Form 10-K for the year ending December 31, 2012, reported that it had earned no revenue since its formation in November 2010 and had "no operations." As of December 31, 2012, SAFC had a cumulative net loss since inception of over $2.1 million. With the exception of ten million SAFC shares that SAFC paid for the license agreement, which the two companies valued at $1.8 million, MFTH's Form 10-K for the year ending December 31, 2012, reported no revenues since its inception in 2009.

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[47] FCGD's daily market trading volume the prior ten trading days ranged from 761,000 shares to 16,518,666 shares.

Several websites were promoting SAFC and MFTH from November 2012 to February 2013, which was around the time that ABC Corp. was depositing and selling these issuers' shares through CLK. For example, on November 7, 2012, the website Stock Reads placed SAFC on its "alert list." The next day, SAFC was this site's "hot new pick" and proclaimed it on "high alert today [so] don't get left behind when our brand new pick rises to new highs!" Stock Reads stated on November 12, 2012, that SAFC was "a golden opportunity that our members should not miss!" Then, the next day, Stock Reads began its promotion of SAFC with "SAFC Show me the money!"

On January 6, 2013, Stock Reads predicted that SAFC "could see Triple Digit Percent Gains" and that "[i]t is Highly Probable that SAFC will be our First Triple Digit Percent Gainer of 2013!" On January 6, 2013, another promoter of SAFC, Penny Stock Lock, disclosed that a third party paid it $15,000 for a "one-day profile of SAFC." On January 8, 2013, the Stock Lock and Load Newsletter said that a recent company news release "certainly Impressed Traders as they were Lined Up @ 9:30am EST to Pick Up shares of SAFC!" and those "who Picked Up Shares at this Price Level were Handsomely Rewarded!" Stock Lock and Load disclosed that a third party paid it $15,000 for "one day coverage of SAFC."

On January 30, 2013, Stock Reads included MFTH on its list of stocks to watch that day. On February 14, 2013, The Hot Stocked Newsletter included a promotion by "The Stock Psycho" who selected MFTH as "Today's Hot 1 Day Play." The Stock Psycho also said that MFTH is "set up for a huge increase in volume today, and possibly a big ONE DAY POP perfect for a quick trade." The Hot Stocked Newsletter disclosed that a third party paid it $45,000 "to conduct two days of investor relations marketing of MFTH." It also disclosed that nearly two years earlier, in May 2011, another third party paid it $30,000 to market MFTH for two days.

From January 10, 2013, to January 22, 2013, ABC Corp. made two deposits of shares of MFTH totaling approximately 37,188,356 shares. Between January 16, 2013, and January 28, 2013, ABC Corp. sold its position in MFTH in three trades, generating $83,580 in proceeds despite the issuer being in the development stage, having no operations, and MFTH's accountants expressing "substantial doubt about [MFTH's] ability to continue as a going concern." CLK earned $3,482 in commissions for these trades.

From June 11, 2013, to August 27, 2013, ABC Corp. made four deposits of SAFC stock totaling approximately 23,825,277 shares. ABC Corp. liquidated its position in SAFC during 15 trading days. On 14 of these days, ABC Corp.'s sales accounted for over 20 percent of total market volume in the stock. On eight of these days, ABC Corp.'s sales accounted for over 40 percent of total market volume. From June 14, 2013, to August 28, 2013, ABC Corp. sold its position in SAFC in approximately 15 trades, generating proceeds of approximately $66,431 in proceeds and $2,774 in commissions for CLK.

d. STKO

STKO was a natural food company.[48] It had an officer and director, but no employees. Total revenues in 2012 were $17,435. As of December 31, 2012, it had net losses of over $5.3 million. STKO had just over 2 billion shares outstanding as of April 8, 2013.

In April 2013, three websites, Stock Market Watch, Penny Stock Tweets, and Stock Promoters, were promoting STKO. These websites described STKO as "another stock we've been tracking recently," and on the "extended watchlist." Another website, Stock Sumo, issued an update on STKO and acknowledged, "on occasion [it] is compensated by a third party," but did not reveal whether it was paid to promote STKO.

From March 19, 2013, through July 26, 2013, ABC Corp. deposited approximately 814,166,667 STKO shares through five deposits into its CLK account. All of the deposits were more than 100 million shares and two exceeded 200 million shares. CLK liquidated ABC Corp.'s position in STKO during 28 trading days between March and July 2013. On 19 of these days, ABC Corp.'s sales accounted for over 20 percent of the stock's total market volume. On three of these days, ABC Corp.'s sales accounted for over 40 percent of the volume. ABC Corp.'s sales of STKO generated approximately $136,893 in proceeds.

e. FFFC

FFFC was a holding company that, through a subsidiary, purportedly provided check cashing services and cash advances to customers at Native American-owned gambling establishments. According to its Form 10-K for the year ended December 31, 2012, it had "incurred significant losses since its inception," and "presently has no ongoing business operations or sources of revenue." FFFC reported revenues of $36,518 and a net loss of $512,444 for 2012. FFFC stated in the Form 10-K that "any investment in the Company must be considered purely speculative."

FFFC was the subject of promotional activity on the Internet. On March 24, 2013, Stock Reads claimed that FFFC "has positioned itself nicely over the course of the past week for another possible bounce play." A third party paid the promoter $3,500 for its marketing efforts. More promotions about FFFC appeared on the website on March 25 and 26, 2013.

FFFC had 129,821,143 shares outstanding as of April 5, 2013. ABC Corp. sold over 25 million shares from December 2012 to September 2013 through CLK.[49] On 12 of the 21 trading

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[48] According to information available on the OTC Market website, STKO changed its name five times before becoming Stakool in December 2009.

[49] In 1994, HF, the Chairman and Director of FFFC when ABC Corp. liquidated its FFFC shares, was the subject of an SEC administrative action in which he consented to an order that he cease and desist from committing future violations of the Investment Company Act of 1940 and disgorge $73,775.

days when CLK liquidated these shares, ABC Corp.'s sales accounted for over 40 percent of the stock's total market volume and over 60 percent on one day in February 2013. When ABC Corp. sold its position in FFFC, it generated proceeds of approximately $70,773 and approximately $2,952 in commissions for CLK.

f. PNCH

According to its periodic filings, PNCH owned and operated "a network of city-based Websites for travelers and local individuals," providing information about hotels, restaurants, and entertainment. PNCH's Form 10-K for the year ending December 31, 2012, reported revenues of $195,082 2012 and net losses of over $6 million in 2012. In July 2012, PNCH had entered into an agreement to acquire a television network and agreed to pay 135 million shares of PNCH for the acquisition. PNCH disclosed in a May 2013 Form 8-K that the entire transaction had been cancelled. PNCH's CEO was a former registered representative with a regulatory history.[50]

PNCH had just over 1.4 billion shares outstanding as of April 15, 2013. ABC Corp. sold over 492 million shares of PNCH from January 2013 to September 2013 through CLK over 40 trading days. On 29 of these days, ABC Corp.'s sales accounted for over 20 percent of the total market volume in the stock and over 40 percent of the volume on 16 trading days. ABC Corp.'s sales of PNCH generated approximately $839,136 in proceeds even though it had minimal revenues in the two years preceding ABC Corp.'s sales and net losses of over $6 million in the preceding year. CLK earned approximately $34,964 in commissions for these sales.

ii. PL Bank's Sales

a. GSAE

PL Bank only sold shares of GSAE during the first three months after opening its CLK account (from June 30 to September 30, 2009). GSAE was incorporated in 2001 under a different name to engage in the business of offering educational seminars and workshops. In July 2008, the company changed its business and began focusing on clean energy joint venture opportunities, including wind energy projects. An April 2009 SEC filing disclosed that GSAE had no revenues in 2007 and 2008, had an accumulated deficit of $201,808 as of December 31, 2008, and carried a going concern opinion from its auditors. In that filing, GSAE stated it had "minimal operations" and was a development stage company. In early June 2009, the British

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50 In 1998, the SEC filed an action against the registered representative and a company he controlled alleging that he publicly circulated securities recommendations without disclosing he received at least $20,000 to make those recommendations, in violation of Section 17(b) of the Securities Act. In 2000, a judgment in the case ordered the registered representative and his company to pay a civil monetary penalty and enjoined them from future violations of the Securities Act. In 2010, the registered representative entered into a stipulation and consent order with the Florida Division of Securities and Investor Protection in which he agreed not to engage in the offer and sale of securities from offices in Florida or to residents of Florida.

Columbia Securities Commission issued a cease trading order to GSAE, which was available on the OTC Markets website.

While PL Bank was selling GSAE through CLK, GSAE was the subject of newsletters, stock alerts, and emails promoting the company.[51] For example, on August 4, 2009, the Green Baron Report described GSAE as its "new stock pick," and the "next SHOOTING STAR." On August 6, 2009, the Green Baron Report and Market Advisors Inc. issued a "speculative buy" recommendation for GSAE with a $2.38 target price. GSAE's closing price that day was approximately $ .55 per share. On August 20, 2009, The Subway exclaimed, "Put GSAE on your radar! We have more to come!!" On August 23, 2009, The Subway again promoted GSAE: "More on GSAE!!" The Subway disclosed that a third party paid it 25,000 shares to market GSAE stock. The 25,000 shares were worth approximately $7,500 at that time.[52]

As of April 1, 2009, GSAE had 26,250,000 million shares outstanding. PL Bank sold 1.9 million of these shares on 47 trading days from June to December 2009. On 17 of these days, PL Bank's sales accounted for over 20 percent of the total market volume in GSAE. On four of these days, PL Bank's sales accounted for over 40 percent of the total market volume. On September 10, 2009, PL Bank's sales accounted for over 60 percent of total market volume. PL Bank's sales of GSAE generated $864,000 in proceeds, even though GSAE had no revenues in the two prior years and had "minimal operations."

b. SRGE

SRGE was in the ethanol business prior to 2012. In 2012, it began a gold and silver exploration and mining business in Mexico. According to its unaudited annual report posted on the OTC Markets website, for the year ending August 31, 2011 (dated December 11, 2011), SRGE reported no revenues since at least September 2009, a net loss of over $2 million, and a going concern statement. SRGE filed its last periodic report with the SEC in 2008 when it filed a Form 8-K. The company filed Form 15-12G/A with the SEC in April 2011 to terminate its registration under Section 12(g) of the Exchange Act and its obligation to file periodic reports.

On January 16, 2012, an investment research firm based in Switzerland issued a report on SRGE that contained a "SPECULATIVE BUY" rating and a target price of $0.20, even though SRGE had no revenues and was trading at approximately $0.0003 per share. The Swiss research firm disclosed that its owners or affiliates "may have interests or positions in equity securities of the companies profiled in this report, some or all of which may have been acquired prior to the dissemination of this report."

PL Bank's penny stock transactions increased in 2012 with its sales of SRGE. From January 6 to January 18, 2012, PL Bank sold 11 million shares of SRGE from its CLK account

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51 Shortly before PL Bank began selling GSAE, on June 24, 2009, OTC Picks disclosed that it was paid 5,000 shares of GSAE for marketing the company as a "featured company." At the time, these 5,000 shares were worth approximately $9,250.

52 GSAE's closing price on August 20 and 23, 2009, was approximately $ .30 per share.

over six trading days and for proceeds of approximately $3,246. On five of these days, PL Bank's sales accounted for over 20 percent of the issuer's total market volume, and on two of the days, its sales constituted over 40 percent of total market volume in SRGE. On January 12, 2012, PL Bank's sales of SRGE accounted for over 80 percent of the issuer's total market volume.

c. CLDS

Accend Media was incorporated in October 2011 and became CLDS in May 2012 as a result of a reverse merger transaction. Its business was researching and developing a software product to provide computers access to the Internet cloud. According to the Form 10-Q for the period ending August 31, 2012, CLDS had earned no revenues since its formation, and it had cash of $169, total assets of $61,448, total liabilities of $80,398, and a net loss of $52,721. Its management also issued a going concern statement.

From February to May 2013, CLDS issued press releases announcing, among other things, that it had retained the services of an investor relations company to market itself and that it planned to explore expanding technology used to defend against cyberattacks. In March 2013, CLDS was the subject of a promotional campaign that included the dissemination of alerts and a newsletter. The newsletter contained various claims about CLDS, including a price prediction of $3 per share, despite the stock trading at $1.00 per share at the time. The newsletter also claimed, "It may only take a few months for CLDS to accelerate into $3.00 to $5.00 territory." The newsletter urged readers, "Bottom Line: You need to act on CLDS now!" A disclaimer in a newsletter disclosed that an affiliate of the promoter was paid $10,000 for the report.

From December 17, 2012, to March 12, 2013, PL Bank sold approximately 480,000 shares of CLDS in eight transactions.[53] On March 6, 2013, PL Bank's sales of CLDS accounted for more than 90 percent of total market volume. The following day, PL Bank's sales accounted for almost 97 percent of CLDS's total market volume. PL Bank's liquidations of CLDS on December 17, 2012, and February 21, 2013, accounted for 100 percent of the issuer's total market volume on those days. These sales generated proceeds of almost $180,000, despite CLDS's Form 10-Q for the period ending August 31, 2012, that reflected no revenues since its formation a year earlier, cash of $169, total assets of $61,448, total liabilities of $80,398, a net loss of $52,721, and a going concern statement by management.

d. DRHC

DRHC claimed it manufactured and distributed sports nutrition and energy beverages. According to its Form 10-Q for the period ending October 31, 2012, DRHC had "virtually no financial resources." In its Form 10-Q for the period ending January 31, 2013, DRHC reported total assets of $351,142 (most of which was classified as deferred loan costs) and a cash balance of $2,529. The company also reported $117,529 in total liabilities and no revenues since its

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[53] Swiss BD previously had requested to sell 2 million shares of CLDS through CLK to a buyer PL Bank had located. CLK refused to do the trade, but took no other steps to investigate PL Bank's trading such as determining how PL Bank had acquired the shares.

inception in 1997. DRHC reported operating at a net loss of $260,582 for the three months ending January 31, 2013.

During the period when PL Bank was selling DRHC shares, the company was the subject of penny stock promotional activities. Three DRHC promoters disclosed that they were compensated $10,000, $15,000, and $50,000 for promoting the company. A March 20, 2013 penny-stock promotional newsletter contained a link to a webcast interview with DRHC's CEO in which he made questionable statements, including a prediction that DRHC, even though it had never earned any revenues, would soon be as successful as Monster Beverage Company, a company with over $2 billion in revenues.

From January 7, 2013, to May 16, 2013, PL Bank liquidated approximately 7.8 million shares of DRHC through its CLK account. These liquidations took place over 41 trading days. On 20 of those days, PL Bank's sales accounted for over 20 percent of total market volume in DRHC. On February 4, 2013, PL Bank's sales of DRHC accounted for over 60 percent of total market volume. PL Bank's sales of DRHC generated proceeds of almost $218,000.

e. INNO

INNO located and salvaged shipwrecks. According to its Form 10-Q for the period ending April 30, 2013, INNO had no revenues since its formation in 2004, total net losses of nearly $300,000, unaudited financial reports, and was the subject of a going concern opinion.

In the midst of PL Bank selling its INNO shares (approximately July 2013), multiple websites were promoting INNO. Some cited a research report that predicted a $2.00 share price. According to a disclaimer contained in one of the promotions, a third party paid the promoter $32,500 for a one-day profile of INNO. A third party paid another promoter $1,500 for one day of coverage of INNO. On July 25, 2013, the Stock Reads website stated, "INNO is my new pick! A stock which can only go up is an awesome thing." A third party paid the Stock Reads promoter $25,000 to promote INNO.

From June 11, 2013, to August 26, 2013, PL Bank sold over 2 million shares of INNO over 18 trading days, generating proceeds of $39,685. On 14 of these days, PL Bank's sales accounted for over 20 percent of total market volume. On three of these days, PL Bank's sales constituted over 60 percent of total market volume in INNO. On August 14, 2013, PL Bank's sales of INNO accounted for over 80 percent of total market volume.

iii. Summary of Red Flags

In summary, CLK and Miller uncovered none of the evidence of suspicious information about the issuers that Enforcement presented at the hearing. These red flags were many, varied, and found in publicly available sources, including SEC filings, press releases, OTCMarkets.com, and websites that aggregate stock promotions.

ABC Corp. and PL Bank owned and liquidated large numbers of shares, which often constituted a high percentage of the daily volume in the stock and earned significant proceeds from the sales. ABC Corp. and PL Bank also liquidated the stock of issuers that had no business,

no revenues, or no product, and many of these issuers frequently changed their name, business strategy, or line of business.

Despite characterizing ABC Corp. as the "riskiest account" that CLK "ever had from an AML perspective," Miller did not find ABC Corp.'s practices at all suspicious. Miller testified that he usually consulted financial websites like Yahoo! Finance or Bloomberg about a stock, but it typically was not his practice to review an issuer's SEC filings. He was not concerned when an issuer whose stock ABC Corp. was selling had no business or revenues because "that was the expectation with [ABC Corp.'s owner], that he loaned money to those types of companies." When asked why the volume of trading in multiple securities did not trigger an investigation, Miller responded that CLK expected ABC Corp. to sell large volumes of stock because its business involved creating new shares in a company. Miller also testified that because ABC Corp. was causing the issuance of new shares in a stock, it was creating interest in the company that caused overall market volume to increase. To that end, Miller explained that the market maker where ABC Corp. directed CLK to execute its sell orders was also contacting clients to purchase ABC Corp.'s stock.

ABC Corp. and PL Bank also often liquidated stocks of issuers that, at the time of the liquidations, were the subject of promotional campaigns. Some of the entities promoting stocks that ABC Corp. and PL Bank sold disclosed third-party payments for marketing the stock. The respondents, however, never identified any of these promotional campaigns because they generally limited their Internet searches to "looking for news" on websites including Bloomberg, and Yahoo! Finance.

Miller could not recall if he ever conducted Internet searches for promotional material about a penny stock and was not familiar with websites that aggregate promotional material. The respondents' argue that they were justified in not reviewing stock promotion websites because such sources "are notoriously unreliable." The "reliability" of the information is not the salient point, but whether the stock promotions coincide with deposits and liquidations of that promoted stock.

In addition, the respondents failed to detect that persons associated with some of these issuers or the customers themselves had a history of securities-related misconduct. For example, PL Bank liquidated the stock of an issuer that had previously been the subject of a cease-trade order issued by the British Colombia Securities Commission. FFFC's chairman had been the subject of SEC regulatory action. STKO's former president and CEO was charged with securities fraud (in connection with a stock other than STKO). The CEO of PNCH had been found liable for securities-related misconduct in an SEC action. FJ, who the SEC had barred as a supervisor in a case involving penny stock manipulation, traded penny stocks through CLK in PL Bank's account. And near the time when CLK opened ABC Corp.'s account, the company and its owner were named as defendants in a lawsuit alleging their participation in securities fraud.

We also find it troubling that CLK capitulated to ABC Corp.'s pressure to shorten the liquidation-waiting period after a stock deposit without further questioning ABC Corp.'s trading. When CLK accepted ABC Corp.'s business, it imposed a four-day waiting period after a stock deposit to ensure the shares were eligible for resale. A few months later, and after pressure from

ABC Corp.'s owner, CLK agreed to shorten that time to enable ABC Corp. to sell its stock quicker.

In March 2013, ABC Corp.'s owner requested to shorten the waiting period from four days to three for two securities it had deposited. ABC Corp.'s owner explained that he wanted to take advantage of positive market news about the securities. In April 2013, ABC Corp. again asked that the waiting period be shortened for two other stocks because of changes in management reported in a recent Form 10-K filing and a press release. Maier told Bulger that he was not concerned because any seller of stock would want to take advantage of positive news, and Bulger agreed to shorten the waiting time to three days for DTC-eligible deposits. ABC Corp.'s owner asked CLK again to shorten the waiting period in June 2013, explaining that the other firms where ABC Corp. had accounts sold its securities the day after a deposit. CLK agreed to match the other firms. Maier explained that he believed there was no risk to shortening the waiting period because the securities ABC Corp. deposited were usually in sellable form within one business day. He testified that the CLK did not view this as a financial or AML risk and the firm continued the due diligence review of each ABC Corp. deposit.

iv. Expert Testimony Regarding the Reasonableness of CLK's AML Program

In reaching its conclusion that CLK's AML program was not reasonable, the Hearing Panel considered and adopted the expert testimony of Arthur D. Middlemiss, an AML expert who testified and provided a report on Enforcement's behalf.[54] Middlemiss opined that, in general, CLK's AML "program was deficient in that it was not appropriately tailored to identify and react to the level of risk to which it was exposed by its penny stock business." When CLK began liquidating penny stocks for PL Bank, CLK failed to enhance its AML program even though this business was admittedly a new and riskier business than that in which CLK had engaged in the past.

In Middlemiss's view, "If you were going to decide that you were going to engage in penny stock business, you have to, at the same time, make the decision that you're going to make a commensurate investment in compliance." Middlemiss explained that if a firm is engaged in "high volumes of penny stocks," then the firm must be "attuned to the news and media and information that's out there about the penny stock" to assess whether the customer is involved in suspicious activity or whether the transaction is tied to a scheme to manipulate the stock's price. CLK failed to do this.

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[54] Since 2013, Middlemiss has been the managing partner of a law firm, where his practice focuses on AML and anti-corruption issues. He is a frequent speaker on money laundering and BSA compliance matters. Middlemiss previously served as an assistant district attorney in the New York County District Attorney's Office for over 12 years. He later was the head of AML surveillance for Bear, Stearns & Co. and JPMorgan Chase investment bank, including J.P. Morgan Securities and J.P. Morgan Clearing Corporation. He also served as the director of JPMorgan Chase's Global Anti-Corruption Program.

When asked about searching for stock promotion materials on the Internet, Middlemiss opined that [i]t's not necessarily going to be found on the front page of Yahoo Finance. It's going to be found in the chat rooms." He explained that "if you're going to do business in the smaller, less well-known darker areas of the securities world, that's where you have to go to do your research."

Middlemiss testified that the respondents failed to recognize the AML risk that PL Bank may have been trading for its own underlying customers. Middlemiss opined that this was a red flag that "should have been investigated," and the firm should have made a determination into "whether to file a SAR." In addition, the respondents should have "enhanced" the monitoring of the PL Bank account.

Middlemiss concluded that CLK and Miller did not recognize and react appropriately to the risks associated with high-volume penny stock liquidations; tailor an AML program reasonably designed to govern the risks presented by its penny stock business and achieve and monitor its compliance with the requirements of the BSA and its implementing regulations; conduct adequate due diligence to identify risks presented by its customers, including PL Bank, a foreign financial institution; design an AML program to address the risks presented by PL Bank's and ABC Corp.'s penny stock sales; or monitor penny stock transactions to detect potentially manipulative trading, including possible pump and dump schemes.

The Hearing Panel also considered testimony from Evan R. Rosser, who was qualified as an AML expert, testified, and provided an expert report on behalf of CLK and Miller.[55] Rosser opined that CLK's due diligence efforts and ongoing monitoring and surveillance of PL Bank's and ABC Corp.'s accounts were consistent with the AML processes that would be expected for a firm of its size during the relevant period. Rosser further concluded that CLK's AML program was reasonably designed and updated as warranted by changes in FINRA's and the SEC's guidance. Rosser noted that the firm's WSPs were amended and updated during the relevant period, the firm received independent reviews of its AML procedures, and the firm had internal transaction and reporting and information systems that provided information for review by firm personnel.

The Hearing Panel, however, fundamentally disagreed with Rosser's conclusions, citing the ample evidence of red flags raised by PL Bank's and ABC Corp.'s trading. Rosser also acknowledged in his hearing testimony that it is not the size of the firm's revenue that is relevant to a reasonably designed AML program, but the size of the risk to the firm. We agree with the Hearing Panel that the evidence amply supports that the risks presented by PL Bank's and ABC Corp.'s trading were significant and went largely unchecked. In addition, the firm did not incorporate the penny-stock red flags enumerated in FINRA's 2010 revised template into CLK's

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[55] Since 2013, Rosser has been a director with Oyster Consulting, a financial services consulting firm that provides compliance, regulatory, audit, strategic management, and other consulting services. Previously, he was a vice president with FINRA's Department of Enforcement where he supervised investigative staff. He supervised complex securities investigations for NASD and FINRA for approximately 25 years. While working as a consultant, Rosser has advised clients and testified on AML and related regulatory issues.

AML procedures until June 30, 2013, after the vast majority of the transactions at issue took place. CLK's procedures also did not address how to monitor for and detect suspicious penny stock activity.

Notably, Rosser provided no opinion on the adequacy of the firm's AML investigations. When asked about the Checklist, Rosser agreed that the firm provided limited documentation in support of its responses and stated he "would hope to see more." In comparison, Middlemiss testified that an adequate AML program would include supporting documentation of reviews. Rosser also agreed with Enforcement that CLK did not know who owned the assets that were being traded through the PL Bank account.

The Hearing Panel found Middlemiss credible. We find no basis to overturn the Hearing Panel's credibility determination, and we agree with Middlemiss's conclusion that CLK's AML program was deficient and not properly tailored to address the risks of its penny stock business. *See Eliezer Gurfel*, 54 S.E.C. 56, 62 n.11 (1999) (explaining that while the NAC conducts a de novo review of hearing panel decisions, it gives substantial weight and deference to the Hearing Panel's credibility findings), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000).

After reviewing the totality of the evidence, we affirm the Hearing Panel's findings of violations under cause three that CLK and Miller failed to establish and implement an AML program reasonably designed to cause the detection and reporting of suspicious transactions under the BSA, in violation of NASD Rule 3011(a) and FINRA Rules 3310(a) and 2010.

4. Required AML Due Diligence on PL Bank

Enforcement alleged in cause four of its complaint that CLK and Miller violated NASD Rule 3011(b) and FINRA Rules 3310(b) and 2010 by failing to conduct adequate due diligence of PL Bank, a foreign financial institution, and responding to red flags regarding its trading activities. We affirm these findings.

a. PATRIOT Act and FINRA Requirements

Section 312 of the PATRIOT Act requires that a broker-dealer, as a "covered financial institution," exercise due diligence when accepting correspondent accounts for a foreign financial institution ("FFI"). 31 U.S.C. §5318(i); 31 C.F.R. § 1010.610. A correspondent account is one "established for a[n FFI] to receive deposits from, or to make payments or other disbursements on behalf of, the [FFI], or to handle other financial transactions related to such [FFI]. 31 C.F.R. § 1010.605(c)(i). An FFI is defined as any entity "organized under foreign law (other than a branch or office of such person in the United States) that, if it were located in the United States, would be a covered financial institution," including a foreign bank and a "broker or dealer in securities registered or required to be registered" with the SEC. 31 C.F.R. § 1010.605(f)(iii), (e)(viii). Swiss BD was an FFI located in Switzerland that introduced multiple FFI accounts to CLK. One of those accounts was PL Bank, a bank organized and domiciled in Liechtenstein and therefore also an FFI under the BSA.

Federal law requires that a broker-dealer's due diligence program for an FFI must include "appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to enable the [broker-dealer] to detect and report, on an

ongoing basis, any known or suspected money laundering activity conducted through or involving any correspondent account." 31 C.F.R. § 1010.610(a). Broker-dealers that handle FFI accounts must implement policies, procedures, and controls to "assess[] the money laundering risk presented by [an FFI] correspondent account, based on a consideration of all relevant factors," including:

- The nature of the FFI's business and the markets it serves;
- The type, purpose, and anticipated activity of the correspondent account;
- The nature and duration of the covered financial institution's relationship with the FFI (and any of its affiliates);
- The AML and supervisory regime of the jurisdiction that issued the charter or license to the FFI; and
- Information known or reasonably available to the covered financial institution about the FFI's AML record.

31 C.F.R. § 1010.610(a)(2).

A broker-dealer's due diligence program for an FFI must adopt "risk-based procedures and controls . . . reasonably designed to detect and report known or suspected money laundering activity, including a periodic review of the correspondent account activity sufficient to determine consistency with information obtained about the type, purpose, and anticipated activity of the account." 31 C.F.R. § 1010.610(a)(3). Consistent with these requirements, NASD Rule 3011(b) and FINRA Rule 3310(b) require that AML programs, at a minimum, "[e]stablish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the [BSA] and [its] implementing regulations." CLK and Miller failed to fulfill these obligations with respect to PL Bank.

b. The Respondents' Failed to Fulfill Their AML Due Diligence Obligations and Respond to Red Flags

PL Bank was an FFI. CLK and Miller were obligated to perform risk-based due diligence into PL Bank's business when it opened an account in June 2009 and conduct periodic reviews of its activities. The respondents, however, failed to perform such due diligence, either at the account's opening or thereafter, and permitted PL Bank to sell 41 million shares of penny stocks through its CLK account without sufficient scrutiny, generating $4.87 million in proceeds.

At account opening, the respondents failed to obtain information sufficient to determine the nature of PL Bank's business and the type, purpose, and anticipated activity of the account. They admittedly had no idea at the time that PL Bank's business would consist of liquidating penny stocks and instead simply assumed that, like other Swiss BD customers, it would trade mid- and large-cap U.S. equities and options. When that assumption proved to be wrong, the respondents again failed to conduct a sufficient inquiry into PL Bank's intentions. CLK and Miller should have conducted a more extensive investigation of PL Bank when it became clear that its trading activity differed materially from that of other Swiss BD-introduced customers.

The respondents also failed to conduct their own separate due diligence into PL Bank. Miller relied on Maier because Maier knew Swiss BD's owner. Miller never spoke directly with

anyone from PL Bank or with Swiss BD's owner about PL Bank's trading. The respondents' reliance on Swiss BD to provide information about PL Bank was misplaced and was no substitute for their own due diligence. CLK was responsible for its own due diligence to meet its AML obligations. *See Lek*, 2018 SEC LEXIS 830, at *22-23.

The Hearing Panel found the opinions of Enforcement's expert, Middlemiss, persuasive on this point. Middlemiss opined that FFI correspondent relationships present inherent AML risk for several reasons. FFIs may not be subject to the same or similar regulatory requirements as U.S. institutions. Although CLK obtained a contractual representation from Swiss BD that Swiss BD maintained a U.S.-compliant AML program, CLK did little to assess meaningfully whether Swiss BD knew its customers, including PL Bank, and was capable of monitoring PL Bank. As Middlemiss determined: "CLK's unreserved reliance on [Swiss BD] to maintain a U.S.-compliant AML program contributed significantly to CLK's own failure to design and execute an AML program tailored to mitigate its AML risks." Moreover, a U.S. institution's lack of familiarly with an FFI's customers makes it easier for bad actors to gain access to the U.S. financial system. Thus, without adequate controls, a U.S. institution may set up a traditional correspondent account with an FFI and not be aware that the FFI is permitting other financial institutions or customers to conduct transactions anonymously through the U.S. account thereby magnifying the AML risk. Indeed, the respondents failed to determine for *years* whether PL Bank was trading for undisclosed customers.

Miller erroneously believed that PL Bank was trading only for its own accounts. When PL Bank submitted its new account paperwork to CLK in June 2009, it included IRS Form W-8IMY ("Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding"). PL Bank disclosed in this form that it was trading for accounts of others, but did not identify the third-party accounts. Miller, however, was unaware that PL Bank indicated that it was "not acting for its own account" and testified that he did not look closely at the IRS form because CLK was not going to withhold any of PL Bank's funds for tax purposes.

For four years, Miller was oblivious to the fact that PL Bank was liquidating penny stocks for undisclosed subaccounts. Maier, in March 2013, first learned that PL Bank was trading for subaccounts in an email conversation with Swiss BD's owner. He did not inform Miller, and Miller continued to believe erroneously that PL Bank was liquidating penny stocks solely for its own account.

Miller mistakenly also believed that the AML requirements did not obligate a firm to know whether a customer with a DVP/RVP account is trading for itself or for others because the other broker-dealer knows more about the customer. Middlemiss opined that from his perspective the AML risk was higher when dealing with a broker-dealer based in Switzerland introducing another firm based in Liechtenstein because of a "[l]ack of transparency" and not knowing "who is behind the business." In addition, a DVP/RVP account is not necessarily low risk in the case of a customer such as PL Bank trading penny stocks while based in an offshore jurisdiction such as Liechtenstein because of the kind of trading activity taking place within that account.

The respondents also failed to implement any procedures to supervise PL Bank's penny-stock liquidations, despite the firm's lack of experience with such business. The new and riskier

PL Bank business should have prompted CLK to re-evaluate its own controls, including its ability to detect and report potentially suspicious activity related to penny stocks. Maier, the registered representative on the account, did not understand the nature of PL Bank's business, and Bulger, the firm's CCO, had never heard of PL Bank until FINRA began its investigation. And Miller had little experience with penny stocks prior to the PL Bank account. Nonetheless, Miller testified that he did not need any "specialized reporting form" to monitor PL Bank's trading because of CLK's small size and a daily trading blotter of approximately 20 pages long on a busy day. Miller also did not utilize any system, other than the trade blotter, to alert him to unusual trading.

As discussed in detail above, the respondents failed to detect and investigate red flags demonstrated by PL Bank's trading. For example, during its first six months of trading at CLK, PL Bank sold more than 1.9 million shares of GSAE for proceeds of $864,000. GSAE had earned no revenues in two years, had minimal operations, and was the subject of a campaign promoting its securities. In addition, the British Columbia Securities Commission had issued a cease trading order against GSAE a few weeks before PL Bank began selling GSAE shares.

We agree with the Hearing Panel that CLK and Miller during the firm's relationship with PL Bank, an FFI, failed to conduct periodic due diligence of the type and purpose of PL Bank's trading as required by 31 C.F.R. § 1010.610(a)(2). By failing to conduct adequate due diligence on PL Bank and appropriately respond to red flags associated with PL Bank's trading, CLK and Miller violated NASD Rule 3011(b) and FINRA Rules 3310(b) and 2010.

C. Sanctions for the AML-Related Violations

For causes three and four related to the respondents' violations of the AML obligations, the Hearing Panel censured the firm and fined it a total of $450,000.[56] For Miller's misconduct under these causes, the Hearing Panel suspended him for six months as a principal, fined him a total of $20,000, and ordered that he requalify as a principal before again acting in that capacity.[57] As explained below, we modify these sanctions.

Because there are no Guidelines specific to AML-related violations, the NAC historically has applied the Guidelines for deficient supervision as the most analogous. *See Merrimac*, 2017 FINRA Discip. LEXIS 16, at *61-62; *Lek*, 2016 FINRA Discip. LEXIS 63, at *38; *Domestic*, 2008 FINRA Discip. LEXIS 44, at *21 n.9. In this case, the Hearing Panel applied the Guidelines for systemic supervisory failures, given the nature and duration of the respondents'

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[56] The Hearing Panel censured the firm and fined it $400,000 for the violations under cause three and imposed an additional censure and $50,000 fine for CLK's misconduct under cause four.

[57] The Hearing Panel suspended Miller for five months as a principal and fined him $15,000 for his misconduct under cause three and imposed an additional one month principal suspension and $5,000 fine for his misconduct under cause four. The Hearing Panel also ordered the requalification requirement under both causes.

AML-related misconduct. These Guidelines are recommended "when a supervisory failure is significant and is widespread or occurs over an extended period of time."[58] "While systemic supervisory failures typically involve failures to implement or use supervisory procedures that exist, systemic supervisory failures also may involve supervisory systems that have both ineffectively designed procedures and procedures that are not implemented."[59]

We agree that the Guidelines for systemic supervisory failures are appropriate here.[60] In this case, the AML-related violations were significant and persisted for more than four years.[61] Beginning in June 2009, the respondents failed to perform adequate due diligence when PL Bank opened its account and to conduct periodic reviews of its activities while PL Bank maintained an account. The respondents further failed to tailor the firm's AML program to address the new penny-stock liquidation business that it took on from PL Bank in 2009 and from ABC Corp. in 2012. Appropriately tailored AML policies and procedures are mandated by federal law and required for every broker-dealer registered with FINRA irrespective of the type of business a firm conducts. The respondents' failures extended into 2013, when the firm failed to detect and

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58 *Guidelines*, at 105.

59 *Id.*

60 The respondents argue that because the systemic supervisory failure Guidelines "did not exist" when they engaged in the relevant conduct, or during Enforcement's investigation, at the time it filed a complaint, or at the time of the hearing, their application "is the epitome of unfairness, arbitrariness and capriciousness." Respondents argue that "[f]airness and due process counsel against the retroactive application" of these Guidelines because the respondents were deprived the opportunity "to present evidence or argument related to its principal considerations." We reject this argument. The Guidelines make plain that they "are effective as of the date of publication, and apply to all disciplinary matters, including pending matters." *Id.* at 8. Moreover, the respondents have had numerous opportunities to present arguments related to the application of these Guidelines and any factors in favor of mitigation of sanctions as reflected in their appellate briefs and oral arguments. The Commission, moreover, recently has upheld the NAC's consideration of the systemic supervisory failure Guidelines in another case involving supervisory and AML violations. *See Meyers Assocs., L.P.*, Exchange Act Release No. 86193, 2019 SEC LEXIS 1626, at *62-63 (June 24, 2019) (upholding NAC's application of systemic supervisory failures Guidelines to increase fine and impose unitary sanction even though complaint was filed in 2015, hearing occurred in 2016, and Hearing Panel decision was issued in 2016, and Hearing Panel applied failure to supervise Guidelines).

61 The respondents argue that the Hearing Panel "grossly overstated" the relevant period of misconduct. The facts, however, support the conclusion that the respondents' AML-related misconduct persisted for an extended period, which serves to aggravate sanctions. *See Guidelines*, at 7 (Principal Consideration No. 9) (whether the respondent engaged in the misconduct over an extended period of time); *see also Meyers*, 2019 SEC LEXIS 1626, at *63-65 (applying systemic supervisory failures Guidelines to misconduct that was significant and occurred over a one-and-a-half-year period).

respond to many red flags surrounding PL Bank's and ABC Corp.'s penny stock liquidations.

The Guidelines for systemic supervisory failures recommend fining a firm $10,000 to $292,000. When aggravating factors predominate, an adjudicator may consider a higher fine and suspending the firm with respect to any or all relevant activities or functions for 10 business days to two years or consider expelling the firm.[62] Depending on the circumstances, an adjudicator also may impose undertakings, order the firm to revise its supervisory systems and procedures, or order the firm to engage an independent consultant to recommend changes to the firm's supervisory systems and procedures.[63] The Guidelines also set forth eight violation-specific considerations that are relevant to determining appropriate sanctions for a systemic supervisory failure.[64]

We determine that several of these considerations, along with the Principal Considerations relevant to all sanction determinations, are applicable to the respondents' misconduct and serve to aggravate sanctions. The respondents egregiously failed to respond reasonably to many conspicuous red flag warnings.[65] As the Hearing Panel correctly found, CLK executed PL Bank's and ABC Corp.'s sell orders without examining whether these sales were timed to coincide with stock promotion campaigns, potential pump-and-dump schemes, or orchestrated with the direct or indirect participation of persons with questionable securities backgrounds. And as a consequence, CLK was unable to assess whether transactions in PL Bank's and ABC Corp.'s accounts at the firm warranted filing a SAR.[66] Moreover, we

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62 *Guidelines*, at 105.

63 In this case, the Hearing Panel ordered no such undertakings because CLK has not liquidated penny stocks for customers since 2014.

64 These considerations are: (1) whether the deficiencies allowed violative conduct to occur or escape detection; (2) whether the firm failed to timely correct or address deficiencies once identified or failed to respond reasonably to "red flag" warnings; (3) whether the firm appropriately allocated its resources to prevent or detect the supervisory failure; (4) the number and type of customers affected by the deficiencies; (5) the number and dollar value of the transactions not adequately supervised as a result of the deficiencies; (6) the nature, extent, size, character, and complexity of the activities or functions not adequately supervised; (7) the extent to which the deficiencies affected market integrity, market transparency, the accuracy of regulatory reports, or the dissemination of trade or other regulatory information; and (8) the quality of controls or procedures available to the supervisors and the degree to which the supervisors implemented them. *Id.* at 105-06.

65 *Id.* at 105.

66 The Hearing Panel found aggravating that the respondents' supervisory deficiencies allowed violative conduct to occur or to escape detection and then referred to the evidence of red flags. While there is ample evidence of red flags of suspicious activity surrounding the penny stock liquidations, Enforcement did not prove violative conduct occurred or escaped detection because of respondents' actions. This factor, therefore, is not relevant; we do not apply it.

determine that the respondents' participation in PL Bank's and ABC Corp.'s liquidations of speculative penny stocks without responding to red flags created a significant risk of harm to the investing public and integrity of the market.[67] The extent of CLK's supervisory failures related to its penny stock business "demonstrates that the [f]irm acted at least recklessly."[68] *See Meyers*, 2019 SEC LEXIS 1626, at *65; *see also William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *113 (July 2, 2013).

The number and dollar value of the transactions not adequately supervised because of the deficiencies, and the nature, extent, size, character, and complexity of the activities or functions not adequately supervised, further serve to aggravate sanctions.[69] PL Bank and ABC Corp. sold over 11 billion shares in securities of companies with little or no histories of operations or revenue.[70] These sales generated proceeds of approximately $19 million for PL Bank and ABC Corp. For the sales of the specific penny stocks that Enforcement highlighted in its complaint, PL Bank received over $1.3 million in proceeds and ABC Corp. received more than $1.9 million. For liquidating penny stocks on behalf of these two customers, CLK received commissions of over $574,000.[71]

CLK and Miller wholly failed to understand their obligations under the BSA and FINRA rules related to PL Bank, an FFI. As a result, they never questioned the nature of PL Bank's trading activity. Although CLK obtained a contractual representation from Swiss BD that it maintained a U.S.-compliant AML program, the respondents did not meaningfully assess whether this was true. For example, Miller testified that that he never obtained any documentary support from Swiss BD that it had a written AML program. Miller also admitted that he did not know what, if any, special due diligence procedures that Swiss BD utilized for PL Bank. The respondents' unreserved reliance on Swiss BD to maintain a U.S.-compliant AML program was unreasonable and contributed to the respondents' failure to design and execute an AML program tailored to mitigate CLK's AML risk. CLK's and Miller's information about PL Bank was limited to what Maier learned from Swiss BD's owner. It was not until March 2013, nearly four years after PL Bank opened its CLK account, when the respondents, through Maier, asked Swiss BD if PL Bank was trading for different subaccounts. Swiss BD confirmed that PL Bank had "sub accounts/banking clients" who traded. The respondents' lack of familiarity with PL Bank's customers could have made it easier for bad actors to gain access to the U.S. financial system.

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67 *Id.* at 106.

68 *Id.* at 8 (Principal Consideration No. 13).

69 *Guidelines*, at 105-06.

70 In an effort to downplay its supervisory failures, CLK contends that PL Bank "did not begin actively trading in high-volume penny stocks with C.L. King until early 2012." The facts, however, demonstrate that PL Bank was trading penny stocks in significant volume beginning in 2009. PL Bank sold 1.9 million shares of GSAE between June and December 2009, which generated $864,000 in proceeds.

71 *Id.* at 8 (Principal Consideration No. 16).

The respondents suggest that the alleged AML-related deficiencies concerned only the small number of the highlighted penny stocks that PL Bank and ABC Corp. traded in their accounts. We do not agree that this is mitigating. While Enforcement focused on certain penny stocks in order to prove its allegations, the respondents were "required to comply with [FINRA's] high standards of conduct at all times." *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); *cf. The Dratel Grp.*, Exchange Act Release No. 77396, 2016 SEC LEXIS 1035, at *69 (Mar. 17, 2016) ("The number of cherry-picked trades or percentage of trades that Applicants cherry picked is not a mitigating factor . . . [and] Applicants must 'comply with [FINRA's] high standards of conduct at all times.'"). There was no less AML risk associated with the other penny stocks that CLK liquidated for these two customers without meaningful scrutiny.

The respondents' argue in favor of mitigation that they had WSPs in place for each business line, revised the firm's WSPs to evolve over time in accordance with FINRA guidance, and followed those procedures. We disagree. The evidence instead shows that, for years, the respondents disregarded FINRA guidance that applied specifically to the firm's penny stock liquidation business.

The respondents also claim that CLK "identified and declined trade requests from [PL Bank and ABC Corp.] that were inconsistent with parameters placed on their accounts to address AML-related concerns." The evidence they cite does not support this argument. For example, the respondents used the Checklist for operational and SEC Rule 144 compliance purposes related to ABC Corp.'s stock deposits—not to address AML-related concerns.

Although the respondents claim their lack of a disciplinary history is mitigating, this argument is without merit.[72] While the existence of a disciplinary history is an aggravating

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[72] CLK has a relevant disciplinary history related to its supervisory systems. Most recently, on January 22, 2018, FINRA censured and fined the firm $75,000. The firm consented to findings that it failed to enforce procedures regarding the distribution of research between the firm's research, trading, and sales personnel, and failed to adequately supervise the process by which the firm distributed research reports to customers.

On July 27, 2016, CLK also settled a FINRA disciplinary action by consenting to findings that the firm, among other things, failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with the securities laws concerning the reporting of positions to the LOPR (large options position reporting). CLK was censured and fined $27,500.

On January 8, 2009, FINRA censured the firm, fined it $22,000, and required it to revise its WSPs. CLK consented to findings that, among other things, the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with the securities laws addressing quality of markets topics. The firm also failed to provide sufficient documentary evidence that it performed the supervisory reviews set forth in its procedures concerning supervisory systems, procedures, and qualifications; order handling; best execution;

[Footnote continued on next page]

factor when determining the appropriate sanction, its absence is not mitigating. *See Rooms*, 444 F.3d at 1214-15 (determining the lack of disciplinary history is not mitigating and representative "was required to comply with the NASD's high standards of conduct at all times"); *Ahmed Gadelkareem*, Exchange Act Release No. 82879, 2018 SEC LEXIS 729, at *29 (Mar. 14, 2018); *Michael E. McCune*, Exchange Act Release No. 77375, 2016 SEC LEXIS 1026, at *34 (Mar. 15, 2016), *aff'd*, 672 F. App'x 865 (10th Cir. 2016).

The respondents further contend "there is no evidence that any customer was harmed." But it likewise is not mitigating that the respondents' misconduct did not result in customer harm. *See Kaminski*, 2011 SEC LEXIS 3225, at *44 ("We find no merit to Kaminski's claim that the NASD's failure to find that his supervisory failures caused customer harm was not a mitigating factor. . . . Kaminski's supervisory failure resulted in the [firm] not reviewing 597 variable annuity transactions in the Red Flag Blotter in a timely manner. As NASD found, the result of Kaminski's failure to supervise could have been devastating to the firm or its customers."); *see also Howard Braff*, Exchange Act Release No. 66467, 2012 SEC LEXIS 620, at *26 & n.25 (Feb. 24, 2012) (explaining that the absence of customer harm is not mitigating, as the public interest analysis focuses on the welfare of investors generally). As the Commission has explained, "[w]hile the presence of any . . . aggravating circumstances justify[] an increase in sanctions, their absence is not mitigating." *Michael Frederick Siegel*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459, at *43 (Oct. 6, 2008), *vacated in part and remanded on other grounds*, 592 F.3d 147, 157 (D.C. Cir. 2010); *see also Andrew P. Gonchar*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797, at *54 (Aug. 14, 2009) (rejecting argument that respondents' violations of FINRA rules were mitigated with their general compliance with the rules in other instances), *aff'd*, 409 F. App'x 396 (2d Cir. 2010).

The respondents argue that the sanctions here "must be in line with sanctions imposed under similar circumstances in prior cases," both settled and litigated. It is well established, however, that "the appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases." *Kaminski*, 2011 SEC LEXIS 3225, at *41. And, indeed, none of the cases upon which the respondents rely encompass the facts and circumstances of this one, including the billions of penny stock shares that CLK liquidated for customers without sufficient scrutiny. Furthermore, "comparisons to sanctions in settled cases are inappropriate because pragmatic considerations justify the acceptance of lesser sanctions in negotiating a settlement such as the avoidance of time-and-manpower-consuming adversary proceedings." *Kent M. Houston*, Exchange Act Release No. 71589, 2014 SEC LEXIS 614, at *33 (Feb. 20, 2014).

Miller argues that the sanctions against him are "unprecedented" and suggest that FINRA never has before held an AMLCO individually responsible for AML-related violations. Miller is mistaken. For example, in *Dep't of Enforcement v. N. Woodward*, the NAC found the firm's AMLCO, who had responsibility for the firm's AML program, failed to implement adequate AML procedures for his firm and failed to conduct timely independent AML testing. 2016

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anti-intimidation/coordination; trade reporting; sales transactions; soft dollar accounts and trading; and OATS.

FINRA Discip. LEXIS 35, at *29-33. As a result of these and other supervisory failings, the NAC barred the AMLCO as a principal and supervisor. *Id.* at *48-51.

Miller argues that FINRA "improperly singled [him] out for discipline" when others at the firm had supervisory responsibilities over him and were "responsible for reviewing and implementing the supervisory policies and procedures that Miller" put in place. In support, Miller cites to other cases involving AML violations when FINRA did not alleged wrongdoing against an AMLCO. "It is well established that Enforcement has broad prosecutorial discretion when deciding who and what violation to charge." *Wedbush*, 2014 FINRA Discip. LEXIS 40, at *80-81; *see also Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993) ("[FINRA] disciplinary proceedings are treated as an exercise of prosecutorial discretion."). We find no evidence that Enforcement's decision to charge Miller and seek sanctions against him was anything other than a proper exercise of FINRA's prosecutorial discretion. Miller, moreover, was the person expressly named in the WSPs as responsible for the firm's adherence to AML requirements. As the Commission has emphasized, "[p]roper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and NASD rules. It is also a critical component to ensuring investor protection." *Kaminski*, 2011 SEC LEXIS 3225, at *35.

The Hearing Panel set forth independent sanctions for each of the violations found under causes three and four. Because we determine instead that the AML violations are closely related, we impose a single set of sanctions upon each respondent for these violations. When "multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate." *Dep't of Enforcement v. Fox & Co. Invs., Inc.*, Complaint No. C3A030017, 2005 NASD Discip. LEXIS 5, at *37 (NASD NAC Feb. 24, 2005), *aff'd*, 58 S.E.C. 873 (2005); *see also Blair C. Mielke*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927, at *59 (Sept. 24, 2015) (sustaining FINRA's imposition of a unitary sanction resulting from a single systemic problem or cause). For the firm's AML-related violations under causes three and four, we censure the firm and determine that a fine at the top end, rather than outside, of the Guidelines is appropriate for the firm's misconduct. Accordingly, we fine the firm $292,000.

We also order that CLK retain an independent consultant to recommend changes to the firm's policies, procedures, and supervisory systems related to AML obligations and to review the process by which the firm enters into new lines of business.[73] We order CLK to comply with the following procedures related to the retention of an independent consultant: CLK shall retain, within 60 days of this decision becoming FINRA's final disciplinary action, an independent consultant, acceptable to Enforcement. The independent consultant shall conduct a review of the firm's policies, procedures, and supervisory systems related to AML obligations and a review of the firm's process by which it enters into new lines of business, including adopting procedures for vetting and supervising that new business.[74] The independent consultant shall make

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[73] *See Guidelines*, at 106.

[74] We note that, if CLK seeks to expand its business, either by adding a new line of business or by substantially increasing the scope and size of the existing business, the order to retain an independent consultant does not shield CLK from the requirements of FINRA Rule 1017(a)(5) to

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recommendations of ways to improve these processes, policies, procedures, and systems. Once retained, CLK shall not terminate its relationship with the independent consultant without Enforcement's written approval.

CLK shall require the independent consultant to submit to CLK and FINRA staff its report, which includes: (1) a description of the review performed and the conclusions reached; and (2) recommended changes or additions to CLK's policies, procedures, and systems related to the firm's AML obligations and process for vetting and supervising new lines of business. CLK shall provide to FINRA staff, within 60 days after receiving the independent consultant's report, a written implementation report, certified by an officer of the firm, attesting to the firm's implementation of the independent consultant's recommendations.

We have considered that the Hearing Panel fined CLK a total of $450,000 for the firm's AML-related violations, but we determine that a reduction in the fine is appropriate given that we direct the firm to retain an independent consultant. Good compliance is critical to the business of the firm. A culture of compliance must be established and passed down through all levels of the firm, with adequate resources allocated to assure that appropriate supervisory and compliance controls are in place. An independent consultant should assist the firm in establishing a successful supervisory program going forward.

We determine that the majority of the Hearing Panel's sanctions for Miller's misconduct are warranted by Miller's failure to discharge his AML responsibilities reasonably. We are also mindful of the Commission's precedent related to holding compliance officers liable and "the principles of fairness and equity, applied in context." *North*, 2018 SEC LEXIS 3001, at *28. Under the circumstances here, we determine that because we have reduced the firm's sanctions, it is appropriate to reduce Miller's six-month suspension as a principal to three months in all principal and supervisory capacities in order to maintain proportional sanctions. Thus, Miller is suspended in all principal and supervisory capacities for three months, fined $20,000, and ordered to requalify as a principal before again acting in any principal or supervisory capacity.[75]

V. Conclusion

We affirm the Hearing Panel's findings that CLK violated NASD Rule 3010 and FINRA Rules 3110 and 2010 by failing to establish and maintain a supervisory system, including WSPs, reasonably designed to ensure compliance with the federal securities laws and FINRA rules in

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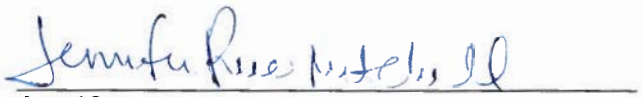
file an application for approval of a material change in business operations as defined in Rule 1011(k).

[75] The Hearing Panel's suspension was in all principal capacities. In harmony with recent precedent, we also suspend Miller in all supervisory capacities. *See Dep't of Enforcement v. North*, Complaint No. 2010025087302, 2017 FINRA Discip. LEXIS 7, at *49 n.39 (FINRA NAC Mar. 15, 2017) (modifying principal suspension to include supervisory capacities), *aff'd*, 2018 SEC LEXIS 3001.

connection with the firm's survivor bonds business. Accordingly, for this violation, we censure the firm and impose a $50,000 fine.

We also affirm the Hearing Panel's findings that CLK and Miller failed to establish and implement a reasonable AML program designed to detect, investigate, and report potentially suspicious activity, and failed to conduct adequate due diligence and respond to red flags, in violation of NASD Rule 3011 and FINRA Rules 3310 and 2010. For these violations, the firm is censured, fined $292,000, and required to retain an independent consultant. Miller is suspended in all principal and supervisory capacities for three months, fined $20,000, and ordered to requalify as a principal before acting in any principal or supervisory capacity. The respondents are also ordered to pay, jointly and severally, hearing costs of $20,175.20.[76]

On Behalf of the National Adjudicatory Council,



Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

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[76] Pursuant to FINRA Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. After seven days' notice in writing, FINRA may summarily revoke the registration of a person associated with a member if such person fails to pay promptly a fine or other monetary sanction imposed pursuant to Rule 8310 or a cost imposed pursuant to Rule 8330 when such fine, monetary sanction, or cost becomes finally due and payable.