

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2019062118301**

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

RE: Wedbush Securities Inc. (Respondent)
Member Firm
CRD No. 877

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

I.

ACCEPTANCE AND CONSENT

- A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

Wedbush has been a FINRA member since 1955. The firm is headquartered in Los Angeles, California and employs approximately 540 registered individuals in approximately 70 branch offices. The firm provides securities brokerage, wealth management, investment banking, and clearing services.¹

OVERVIEW

From January 2013 through December 2018, Wedbush negligently misrepresented on monthly account statements that it sent to approximately 610 customers that certain corporate and municipal bonds were making interest or principal payments when, in fact, the bonds were in default. As a result, Wedbush violated FINRA Rule 2010 and MSRB Rule G-17. Wedbush also violated FINRA Rules 4511 and 2010 and MSRB Rule G-8 by making inaccurate customer account statements. During the same period, Wedbush failed to establish and maintain a supervisory system reasonably designed to review the accuracy of information included on customer account statements in violation of NASD Rule 3010,² FINRA Rules 3110 and 2010, and MSRB Rule G-27.

¹ For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

² FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014.

In addition, from January 2010 through August 2020, Wedbush failed to deliver to a total of approximately 14,900 customers three types of annual notices and disclosures required by FINRA and SEC rules: (1) privacy notices required by SEC Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Personal Information; (2) order execution disclosures required by Rule 606 of Regulation NMS of the Securities Exchange Act of 1934; and (3) margin disclosures required by FINRA Rule 2264. By failing to deliver these notices, Wedbush violated Regulation S-P, Exchange Act Rule 606, and FINRA Rules 2264 and 2010. During the same period, Wedbush failed to establish, maintain, and enforce a supervisory system, including written supervisory procedures (WSPs), reasonably designed to achieve compliance with its obligation to deliver annual notices to customers, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.

FACTS AND VIOLATIVE CONDUCT

A. Wedbush negligently misrepresented the default status of bonds on customer account statements.

FINRA Rule 2010 requires “a member, in the conduct of its business, [to] observe high standards of commercial honor and just and equitable principles of trade.” Making a negligent misrepresentation of material fact or omitting material information in connection with business-related activities is a violation of FINRA Rule 2010.

FINRA Rule 4511 requires member firms to make and preserve “books and records as required under the FINRA rules, the Exchange Act and the applicable Exchange Act rules.” During the relevant period, NASD Rule 2340 required firms to send customer account statements not less than once every calendar quarter.³ Inherent in the requirement to make and preserve books and records is the requirement that information in those books and records be accurate. A violation of FINRA Rule 4511 is also a violation of FINRA Rule 2010.

MSRB Rule G-17 provides that “[i]n the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.” Providing inaccurate or misleading information to a customer violates MSRB Rule G-17. MSRB Rule G-8(a)(ix) requires municipal dealers to make and keep current and accurate books and records, including “notices sent to customers concerning debits and credits to customer accounts.”

As part of clearing services it provides to correspondent firms, Wedbush generates and distributes to customers monthly statements concerning securities positions held in the customers’ accounts. Such statements report, among other things, whether municipal bonds and corporate bonds held by the customers are making interest or principal payments, or whether the bonds have defaulted.

³ FINRA Rule 2231 superseded NASD Rule 2340 on May 8, 2019.

From January 2013 through December 2018, Wedbush generated and distributed more than 19,600 monthly account statements to approximately 610 customers that inaccurately represented that 38 municipal or corporate bonds held by customers were making interest or principal payments, when, in fact, the bonds were in default. In each instance, Wedbush received notice that the bonds in question were in default, but Wedbush did not provide such information to the vendor the firm used to maintain information about securities held by customers.⁴ As a result, when Wedbush used data from that vendor to generate monthly account statements, those statements did not reflect that the bonds in question were in default and, instead, misrepresented that the bonds were making interest or principal payments.

By making negligent misrepresentations, Wedbush violated FINRA Rule 2010 and MSRB Rule G-17. By making and preserving inaccurate account statements, Wedbush violated FINRA Rules 4511 and 2010 and MSRB Rule G-8.

B. Wedbush failed to establish and maintain a supervisory system reasonably designed to review the accuracy of account statements it sent to customers.

FINRA Rule 3110(a), like its predecessor, NASD Rule 3010(a), requires a member firm to establish and maintain a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. MSRB Rule G-27 similarly requires firms that sell municipal securities to establish and maintain a system reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable MSRB rules. The duty of supervision imposed by these rules includes the responsibility to investigate red flags that suggest misconduct may be occurring and to act upon the results of such investigation.

From January 2013 through December 2018, Wedbush did not reasonably review the accuracy of account statements it sent to customers. Although Wedbush received notice when bonds held by customers had defaulted, it did not have any system to verify that such information was reflected in the system the firm used to maintain information about securities held by customers. Wedbush also did not have a system to review account statements to determine whether they accurately reported the default status of bonds. Wedbush failed to develop such systems even though it was aware of red flags that it may have been reporting such information incorrectly. In September 2016, one of Wedbush's correspondent firms notified the firm that a bond position held by the correspondent firm's customers was in default and that the monthly account statements sent by Wedbush to those customers inaccurately stated that the customers were receiving interest payments for this position. Wedbush, however, did not at that time take steps to verify that the account statements it sent to customers accurately reported the default status of bonds. The firm continued to misreport such information on customer account statements until approximately December 2018, at which time the firm began to revise its procedures concerning the accurate reporting of the default status of bonds on account statements.

⁴ In many cases, customers received notices of default from a Wedbush vendor, but the defaults were not accurately reflected on account statements.

As a result, Wedbush violated NASD Rule 3010, FINRA Rules 3110 and 2010, and MSRB Rule G-27.

C. Wedbush failed to deliver required annual privacy notices, margin disclosures, and order execution disclosures.

From January 2010 through August 2020, Wedbush failed to deliver to customers three types of annual notices and disclosures required by FINRA and SEC rules: privacy notices required by Regulation S-P, order execution disclosures required by Exchange Act Rule 606, and margin disclosures required by FINRA Rule 2264.

- Regulation S-P requires that financial institutions, including broker-dealers, provide annual notice to customers about their privacy policies and practices. Such notices must, among other things, describe the conditions under which the financial institutions may disclose nonpublic personal information about customers to nonaffiliated third parties and provide an explanation of the customer's right to "opt out" of such disclosure.
- Exchange Act Rule 606 requires broker-dealers to make annual disclosures to customers about the availability on request of information relating to the firm's order routing practices for national market system (NMS) securities, including the identity of the venue to which the customer's orders were routed for execution in the six months prior to the request, whether the orders were directed orders or nondirected orders, and the time of the transactions, if any, that resulted from such orders.
- FINRA Rule 2264(b) requires that, at least annually, a firm deliver in paper or electronic form certain margin disclosures specified in the rule to all non-institutional customers with margin accounts. These disclosures alert customers to risks and procedures relating to trading securities on margin.

Violations of Regulation S-P, Exchange Act Rule 606, and FINRA Rule 2264, also are violations of FINRA Rule 2010.

From January 2010 through August 2020, Wedbush used a third-party vendor to provide monthly account statements to customers via mail or electronic delivery through the firm's online platform. Wedbush was responsible for providing the vendor with required notices and disclosures to include with the account statements delivered to customers. Wedbush, however, failed to instruct the vendor to append the required notices and disclosures to the account statements sent electronically to the firm's customers, and as a result, the firm failed to deliver more than 400,000 required privacy notices, order execution disclosures, and margin disclosures to approximately 14,900 customers.⁵

⁵ The notices were available on Wedbush's website.

As a result, Wedbush violated Regulation S-P, Exchange Act Rule 606, and FINRA Rules 2264 and 2010.

D. Wedbush did not have a supervisory system reasonably designed to achieve compliance with its obligation to deliver annual privacy notices, order execution disclosures, and margin disclosures.

As noted above, NASD Rule 3010(a) and FINRA Rule 3110(a) require a member firm to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. NASD Rule 3010(b) and FINRA Rule 3110(b) require a member firm to establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.

From January 2010 through August 2020, Wedbush's WSPs required the firm to deliver the privacy notices, order execution disclosures, and margin disclosures described above to customers on an annual basis. However, Wedbush did not have any system to verify that such notices were sent to customers who elected to receive materials from the firm via its online platform. Instead, Wedbush relied on its vendor to deliver these required annual notices and disclosures to customers, but the firm did not take any steps to verify that its vendor had appended the required notices and disclosures to the account statements sent electronically to customers.

In August 2020, Wedbush identified that customers had not been receiving the required notices and disclosures, implemented changes in its delivery process, and self-reported the issue to FINRA. Subsequently, Wedbush revised its policies to require firm personnel to validate that the required annual notices and disclosures had been delivered to customers.

As a result of the foregoing, Wedbush violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

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

- a censure;
- a \$850,000 fine (\$300,000 of which pertains to the violations of MSRB Rules G-8, G-17 and G-27); and
- an undertaking that within 90 days of the effective date of the AWC, a registered principal of Wedbush shall certify in writing to Noel Downey, Senior Counsel, FINRA Department of Enforcement, 581 Main Street, Suite 710, Woodbridge, NJ 07095 (noel.downey@finra.org), that the firm's written supervisory procedures and supervisory system are reasonably designed to review the accuracy of account statements sent to customers and to achieve compliance with its obligation to

deliver to customers annual privacy notices, margin disclosures, and order execution disclosures.

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

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

II.

WAIVER OF PROCEDURAL RIGHTS

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

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

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

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

III.

OTHER MATTERS

Respondent understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and
 - 4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.
- D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this statement. This statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to the AWC's

provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

October 19, 2022

Date

Andrew Druch

Wedbush Securities Inc.
Respondent

Print Name: Andrew Druch

Title: General Counsel

Reviewed by:

John L. Erikson, Jr., Esq.
John L. Erikson, Jr., Esq.
Counsel for Respondent
Wedbush Securities Inc.
1000 Wilshire Blvd
Los Angeles, CA 90017

Accepted by FINRA:

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

November 3, 2022

Date

Noel Downey

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