

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2018060195201**

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

RE: Hilltop Securities Inc., Respondent
Member Firm
BD No. 6220

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

I.

ACCEPTANCE AND CONSENT

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

BACKGROUND

Hilltop has been a FINRA member firm since May 1972, and its registration remains in effect. Hilltop conducts a full service retail brokerage business and provides correspondent clearing services to, and carries customer accounts for, approximately 149 introducing firms on a fully disclosed basis. Hilltop's headquarters is in Dallas, Texas. It employs approximately 540 registered persons across 69 offices.

RELEVANT DISCIPLINARY HISTORY

Hilltop does not have any relevant disciplinary history.

OVERVIEW

The Securities and Exchange Commission adopted Rule 10b-16 (17 C.F.R. § 240.10b-16) to require that broker-dealers extending credit in margin transactions have "established procedures to assure that each customer" receives certain initial

and periodic disclosures. Rule 10b-16(a)(1) requires that the initial disclosure include a “written statement or statements disclosing . . . the annual rate or rates of interest that can be imposed.” The initial disclosure is designed to ensure that a customer, before account opening, understands the terms and conditions under which margin interest charges will be made, and to enable the customer to compare the various credit terms available.

From 2015 through the present (the “Relevant Period”), Hilltop failed to establish procedures reasonably designed to assure that customers received the initial margin interest rate disclosures and failed to establish, maintain, and enforce a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with Rule 10b-16(a)(1). In fact, many customers did not receive the initial disclosure stating the annual rate or rates of margin interest that could be imposed. As a result, Hilltop violated SEC Rule 10b-16(a)(1) and FINRA Rules 3110(a) and (b) and 2010.

FACTS AND VIOLATIVE CONDUCT

SEC Rule 10b-16(a)(1) (17 CFR § 240.10b-16(a)(1)) states, in relevant part:

- (a) It shall be unlawful for any broker or dealer to extend credit, directly or indirectly, to any customer in connection with any securities transaction unless such broker or dealer has established procedures to assure that each customer:
 - (1) [i]s given or sent at the time of opening the account, a written statement or statements disclosing . . . the annual rate or rates of interest that can be imposed.

The Adopting Release for SEC Rule 10b-16 provides the following additional guidance related to margin interest rates that can vary:

If the rate of interest to be imposed will vary depending upon the size of the debit balance, the schedule of rates and the range of balances to which each is applicable should be shown. Since broker-dealers frequently relate their interest charges to the call money rate, it is permissible to express the interest rates in terms of their relationship to the current call money rate, as, for example, ‘½ of 1 percent above the current call money rate’.¹

FINRA Rules 3110(a) and (b) require each member to establish, maintain, and enforce a supervisory system, including written supervisory procedures, related to its business that is reasonably designed to achieve compliance with applicable

¹ SEC, *Disclosure of Credit Terms in Margin Transactions*, Exchange Act Rel. No. 34-8773, 34 FR 19717 (Dec. 16, 1969).

securities laws and regulations, and with applicable FINRA rules. A violation of SEC Rule 10b-16(a)(1) and FINRA Rule 3110 also constitutes a violation of FINRA Rule 2010, which requires member firms in the conduct of their business to “observe high standards of commercial honor and just and equitable principles of trade.”

The margin interest rate that Hilltop charged customers was typically comprised of three components: a “base rate”; a “mark-up/mark-down”; and an introducing-firm specific mark-up. Hilltop set the base rate. Hilltop also set the mark-up/mark-down, which increased or decreased the applicable margin interest rate based on the size of the customer’s debit balance. At the request of certain introducing firms, Hilltop also charged an additional mark-up, which Hilltop set on a firm-by-firm basis. Hilltop then rebated this additional mark-up back to the introducing firm.

During the Relevant Period, Hilltop provided its introducing broker-dealers with a customer information brochure (the “Brochure”) that each introducing firm was obligated to provide to each customer opening a margin account. Hilltop’s Brochure stated as follows:

The annual rate of interest which [Hilltop] charges on your debit balance is determined by [Hilltop’s] cost of borrowing money and other factors. The rate is set at the discretion of [Hilltop] or your [introducing broker-dealer]. When your [introducing broker-dealer] sets the rate, you will receive an additional disclosure brochure from your [introducing broker-dealer].²

During the Relevant Period, Hilltop opened more than 12,000 margin accounts for introduced customers and more than 800 margin accounts for direct customers.

As the broker extending credit, Hilltop was responsible for assuring that the required disclosure was made. However, Hilltop’s Brochure did not provide the current base rate or explain the relationship of the base rate to any publicly available rate, and Hilltop did not otherwise assure that the current base rate (or an explanation of how the base rate was calculated) was given to customers seeking to open margin accounts. Hilltop also did not provide in its Brochure the mark-up/mark-down or introducing broker-dealer-specific mark-up, or otherwise assure that the mark-up/mark-down or introducing broker-dealer-specific mark-up was provided to customers.

² Hilltop also provided to its direct customers a customer information brochure stating that “[t]he annual rate of interest which [Hilltop] charges on your debit balance is determined by [Hilltop’s] cost of borrowing money and other factors. The rate is set at the discretion of [Hilltop] or your Financial Advisor. When your Financial Advisor sets the rate, you will receive an additional disclosure brochure from your Financial Advisor.”

Hilltop's supervisory system and written supervisory procedures were not reasonably designed to assure that each customer was provided, at the time of account opening, the rate or rates of margin interest that Hilltop could charge. Although Hilltop's supervisory system was designed to assure that customers be provided with the Brochure upon opening a margin account, Hilltop's supervisory system was not designed to assure that the Brochure included the interest rate disclosure required by SEC Rule 10b-16(a)(1). Further, although Hilltop's written supervisory procedures required that each customer, upon opening a margin account, be provided a margin disclosure document, the written supervisory procedures did not require that the disclosure document include the margin interest rate or rates that Hilltop could charge.

As a result of the foregoing conduct, Hilltop violated SEC Rule 10b-16(a)(1) and FINRA Rules 3110 (a) and (b) and 2010.

B. The Firm also consents to the imposition of the following sanctions:

- a censure;
- a \$250,000 fine; and
- within 90 days of Notice of Acceptance of this AWC, or such additional period as agreed to by a FINRA staff member in writing, a registered principal on behalf of Hilltop shall submit to Kevin Hartzell, Director, FINRA, at the address set forth below, a written certification that (i) Hilltop has completed a review of its systems and procedures regarding SEC Rule 10b-16(a)(1), and (ii) as of the date of the certification, the Firm's policies, systems and procedures are reasonably designed to achieve compliance with SEC Rule 10b-16(a)(1).

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

The Firm specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

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

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Firm further specifically and voluntarily waives any right to claim that a person violated the *ex parte* prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

The Firm understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against it; and

C. If accepted:

1. this AWC will become part of its permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
4. The Firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects its: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.**

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

Date 08/26/2019

Hilltop Securities, Inc., Respondent

By: _____

Name: Mike Cogliano

Title: Chief Compliance Officer

Accepted by FINRA:

September 23, 2019
Date

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



Kevin Hartzell
Director
FINRA Department of Enforcement
581 Main Street
Woodbridge, NJ 07095
Tel: (732) 596-2048
Fax: (301) 527-4874