

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72340 / June 6, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3845 / June 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15913

In the Matter of

**Wedbush Securities Inc.,
Jeffrey Bell, and Christina
Fillhart,**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT
OF 1934 AND SECTION 203(e) OF THE
INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”) against Wedbush Securities Inc. (“Wedbush”), Jeffrey Bell (“Bell”), and Christina Fillhart (“Fillhart”) (collectively “Respondents”).

II.

After an investigation, the Division of Enforcement alleges that:

Summary

1. These proceedings involve the market access business of Wedbush, one of the largest volume market access providers in the United States. From July 2011 until at least January 2013 (the “relevant period”), Wedbush served as the gateway to U.S. markets for dozens of trading firms, including foreign, domestic, registered, and unregistered firms, as well as thousands of their traders. Most of these firms and their traders engaged in trading activity that did not flow through any Wedbush systems before reaching exchanges and other trading venues in the U.S.

2. During the relevant period, Wedbush failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the risks associated with its market access business, as required by Exchange Act Rule 15c3-5 (the

“Market Access Rule” or “Rule”).¹ Violations of the Market Access Rule pose significant risks to the orderly functioning of the U.S. securities markets. Wedbush allowed thousands of essentially anonymous foreign traders to send orders directly to U.S. trading venues to trade billions of shares every month. Wedbush enjoyed increased trading commissions and fees generated by its high-volume market access customers from its risky market access business.

3. As alleged below, Wedbush failed to adopt and implement risk management controls that were reasonably designed to ensure compliance with applicable regulatory requirements—such as those for preventing naked short sales, wash trades, manipulative layering and money laundering. Wedbush’s failure to adopt and implement such controls came after communications by the Commission’s staff through an examination deficiency letter and in face-to-face meetings regarding Wedbush’s compliance procedures whereby the staff informed Wedbush of compliance shortcomings and significant compliance concerns, particularly the access provided to unknown overseas traders. By nonetheless failing to adopt and implement the necessary risk management controls, Wedbush willfully violated the Market Access Rule, while Bell and Fillhart caused Wedbush’s violation of the Rule by virtue of their responsibilities at the firm and their participation in communications with the Commission’s staff.

4. Wedbush’s lack of reasonably-designed market access controls and procedures resulted in Wedbush violating other regulatory requirements, including Regulations SHO and NMS. Wedbush also failed to preserve certain written communications with customers pertaining to its business as required by Exchange Act Rule 17a-4, including communications containing trading instructions relating to brokerage orders submitted directly by Wedbush’s market access customers. In connection with its market access business, Wedbush also failed to file suspicious activity reports pursuant to anti-money laundering (“AML”) requirements in violation of Exchange Act Rule 17a-8.

Respondents

5. Wedbush Securities Inc. is a California corporation with its headquarters in Los Angeles, California. The firm was founded in 1955 and registered with the Commission as a broker-dealer in 1966 and as an investment adviser in 1970. Wedbush is a wholly-owned subsidiary of Wedbush, Inc., a privately-held company. As of December 31, 2012, Wedbush had 79 branch offices and 844 employees. During the relevant period, Wedbush was consistently ranked as one of the five largest firms by trading volume on NASDAQ.

6. During the relevant period, Jeffrey Bell was Executive Vice President of the Correspondent Services Division of Wedbush, reporting to the firm’s President, and was an associated person of Wedbush. Bell also was a member of Wedbush’s Board of Directors and President of Lime Brokerage LLC (“Lime”), another wholly-owned subsidiary of Wedbush, Inc. Bell, age 39, is a resident of Hermosa Beach, California, and holds Series 7 and 24 licenses.

7. During the relevant period, Christina Fillhart was a Senior Vice President in the Correspondent Services Division of Wedbush and was an associated person of Wedbush. Fillhart reported to Bell until late 2012, when she began reporting to one of Wedbush’s Co-Chief Compliance Officers. Fillhart, age 55, is a resident of Covina, California, and holds Series 7, 24, 27, 53, and 63 licenses.

¹ 17 C.F.R. § 240.15c3-5.

The Market Access Rule

8. The Commission adopted the Market Access Rule in November 2010 to require that broker-dealers with market access “appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.” *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (Final Rule Release).

9. Section (b) of the Market Access Rule requires a broker-dealer with market access, or that provides a customer or any other person with access to an exchange through the use of its market participant identifier (“MPID”) or otherwise, to “establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks” of its market access business.

10. Section (c) of the Market Access Rule identifies specific required elements of a broker-dealer’s system of risk management controls and supervisory procedures relating to market access. Subsection (c)(1) addresses financial controls and procedures and subsection (c)(2) addresses regulatory controls and procedures. Under subsection (c)(2), a broker-dealer must have controls and procedures that are reasonably designed to ensure compliance with all regulatory requirements, including controls to prevent the entry of orders that do not comply with all regulatory requirements that must be satisfied on a pre-order entry basis and controls to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker-dealer with market access.

11. Section (d) of the Market Access Rule requires the risk management controls and supervisory procedures to be under the “direct and exclusive control” of the broker-dealer with market access. Subsection (d)(1) contains an exception to the direct and exclusive control requirement that applies when a broker-dealer with market access reasonably allocates, by written contract, after a thorough due diligence review, control over specific regulatory risk management controls and supervisory procedures to a broker-dealer customer who is registered with an exchange in the United States where the broker or dealer with market access has a reasonable basis for determining that such broker-dealer customer, based on its position in the transaction and relationship with an ultimate customer, has better access to the ultimate customer and its trading information such that it can more effectively implement the specified controls or procedures.

12. Section (e) of the Market Access Rule requires a broker-dealer with market access to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access. Subsection (e)(1) requires the broker-dealer to conduct and document a review of its market access business at least annually in accordance with written procedures, and subsection (e)(2) requires the CEO to certify annually that the broker-dealer conducted the review and is in compliance with the Rule.

Wedbush’s Market Access Business

13. The market access business at Wedbush is part of the Correspondent Services Division, which originally handled only traditional clearing operations for introducing broker-dealers, otherwise known as “correspondent” firms. Wedbush began providing “sponsored” market access to customer firms in 2004, which allowed customer firms and their traders to send orders that

bypassed Wedbush's trading systems and were routed directly to exchanges and other trading venues under a Wedbush MPID. Sponsored access customers were able to send orders that bypassed Wedbush's systems by using online trading platforms or software programs that the customer either owned directly or leased from a third-party platform provider, referred to as a service bureau.

14. During the relevant period, Wedbush had about 50 sponsored access customers that generated average monthly trading volume of 30 billion shares. Several of Wedbush's sponsored access customer firms had more than 1,000 authorized traders each, and one had more than 10,000 traders. Wedbush's correspondent services business was the most profitable operation of Wedbush, Inc. Bell and Fillhart each received bonus compensation based on the profitability of the Correspondent Services Division, which depended largely on the trading volumes of Wedbush's market access customers. During the relevant period, Bell received salary of \$344,000 and bonus compensation of \$310,000 and Fillhart received salary of \$150,000 and bonus compensation of \$105,000.

15. In June 2011, Wedbush acquired Lime Brokerage LLC, a provider of trading technology platforms. After Wedbush acquired Lime, about 20% of Wedbush's sponsored access customers began using the Lime platform. The other 80% continued to use sponsored access either through their own proprietary trading platform or through a third-party platform that the customer leased from a service bureau. As a result, during the relevant period, the vast majority of orders from Wedbush's sponsored access customers did not flow through Wedbush's own risk management systems.

16. Wedbush's primary risk management controls and supervisory procedures relating to market access were described in Chapter 31 of the firm's written supervisory procedures ("WSPs"), titled "Sponsored Access." On July 14, 2011, the day most provisions of the Market Access Rule took effect, Wedbush updated Chapter 31 to cite certain provisions of the Rule.

17. Bell and Fillhart, along with one other senior Wedbush employee in the Correspondent Services Division, had the primary responsibility for preparing and adopting Wedbush's controls and procedures relating to market access. Bell and Fillhart had authority to adopt and revise the firm's controls and procedures relating to market access, including the WSPs, without approval of Wedbush's President or Co-Chief Compliance Officers.

Wedbush Knew Of Compliance Issues For Its Sponsored Access Trading

18. Prior to the effective date of Rule 15c3-5, Wedbush received a number of indications that its sponsored access trading business posed particular regulatory and compliance risks. In 2009 and 2010, just before the relevant period, two of Wedbush's sponsored access customer firms extended their market access to a Latvian trader who used that access to conduct profitable trading as part of a widespread account intrusion and market manipulation scheme. The Commission obtained a judgment by default against the Latvian trader in connection with the scheme after learning the trader's identity from Fillhart in 2011. *See SEC v. Nagaicevs*, N.D. Cal. Case No. 12-CV-00413-JST (Order Granting Motion for Default Judgment, dated July 12, 2013; Order of Judgment and Equitable and Other Relief Against Defendant Igors Nagaicevs, dated July 18, 2013).

19. The Commission also imposed cease-and-desist orders, civil monetary penalties, and other relief against one of the Wedbush customer firms for acting as an unregistered broker in

extending market access to the Latvian trader, and also obtained relief against the firm's principals. *See In the Matter of KM Capital Management, LLC, et al.*, Admin. Proc. File No. 3-14720 (Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Yisroel M. Wachs, dated Sept. 19, 2012; Initial Decision as to KM Capital Management, LLC and Joshua A. Klein, dated Nov. 28, 2012; Notice that Initial Decision Has Become Final, dated Oct. 17, 2013).

20. Wedbush was well aware of the requirements, objectives, and importance of Rule 15c3-5. During the public comment period for the then-proposed Rule 15c3-5, Bell submitted a comment letter to the Commission on behalf of Wedbush on February 23, 2009. Although proposing certain changes to the proposed Rule, Bell and Wedbush stated that sponsoring non-broker-dealer customers "requires the highest level of due diligence, oversight and controls. In this case, the sponsoring member is also the broker-dealer of record and would be accountable for all the responsibilities as such." Despite this acknowledgement, one of Wedbush's largest sponsored access customers was not a broker-dealer registered in the United States, and Wedbush failed to engage in the "highest level of due diligence, oversight and controls."

21. On May 17, 2011, Commission staff from the Office of Compliance Inspections and Examinations ("OCIE") sent an Examination Deficiency Letter addressed to Bell on behalf of Wedbush. That letter advised Wedbush that the staff had identified deficient Wedbush controls relating to short sales, in violation of Regulation SHO, due in part to an excessive reliance upon a non-broker-dealer sponsored access client to locate shares before placing a short sale order. The Deficiency Letter also identified problems with internal controls over a third-party order management system. The Letter also stated that Wedbush had failed to respond promptly to compliance issues when they arose and there were weaknesses in its anti-money-laundering controls. This letter put Wedbush on notice that it was relying on inadequate regulatory controls that were outside of its direct and exclusive control.

22. On July 5, 2011, Wedbush representatives, including Bell and Fillhart, met with representatives of OCIE to discuss the impending effectiveness of the final Rule 15c3-5. During that meeting, the Commission's staff expressed concerns about Wedbush's largest sponsored non-broker-dealer client and the need to identify the ultimate traders. Wedbush's presentation to the staff cited the Market Access Rule requirements relating to allocating compliance responsibilities to the sponsored access client and maintaining "direct and exclusive control" of risk settings in customer trading platforms.

Market Access Through Third-Party Trading Platforms

23. Section (d) of the Market Access Rule requires Wedbush to maintain exclusive control over the risk settings in the trading platforms that its customers use to access the markets, including both Wedbush's own Lime platform and the non-Wedbush trading platforms that 80% of Wedbush's customers used. As described below, for many customers that used non-Wedbush trading platforms, Wedbush's control was not exclusive because it allowed customers to have access to determine and make changes to risk settings in the trading platforms.

24. Wedbush did not directly set or monitor regulatory risk settings in the third-party or client-proprietary trading platforms that 80% of Wedbush's customers used. Customers had access to set and revise the risk settings, and could disable risk settings intended to prevent violations of specific regulatory requirements, such as illegal short sales, wash trades, and violations of

Regulation NMS. In addition to Wedbush not having exclusive control over the settings, Wedbush's customers, rather than Wedbush, leased the trading platforms from third parties and Wedbush had no contractual relationship with the platform providers.

25. Wedbush employees in the Correspondent Services Division received access from platform providers to view risk settings and trading activity in the platforms, but Bell and Fillhart knew that Wedbush did not have exclusive control over the settings.

26. Shortly before most provisions of the Market Access Rule took effect, Wedbush obtained email statements from many of the trading platform providers that the risk management settings in the platforms were under the direct and exclusive control of Wedbush. In reality, Wedbush did not have exclusive control of the risk management settings because Wedbush continued allowing sponsored access customers to determine and make changes to the risk settings in the platforms, and Wedbush had no contractual relationship with the platform providers. These statements also were not part of any legally enforceable contract; Wedbush had no contractual relationship with the platform providers.

27. Wedbush's WSPs stated that each new sponsored access customer would perform an initial "risk demonstration" to show Wedbush the customer's trading platform settings for certain financial and regulatory risk controls. Wedbush had a checklist for the risk demonstration that included settings to prevent clearly erroneous trades, wash trades, illegal short sales,² and, unless authorized by Wedbush, intermarket sweep orders ("ISOs").³ That Wedbush needed the customer to show the settings to Wedbush demonstrates that Wedbush did not have "direct and exclusive control" over the risk settings in the platforms, as required by Rule 15c3-5(d).

28. In June 2012, platform providers, rather than sponsored access customers, began providing Wedbush initial demonstrations of risk settings in their trading platforms. During a demonstration, the provider would submit test orders and confirm that certain risk settings were in place at the time of the demonstration.

29. Wedbush did not receive demonstrations of the actual risk settings in effect for particular sponsored access customers, and Wedbush did not have any physical ability to prevent customers from subsequently changing the settings shown during the platform provider's initial demonstration. Wedbush also did not maintain records of the risk settings in the platforms so that it could determine whether any settings had been changed without its consent.

² Rule 203(b)(1) of Regulation SHO prohibits broker-dealers from accepting or effecting a short sale order unless the broker-dealer has borrowed the security or entered into an arrangement to borrow the security, or has reasonable grounds to believe that the security can be timely borrowed, and has documented its compliance with Rule 203(b)(1).

³ Rule 611(c) of Regulation NMS requires the broker-dealer responsible for routing an ISO to take reasonable steps to establish that the order meets the requirements of Rule 600(b)(30) of Regulation NMS, which requires the broker-dealer routing the ISO to route simultaneously additional orders, as necessary, to execute against the full size of all better-priced protected quotations.

30. Customers could, and sometimes did, change the risk settings without Wedbush's knowledge or consent. For example, as discussed below, Fillhart learned that a customer repeatedly disabled a risk setting to prevent wash trades, and that on numerous occasions a risk setting to prevent illegal short sales failed to prevent violations of Regulation SHO because the wrong list of securities that were easy to borrow was loaded into the customer's third-party trading platform. Fillhart also learned that a customer repeatedly circumvented a risk setting that was designed to prevent the use of ISOs.

Attempts to Allocate Responsibility for Regulatory Controls and Procedures

31. The Final Rule Release for the Market Access Rule stated that Section 15c3-5(d) "is designed to eliminate the practice . . . whereby the broker-dealer providing market access relies on its customer, a third party service provider, or others, to establish and maintain the applicable risk controls." *See* 75 Fed. Reg. at 69804. The Final Rule Release further cautioned that "the Commission continues to be concerned about circumstances where broker-dealers providing market access simply rely on assurances from their customers that appropriate risk controls are in place. . . . Accordingly, the Commission emphasizes that in any permitted allocation arrangement, the broker-dealer providing market access may not merely rely on another broker-dealer's attestation that it has implemented appropriate controls or procedures." *Id.* at 69808.

32. After the Market Access Rule took effect, Wedbush simply relied on attestations in the exact manner that the Final Rule Release said was improper. Wedbush attempted to assign to other broker-dealers the responsibility for regulatory risk management controls and supervisory procedures for many of its sponsored access customers. Wedbush employees documented purported agreements to assign responsibilities to other broker-dealers, but as described below, despite the plain language of Rule 15c3-5(d) and the staff's statements on July 5, 2011, Wedbush failed to conduct the required "thorough due diligence review" when purporting to allocate responsibility to another broker-dealer and continued to simply rely on the other broker-dealer's attestation that it had implemented appropriate controls and procedures.

33. For some customers, Wedbush entered into an allocation agreement with a registered introducing broker-dealer. For other customers, Wedbush entered into an allocation agreement directly with the sponsored access customer itself, if it was a registered broker-dealer trading its own capital on a proprietary basis. Some of these sponsored access customers used trading platforms that they themselves owned, either directly or through a corporate affiliate that they controlled. As a result, Wedbush often relied on a broker-dealer customer to monitor its own trading.

34. All of Wedbush's purported allocation agreements were based on the same form, which Bell approved. The agreements did not specify any particular controls or procedures that Wedbush purported to be allocating. Even though Wedbush, as the party with market access, purportedly was attempting to allocate responsibility for controls or procedures to another broker-dealer, the agreements mistakenly stated that the other broker-dealer, rather than Wedbush, had "allocatable regulatory responsibilities as defined within SEC Rule 15c3-5." As a result, it was not even clear from the documents themselves from and to which broker-dealer the controls or procedures purportedly were being allocated.

35. Bell knew that Wedbush did not conduct the required due diligence reviews of the other broker-dealers in connection with its attempts to allocate responsibilities for market access

controls and procedures, and that Wedbush also did not conduct later reviews to determine whether the other broker-dealers were adequately carrying out the responsibilities purportedly allocated. The agreements simply contained a statement by the introducing broker-dealer or registered customer firm that its regulatory risk management controls and supervisory procedures were reasonably designed to ensure compliance with all regulatory requirements.

36. Better access to the ultimate customer was discussed in the Final Rule Release as the reason why control over certain regulatory controls could be allocated after due diligence. Yet Wedbush did not have any policies or procedures for determining whether a broker-dealer to which it claimed to have assigned responsibilities had better access than Wedbush to ultimate customers such that the other broker-dealer could more effectively implement the risk management controls and supervisory procedures relating to market access.

Regulatory Requirements That Must Be Satisfied On a Pre-Order Entry Basis

37. Subsection (c)(2)(i) of the Market Access Rule required Wedbush to have risk management controls and supervisory procedures that were reasonably designed to prevent the entry of orders that do not comply with all regulatory requirements that must be satisfied on a pre-order entry basis. The Final Rule Release for the Market Access Rule specifically identified Regulations SHO and NMS as examples of regulatory requirements that must be satisfied on a pre-order entry basis, and with which a broker-dealer's controls and procedures must ensure compliance. *See* 75 Fed. Reg. at 69803. As described below, Wedbush's risk management controls and supervisory procedures were not reasonably designed to satisfy these pre-trade regulatory requirements and, in fact, did not prevent Wedbush customers from entering numerous orders that violated Regulations SHO and NMS.

38. Wedbush was responsible for ensuring that all short-sale orders submitted by its sponsored access customers complied with Regulation SHO. Among other things, Regulation SHO required Wedbush, prior to accepting or effecting a short sale order, to borrow the security or enter into an agreement to borrow the security, or have reasonable grounds to believe that the security could be timely borrowed (generally known as the "locate" requirement). Absent countervailing factors, "easy-to-borrow" lists may provide "reasonable grounds" for a broker-dealer to believe that the security sold short is available for borrowing without directly contacting the source of the borrowed securities (known as "easy-to-borrow securities"). Thus, for instance, if a broker-dealer seeking to rely on the list knows or should know that there are concerns regarding the list, it would not be reasonable for the broker-dealer to rely on the list. As an example, the Commission has stated that repeated failures to deliver in securities included on an "easy-to-borrow" list would indicate that the broker-dealer's reliance on such a list did not satisfy the "reasonable grounds" standard of Rule 203. *See Short Sales*, 69 Fed. Reg. 48008, 48014 (Aug. 6, 2004).

39. Wedbush's WSPs stated that the firm sometimes relied on sponsored access customers to meet the short-sale requirements of Regulation SHO. Wedbush maintained a list of easy-to-borrow securities, but Wedbush relied on sponsored access customers or their platform providers to load that list into third-party trading platforms rather than taking direct steps to make sure that customers were using the correct list. Maintaining up-to-date lists in the trading platforms was a key step in the control process because the platforms relied on the lists to determine whether Regulation SHO had been satisfied before routing a short-sale order for execution.

40. Wedbush's procedures asserted that Wedbush allowed customers to submit short-sale orders for securities on the easy-to-borrow list and that it required customers to otherwise locate shares to borrow before submitting short-sale orders for securities not on the easy-to-borrow list. However, Wedbush had no controls or procedures to verify that a security for which a customer submitted a short-sale order was in fact easy-to-borrow at the time the customer submitted the order.

41. On three occasions between July 2011 and November 2012, Fillhart learned that a customer or platform provider loaded the wrong easy-to-borrow list, which resulted in Wedbush customers submitting short-sale orders for securities that were not easy to borrow without first otherwise locating shares to borrow as required by Regulation SHO. Bell and Fillhart knew that similar incidents had occurred numerous times before July 2011, based on the May 2011 OCIE Deficiency Letter and face-to-face meetings that Bell and Fillhart attended with Commission staff. The incidents demonstrated that Wedbush did not have "direct and exclusive control" over these risk settings in the trading platforms as required by Rule 15c3-5(d) and did not have controls reasonably designed to ensure compliance with all regulatory requirements that must be satisfied on a pre-order entry basis.

42. Wedbush was responsible for ensuring that all orders marked as ISOs by its sponsored access customers complied with Regulation NMS, which requires the broker-dealer responsible for routing an ISO to route simultaneously additional orders, as necessary, to execute against the full size of all better-priced protected quotations. Sending the simultaneous orders to sweep the market of better-priced protected quotations is essential to ensuring that the ISO order type is not misused and that other market participants willing to trade at more favorable prices do not have their orders bypassed.

43. Wedbush's WSPs asserted that in order to comply with Regulation NMS, Wedbush did not permit a customer to use ISOs unless the customer swept the market of all better-priced protected quotations. However, Wedbush did not have any controls or procedures reasonably designed to ensure that its customers complied with this regulatory requirement.

44. As a result of Wedbush's lack of "direct and exclusive control" over risk settings designed to ensure ISO compliance, and its failure to have controls and procedures reasonably designed to ensure compliance with the ISO requirements of Regulation NMS, at least one Wedbush customer submitted ISOs without Wedbush's prior knowledge and without a broker-dealer acting to ensure compliance with the relevant regulatory requirements. In April 2011, Fillhart learned from an exchange that one of Wedbush's largest sponsored access customers was submitting ISOs even though Wedbush did not authorize the customer to submit ISOs and even though Wedbush had not allocated responsibility to another registered broker-dealer to ensure that ISOs submitted by the customer complied with Regulation NMS. Without Wedbush's knowledge, the customer and its third-party platform provider had enabled an order route that was configured to allow ISOs, even though the platform provider had previously informed Wedbush that the customer was not able to submit ISOs. This also demonstrated that it was unreasonable for Wedbush to rely on the written attestations that it received from the platform providers, as described above.

45. Because Wedbush had not authorized the customer to submit ISOs, Wedbush had not taken any steps to ensure that the ISOs complied with Regulation NMS. Fillhart instructed the platform provider to close the ISO route, but she did not directly close or disable the route and she knew that Wedbush did not have any controls or procedures to prevent a similar route from being enabled again in the future.

46. In November 2011, Fillhart learned that the same customer had again enabled an ISO route in its trading platform and submitted ISOs without Wedbush's knowledge. As in April 2011, Wedbush had not taken any steps to ensure that the ISOs complied with Regulation NMS because Wedbush had not authorized the customer to submit ISOs. These incidents demonstrate that Wedbush did not have "direct and exclusive control" over these risk settings as required by Rule 15c3-5(d), and did not have controls reasonably designed to ensure compliance with all regulatory requirements that must be satisfied on a pre-order entry basis.

Other Regulatory Requirements

47. Subsection (c)(2) of the Market Access Rule required Wedbush to have risk management controls and supervisory procedures that were reasonably designed to ensure compliance with all existing regulatory requirements. Wedbush did not have controls and procedures in connection with its market access business that were reasonably designed to ensure that Wedbush complied with all AML reporting and recordkeeping requirements applicable to Wedbush.

48. Exchange Act Rule 17a-8 requires broker-dealers to comply with the reporting, recordkeeping, and record retention requirements of the regulations adopted by the Department of the Treasury pursuant to the Bank Secrecy Act. The Bank Secrecy Act requires financial institutions such as broker-dealers to establish AML programs that include, among other things, internal policies, procedures, and controls, and authorizes the Department of the Treasury to adopt regulations prescribing minimum standards for AML programs. 31 U.S.C. §§ 5318(h)(1) and (2). Treasury regulations require broker-dealers to file reports of any suspicious transactions relevant to a possible violation of law or regulation, 31 C.F.R. § 1023.320, and state that broker-dealers regulated by a self-regulatory organization ("SRO") are deemed to satisfy the Bank Secrecy Act's AML program requirements if they comply with the AML program requirements of their SRO. 31 C.F.R. § 1023.210.

49. Wedbush's SRO, FINRA, requires its members to establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions as required by the Bank Secrecy Act and Treasury regulations thereunder. *See* FINRA Rule 3310. As described below, on numerous instances Fillhart became aware of potential wash trading and other forms of potential manipulation, but she did not cause Wedbush to file reports regarding the suspicious activity, and Wedbush's policies and procedures did not cause Wedbush to detect suspicious activity and file such reports.

50. Wedbush's WSPs asserted that it did not permit its customers to execute wash and pre-arranged trades. Wedbush's WSPs defined "wash trades" as "transactions which result in no beneficial change of ownership" and defined a "pre-arranged trade" as "an offer to sell coupled with an offer to buy back at the same or at an advanced price, or the reverse."

51. In most of the trading platforms used by Wedbush sponsored access customers, individual traders were identified by a unique trader ID. While most traders received a single trader ID, on some occasions a single trader had multiple trader IDs. Wedbush did not have any controls or filters to prevent a single trader from trading with himself or herself in a customer firm's account, or to prevent two different traders from trading with each other in a customer firm's account.

52. Most trading platforms used by Wedbush's customers had risk settings to prevent potential wash trades, but Wedbush had no controls or procedures to prevent customers or platform providers from deactivating the settings. Some exchanges offered functionality to block wash trades, but Wedbush had no controls or procedures requiring customers to use this anti-wash trade functionality.

53. Wedbush personnel responsible for filing suspicious activity reports pursuant to the Bank Secrecy Act relied on Fillhart and other employees in the Correspondent Services Division, which Bell oversaw, to review trading activity by sponsored access customers to determine whether it was relevant to potential violations of securities laws or regulations. But Bell and Fillhart knew that Wedbush did not have policies or procedures describing how Correspondent Services employees were to review trading to determine whether it was suspicious and should be reported.

54. The WSPs stated that Wedbush would review reports of potential wash trades from vendors and exchanges, determine whether there were potential securities violations, and if so, obtain representations from sponsored access customers regarding their internal wash trade reviews and systems.

55. A Wedbush employee who reported to Fillhart received reports of potential wash or pre-arranged trades from exchanges on a daily basis during the relevant period. For most of the trades on the reports, which involved two trader IDs in a single customer account, Fillhart did not ask the Wedbush employee to follow up with the customer firm because Fillhart assumed the two traders were independent and did not consider the trading suspicious. No one from Wedbush ever attempted to contact traders to determine whether they were pre-arranging their trades.

56. For trades with a single trader ID on both sides, Fillhart relied on the customer firm to follow up with the trader. On many occasions, the customer simply responded that it was not wash trading or was an error. On some occasions, the customer did not respond at all. Fillhart generally did not ask the Wedbush employee to follow up with customers for further explanation and did not report the trading to the AML officer as suspicious.

57. In February 2012, Fillhart learned from exchanges that numerous traders in the account of one of Wedbush's largest sponsored access customers appeared to be engaged in wash or pre-arranged trading. Fillhart determined that the customer or its platform provider had disabled the risk setting in the platform that would have prevented the trading. The customer informed Wedbush that it would either enable the risk setting or send future orders through a route that blocked wash trades. Fillhart did not directly enable the risk setting and did not cause Wedbush to adopt any procedures to ensure that the customer enabled it.

58. In March 2012, Fillhart learned that traders in the same customer account again appeared to be engaged in wash or pre-arranged trading. Because the customer had recently begun using an introducing broker-dealer, Wedbush notified personnel at the introducing broker-dealer, who responded that they were working to resolve the problem. Fillhart again did not directly enable the anti-wash trading risk setting in the platform and did not cause Wedbush to take steps to ensure that the customer or its introducing broker-dealer enabled it.

59. The customer informed Wedbush that it had disabled one of the traders involved in the incidents, but Wedbush did not directly disable any of the traders. Wedbush had no controls or

procedures for preventing traders that had been disabled by a customer from obtaining a new trader ID through the same or a different Wedbush customer account.

60. On multiple occasions, Fillhart learned from exchanges that traders in the same customer account appeared to be engaged in potentially manipulative trading referred to as “layering,” which involves submitting and cancelling large numbers of non-*bona fide* orders on one side of the market in order to obtain executions at more favorable prices for smaller bona fide orders on the other side. *See, e.g., In the Matter of Hold Brothers On-Line Investment Services, LLC, et al.*, Admin. Proc. File No. 3-15046 (Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders, dated Sept. 25, 2012), at 5-6.

61. As early as February 2011, Fillhart notified the customer of potential layering activity in its account and told the customer that layering “is a manipulative activity.” Until at least September 2012, Fillhart continued receiving reports from exchanges of potential layering activity through the same customer account, but she did not cause Wedbush to develop or acquire any tools to detect or cause the reporting of potential layering activity and did not warn the customer’s principals that the account would be disabled if the trading activity continued.

62. In late 2011, Bell and Fillhart met with another senior officer in the Correspondent Services Division to discuss the substantial compliance risks posed to Wedbush by sponsored access customers like the one that had been the subject of numerous reports of potential layering and wash trading and had been addressed in face-to-face meetings with Commission staff—the customer that had thousands of essentially anonymous foreign traders trading through a single Wedbush customer account. Bell, Fillhart, and the other officer decided not to terminate the customer’s relationship with Wedbush, but agreed that Wedbush should not take on new market access customers with similar business models because of the compliance risks to Wedbush.

63. During the relevant period, Wedbush did not file any suspicious activity reports relating to potential layering and filed only two reports relating to potential wash or pre-arranged trading. More broadly, Fillhart knew that Wedbush did not review for a variety of manipulative trading practices, including fictitious orders, marking the open or marking the close, traders at a Wedbush customer trading a security between each other to manipulate the price of the security, manipulating securities prices through wash trades, or layering.

Authorization of Traders

64. Subsection (b) of the Market Access Rule requires a broker-dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through the use of its MPID or otherwise, to “establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks” of its market access business. Subsection (c)(2)(iii) of the Market Access Rule required Wedbush to have risk management controls and supervisory procedures that were reasonably designed to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by Wedbush, the broker-dealer with market access. As described below, for many of its largest sponsored access customers, Wedbush only pre-approved and authorized the principals for the account and relied on its customer to pre-approve and authorize the thousands of individual traders who received market access through the

account without reasonably designed controls and supervisory procedures to restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker or dealer. Accordingly, Wedbush failed to have controls and procedures that complied with Subsection (c)(2)(iii) of the Market Access Rule. Wedbush also did not effectively allocate these obligations, to the extent permitted by Subsection (d)(1) of the Market Access Rule, to its registered broker-dealer customers.

65. Wedbush's WSPs asserted that sponsored access customers were required to provide authorized trader information to Wedbush "upon commencement of sponsored access and when a change occurs." The WSPs also asserted that Wedbush would verify authorized trader information annually. Wedbush did not have any controls or procedures requiring customers to obtain approval from Wedbush before authorizing new traders.

66. When Wedbush opened a sponsored access account, Wedbush employees obtained identifying information and performed background checks only on the principals of the entity opening the account, not on other individuals that the entity authorized to trade through the account. While customers sometimes copied a Wedbush employee on their emails instructing platform providers to authorize new traders to trade through the customer's account, Wedbush did not have any written policies or procedures for pre-approving or authorizing new traders for existing sponsored access accounts.

67. Some customer firms and platform providers used a one-page "AccountID creation form" that called for certain information about each authorized trader, but Wedbush did not require use of the form and Wedbush rarely obtained copies of the forms from customers. There was a section on the form for approval of the trader's access, but neither Wedbush nor the customers completed that section of the form.

68. For customer firms with hundreds or thousands of traders, Wedbush usually relied on the customer firm to maintain a list of authorized traders and their trader IDs. Beginning in September 2011, Wedbush employees who reported to Fillhart occasionally obtained lists of authorized traders from customer firms with large numbers of traders and ran searches by name to determine whether any traders were subject to sanctions or restrictions on business activity by the Office of Foreign Assets and Control (OFAC), an office with the Department of the Treasury that administers economic and trade sanctions based on U.S. foreign policy and national security goals. These searches were done after, not before, the customer firm extended market access to the traders. OFAC's programs are separate and distinct from the AML requirements imposed on broker-dealers by Exchange Act Rule 17a-8 and underlying Treasury regulations.

69. For customer firms with hundreds or thousands of traders, neither Fillhart nor Bell asked Wedbush employees to take any steps to verify trader names or identities or to speak to any of the traders. Bell and Fillhart knew that Wedbush relied exclusively on the customer firms, some of which were not registered broker-dealers, to confirm trader identities and oversee their trading strategies. Fillhart herself had the experience of being unable to find a list of trader information for a particular Wedbush client. Because of these facts, particularly the component of Wedbush's business that provided sponsored access to hundreds or thousands of traders through Wedbush's customers, Wedbush's controls and procedures for the pre-approval and authorization of traders were not reasonable. As noted above, Wedbush also did not effectively allocate these obligations, to the extent permitted by Subsection (d)(1) of the Market Access Rule, to its registered broker-dealer customers.

Review of Effectiveness of Market Access Controls and Procedures

70. Section (e) of the Market Access Rule required Wedbush to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access and to conduct a review of its market access business in accordance with written procedures at least annually. Wedbush did not have any written procedures for regularly reviewing the effectiveness of its market access controls and procedures, and Bell and Fillhart both acknowledged that they had primary responsibility for designing and implementing Wedbush's controls and procedures relating to its market access business. As described below, the only review relating in any way to the market access business that Wedbush conducted during the relevant period did not mention the Market Access Rule or any specific risk management controls or supervisory procedures relating to market access.

71. On Friday, March 23, 2012, in preparation for Wedbush's required certification of supervisory controls pursuant to SRO rules, one of Wedbush's Co-Chief Compliance Officers asked the two internal audit employees at Wedbush to review five areas of Wedbush's business, including one described as "High Frequency Trading." The memorandum containing this request did not mention the Market Access Rule, any other Commission rules, or sponsored access.

72. The internal audit employees prepared a written report dated Monday, March 26, 2012, describing their review, including one page relating to "High Frequency Trading/Exchange Traded Funds." The report did not mention the Market Access Rule, any other Commission rules, sponsored access, Wedbush's WSPs, or any specific risk management controls or supervisory procedures that Wedbush had adopted to comply with the Rule.

73. According to the report, the employees reviewed documents, observed procedures, and spoke with three employees in the Correspondent Services Division as part of the review. The report cited two specific steps—reviewing the checklist for onboarding new customers and observing software applications used for monitoring customer buying power and trading activities. The report noted that the software applications included risk management settings, but did not state that any specific settings were reviewed or tested.

74. The report concluded that, based on the internal audit employees' review, management's controls in the "High Frequency Trading/Exchange Traded Funds" area were adequate and functioning as intended.

75. The Co-Chief Compliance Officer incorporated this section of the report verbatim in a report that he sent to Wedbush's President and the rest of Wedbush's management team and Board on March 30, 2012. Like the internal audit report, this report did not mention the Market Access Rule, any other Commission rules, sponsored access, Wedbush's WSPs, or any specific risk management controls or supervisory procedures that Wedbush had adopted to comply with the Rule. No other reviews of the market access business were conducted by Wedbush employees during the relevant period.

76. Based on the report, as well as representations and assurances provided by Bell, Wedbush's President signed a certification dated March 30, 2012, citing SRO rules and Rule 15c3-5 (the Market Access Rule), and stating that the firm's risk management controls and supervisory procedures in connection with market access complied with Rule 15c3-5. For the reasons described above, that certification was inaccurate.

Preservation of Records

77. Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder require broker-dealers to preserve for three years originals of all communications received and copies of all communications sent relating to its business as such. Wedbush did not preserve originals or copies of communications containing trading instructions relating to ISOs submitted by some of its customers under a Wedbush MPID through third-party trading platforms. As a result, Wedbush employees could not determine which orders submitted by those customers during the relevant period were ISOs.

Violations

78. Section 15(c)(3) of the Exchange Act requires broker-dealers to comply with the Commission's rules regarding safeguards, financial responsibility, and related practices of broker-dealers. Rule 15c3-5 thereunder requires broker-dealers with market access to establish, document, and maintain a system of risk management controls and supervisory procedures that is reasonably designed to manage the financial, regulatory, and other risks of its market access business; to maintain direct and exclusive control over the market access controls and procedures; and to establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access. As discussed above, Wedbush willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder because it did not maintain exclusive control over risk management controls in sponsored access trading platforms; did not have a system of risk management controls and supervisory procedures that was reasonably designed to ensure compliance with all regulatory requirements, including those that must be satisfied on a pre-order entry basis; did not have controls and procedures reasonably designed to restrict access to market access trading systems to persons and accounts pre-approved and authorized by Wedbush; did not establish, document, and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures relating to market access; and did not conduct an adequate review of its market access controls and procedures during the relevant period.

79. Under Section 21C(a) of the Exchange Act, a person is a cause of a securities violation if there is an underlying primary violation to which an act or omission of the person contributed and the person knew or should have known that his or her conduct would contribute to the violation. As discussed above, Bell and Fillhart each was a cause of Wedbush's violation of Rule 15c3-5 because their acts and omissions contributed to Wedbush's violation and they knew or should have known that their conduct would contribute to the violation.

80. Section 17(a) of the Exchange Act and Rule 17a-8 thereunder require broker-dealers to comply with the reporting, recordkeeping, and record retention requirements of the regulations adopted by the Department of the Treasury pursuant to the Bank Secrecy Act. Treasury regulations require broker-dealers to file reports of any suspicious transactions relevant to a possible violation of law or regulation. As discussed above, Wedbush willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder because it failed to file reports of suspicious trading activity in connection with its market access business.

81. Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder require broker-dealers to preserve for three years originals of all communications received and copies of all communications sent relating to their business as such. As discussed above, Wedbush willfully

violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder because it failed to preserve originals or copies of communications containing trading instructions relating to ISOs submitted by its customers under a Wedbush MPID through third-party trading platforms.

82. Rule 203(b)(1) of Regulation SHO prohibits a broker-dealer from accepting or effecting a short sale order unless the broker-dealer has borrowed the security or entered into an arrangement to borrow the security, or has reasonable grounds to believe that the security can be timely borrowed, and has documented its compliance with Rule 203(b)(1). As discussed above, Wedbush willfully violated Rule 203(b)(1) of Regulation SHO because it allowed sponsored access customers to submit short-sale orders for securities that were not easy to borrow without first otherwise locating shares to borrow.

83. Rule 611(c) of Regulation NMS requires the broker-dealer responsible for routing an ISO to take reasonable steps to establish that the order meets the requirements of Rule 600(b)(30), which requires the broker-dealer routing the ISO to sweep the market by routing simultaneously additional orders, as necessary, to execute against the full size of all better-priced protected quotations. As discussed above, Wedbush willfully violated Rule 611(c) of Regulation NMS because it allowed sponsored access customers to submit ISOs without Wedbush taking reasonable steps to ensure that it satisfied the requirements for sending ISOs.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act, including but not limited to disgorgement, prejudgment interest, and civil penalties from Respondents pursuant to Section 21B of the Exchange Act; and

C. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-5, 17a-4, 17a-8, 203(b)(1), and 611(c) thereunder.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents each shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If any of the Respondents fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against that Respondent upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally, by certified mail, or as otherwise provided by Rule 141 of the Commission's Rules of Practice, 17 C.F.R. § 201.141.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Jill M. Peterson
Assistant Secretary