

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2020066627201**

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

RE: First Manhattan Co. (Respondent)
Member Firm
CRD No. 1845

Pursuant to FINRA Rule 9216, Respondent First Manhattan Co. 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

First Manhattan Co. has been a FINRA member since 1955.¹ The firm conducts a general securities business. It currently has 96 registered representatives and two branch offices located in New York, New York, and Greenwich, Connecticut.²

OVERVIEW

From January 2012 through May 2020, First Manhattan failed to establish and maintain a supervisory system, and failed to establish, maintain, and enforce written procedures, reasonably designed to achieve compliance with Section 5 of the Securities Act of 1933, in violation of FINRA Rules 3110 and 2010. The firm also failed to establish and implement anti-money laundering (AML) policies and procedures reasonably expected to detect and cause the reporting of suspicious activity, in violation of FINRA Rules 3310(a) and 2010.

FACTS AND VIOLATIVE CONDUCT

This matter originated from a FINRA cause investigation concerning a June 5, 2020 Uniform Termination Notice for Securities Industry Registration (Form U5) filing stating

¹ First Manhattan was founded in 1964, at which time it took over a FINRA registration effective from 1955.

² For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

that First Manhattan had discharged Principal A because of a “[l]oss of trust and confidence regarding [her] compliance responsibilities....”

During the relevant period, First Manhattan’s business focused on advisory accounts for high-net-worth individuals and family offices. Although First Manhattan allowed its customers to transact in microcap securities, revenue generated from its microcap business represented less than 1% of the firm’s total revenue. The customer at the firm who transacted most frequently in microcap securities, Customer A, was an immediate family member of Principal A. At all relevant times, Principal A had primary responsibility for First Manhattan’s compliance with Section 5 of the Securities Act and, beginning in January 2018, also acted as the firm’s AML compliance officer with responsibility for the firm’s compliance with the Bank Secrecy Act (BSA). Principal A also was the registered representative for Customer A’s accounts at the firm.

First Manhattan failed to establish and maintain a supervisory system, and failed to establish, maintain, and enforce written procedures, reasonably designed to achieve compliance with Section 5 of the Securities Act.

FINRA Rule 3110(a) requires members 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.” FINRA Rule 3110(b) requires members to “establish, maintain, and enforce written procedures to supervise the types of business in which [they] engage[] and the activities of [their] associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules.” A violation of FINRA Rule 3110 also is a violation of FINRA Rule 2010, which requires member firms to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

The Securities Act prohibits the offer or sale of any security unless there is a registration statement in effect as to that security or there is an exemption or safe harbor available for that securities transaction. In January 2009, FINRA issued Regulatory Notice (RN) 09-05, which reminded firms that prior to selling any securities in reliance on an exemption, the firm must “take reasonable steps to ensure that the transaction qualifies for the exemption. . . . This includes taking whatever steps necessary to ensure that the sale does not involve an issuer, a person in a control relationship with an issuer, or an underwriter with a view to offer or sell the securities in connection with an unregistered distribution.” RN 09-05 instructed firms that they “must have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities.” In addition, RN 09-05 cautioned that firms should recognize, and take action to address, red flags of improper unregistered distributions of securities, including when an issuer has been through several recent name changes, business combinations, or recapitalizations or when a customer has a pattern of depositing physical share certificates, immediately selling the shares, and then wiring out the proceeds.

First Manhattan's written supervisory procedures (WSPs) were not reasonably designed to avoid becoming a participant in the potential unregistered distribution of securities. Although the firm's WSPs mentioned control or restricted securities and the use of the safe harbor set forth in Securities Act Rule 144 (17 C.F.R. § 230.144), they did not include procedures regarding how to conduct a searching inquiry to determine whether a transaction complied with the registration requirements of Section 5. Instead, First Manhattan's WSPs only stated that Principal A should be consulted for assistance. Moreover, even though the firm, in practice, used a "pre-clearance form" in connection with its Section 5 reviews, the WSPs failed to even mention the pre-clearance form.

First Manhattan's system for compliance with Section 5 relied entirely on a pre-clearance form, which representatives at the firm were required to complete "prior to the deposit or sale/transfer" of microcap shares. The pre-clearance form required the representative to provide certain information relevant to making a determination pursuant to Rule 144. The pre-clearance form, however, did not provide any guidance about what documentation the representative should review prior to the deposit or sale of any microcap security to verify the information set forth on the pre-clearance form. First Manhattan also did not have any process for ensuring that representatives completed the pre-clearance form, and as a result, from January 2012 through May 2020, First Manhattan accepted deposits of microcap securities without first having received a completed pre-clearance form from the customer's registered representative.

For example, from May 2015 through May 2020, Customer A made 55 deposits of microcap securities, many of which involved issuers that had recently changed their names and lines of business. Frequently, Customer A deposited physical share certificates, sold the shares within days or weeks, and then immediately wired out the proceeds. Those red flags notwithstanding, First Manhattan accepted 25 of Customer A's 55 deposits even though no pre-clearance form had been completed and, therefore, the firm had no information to determine whether the securities were registered or exempt from registration. With respect to the remaining 30 deposits, although Principal A ostensibly submitted a pre-clearance form for each of those deposits to the firm, those forms were incomplete, lacking, among other things, specific details about Customer A's acquisition of the shares and Customer A's relationship, if any, to the issuer. The firm therefore lacked sufficient information to determine whether the transactions complied with Section 5.³

Therefore, Respondent violated FINRA Rules 3110 and 2010.

First Manhattan failed to establish and implement an AML program reasonably expected to detect and cause the reporting of suspicious transactions in microcap securities.

FINRA Rule 3310 requires that each member firm develop and implement a written AML program reasonably designed to achieve and monitor the member's compliance

³ First Manhattan terminated Principal A's employment in May 2020 and has since changed its WSPs and supervisory system pertaining to compliance with Section 5.

with the requirements of the BSA (31 U.S.C. 5311, *et seq.*) and its implementing regulations promulgated by the Department of the Treasury. FINRA Rule 3310(a) further requires that each firm “[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under [the BSA] and the implementing regulations.” The regulations implementing the BSA, in turn, require broker-dealers to file with the Financial Crimes Enforcement Network “a report of any suspicious transaction relevant to a possible violation of law or regulation.”⁴ A violation of FINRA Rule 3310 also is a violation of FINRA Rule 2010.

NASD Notice to Members (NTM) 02-21 provided detailed guidance to member firms about their obligation to monitor for and report suspicious transactions. The Notice reminded firms of their duty to look for red flags suggestive of money laundering or other violative activity, and it provided a non-exhaustive list of such red flags. The Notice also reminded firms that “the obligation to develop and implement an AML compliance program is not a ‘one-size-fits-all’ requirement ... [and] each financial institution should ... tailor its AML program to fit its business.” In May 2019, FINRA published Regulatory Notice (RN) 19-18, which reminded firms of their suspicious activity monitoring and reporting obligations and which updated the list of red flags provided in NTM 02-21. The red flags identified in RN 19-18 include the following:

- The customer “has a pattern of depositing physical share certificates ... immediately selling the shares and then wiring, or otherwise transferring out the proceeds of the sale(s)”;
- “The customer’s activity represents a significant proportion of the daily trading volume in a thinly traded or low-priced security”; and
- “A customer deposits into an account physical share certificates ... that ... were issued by a company that has no apparent business, revenues, or products ... [or] ... has been through several recent name changes or business combinations or recapitalizations”.

RN 19-18 further explained that “[u]pon detection of red flags through monitoring, firms should consider whether additional investigation, customer due diligence measures or a SAR [suspicious activity report] filing may be warranted.”

First Manhattan’s AML procedures did not provide guidance about how to identify or address red flags of suspicious trading in microcap securities. The procedures did not include a list of red flags identified in NTM 02-21 or RN 19-18 that was tailored to fit First Manhattan’s business. The firm’s procedures also failed to require that the firm monitor, for AML purposes, information collected during the firm’s pre-clearance process for microcap securities. Therefore, even when customers deposited and quickly liquidated and wired out the proceeds of microcap securities, activity identified as a red flag in RN 19-18, the firm’s procedures did not require the firm to review those transactions for potential BSA reporting.

⁴ 31 C.F.R. § 1023.320.

Additionally, First Manhattan did not have a reasonable system to identify suspicious trading in microcap securities. The firm's exclusive method for doing so was through the use of an exception report that only surveilled transactions of 50 million shares or more. As nearly all of the firm's customers' microcap activity involved fewer than 50 million shares per transaction, this exception report was not tailored to the firm's business. As a result, on more than 150 occasions during the relevant period, a small number of firm customers deposited fewer than 50 million shares of microcap securities, liquidated some or all of the securities, and withdrew the funds shortly thereafter—without the firm detecting or investigating that activity.

As noted in the prior section, Customer A deposited large blocks of microcap securities (but never 50 million shares or more) on 55 separate occasions from May 2015 through May 2020. Often, Customer A liquidated the position shortly after deposit and then wired out the proceeds. Many of Customer A's transactions raised other red flags of money laundering or market manipulation, such as involving issuers with limited or no revenues or frequent name or business line changes. Moreover, on many occasions, Customer A's transactions comprised a significant proportion (or all) of the daily trading volume in the security, and, often, Customer A's sales were the initial public sales of the security. Because of the 50-million-share threshold for the firm's microcap trading exception report, Customer A's activity never appeared on the report and thus was never investigated by the firm as suspicious.⁵

Therefore, First Manhattan violated FINRA Rules 3310(a) and 2010.

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

- a censure;
- a \$250,000 fine; and
- an undertaking that within 90 days of notice that this AWC has been accepted, a registered principal of First Manhattan shall certify in writing to Amanda Fein, Principal Counsel, FINRA Department of Enforcement, 99 High Street, 9th Floor, Boston, MA 02110 (amanda.fein@finra.org), that: (1) the firm's written supervisory procedures and supervisory system are reasonably designed to achieve compliance with Section 5 of the Securities Act of 1933; and (2) the firm has established and implemented policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under the Bank Secrecy Act (31 U.S.C. 5311, *et seq.*) and the implementing regulations thereunder.

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

⁵ First Manhattan has changed its AML policies and procedures since terminating Principal A's employment in May 2020.

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:

- [REDACTED]
- 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.

January 28, 2022

Date

Andrew Aspen

First Manhattan Co.
Respondent

Print Name: Andrew Aspen

Title: Chief Legal officer

Reviewed by:

Michael Leotta

Michael J. Leotta, Esq.
Brenda E. Lee, Esq.
Counsel for Respondent
WilmerHale
1875 Pennsylvania Ave.
Washington, DC 20006

Accepted by FINRA:

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

Amanda Fein

February 11, 2022

Date

Amanda E. Fein
Principal Counsel
FINRA
Department of Enforcement
99 High St., 9th Floor
Boston, MA 02110