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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15873

In the Matter of

Thomas R. Delaney II and
Charles W. Yancey

Respondents.

DIVISION OF ENFORCEMENT'S
POST HEARING CONCLUSIONS OF
LAW AND FINDINGS OF FACT

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CONCLUSIONS OF LAW

I. BACKGROUND

A. Rule 204T/204

1. Rule 204T/204 require participants of a registered clearing agency to deliver equity securities to a registered clearing agency when delivery is due; that is, by settlement date. As relevant here, settlement date is generally three days after the trade date ("T+3"). For short sales, if the participant does not deliver securities by T+3 and has a failure-to-deliver position at the clearing agency (also referred to as CNS fails/failures to deliver), at market open on the morning of the settlement day following the settlement date ("T+4"), it must take affirmative action to close-out the failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on T +4. For long sales, if the participant has a failure-to-deliver position at the clearing agency (also referred to as CNS fails/failures to deliver) at market open on the morning of the third day following the settlement date ("T+6"), it must take affirmative action to close-out the failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on T+6.

- Stipulated Conclusion of Law 1.

II. THE DIVISION'S CLAIMS AGAINST RESPONDENT DELANEY

A. The Division brings its claims against Respondent Delaney under Sections 15(b) and 21C of the Exchange Act of 1934

2. Section 15(b)(6) of the Exchange Act provides that, with respect to any person who is associated with a broker or dealer, the Commission shall sanction such person, if the Commission finds that such sanction is in the public interest and that such person has committed any act enumerated in subparagraph (E) of paragraph (4) of subsection 15(b). See 15 U.S.C. §78o(b)(6)(A)(i).

3. Section 15(b)(4)(E) provides for sanctions against one who has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any rules or regulations under the Exchange Act. See 15 U.S.C. §78o(b)(4)(E).

4. Section 21C of the Exchange Act provides that, if the Commission finds that any person has violated any rule or regulation under the Exchange Act, the Commission may publish its findings and enter an order requiring any person that was a cause of the violation to cease and desist from causing any future violation of the same provision, rule, or regulation. See 15 U.S.C. §78u-3(a).

5. Rule 204T/204 is a rule under the Exchange Act. 17 C.F.R. §242.204.

6. With respect to PFSI's violation of Rule 204 and Rule 204T, the Division is not required to show either materiality or scienter. *In the Matter of Optionsxpress, Inc.*, Rel. No. 490, 2013 WL 2471113 at *62 (June 7, 2013) ("Rule 204 and Rule 204T are strict liability provisions and scienter is not required for a violation.").

B. The Division has charged Respondent Delaney with causing PFSI's violations of Rule 204/204T.

7. To prove that Delaney caused PFSI's violations, the Division must show that: 1) PFSI violated Rule 204/204T; 2) an act or omission by Delaney contributed to PFSI's violation; and 3) Delaney knew, or should have known, that his conduct would contribute to PFSI's violation. *In the Matter of Robert M. Fuller*, Rel. No. 34-48406, 2003 WL 22016309 at *4 (Aug. 25, 2003) ("Section 21C of the Exchange Act authorizes the Commission to order a person who was a cause of a violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation. To issue such an order, we must find that: (1) a primary violation occurred, (2) there was an act or omission by the respondent that was a cause of the violation, and (3) the respondent knew, or should have known, that his conduct would contribute to the violation."); see also 15 U.S.C. §78u-3(a) ("If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this chapter, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation.").

8. The Division need only show that Delaney was negligent to prove that he caused PFSI's violation. See *KPMG Peat Marwick LLP*, Rel. No. 34-43862, 2001 WL 47245, at *19 (Jan. 19, 2001) ("We hold today that negligence is sufficient to establish "causing" liability under Exchange Act Section 21C(a), at least in cases in which a person is alleged to "cause" a primary violation that does not require scienter.").

C. The Division has charged Respondent Delaney with willfully aiding and abetting PFSI's violations of Rule 204/204T.

9. A finding of willfulness does not require an intent to violate the law, but merely an intent to do the act which constitutes a violation. See, e.g., *Wonsover v. SEC*, 205 F.3d 408, 413-15 (D.C. Cir. 2000) ("*In Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798 (D.C.Cir.1965), we rejected the argument 'that specific intent to violate the law is an essential element of the willfulness required to violate Section 15(b)' and noted that the argument 'ha[d] been rejected by this court, by the Second Circuit, and by the Commission.' 348 F.2d at 802-03. We further stated that '[i]t has been uniformly held that "willfully" in this context means intentionally committing the act which constitutes the violation' and rejected the contention that 'the actor [must] also be aware that he is violating one of the Rules or Acts.'" Id. at 803.").

10. Negligent conduct meets the requirement of willfulness. See *Matter of C. James Padgett*, Rel. No. 34-38423, 1997 WL 126716 at *7 & n. 34 (March 20, 1997) (“Padgett and Graff argue that negligent conduct cannot support a finding of ‘willful’ conduct. Section 15(b) of the Exchange Act, under which this proceeding was brought, requires a finding of a violation of the securities laws to be ‘willful.’ The courts have long held that willfulness here means no more than intentionally committing the act that constitutes the violation. *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965); *Arthur Lipper Corp. v. SEC*, 547 F.2d at 180.”)

11. To prove that Delaney aided and abetted PFSI’s violations, the Division must show that: 1) PFSI violated Rule 204/204T; 2) Delaney substantially assisted PFSI’s violation; and 3) Delaney knew of, or recklessly disregarded, the wrongdoing and his role in furthering it. In *the Matter of Eric J. Brown, et al.*, Rel. No. 34-66469, 2012 WL 625874 (February 27, 2012) (“To establish that a respondent aided and abetted a books and records violation, we must find that (1) a violation of the books and records provisions occurred; (2) the respondent substantially assisted the violation; and (3) the respondent provided that assistance with the requisite scienter. The scienter requirement for aiding-and-abetting liability in administrative proceedings may be satisfied by evidence that the respondent knew of, or recklessly disregarded, the wrongdoing and his or her role in furthering it.”).

12. The Division may show that Delaney substantially assisted PFSI’s violations by demonstrating that he repeatedly disregarded red flags of suspicious activity and did not report that activity to Yancey. See *In The Matter Of Ronald S. Bloomfield, et al.*, Rel. No. 34-71632, 2014 WL 768828 at *17 (Feb. 27, 2014) (“Bloomfield and Martin substantially assisted Leeb’s violations by repeatedly disregarding red flags of suspicious activity in the Uselton and Thimble accounts and not reporting that activity to Leeb.”).

13. Recklessness may be found if Delaney encountered red flags or suspicious events creating reasons for doubt that should have alerted him to the improper conduct of the primary violator. *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (“‘Extreme recklessness’ - or as many courts of appeals put it, ‘severe recklessness’ - may be found if the alleged aider and abettor encountered ‘red flags,’ or ‘suspicious events creating reasons for doubt’ that should have alerted him to the improper conduct of the primary violator, *Graham*, 222 F.3d at 1006; see also *Wonsover v. SEC*, 205 F.3d 408, 411 (D.C.Cir.2000), or if there was ‘a danger ... so obvious that the actor must have been aware of the danger. *Steadman*, 967 F.2d at 641-42, quoting *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir.), cert. denied, 434 U.S. 875, 98 S.Ct. 225, 54 L.Ed.2d 155 (1977); see also *Wonsover*, 205 F.3d at 414.”).

14. A finding that one willfully aids and abets a violation necessarily makes that person a “cause” of those violations. *Matter of Sharon M. Graham*, Rel. No. 34-40727, 1998 WL 823072 at n. 35 (Nov. 30, 1998). (“Our finding that Graham willfully aided and abetted Broumas’ violations necessarily makes her a “cause” of those violations. See *Dominick & Dominick, Incorporated*, 50 S.E.C. 571, 578 n.11 (1991). As noted above, to conclude that a respondent aided and abetted another’s violation, it must be found that

the respondent acted with scienter. A respondent is a "cause" of another's violation if the respondent "knew or should have known" that his or her act or omission would contribute to such violation. Exchange Act Section 21C(a).").

III. THE DIVISION'S FAILURE TO SUPERVISE CLAIMS AGAINST YANCEY

A. The Division brings its claims against Respondent Yancey under Section 15(b) of the Exchange Act

15. Section 15(b)(4)(E) provides for sanctions against one who has failed reasonably to supervise, with a view to preventing violations of the rules and regulations under the Exchange Act, another person who commits such a violation, if such other person is subject to his supervision. See 15 U.S.C. §78o(b)(4)(E).

16. Section 15(b)(4)(E) provides an affirmative defense to a failure to supervise charge: That section provides that no person shall be deemed to have failed reasonably to supervise any other person, if (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with. See *Matter of Michael Bresner*, Rel. No. 517, 2013 WL 5960690 at * 117 (Nov. 8, 2013) ("Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(6) of the Advisers Act provide an affirmative defense: no person may be deemed to have failed to reasonably supervise if (1) there have been established procedures, and a system for applying such procedures, to prevent and detect any violation; and (2) the person has reasonably satisfied his duties and obligations without reasonable cause to believe that the procedures and system were not being followed."); 15 U.S.C. §78o(b)(4)(E).

17. The affirmative defense provided by Section 15(b)(4)(E) does not apply where there are no "established procedures, or a system for applying those procedures, which together reasonably could have been expected to detect and prevent the violations." *Michael Bresner*, 2013 WL 5960690 at * 116 ("This affirmative defense does not apply where there are no 'established procedures, or a system for applying those procedures, which together reasonably could have been expected to detect and prevent the violations.'") (citing *John H. Gutfreund*, Rel. No. 34-31554, 1992 WL 362753 at n. 20 (Dec. 3, 1992)).

18. NASD Rule 3010 provides that a broker-dealer's supervisory system shall provide for the assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities. NASD Rule 3010(a)(5) ("Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Final responsibility for proper supervision shall rest with the member. A

member's supervisory system shall provide, at a minimum, for the following: ... (5) The assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person's activities.”).

B. The Division has charged Respondent Yancey with failing to supervise Delaney and Michael Johnson.

19. Proper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and NASD rules. It is also a critical component to ensuring investor protection. *Matter of Dennis S. Kaminski*, Rel. No. 34-65347, 2011 WL 4336702 (September 16, 2011) (“Proper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and NASD rules. It is also a critical component to ensuring investor protection.”).

20. To prove that Yancey failed to supervise Delaney, the Division must show that: 1) Yancey was a registered person; 2) Yancey failed to reasonably supervise Delaney with a view to preventing violations of the securities laws; 3) Delaney was a registered person; 4) Delaney was subject to Yancey’s supervision; and 5) Delaney committed such violation. See 15 U.S.C. §78o(b)(4)(E) (“The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated-- ... has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision.”).

21. To prove that Yancey failed to supervise Johnson, the Division must show that: 1) Yancey was a registered person; 2) Yancey failed to reasonably supervise Johnson with a view to preventing violations of the securities laws; 3) Johnson was a registered person; 4) Johnson was subject to Yancey’s supervision; and 5) Johnson committed such violation. See 15 U.S.C. §78o(b)(4)(E) (“The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated-- ... has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision.”)

22. Neither scienter nor willfulness is an element of a failure to supervise charge. *Matter of Michael Bresner*, Rel. No. 517, 2013 WL 5960690 at * 117 (Nov. 8, 2013) (“Neither scienter nor willfulness is an element of a failure-to-supervise charge,

although scienter may be considered in evaluating the reasonableness of supervision.”) (citing *Clarence Z. Wurts*, Rel. No. 34-43842, 2001 WL 32844 at * 8 (2001)).

23. To prove that Yancey failed to reasonably supervise Delaney, the Division may show that Yancey ignored red flags. *Matter of Banc of America Investment Services, Inc. and Virginia Holliday*, Release No. 34-60870, 2009 WL 3413048 *6 (October 22, 2009) (“Red flags and suggestions of irregularities demand inquiry as well as adequate follow up and review. When indications of impropriety reach the attention of those in authority, they must act decisively to detect and prevent violations of federal securities laws.”). Particular vigilance in response to red flags is especially important in large firms such as PFSI. See *Wedbush Securities, Inc.*, Exch. Act Rel. No. 25504, 48 SEC 963, 967 (Mar. 24, 1988) (Commission opinion reviewing NASD disciplinary action) (“In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention”).

24. The Division may prove that Johnson was subject to Yancey’s supervision by showing that Yancey was the CEO, who is ultimately responsible for supervision of all registered employees. *Matter of Johnny Clifton*, Rel. No. 34-69982, 2013 WL 3487076 at *12 & n.81 (July 12, 2013) (“As the president of MPG Financial, and under the firm’s WSPs, Clifton was responsible for supervising Registered Representative No. 1.”).

25. The “facts and circumstances” or “*Gutfreund*” test has never been applied to relieve a CEO of supervisory responsibility. See *John H. Gutfreund*, 1992 WL 362753; *Matter Of James J. Pasztor*, Rel. No. 34-42008, 1999 WL 820621 at n. 27 (October 14, 1999) (“The Commission did not suggest in *Gutfreund* that there are circumstances under which [line supervisors] might be relieved of their responsibility for associated persons subject to their supervision.”); *Matter Of Angelica Aguilera*, 2013 WL 3936214, *23 (July 31, 2013) (The “facts and circumstances” test (“*Gutfreund*”) “related to the Commission’s discussion of liability regarding the chief legal counsel of the firm who the Commission stated did not become a supervisor “solely” because of his position, as opposed to the president of the firm, who the Commission stated “was responsible for compliance with all of the requirements imposed on his firm, ...”).

26. The CEO may delegate supervision of registered persons, but such delegation must be clear, reasonable, and effective. See *Application of Midas Securities, LLC*, Rel. No. 34-66200, 2012 WL 169138 at * 13 (Jan. 20, 2012) (effective delegation of supervision requires clear vesting of supervisory responsibility; “Lee’s cited evidence does not refute his failure to effectively delegate supervision by clearly vesting supervisory responsibility in Cantrell for Centeno’s and Santohigashi’s sales.”); *Application of Kirk A. Knapp*, Rel. No. 34-30391, 1992 WL 40436 at * 4 Feb. 21, 1992) (President who failed to make an effective delegation of authority retained his responsibility for supervision; “The president of a brokerage firm is responsible for the firm’s compliance with all applicable requirements unless and until he reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his duties. We think it clear that Seshadri never made a reasonable or effective delegation of authority to Skalski.

Seshadri therefore retained his responsibility for supervising sales, a responsibility he failed to shoulder.”).

27. It is the burden of the CEO to prove that there has been clear, reasonable, and effective delegation. *SEC v. Yu*, 231 F. Supp. 2d 16, 21 (D. D.C. 2002) (Defendant must submit “reliable evidence” of delegation to another individual).

28. The “facts and circumstances” or “*Gutfrueud*” test has never been applied to prove a delegation.

29. If there is confusion concerning delegation, the delegation is not clear, reasonable, and effective, and the CEO of the broker dealer retains responsibility. See *Matter Of Koch Capital, Inc.*, Rel. No. 34-31652, 1992 WL 394580 at *5 (December 23, 1992) (“Applicants contend that Wolford was responsible for Kochcapital's compliance with Rule 15c2–6. However, as President, Koch had the ultimate individual responsibility for assuring that the firm's compliance procedures were adequate. *Far from discharging this obligation, the record shows that Koch took no responsibility for compliance with Rule 15c2–6, but rather created confusion as to who was responsible.* Koch testified that he was not responsible for compliance, and he was not sure whether Wolford or Jones was responsible for compliance during the relevant period of time. While Koch assertedly delegated to Wolford the duty to write the compliance procedures, he knew that Wolford was inexperienced, and that the transition of day-to-day compliance responsibilities from Wolford to Jones resulted in a state of confusion in which no one assumed responsibility for compliance. In any event, Koch did nothing to ensure that Wolford wrote the procedures, that the procedures that she wrote were adequate, or that the firm implemented the procedures. To the contrary, as developed in the hearing before the Board of Governors, Koch ignored Wolford's insistence that Kochcapital adopt more extensive procedures to secure compliance, and refused even to review her written drafts of such procedures.”) (emphasis added).

30. The Division may prove that Yancey failed to reasonably supervise Johnson by showing that there was a supervisory vacuum resulting in violations of Rule 204T/204. See *Matter Of The Application Of Bradford John Titus*, Rel. No. 34-38029, 1996 WL 705335 (December 9, 1996) (“Titus contends that he should not be held responsible for Dickinson's failure to fill the supervisory vacuum created by the departure of Broker/Dealer Services. As discussed above, however, Titus failed to fulfill his responsibilities as SROP and compliance director. We have previously rejected the assertion that a firm's change in corporate structure or supervisory systems provides a defense for abdicating obligations. As compliance officer, Titus was responsible for enforcing adequate supervisory procedures. Yet, after Viggers left the Firm and Broker/Dealer Services was disbanded, Titus did not approach senior management to provide replacement supervision.”).

IV. THE REMEDIES SOUGHT BY THE DIVISION AGAINST RESPONDENTS

A. A cease-and-desist order against Delaney pursuant to Section 21C of the Exchange Act.

31. Section 21C of the Exchange Act provides that, if the Commission finds that any person has violated any rule or regulation under the Exchange Act, the Commission may publish its findings and enter an order requiring any person that was a cause of the violation to cease and desist from causing any future violation of the same provision, rule, or regulation. See 15 U.S.C. §78u-3(a).

32. In deciding whether to issue a cease-and-desist order, the court must consider whether there is a reasonable likelihood of future securities violations. *KPMG Peat Marwick LLP*, Rel. No. 34-43862, 2001 WL 47245 at *26 (Jan. 19, 2001). In the ordinary course, a past violation suffices to establish a risk of future violations. *Id.* The showing necessary to demonstrate the likelihood of future violations is “significantly less than that required for an injunction.” *Id.*

33. In deciding whether to issue a cease-and-desist order, the court may consider several factors including the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, the respondent's opportunity to commit future violations, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings. *KPMG Peat Marwick LLP*, Rel. No. 34-43862, 2001 WL 47245 at *26 (Jan. 19, 2001). This inquiry is a flexible one and no one factor is dispositive. *Id.* It is undertaken not to determine whether there is a “reasonable likelihood” of future violations but to guide the court's discretion. *Id.*

B. Bars from association against Delaney and Yancey pursuant to 15(b)(6) of the Exchange Act.

34. Section 15(b)(6) of the Exchange Act provides that the Commission shall censure, limit, suspend, or bar any associated person from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, or from participating in an offering of penny stock, if the Commission finds that such censure, limitation, suspension, or bar is in the public interest. See 15 U.S.C. §78o(b)(6)(A)(i).

35. The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on July 21, 2010, provided additional collateral bar sanctions to Exchange Act Section 15(b). Pub. L. No. 111-203, 124 Stat. 1376 (2010). In addition, the collateral bars added by the Dodd-Frank Act may be imposed even if some of the violative conduct pre-dated the Dodd-Frank Act because the bars are prospective remedies “whose

purpose is to protect the investing public from future harm.” *Matter of John W Lawton*, Rel. No. 3513, 2012 WL 6208750 at *7 - 10 (Dec. 13, 2012).

36. In determining the public interest the Commission has considered the following factors: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, the likelihood that the respondent's occupation will present opportunities for future violations, the age of the violation, the degree of harm to investors and the marketplace resulting from the violation, and, in conjunction with other factors, the extent to which the sanction will have a deterrent effect. See *Matter of Gary M. Kornman*, Rel. No. 34-59403, 2009 WL 367635 at * 6 (Feb. 13, 2009) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)); *Matter of Ralph W. LeBlanc*, Rel. No. 34-48254, 2003 WL 21755845 at * 6 (July 30, 2003); *Matter of Peter Siris*, Rel. No. 34-71068, 2013 WL 6528874 at n.72 (Dec. 12, 2013).

37. The “inquiry into the appropriate sanction to protect the public interest is a flexible one and no one factor is dispositive.” See *Kornman*, 2009 WL 367635 at * 6 (quoting *Matter of David Henry Disraeli*, Rel. No. 34-57027, 2007 WL 4481515 at * 15 (Dec. 21, 2007)).

38. The determination of what is in the public interest “extends ... to the public-at-large,” “the welfare of investors as a class,” and “standards of conduct in the securities business generally.” See *Matter of Christopher A. Lowry*, Rel. No. IA-2052, 2002 WL 1997959 at * 6 (Aug. 30, 2002), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *Matter of Arthur Lipper Corp.*, Rel. No. 34-11773, 1975 WL 163472 at * 15 (Oct. 24, 1975).

C. Civil penalties against each Respondent pursuant to 21B of the Exchange Act.

39. Section 21B(a)(2) of the Exchange Act provides that, in any proceeding instituted under Section 21C, the Commission may impose a civil penalty if the Commission finds that person is or was a cause of the violation of any rule or regulation issued under the Exchange Act. 15 U.S.C. §78u-2(a)(2)(B).

40. Section 21B(a)(1) of the Exchange Act further provides that, in any proceeding instituted under Section 15(b), the Commission may impose a civil penalty if it finds that such penalty is in the public interest and that such person has willfully aided and abetted a violation of the securities laws. 15 U.S.C. §78u-2(a)(1)(B).

41. Section 21B(a)(1) of the Exchange Act also provides that the Commission may impose a civil penalty if it finds that such penalty is in the public interest and that such person has failed reasonably to supervise, within the meaning of section 15(b)(4)(E), with a view to preventing violations of rules and regulations, another person who commits such a violation, if such other person is subject to his supervision. 15 U.S.C. §78u-2(a)(1)(D).

42. In making the public interest determination required by Section 21B(a)(1) of the Exchange Act, the Commission may consider (1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior; (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 15(b)(4)(B) of this title; (5) the need to deter such person and other persons from committing such acts or omissions; and (6) such other matters as justice may require. 15 U.S.C. §78u-2(c).

43. Section 21B(b) establishes a three-tier penalty structure and provides that a third-tier penalty is appropriate where (A) the act or omission involved a deliberate or reckless disregard of a regulatory requirement; and (B) such act or omission directly or indirectly created a significant risk of substantial losses to other persons. 15 U.S.C. §78u-2(b)(3).

D. Disgorgement against each defendant pursuant to Exchange Act Section 21B.

44. Section 21B(e) of the Exchange Act provides that, in any proceeding in which the a penalty may be imposed, disgorgement may also be ordered. 15 U.S.C. §78u-2(e).

45. Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. See *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989).

FINDINGS OF FACT

I. BACKGROUND

A. The Securities and Exchange Commission

1. The primary mission of the Securities and Exchange Commission is protection of investors.

- Poppalardo Testimony

Q What do you understand to be the mission of the Securities and Exchange Commission?

A The protection of investors.

Q Okay. And the --

A And assisting the capital markets in public companies in raising money.

Q And ensuring the integrity of the capital markets?

A Right.

(Hearing- Day 8, 2004:22-2005:7, Nov. 5, 2014)

Q And why is it important that the Securities and Exchange Commission protect investors?

A Because that's -- you know, the -- our capital markets depend on it. If people don't have faith in our capital markets, they won't participate. And if they feel like it's rigged, they'll leave the market, and that's bad for the U.S. economy.

Q Okay. And it's also true, isn't it, that people have their retirement invested in the capital markets?

A Sure.

Q And their nest eggs?

A Sure.

Q And their kids' college education funds?

A I don't have any of those things, so I don't know, but I guess.

Q But you know that investors have those things invested in the -- in the securities markets, right?

A Yes.

(Hearing- Day 8, 2005:18-2006:11, Nov. 5, 2014)

2. One of the ways the Commission protects investors is by implementing rules and regulations. The purpose of those rules and regulations is to protect investors.

- Poppalardo Testimony

Q But the first thing you said was protection of investors, right?

A Right.

Q Okay. And how does the Securities and Exchange Commission do that?

A They do that through making rules that govern broker-dealer regulated entities and by ensuring that those rules are carried out through their examination and inspection program, and by bringing enforcement actions.

(Hearing- Day 8, 2005:8-2005:17, Nov. 5, 2014)

Q And so you said firms are -- are subject to thousands of regulations. Again, why is that? Why are firms subject to all those regulations?

A It's -- there's a variety of very complex products that are offered, and there's a lot of services that are offered, and there's just a lot of regulation needed around that to make sure that those products are appropriate, they're offered in a way that the investor understands what they're buying, and it's just -- it's a very complex industry.

Q And at the end of the day, the purpose of every single one of those regulations is to protect investors; is that right?

A Correct.

(Hearing- Day 8, 2006:12-2006:25, Nov. 5, 2014)

3. Compliance with the securities laws is extremely important. Market integrity, market structure, and investor protection depend on compliance with the securities laws.

- Yancey Testimony

You would agree with me that compliance with the securities laws is extremely important?

A Yes, sir.

Q You would agree with me that market integrity depends on compliance with the securities laws?

A Yes, sir.

Q We can also agree that compliance with the securities laws is important for market structure?

A Yes, sir.

Q And that compliance with the securities laws is important for investor protection?

A Yes, sir.

(Hearing- Day 3, 876:13-876:25, Oct. 29, 2014)

4. In the securities industry, a business must be operated within the guidelines of the rules.

- Yancey Testimony

Q And that is an important principle because, among other things, market integrity is encompassed in operating your business within the guidelines of the rules, correct?

A Yes, sir.

Q It's also an important principle because investor protection is encompassed in operating your business within the guidelines of the rules?

A Yes, sir.

Q And again, it's an important principle because market structure is encompassed in operating your business within the guidelines of the rules?

A Yes, sir.

Q In fact, we can agree that you can't build a sustainable business if you don't operate within the guidelines of the rules?

A Yes, sir.

(Hearing- Day 3, 877:6-877:22, Oct. 29, 2014)

5. If there is a conflict between the securities laws and industry practice, the securities laws trump.

- Yancey Testimony

Q Mr. Yancey, I believe we can also agree that if there's a conflict between, on the one hand, industry practice, and on the other hand, the securities laws, you think the securities laws trump?

A As a principle, yes.

(Hearing- Day 3, 877:1-877:5, Oct. 29, 2014)

Now, I think we agreed yesterday that if industry practice conflicts with securities laws, the securities laws will trump. Do you agree?

A I would.

(Hearing- Day 4, 939:20-939:24, Oct. 30, 2014)

B. Penson Financial Services, Inc.

6. Penson Financial Services, Inc. ("PFSI") was a North Carolina corporation with a principal place of business in Dallas, Texas. It was a broker-dealer registered with the Commission. From at least 2010 to 2012, PFSI was one of the largest clearing firms in the United States as measured by the number of correspondent brokers for which it cleared. PFSI was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide, Inc. ("PWI"). PFSI filed a Form BDW, which was effective in October 2012, and then declared bankruptcy in January 2013.

- Stipulated Finding of Fact 3

7. PFSI operated under a parent company, Penson Worldwide, Inc. ("PWI").

- Stipulated Finding of Fact 3
- Yancey Testimony

Q Let's go back to Penson Financial. You held the title of CEO; is that correct? A Yes, I did.

Q To whom did you report?

A To Phil Pendergraft.

Q What was his role?

A Phil Pendergraft was the CEO of what we call the parent organization, PWI, which was Penson Worldwide, Inc.

(Hearing- Day 7, 1817:19-1818:2, Nov. 4, 2014)

8. During the relevant time period, PWI was a public company; it had a number of subsidiaries, including: PFSI; Penson Financial Services, London; Penson Financial Services, Canada; and Nexus Technologies.

- Stipulated Finding of Fact 103

C. PFSI Departments and Employees and Other Individuals

9. Yancey, 58, of Colleyville, Texas, was the President and CEO of Penson from at least October 2008 through February 2012. Yancey is currently a Managing Director at a registered broker-dealer. Yancey holds Series 7, 24, 55, and 63 licenses.

- Stipulated Finding of Fact 2

10. Delaney, 45, of Colleyville, Texas, was the CCO at Penson from at least October 2008 through April 2011. Delaney currently works in compliance at a registered broker-dealer. He holds Series 4, 7, 24, 27, 53, and 63 licenses.

- Stipulated Finding of Fact 1

11. Michael Johnson, the Senior Vice President of Stock Loan, was an associated person of PFSI. He had primary authority and responsibility within Stock Loan for its operational practices. Johnson knew that Rule 204T(a)/204(a) required PFSI to close-out CNS failures to deliver for long sales, including long sales of loaned securities, by market open T+6. From October 2008 through November 2011, the Johnson knew PFSI was at times violating Rule 204T(a)/204(a) in connection with long sales of loaned securities.

- Stipulated Finding of Fact 41

12. Mike Johnson was charged by the Commission for willfully aiding and abetting the Rule 204 violations at issue in this matter, and settled his case on a neither admit nor deny basis.

- Stipulated Finding of Fact 104

13. Johnson was a hostile witness toward the Division; he believes he was mistreated during the charging and settlement process, and continues to believe this matter is nothing but a “witch hunt.”

- Johnson Testimony

Q Okay. My last question, Mr. Johnson: Did you settle with the SEC in or about March of this year?

A Yes.

Q Do you think you were treated fairly in that process?

A No.

Q Why not?

A Based on FINRA's finding with Merrill Lynch Pro yesterday that came out. And they got a 6 million fine for numerous violations from 2008 forward. They didn't name people. I think this whole thing has been a witch hunt, and none of us -- I only settled because my wife and I are both ill. And I disagree with the whole thing.

(Hearing- Day 2, 562:24-563:11, Oct. 28, 2014)

14. Rudy De La Sierra began working at PFSI in March 2000. He joined the Stock Loan department in June 2000. He became Vice President of Stock Loan in approximately 2006. He was involved in all functions of the department.

- Stipulated Finding of Fact 105
- De La Sierra Testimony

Q Okay. What did you do at Stock Loan at Penson?

A What was my role there?

Q Yes, sir.

A When I -- when I started there, it was all functions. We were operations, including recalls, handling rate changes, some sales lending, the box, our inventory, and borrowing securities as well and also short sale locates.

Q So you did all the functions in Stock Lending?

A Yes.

(Hearing- Day 1, 203:8-204:15, Oct. 27, 2014)

15. De La Sierra has entered into a cooperation agreement with the Commission, which requires him to testify truthfully in this proceeding.

- De La Sierra Testimony

Q ... Did you enter into a cooperation agreement with the SEC in connection with this matter?

A I did.

Q And are you aware that that agreement requires you to tell the truth in your testimony?

A I am.

Q Is that what you've done today?

A It is.

(Hearing- Day 1, 248:14-248:23, Oct. 27, 2014)

16. Lindsey Wetzig began working at PFSI out of college in March 2000. In 2004, he joined the Stock Loan group. In approximately 2006 or 2007, he was promoted to Operations Manager of the Stock Loan group.

- Stipulated Finding of Fact 106

17. Wetzig was charged by the Commission for his role in the Rule 204 violations at issue in this matter, and settled his case.

- Wetzig Testimony

Q You settled with the Division, in this matter, didn't you?

A That is correct.

(Hearing- Day 2, 403:15-403:17, Oct. 28, 2014)

18. Eric Alaniz was a PFSI compliance department employee from 2009 through 2011. One of Alaniz' responsibilities was to conduct 3012 testing.

- Alaniz Testimony

Q Okay. Mr. Alaniz, at some point in time were you employed at Penson Financial Services, Inc.?

A Yes.

Q And when was that?

A My employment began the summer of 2008. I believe it was June or July.

Q Okay. And how long were you employed at Penson Financial Services, Inc.?

A I believe the summer of 2012, and it was around the same time 20 -- June or July.

Q Okay. If I say "PFSI," do you understand that to mean Penson Financial Services, Inc.?

A Yes.

Q And when you were at PFSI, what did you do?

A I conducted the 3012 testing, the 3130 CEO certification, answered general questions, e-mails that came from our correspondents.

Q Okay. Did you reside in a particular department?

A Compliance, yes.

(Hearing- Day 3, 702:19-703:13, Oct. 29, 2014)

19. Holly Hasty was a PFSI compliance department employee.

- Hasty Testimony

Q Okay. So walk me through, what were your different roles and responsibilities while at Penson?

A So when I originally I came to Penson, I was hired in as the director of I -- believe it was transactional compliance -- regulatory or transactional compliance, and the idea initially was that I was going to handle our regulatory response team and also work with the trading units on a relatively new program that Penson had instituted, which was their direct market access and their sponsored access program.

Q If you recall, and maybe you said this and I missed it, what was your title when you were hired?

A I was originally director -- I believe it was transactional compliance. I believe at that time it was also co-chief compliance officer.

Q Okay. When did you become the co-chief compliance officer?

A That was part of my original title. It was very long, if I recall correctly. It sort of morphed over time.

(Hearing- Day 7, 1697:6-1697:25, Nov. 4, 2014)

20. Kim Miller was a PFSI compliance department employee from 2000 until 2012. One of Kim Miller's responsibilities was to provide information in response to requests from regulators and other outside sources.

- Stipulated Finding of Fact 10

21. Phil Pendergraft was one of the creators of Penson.

- Pendergraft Testimony

Q Okay. And did you have a role in the creation of Penson, the changing of the name and the creation of the broker-dealer at that time? A Yes, ma'am. Q And what was that? A Well, Dan Son and I viewed ourselves as partners, although Dan was the one who purchased the broker-dealer. And so we were the first two employees of Penson. Q Okay. How was the name "Penson" created? A Penson is an amalgamation of my name and Daniel Son's name, it's "Pen" and "Son."

(Hearing- Day 6, 1456:4-1456:15, Nov. 3, 2014)

22. From 2008 to 2011, Pendergraft was chief executive officer and a member of the board of directors of PWI.

- Pendergraft Testimony

Q Okay. Let's talk about from 2008 to 2011. What was your role at PWI during that time period?

A I would have been the chief executive officer and a member of the board of directors of PWI.

(Hearing- Day 6, 1459:13-1459:16, Nov. 3, 2014)

23. During the Division's investigation of this matter, Yancey encouraged the Division to take testimony from Pendergraft in order to properly understand the supervisory structure over Johnson and Stock Loan.

- Ex. 229 at 10

The staff's failure to speak with Mr. Pendergraft and Mr. Kenny, the individuals with direct oversight for Stock Loan and Operations and the individuals who knew and discussed Rule 204 violations, lacks prudence and logic. It is a chasm in the investigation that allows the staff to ignore Mr. Yancey's separation from these departments and from the Reg SHO concerns. It also illustrates the staff's baseless rush to judgment regarding Mr. Yancey.

- Ex. 230 at 16

Because the staff is conducting further investigation and taking additional testimony from Mr. Delaney, we believe it is prudent and important for the staff to seek information from Mr. Kenny and Mr. Pendergraft before reaching a conclusion on the investigation. A failure to do so is unfair to both the Commission and to Mr. Yancey, who are deprived of the full scope of information regarding the reporting structuring of the Stock Loan department and discussions of Reg SHO concerns.

- Yancey Testimony

Q Do you recall, in these Wells submissions, encouraging the staff of the Division to talk to Phil Pendergraft?

A After conferring with Counsel.

Q And please don't tell me what you and your counsel discussed, but again --

A I did encourage that -- Mr. Pendergraft's testimony, yes.

(Hearing- Day 4, 990:10-990:17, Oct. 30, 2014)

24. Bart McCain began working at PFSI in 2006. He was PFSI's chief administrative officer, and also served as PFSI's chief financial officer for a time. McCain also served as the PWI interim treasurer in 2011 and interim chief financial officer in 2012.

- Stipulated Finding of Fact 108

25. Yancey was instrumental in securing every job McCain had in the securities industry, including hiring McCain to work at PFSI.

- McCain Testimony

Q In fact, your first job in the securities industry was at Southwest Securities; is that right?

A Yes.

Q And Bill Yancey hired you?

A Yes.

Q And then you went to Automated Trading Desk? Do I have that right?

A Yes.

Q And I think you said to Ms. Addleman earlier Mr. Yancey made the introduction between you and the CFO of Automated Trading Desk; is that right?

A Yes.

Q You left Automated Trading Desks to go to Penson; is that right?

A I did.

Q And Mr. Yancey had left ATD before you, right?

A Yes.

Q And when you were at ATD -- well, let me take a step back.

Mr. Yancey then reached out to you about coming to Penson, right?

A He did about a year after he left.

Q About a year after he left.

And at that time, you were having a lot of success at ATD, right?

A I was.

Q It was a great firm, doing well; you weren't being asked to leave, right?

A Right.

Q You didn't have any pressure to leave ATD?

A No.

Q There was no discussion of leaving ATD?

A No.

(Hearing- Day 9, 2235:22-2237:5, Nov. 6, 2014)

26. McCain and Yancey have a close personal and professional relationship. McCain considers Yancey his dearest friend, and feels indebted to Yancey for, among other things, the bonus payments he received while at PFSI.

- McCain Testimony

Q Did you ever address Mr. Yancey as your dearest friend?

A I'm sure I have.

Q In fact, is it fair to say there were times in your career at Penson that Mr. Yancey was the only one you could talk to without filtering your thoughts?

A Outside of my wife, yes.

Q Did you and Mr. Yancey ever exchange birthday gifts?

A Yes.

Q Do you recall giving him a set of picture frames as a reminder of a trip to Pebble Beach that you and Mr. Yancey took?

A Yes.

(Hearing- Day 9, 2238:1-2238:14, Nov. 6, 2014)

Q You were thankful to Mr. Yancey for your bonuses; is that fair?

A Of course.

(Hearing- Day 9, 2238:25-2239:2, Nov. 6, 2014)

Mr. McCain, it's fair to say you and Mr. Yancey are close professionally?

A Yes.

Q You're close personally?

A Yes.

(Hearing- Day 9, 2240:2-2240:6, Nov. 6, 2014)

- Ex. 276

To: Bill Yancey[BYancey@PENSON.COM]
From: Bart McCain
Sent: Sat 3/12/2011 3:33:23 PM
Importance: Normal
Subject: Thank you!

William,

I never thanked you for my bonus, both cash and equity. As always, Bill, I so appreciate all that you do for me, and this is no exception. I'm so thankful for the day that you invited me to join you at SWST, but more thankful for the day we met. I'm a better person because of you, as you set an extraordinarily high standard to emulate. Thank you, my friend, for all that you do for me.

I hope you had a great week at Wharton, and that I (or anyone else) intruded on it too much.

Bart

27. In contrast to his loyalty to Yancey, McCain was hostile toward Pendergraft.

- McCain Testimony

A Phil, I believe, was a -- until, say, 2012, just before the Apex transaction, I believe Phil to be a very honorable person, but in retrospect, the way the transition from -- or the transition of me into the CFO role and the way that occurred, and his departure within six to eight weeks after that, I felt like he fled the company when it was just, frankly, teetering. He made representations to me that my role would be interim. He made representations that we were going to survive after the Apex transaction. And neither of those were true. Very disappointed. He left me holding the bag, frankly.

(Hearing- Day 9, 2177:8-2177:19, Nov. 6, 2014)

A So I felt like, as I mentioned a while ago, that Phil left me, you know, holding the bag on the whole problem, the whole mess.

(Hearing- Day 9, 2215:5-2215:7, Nov. 6, 2014)

Q Now, you said earlier with Ms. Addleman, and I think you repeated it earlier with me, that you felt that Phil Pendergraft -- I think your word for it -- left you holding the bag. Is that fair?

A Yes.

Q You don't feel that way about Mr. Yancey, right?

A Not at all.

Q Mr. Yancey, I think you described earlier as a good friend, right?

A Yes.

(Hearing- Day 9, 2235:11-2235:21, Nov. 6, 2014)

28. Brian Gover began working at PFSI in April, 2007. Over time he managed several departments, including the buy-ins department. In April 2012, Gover moved into the compliance department at PFSI. He is currently the Chief Compliance Officer of Apex Clearing.

- Stipulated Finding of Fact 109

29. Summer Poldrack and Angel Shofner were PFSI employees in the Buy-ins department during the relevant time period.

- Stipulated Finding of Fact 110

D. Settlement

30. The Depository Trust and Clearing Corporation ("DTCC") operates the National Securities Clearing Corporation ("NSCC"), a clearing agency registered with the Commission that clears and settles the majority of United States transactions in equities. When NSCC members purchase or sell securities on the exchanges, the exchanges send the trade information to the NSCC. NSCC operates the Continuous Net Settlement ("CNS"). NSCC member clearing firms receive reports that, as of at least close of business T+1, notify the firms of transactions scheduled to clear and settle by close of business T+3. CNS also sends reports to the firms listing net fails to deliver in each security as of T+3.

- Stipulated Finding of Fact 5.

31. If a trade fails to settle, there are consequences to the buyer of the shares, and to the market more generally. For example, the buyer does not receive certain rights that come along with owning shares.

- Harris Testimony

Q Now, in -- the next point that I think is a highlight of your report, you note that settlement failures are problematic. What are you intending to convey here?

A Well, a settlement failure is what happens when a contract fails to settle; the contract being the trade arranged between the buyer and the seller. And the standard, or what they call "normal way settlement," provides that the trade will typically settle three settlement days after the trade is done.

And when the trade doesn't settle, the buyer doesn't receive shares, and the shares have a number of rights that the buyer does not have.

...

And then finally, I'll note that if a trade fails to settle, when you no longer own the security, you effectively own a forward contract in which -- it's undated, in which you have the right to receive a security, but the -- but you can't -- you don't even yet have it. And the problem is that forward contracts put you in a position where you have counter-party risk. The people who are supposed to deliver that security to you are obligated to do so, but if they go bankrupt, you may not receive the security. That can be quite problematic for the individual who wants to receive the security, or the institution.

Q Professor Harris, you've been talking there about sort of individual consequences -

-

A Yes.

Q -- if you don't settle. Are there systemic consequences?

A Yes, there are. When securities don't settle, generally, people lose confidence in the markets. After all, we live in a system of law where we expect contracts to settle, and when they don't settle, that's a problem. But more specifically, the -- when securities don't settle, you get -- you get a systemic risk. In the event of the bankruptcy of a broker-dealer, unraveling the failures can be quite difficult and can cause some very serious financial problems. ...

So we have a strong public policy interest in trying to ensure that -- that these broker-dealers aren't entangled with each other because they failed to settle one against the other or another against the one. So we want to get these things settled as quickly as possible to remove systemic risk....

(Hearing- Day 4, 1005:13-1008:21, Oct. 30, 2014)

- Sirri Testimony

Q Now, Professor Sirri, you have written about the harmful effects on markets of failing to deliver securities, haven't you?

A I have written an article about the regulatory politics of short selling, and there were issues about that in that article.

(Hearing- Day 6, 1677:7-1677:12, Nov. 3, 2014)

Q The Commission was concerned about the harmful effects on the markets of

failing to deliver securities. Failing to deliver a share converts ownership of a security into a forward contract, causing the buyer (or a clearing agency) to be exposed to the credit risk of the seller. It can also create problems with respect to the voting of shares as a buyer might not be in possession of the security at the required time and thus would lose the ability to vote."

Those were your words in this article, correct?

A Correct.

(Hearing- Day 6, 1678:17-1679:3, Nov. 3, 2014)

- Ex. 260 at 2, 9.

REGULATORY POLITICS AND SHORT SELLING

*Erik R. Sirri**

"selling short without borrowing the security to make delivery."²¹ The Commission was concerned about the harmful effects on the markets of failing to deliver securities. Failing to deliver a share converts ownership of a security into a forward contract, causing the buyer (or a clearing agency) to be exposed to the credit risk of the seller. It can also create problems with respect to the voting of shares as a buyer might not be in possession of the security at the required time and thus would lose the ability to vote. Over the years, the SEC

E. Rule 204T/204

i. Background of the Rule

32. Rule 204T/204 was adopted to, among other things, address prolonged failures to deliver. Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009.

- Stipulated Finding of Fact 4

ii. PFSI Violated Rule 204T/204

33. At all relevant times, PFSI was a clearing firm, i.e., a participant of a registered clearing agency and a member of NSCC. As a clearing firm, PFSI had obligations under Rule 204(a) to close-out CNS failures to deliver resulting from long sales no later than market open T+6.

- Stipulated Finding of Fact 6

34. No PWI entity other than PFSI had close-out obligations under Rule 204.

- Stipulated Finding of Fact 111

35. From October 2008 until November 2011, PFSI failed to close-out CNS failures to deliver resulting from long sales of loaned securities by market open T+6. The relevant long sales originated with securities held in customer margin accounts. Under the Commission's customer protection rule, PFSI is permitted, subject to certain conditions and limitations, to re-hypothecate margin securities to third parties. PFSI re-hypothecated margin securities according to the terms of the Master Securities Lending Agreement ("MSLA") developed by the Securities Industry and Financial Markets Association ("SIFMA").

- Stipulated Finding of Fact 7

36. When a margin customer sold the hypothecated securities that were out on loan, PFSI issued account-level recalls to the borrowers on T+3, i.e., three business days after execution of the margin customer's sale order. When the borrowers did not return the shares by the close of business T+3, and PFSI did not otherwise have enough shares of the relevant security to meet its CNS delivery obligations, PFSI incurred a CNS failure to deliver.

- Stipulated Finding of Fact 8

37. It was Stock Loan's obligation to close-out CNS fails arising from long sales of loaned securities.

- Gover Testimony

Q And then if the fail arose from -- because of a long sale of a loaned security, that was Stock Loan's obligation, correct?

A That is correct.

(Hearing- Day 1, 173:3-173:6, Oct. 27, 2014)

Q Buy-ins had its close -- close-out procedures for customer loans and customer short sales, correct?

A That's correct.

Q And Stock Loan had its procedures for fails arising from long sales of loaned security, correct?

A Correct.

(Hearing- Day 1, 173:16-173:21, Oct. 27, 2014)

- De La Sierra Testimony

Q And again, just to make sure we've got the process right, if there were buy-in responsibilities for customer short sales, this group handled that?

A The buy-ins operations group.

Q And if there were buy-in responsibilities with respect to a fail related to a long sale of loaned securities, who handled that?

A Stock Loan buy-ins.

(Hearing- Day 1, 235:5-235:12, Oct. 27, 2014)

- Wetzig Testimony

Q So I want to turn from the process of closing out customer short sales on T4 to the process of closing out long sales only T6. Describe that process. What, if any, role did Stock Lending play for closeouts on T+6.

A So if we still had an obligation at the end of the day, T6, we would let the broker-dealer know that -- who we were lending the shares to, that we would buy them in.

Q And was that something the Stock Lending group did or the buy-ins group did?

A We would write up a ticket, the Stock Loan department would, and we would deliver that to the trade desk.

(Hearing- Day 2, 364:4-364:16, Oct. 28, 2014)

38. By contrast, PFSI's Buy-ins department had the responsibility to close-out CNS fails caused by customers by buying in the shares owed, e.g., customer short sales. The cost of the buy-in, and the attendant market risk, was borne by the customer or broker causing the fail.

- Gover Testimony

Q Okay. What did buy-ins do at PW- -- PFSI?

A Well, we certainly handled the Reg SHO buy-ins, and we can, I imagine, talk about that. We also handled broker-to-broker buy-ins. So if we had trades that were not selling perhaps through CNS, that they were selling just DTC trade for trade, if we were failing to receive from a party, we -- we could issue a -- a buy-in. If we were failing to deliver on a position and another firm issued us a buy-in, we would look at it and either -- retrans is the industry jargon -- we were retransmitting the buy-in to the party that owes you the shares, or, you know, if it was due to a failure on our part, we would -- we would handle those buy-ins. I mean, if we were being bought in, notified we were being bought in, making sure we were ascribing the buy-in costs correctly to the party that caused it.

Q Okay. What do you mean by "buy-in"?

A You're going to market and you are buying shares at the market. So let's go back to the trade settlement. And you have a contractual agreement or your customer has a contractual agreement to sell -- sell 100 shares of IBM and deliver them for X amount of money. If the party that is not -- that is due to receive those 100 shares of IBM doesn't receive them, they -- they have some recourse which -- to prevent them from having undue financial risk and they can -- they can buy it in. They can go and say, hey, the broker was supposed to deliver this to me. He didn't deliver it. I need to have

the shares because I have to deliver them to somebody else. I'm notifying you, I'm buying you in at the market. And they go buy the shares that you were supposed to deliver to them. So now they've -- they've fulfilled their obligation that they can -- they had to buy the shares so they can make forward delivery or to give them to your customer who they're owed. The party that should have delivered them to them now has market risk because now they've got shares that they -- they don't need to deliver them anymore. That -- that receiving firm no longer needs them because they bought in. So that's -- that's the core of it. You are -- generally with buy-ins, it's -- you're -- you are -- it's a very risk manage- -- it's a risk-management-centered function.

Q And who bears the cost of that buy-in?

A In general terms, whoever caused it.

Q Okay. Whoever caused what?

A The buy-in. So, you know, if -- if you have a customer that caused a buy-in, there's a whole bunch of different kinds of -- you know, different types of trades. But let's say that they have a physical certificate, and they go to deliver the shares to the transfer agent, who is then going to re-register them into the street name for Penson, and they sell the shares. But if you don't have the shares to deliver and they sold them before they were cleared through the agent, and we get bought in, or we get notified that we're going to be bought in, we're going to pass those costs back to the customer. If it's another broker that's failing to deliver to us and -- and Penson is buying in, we're -- we're putting that cost back to that broker who is failing to deliver to us. If it's Penson that is being bought in or should have been bought in, generally Penson is going to have the market risk and the cost on it. So it's whichever party is causing the buy-in is the one that is going to bear the market risk and the cost.

(Hearing- Day 1, 87:13-90:3, Oct. 27, 2014)

- Wetzig Testimony

Q I want to talk about who, at Penson, had the responsibilities to deal with those various things. So let's start with customer short sales. What was the process at Penson for closing out a customer short sale by market open T+4? A So we would get in on T+4 at around 6:00 in the morning, and we would receive a list, the potential 204 customer closeouts, and we would try to go borrow those items before the market opened.

Q And when you say "we," who's the we in that sentence?

A Rudy would try to borrow the items, initially, and Dawnia would forward the items to me, and I would try it as well.

Q So that -- you're talking about people in Stock Lending?

A Correct.

Q Okay. So on the morning of T+4, after Stock Lending had tried to borrow to cover the customer shorts, were you successful in covering some of the shorts? A We were successful in covering most of the shorts.

Q Okay. So if Stock Lending couldn't borrow to cover a customer short, what happened next?

A We would send the list back down to the buy-in department. And then they would

receive that list and send me instructions, to the trade desk, to close-out the customer short sales.

...

Q What did buy-ins then do with the list?

A They would send those securities to the trade desk for execution.

Q And "execution" means -- means what?

A They would buy the customer's short sale.

Q So that was handled by the buy-ins group?

A Correct.

(Hearing- Day 2, 361:24-364:3, Oct. 28, 2014)

- De La Sierra Testimony

Q And let's -- let's talk about those two processes. So on T3, if you queried and determined it was the result of a short sale, what did Stock Lending do?

A We would put our list together and start borrowing --

Q Who was the borrower?

A There was a lot of those as well. So part of that was what it put -- the Dawnia Robertson reviews is loaded up into LoanNet to try to automate some of these borrows.

Q So when there's a fail due to a short sale on T3, Stock Lending tries to borrow to cover that fail?

A That is correct.

Q What about on T4? Does Stock Lending do anything on T4?

A If the customer requested us to borrow it, we would attempt to borrow it in the morning of T4 before the opening.

Q And if Stock Lending couldn't borrow on the morning of T4 before the open, what would Stock Lending do?

A We'd notify the buy-ins group.

(Hearing- Day 1, 230:21-231:18, Oct. 27, 2014)

39. PFSI violated Rule 204T/204 at least 1500 times during the time period relevant to this case.

- Stipulated Finding of Fact 49

40. PFSI violated Rule 204T/204's requirement to close-out at market-open T+6 approximately 2-10 times each trading day.

- De La Sierra Testimony

Q Mr. De La Sierra, how frequently was Stock Lending buying in on the afternoon of T+6?

A It would have been daily.

Q And do you recall how many instances each day?

A It could be -- it would vary. A couple to, you know, a few.

(Hearing- Day 1, 227:22-228:2, Oct. 27, 2014)

- Wetzig Testimony

Q On average, how many times during the week were you buying someone in, at the end of the day, on T+6?

A I would say, on average, two to three times a day we bought somebody in. Q Two to three times a day?

A Correct.

Q All right. Now, if I understood you right, that would only happen if the obligation -- excuse me -- if the deficit still existed at the end of the day on T+6; is that right?

A That is correct.

Q Are there times where that deficit could have cleaned up during the day on T+6?

A That is correct.

Q Do you have a sense of -- so we talked about at the end of the day, there were two to three buy-ins every day. Do you have a sense of, at the beginning of the day at market open T+6, how often -- or how many open deficits there still were?

A I would say, maybe, eight to ten.

Q On -- on every day?

A Correct.

(Hearing- Day 2, 370:18-371:14, Oct. 28, 2014)

41. While many trades naturally settled prior to market-open T+6, when a settlement failure reached market-open T+6, which is the point at which Rule 204 says PFSI must take action to close-out the fail, PFSI Stock Loan took no action to close-out the fail. Thus, 100% of the fails that reached the point where Rule 204 required action were not closed out on time.

- De La Sierra Testimony

So let me see if I understand this: If Stock Lending was in a fail to deliver position as a result of a long sale of a loan security on the morning of T+6, would it take any action until the afternoon?

A No, it would not.

(Hearing- Day 1, 227:11-227:21, Oct. 27, 2014)

- Harris Testimony

Q You also note, Professor Harris, that Dr. Sirri -- or Professor Sirri, and I think Mr. Paz as well, generally comment that the number of 204 violations identified in your report, something to the effect of it's small compared to the overall universe of trades that Person cleared. Do you recall those comments?

A Yes, I do.

Q Do you have a response to that?

A Well, there's no question that the observation is accurate, but is it relevant. Rule 204 says you're supposed to settle on T+3, and if not, you must close-out on T+4 or T+6. But this case is not about the settlement of the vast majority of the trades; this case is about CNS delivery failures, and most trades do settle as they should. The relevant question, of course, is what fraction of long sale fails of loaned securities that reached the market open on T+6 were closed out on time. And we already have testimony from Wetzig that -- that they essentially didn't do it. It was 100 percent. And that, of course, is why we're here.

(Hearing- Day 4, 1018:9-1019:4, Oct. 30, 2014)

42. It is not surprising that only a small percentage of all trades PFSI cleared violated Rule 204, because the vast majority of all trades settle on time, *i.e.*, by T+3. That fact does not excuse or diminish PFSI's Rule 204 violations.

- Harris Testimony

Q Now, Professor Harris, I won't get the numbers exactly right, but I think Dr. Sirri, you know, posits essentially that, you know, your analysis only shows something less than 1 percent of all trades being in a fail position. Do you recall, generally, those numbers?

A Yes.

Q And did that surprise you?

A Not in the slightest.

Q Why not?

A Because the vast majority of trades settle. There are -- shares are on-hand that are either -- weren't loaned out. The systems work as they should.

Q So just because the vast majority of trades settle on time, does that mean Rule 204 is not important?

A Not in the slightest.

Q Why is that?

A Because there are trades that don't settle, and if they aren't somehow forced to settle, they accumulate. And as we mentioned before, there are serious problems with settlement failures.

(Hearing- Day 4, 1019:5-1019:24, Oct. 30, 2014)

- Sirri Testimony

Q But we can agree, right, that at the time the Commission implemented Rule 204T, it noted, it was aware that the vast majority of all trades settle by T+3. Fair?

A That's correct.

Q And it still adopted and implemented Rule 204T. Fair?

A Correct.

(Hearing- Day 6, 1640:17-1640:24, Nov. 3, 2014)

Q And let's see what the Commission said with that in mind. The Commission said, in adopting Rule 204T, it said, "Although this information shows that delivery is being made, it demonstrates that often delivery is not being made until several days following the standard three-day settlement cycle. In addition, the current close-out requirement for threshold securities under Reg SHO and the lack of any close-out requirement for non-threshold securities under Reg SHO enables fails to deliver to persist for many days beyond the settlement date. We believe that allowing fails to deliver to extend out beyond settlement date for a transaction is too long." That's what the Commission said in adopting Rule 204T, correct?

A Correct.

Q So -- okay. And again, the Commission still adopted the rule, correct?

A Correct.

(Hearing- Day 6, 1642:10-1643:2, Nov. 3, 2014)

43. There would have been substantial costs to PFSI if it had bought shares at market-open T+6, without being able to pass those costs on to customers.

- Harris Testimony

But more importantly, I made no effort, though I observed, that there would be substantial costs associated with buying in or with borrowing if they -- if they had to -- with buying in if they couldn't borrow.

Q So let's talk for a minute just so we understand that distinction and those costs. So your analysis looked at essentially the interest earned or avoided by not closing out on T6, fair?

A That's correct.

Q Now you're talking about the costs of closing out. You said those would be -- would be higher. Why is that?

A So if they couldn't borrow, they would have to have bought at market open. And the securities that they would be buying would be illiquid securities for which transaction costs would be large. And as others have testified earlier, these are securities that tend to be illiquid and hard to borrow.

So they're -- the hard to borrow securities are particularly dangerous and often quite volatile. And they'd have to hold these positions, which would expose them to risk in a proprietary account that we wouldn't want to hold.

Now, not mentioned, but I'll show the benefit of my knowledge. These securities are securities that tend to drop in value. Short sellers, as a group, academic studies have shown that they tend to be right about their positions. Not always, of course, but on average they do. And given large numbers of securities, if you're holding securities that -- that are subject to very large borrow fees, those securities tend to drop in value. And so these are securities that you don't want to hold. And, of course, you have to sell them eventually, and you incur additional transaction costs. And since these securities are often thinly traded, the transaction costs can be quite substantial.

(Hearing- Day 4, 1028:17-1030:4, Oct. 30, 2014)

44. Stock Loan did not attempt to borrow shares before market open T+6 to close-out fails to deliver caused by long sales of loaned securities.

- De La Sierra Testimony

Q ... Would Stock Lending ever try to borrow on the morning of T+6 to close-out a fail due to a Stock Loan?

A No.

Q Why not?

A These are illiquid names. They would -- we would likely not have very much success borrowing those type names. If we're buying in Citigroup or Merrill, and they don't want to be bought in any more than we want to buy them in, and if they haven't returned the shares, most of these recalls, if they go to the settlement date, are extremely illiquid names.

Q If someone in the Stock Lending department was attempting to borrow on the morning of T+6, was that something you would know about?

A Yes.

Q If Marc McCain was trying to borrow to close-out fails related to long sales of loaned securities, is that something you would know about?

A Yes.

Q If Logan Satterwhite were trying to borrow on the morning of T+6 to close-out long sales of loaned securities, is that something you would know about?

A Yes.

Q And did they do that?

A No.

(Hearing- Day 1, 233:20-234:21, Oct. 27, 2014)

- Wetzig Testimony

Q Did Stock Lending -- you talked earlier about how Stock Lending worked on the morning of T+4 to borrow to close-out deficits related to the customer short sales. Do you remember that?

A Correct.

Q Did Stock Loan do the same thing on the morning of T+6 to close-out these long sales? Did they borrow?

A We did not.

Q If the Stock Lending group was doing that, if someone in Stock Lending was borrowing on the morning of T+6, is that something you, as the Operations Manager, would know about?

A Yes, I would know about that.

(Hearing- Day 2, 372:6-372:18, Oct. 28, 2014)

45. If Stock Loan had decided to close-out fails on the morning of T+6 by buying shares in its own proprietary account, as opposed to buying in the borrowing counterparty, that decision would have had to be approved at a very high level within PFSI because taking a proprietary position could expose the firm to significant losses.

- De La Sierra Testimony

Q ... [I]f Stock Lending had bought in on Penson's own propriety account on the morning of T+6, is that something you think you would have had authority to do?
A I would not have, no.
Q Why not?
A Well, now you're taking proprietary positions in illiquid names, and that would have had to have been approved above me, probably above Mike Johnson.
Q What's the risk with taking shares in proprietary?
A It's market risk. And, like I said, these are illiquid names, so any small movement - - or I'm sorry -- any trading of these could create large moves in stock price. And now you're proprietary -- I mean, we're not traders. We're Stock Loan. We're just -- we're agents. We're lending securities that are -- are inventory.
Q I see.
Help me understand. What is the risk, though, that -- if you hold it and the markets moves, so what?
A Big -- large losses.

(Hearing- Day 1, 228:6-229:2, Oct. 27, 2014)

- Wetzig Testimony

Q Well, why couldn't Stock Loan or Penson just buy those positions in?
A That wouldn't have been my decision.
Q Pardon?
A That would not have been a decision that I could have made.
...
A If they would have told me to close-out, I would have closed out. That was not my decision to make.
Q Whose decision was it?
A That would be Mike Johnson, Senior Vice President of Stock Loan.
Q So he was in there telling you how to make every decision on your management job?
A No. He was not telling me how to make every decision, but taking a large dollar position on proprietary trading would have gone to him.
Q So you would have had to clear a 204 buy-in through Mike Johnson?
A Yes, that is correct.

(Hearing- Day 2, 395:3-396:14, Oct. 28, 2014)

Q And one of the things you said, if I heard you right, is that something about taking

a large dollar position on a proprietary trade wasn't something you would have authority to do. Do you recall that?

A Yes, sir, I do.

Q What did you mean by that?

A That wouldn't have been my decision to make, to buy ourselves in on one, on T+6, without any coverage.

Q Why not?

A Because we would have large market risk exposure if we were to buy ourselves in. It would be long, that security.

Q Large market risk and exposure. And if you're long on a security with large market risk and exposure, what -- what does that risk mean in real world terms?

A So depending on the change in the stock price, you can essentially lose a lot of money very quickly.

(Hearing- Day 2, 425:6-425:22, Oct. 28, 2014)

46. It was not typical for PFSI to buy stock in its proprietary account.

- Wetzig Testimony

Q And was it not typical for Penson to buy positions in its proprietary account?

A That is correct.

(Hearing- Day 2, 425:23-425:25, Oct. 28, 2014)

47. Had PFSI Stock Loan been buying in for PFSI's proprietary account at market-open T+6, that is something that would have been a big deal and a topic of conversation at the firm.

- Wetzig Testimony

Q Would it have been, in your view, a -- a big deal if Penson started buying itself in on T+6 in its proprietary account?

A I think it would have been a fairly big deal.

Q You think you would have had to go -- I think you said this. But you would have had to go up the chain, correct?

A Yes, sir, that is correct.

Q And it's something, in your view, people at the firm would have been talking about, that's something Penson was doing?

A Absolutely.

(Hearing- Day 2, 426:1-426:12, Oct. 28, 2014)

48. Buying in a borrowing counterparty allowed PFSI to pass the risks involved without taking a proprietary position along to the counterparty.

- De La Sierra Testimony

Q ... What is the risk, though, that -- if you hold it and the markets moves, so what?
A Big -- large losses.
Q Large losses.
Why wasn't that a risk when you were doing your buy-ins at the end of the day on T+6?
A Because those you pass along to your customer or to the counterparty.

(Hearing- Day 1, 228:25-229:3, Oct. 27, 2014)

iii. Johnson Aided & Abetted PFSI's Violations of Rule 204T/204

49. Prior to the implementation of Rule 204T, PFSI issued recalls for stock that it had loaned out, but was now needed to fulfill a settlement obligation, on T+3. Based on PFSI's recall letter, as well as the terms of the MSLA, the borrowing counterparty had until the end of the third business day after receiving the recall (*i.e.*, until the end of the day on T+6) to return the shares. If they did not return the shares by the end of the day on T+6, at that point PFSI would buy the counterparty in.

- De La Sierra Testimony

Q Was there any complexity to the time of when the close-out had to happen?
A Yes.
Q Describe the complexities.
A Well, we -- Penson, and probably a majority of the street, before this rule would deal in settlement, so we would deal with T3. To -- to buy-in before the -- by the open of T6, you would have to have some view of future settlement.
Q So help us understand what that means. If you recall on T+3, what does it mean for three days later, for T+6?
A So we would not be in a time line -- a proper time line to be able to buy morning of T6, part of the recall letter. The recall letter when we send it out would say if it's not returned by the close of business T3, then we can close-out. By trying to buy-in the morning of T6, our counterparties were saying to us that we were in violation of the -- the letter. And also the MSLA of the standard loan agreement also gives that same time line of three days after the recall.
Q I see.
So if the recall happens on settlement date trade date plus 3, how long does the counterparty have to return the shares to you?
A They have three days.
Q The beginning of the day, end of the day?
A By the close of business of T3.

(Hearing- Day 1, 225:11-226:13, Oct. 27, 2014)

- Wetzig Testimony

Q And explain that confusion. What -- what was the confusion in the stock loan area?

A So we recalled on T+3, which is the first day we had an obligation.
Q And what was the results of recalling on T+3?
A If we recalled on T+3, the first day of the week you close-out, the counterparty that we were lending the security to would have been the entity on [sic] T+6.

(Hearing- Day 2, 361:16-361:23, Oct. 28, 2014)

- Johnson Testimony

Q Describe for the Court those conversations, please.
A I was looking for help on interpreting it, on what to do with Rule 204. Industry practice, whatever, has been what you've showed me prior. That's the way the whole industry operated, the three o'clock in the afternoon, for 40 years. 204 presented a new light in those, and I was searching for interpretation and guidance on how to comply.

(Hearing- Day 2, 518:3-518:11, Oct. 28, 2014)

Q And you said, "by us not doing it the old way." What is that reference, sir?
A It's what you just said in this box that's sticking out. That's the way the industry has done it for years.
Q So by you not buying in the afternoon of T6; is that what you mean, sir?
A By buying in, we would always buy-in when -- when -- when -- when -- when -- when it was at the end of market.

(Hearing- Day 2, 519:6-519:15, Oct. 28, 2014)

Q And explain what you mean by "the window problem," Mr. Johnson.
A The rule, for 40 years, said buy-in at 3:00 p.m. The new rule said in the morning, by 9:00 a.m., at the open.

(Hearing- Day 2, 521:15-521:19, Oct. 28, 2014)

50. Stock Loan personnel, including Mike Johnson, understood that Rule 204 required close-outs of fails to deliver related to long sales of loaned securities at market-open T+6.

- Stipulated Finding of Fact 41
- Stipulated Finding of Fact 70
- De La Sierra Testimony

Mr. De La Sierra, when the rule came out, did you have an understanding of what it required with respect to closing out long sales?

A Yes, to close-out the morning of T6.

Q The morning of T6.

By any particular time?

A By the open.

Q Was there any ambiguity in that provision of the rule?

A No.

(Hearing- Day 1, 225:1-225:10, Oct. 27, 2014)

- Wetzig Testimony

Q All right. What did you understand the language of the rule to require? When on T+6, did the rule say you had to recall?

A The rule said we were supposed to close-out on the morning of T+6.

(Hearing- Day 2, 368:10-368:14, Oct. 28, 2014)

Q And you knew that this T+6 requirement required you to buy-in, by market open, T+6, right?

A Yes. We all knew that. We weren't sure how to comply with the rule.

(Hearing- Day 2, 396:19-396:22, Oct. 28, 2014)

- Johnson Testimony

Q And as you sit here today, to the best of your memory, what does Rule 204 say about closing out long sales of securities?

A I think the rule says that as it pertains to SEC fails, that you have to close them out or issue a recall and then buy-in on the morning of T6.

Q The morning of T6?

A Yes, sir.

(Hearing- Day 2, 514:22-515:4, Oct. 28, 2014)

Q And -- and your reading of the rule was that it required close-out by market open on T+6?

A My reading of the rule as it pertained to long sales and CNS, yes.

(Hearing- Day 2, 536:3-536:6, Oct. 28, 2014)

51. When 204T was implemented, PFSI Stock Loan initially attempted to close-out fails to deliver related to long sales of loaned securities on the morning of T+6. However, because the recall had not been issued until T+3, the counterparties would not accept the buy-in on the morning of T+6, and instead insisted that they had until the end of the day on T+6 to return the borrowed shares.

- Stipulated Finding of Fact 10
- De La Sierra

Q ... When the rule came out, did Stock Lending attempt to buy-in its counterparties at the market open of T6?

A Yes, we did.

Q What happened?

A Our counterparties would not accept that.

Q Why not?

A They said that we were in violation. Our own recall letters state that the recalls had to -- that they had the right to -- they had the entire day to return the securities.

(Hearing- Day 1, 226:14-226:25, Oct. 27, 2014)

- Wetzig Testimony

Q When the rule came out, did Stock Lending try to close-out on the morning of T+6?

A We did.

Q What happened?

A We got -- we received quite a bit of pushback from the brokers that we were lending the securities to.

Q And are those brokers the same brokers we were talking about earlier, where Person had relationships?

A Correct.

Q All right. What did those brokers say? What was the pushback?

A With every broker-dealer that we had a relationship with, we have what's called an MSLA agreement. That stands for Master Standard Loan Agreement. And that agreement, if you recall a security, you have to give the broker-dealer three full days before you can close-out that loan.

(Hearing- Day 2, 368:15-369:6, Oct. 28, 2014)

52. Stock Loan determined that it would not close-out fails to deliver related to securities that had been loaned until the end of the day on T+6, at which time it would buy-in the counterparty.

- Stipulated Finding of Fact 11
- DeLaSierra Testimony

Q ... When was stock lending buying in on T+6?

A The afternoon of T6 after the close.

Q The afternoon.

So let me see if I understand this: If Stock Lending was in a fail to deliver position as a result of a long sale of a loan security on the morning of T+6, would it take any action until the afternoon?

A No, it would not.

(Hearing- Day 1, 227:11-227:21, Oct. 27, 2014)

- Wetzig Testimony

What, if any, role did Stock Lending play for closeouts on T+6.

A So if we still had an obligation at the end of the day, T6, we would let the broker-dealer know that -- who we were lending the shares to, that we would buy them in.

Q And was that something the Stock Lending group did or the buy-ins group did?

A We would write up a ticket, the Stock Loan department would, and we would deliver that to the trade desk.

Q And tell me again what timeline, T6, that was occurring?

A That was in the afternoon on T+6.

(Hearing- Day 2, 364:6-364:20, Oct. 28, 2014)

Q Okay. And I'd like to turn to Page 32 of 38, please. Mr. Wetzig, the second paragraph from the top, I'd like to take a look at that. Mr. Wetzig, that paragraph says, With regards to the time of long-sale closeouts, the firm does not believe it is its industry practice to close-out long sales prior to the market open on T+6. Not once has the firm ever had a borrow closed out by a lending counterparty at the open.

Conversely, the firm's borrowing counterparties will not accept the closeout price on a stock loan at the market open. Thus, the firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3 o'clock Eastern Time daily.

Mr. Wetzig, does that accurately describe Stock Lending's practices from the time Rule 204 came out?

A It does.

(Hearing- Day 2, 375:10-375:25, Oct. 28, 2014)

- Exhibit 89 at pp. 31-32

13. Exception

The Firm was not compliance with Regulation SHO SEC Rule 204 (Close-Out Requirement) and NASD Conduct Rule 3010 (Supervision).

With regards to the timing of long-sale closeouts, the Firm does not believe it is industry practice to close out long sales prior to the market open on T+6. Not once has the Firm ever had a borrow closed out by a lending counterparty at the open. Conversely, the Firm's borrowing counterparties will not accept a closeout price on a stock loan at the market open. Thus, the Firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced. Closing out loans at the market open would put the Firm at a competitive disadvantage and ultimately hinder the Firm's ability to cover its customers' delivery obligations.

53. Mike Johnson knew that Stock Loan was not closing out fails to deliver at market open T+6.

- Stipulated Finding of Fact 41
- De La Sierra Testimony

Q Okay. Now you mentioned at the beginning of our conversation that you understood Mr. Delaney was aware that Stock Loan was not closing out at market open T+6. Do you recall that?

A Yes.

Q How do you know that?

A Mike had gone over to talk to him, and then Tom had come back to our group and there was an open discussion there. And then I think Mike and, you know, Tom had gone into their -- into Mike's office to discuss further.

Q When were the conversations that you observed between -- Mike Johnson?

A Correct, Mike Johnson.

Q -- and Mr. Delaney, approximately when did those conversations occur?

A When this rule -- when -- when 204T went into effect.

Q And, in substance, what were those conversations?

A We notified them that our counterparties were not accepting our recalls.

Q Your recall --

A I'm sorry. Not our recalls. Our -- our morning -- our open buy-ins on T6. ...

Q So with the conversations that you personally observed between Mr. Johnson and Mr. Delaney, tell me again -- I'm sorry, my train of thought was interrupted -- what was the substance of that conversation.

A We notified Tom, or Mike notified Tom, that our counterparties were not accepting our morning buy-ins. Then they were stating that it was contradictory to the recall letter and -- and the MSLA, the Stock Loan agreement.

Q And you may have said this in part, and if you did, approximately when did those conversations occur?

A Right -- right at the inception of 204T.

Q Do you recall about when that was?

A October, I think.

Q October 2008?

A Yeah.

Q Did you personally observe those conversations?

A I did.

(Hearing- Day 1, 235:13-237:16, Oct. 27, 2014)

- Johnson Testimony

Q Sure. Maybe I'll ask you more broadly. From 2008 to 2011, when on T6 did Stock Lending buy-in to close-out fails to deliver?

A I think we bought in in the morning and then throughout the day.

Q On T+6?

A Yes.

Q Let me ask you, were there instances during -- between 2008 and 2011 where the buy-ins on T6 would occur in afternoon?

A Yes. That's throughout the day, what I'm referencing.

(Hearing- Day 2, 515:9-515:20, Oct. 28, 2014)

Q Okay. So, Mr. Johnson, this is a response by Penson in March of 2011 with respect to Rule 204, and it says, "With regards to the timing of long-sale closeouts, the firm does not believe that it is industry practice to close-out long sales prior to the market open on T+6."

And a couple of sentences later it says, Thus, the firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 Eastern Standard Time daily. Is that an accurate description of Stock Lending's practices?

A Yes.

(Hearing- Day 2, 517:5-517:15, Oct. 28, 2014)

- Wetzig Testimony

Q Did you believe that what you were doing was violating the rule, as you understood the rule?

A How we were currently -- how we were doing the rule, recalling T+6, we knew something wasn't right there because the rule told us to close-out at T+6.

Q Did you believe that you were violating the rule, as you understood the rule?

A Yes, we did.

Q When you say "we did," do you include Mr. De La Sierra in that?

A I would.

Q Do you include Mr. Hall in that?

A Yes, I would.

Q Do you include Mr. Johnson in that?

A Yes, I would.

(Hearing- Day 2, 411:3-411:17, Oct. 28, 2014)

54. As head of PFSI Stock Loan, Mike Johnson ultimately made the decision that Stock Loan would not close-out fails to deliver until the afternoon of T+6.

- Wetzig Testimony

Q So who developed Stock Loan's practices and procedures for closing out 204 -- for closing out long sales of loan securities for 204 purposes?

A From my knowledge, it would be Mike Johnson.

Q And the practice then was -- was Rudy De La Sierra or Mike or Brian Hall ever -- do you know if they had any role in it?

A Maybe a minimal role at the end of the day. Mike was the guy in charge and the guy who ultimately told us what to do.

Q So Mike Johnson developed the procedure by which you would not close-out until afternoon of T+6?

A Correct.

(Hearing- Day 2, 389:11-389:23, Oct. 28, 2014)

55. One of the pressure points in PFSI's relationships with its counterparties was around being bought in, because it could be a cost for the counterparty.

- Wetzig Testimony

Q Mr. Wetzig, when you were at Stock Lending, at Penson Financial Services, did you observe any pressure points on those relationships with other broker-dealers?

A I did.

Q What were those pressure points?

A More so on when we were trying to buy them out.

Q What do you mean by that? Explain why buying --

A So --

Q -- would be a pressure point.

A -- we would recall the stock that we were loaning them, and they would essentially push back quite a bit when we tried to buy them out on that loan that they were not returning.

Q Did they tell you why they were pushing back on a buy-in?

A Normally, it was because their customer had already covered the trade.

Q And why -- just help us understand. Why would a broker-dealer care if you were buying them in?

A Because they had a client on the other side of that trade. So if they -- if you essentially buy-in a broker-dealer, you're closing out their customer's trade --

Q Is there --

A -- or the --

Q I'm sorry. I didn't mean to talk over you. I was going to ask, is there cost to that broker-dealer, of you buying them in?

A That would depend if they could -- if their customer had not covered the trade amount, they could just pass the price directly to the customer. If the trade has already been closed out, that broker would be -- or the customer would be long in the shares once they got bought in.

(Hearing- Day 2, 358:9-359:18, Oct. 28, 2014)

56. Maintaining relationships with PFSI's counterparties was extremely important to PFSI's business model. Without those relationships, PFSI would likely have gone out of business.

- Wetzig Testimony

Q Earlier, when you were discussing the mechanics of Stock Lending and who you would loan or borrow shares from, I thought I heard you say something like there were

-- there were big guys like Citigroup. Do you recall that?

A I do.

Q Help us understand what that means. Where did Penson fit in the world of broker-dealers, and was it a big guy, small guy?

A So while we were considered big by clearing firm standards, we were kind of an asset size, a lot smaller than, obviously, the Citigroups and Goldman Sachs and the Ameritrades and those types of broker-dealers that we were doing business with.

Q Were the relationships with those broker-dealers important to Penson Stock Lending?

A They were extremely important.

Q Why?

A If we did not have those relationships, we could not go out and borrow. We could not borrow or lend securities to perform stock lending.

Q Why not?

A If we couldn't go out to -- they could essentially quit doing business with us and shut us off.

(Hearing- Day 2, 357:10-358:8, Oct. 28, 2014)

Q You may have said this, and I apologize: But if Penson Financial Services didn't have these relationships with the broker-dealer, what -- what would happen?

A We probably would have -- we wouldn't have been able -- we wouldn't have been able to cover trades. We wouldn't have been able to borrow securities. We wouldn't have been able to loan to make revenue. So at some point, I would assume that the firm would have gone out of business.

(Hearing- Day 2, 360:13-360:22, Oct. 28, 2014)

57. Nothing in Rule 204T or Rule 204 allowed PFSI to delay its close-out until the end of the day on T+6 based on the terms of PFSI's recall letter or the terms of the MSLA.

- De La Sierra Testimony

Q You talked about the recall letters stating that they had all day on T6. Was there anything in the rule that said that, to your knowledge?

A No.

(Hearing- Day 1, 227:1-227:4, Oct. 27, 2014)

58. The MSLA and PFSI's recall letter were specific to the date the recall was issued, rather than the date the trade was executed, meaning that if a recall was issued on, for example, T+2, the borrower would have three full business days, or until the end of the day on T+5, to return the shares.

- Wetzig Testimony

Q Now, I want to make sure something is clear for the record. The MSLA that you're talking about, does it talk about on what T date you can close-out a loan or is it specific to when you issued the recall?

A It is specific to when you issue the recall.

Q So hypothetically, help us understand this. If Penson had issued a recall on T+1, when could -- under the Master Securities Lending Agreement, when could you buy-in a customer?

A On T+4, if we would have issued on T+1.

Q All right. And the same thing, if Penson had issued the recall on T+2, when could it have recalled -- bought in a customer?

A We could bought in a customer on T+5.

(Hearing- Day 2, 369:7-369:20, Oct. 28, 2014)

iv. PFSI's ultimate compliance with Rule 204

59. In approximately the fall of 2011, Stock Loan became aware of a provision in Rule 204's adopting release that suggested that compliance with Rule 204 could be achieved by issuing recalls of loaned stock on T+2.

- De La Sierra Testimony

Q ... What did Stock Lending do in the fall of 2011?

A Once we became aware of the Footnote 55, we started working with Sendero to -- to have some visibility into future settlement. That way we could accurately send recalls out on T2.

(Hearing- Day 1, 247:19-247:24, Oct. 27, 2014)

60. At that time, Stock Loan reprogrammed its Sendero system to issue recalls on T+2, which allowed it to comply with both Rule 204 and the MSLA. By recalling on T+2, Stock Loan could buy-in a counterparty three days after the recall, or at the close of business on T+5, and still close-out the fail to deliver before market-open T+6. The re-programmed system was extremely accurate in allowing Stock Loan to recall shares that were going to be in a fail position.

- De La Sierra Testimony

Q At some point in time, did Penson Stock Lending do anything to begin recalling on T+2?

A Yes, we did.

Q Describe that process for us. When did that occur?

A It would have been in the fall of 2011.

...

Q ... What did Stock Lending do in the fall of 2011?

A Once we became aware of the Footnote 55, we started working with Sendero to -- to have some visibility into future settlement. That way we could accurately send

recalls out on T2.

Q And -- and was Stock Lending able to reprogram Sendero to have visibility into future settlements?

A Yes.

Q How accurate was it?

A It was extremely accurate. From all our testing, most of the -- the fails that occurred from that were -- were not accurate, were not legitimate. They were based on a glitch. But we were recalling our -- for our fails on -- very accurately.

(Hearing- Day 1, 247:5-248:9, Oct. 27, 2014)

Q ... I think you also said that recalling on T2 enabled Penson to do recalls and handle the tensions with the Master Securities Lending Agreement. Am I summarizing accurately?

A That's correct.

Q Explain that, just so we understand.

A So by recalling on T2, now we were within the timelines of our recall letter. We could close -- we could close-out the security at the afternoon of T5 or, if need be, open it as T6 and -- because our counterparties would accept these buy-ins.

(Hearing- Day 2, 333:8-333:20, Oct. 28, 2014)

- Wetzig Testimony

Q Did there ever come a point in time where Sendero was reprogrammed to change when that recall was happening?

A Yes.

(Hearing- Day 2, 372:25-373:3, Oct. 28, 2014)

Q Do you recall how the reprogramming worked? I mean, what happened? What -- what did you do to reprogram Sendero?

A So our programmer, Matt Battaini, programmed Sendero so that we could see what we needed to recall on T+2 instead of T+3.

(Hearing- Day 2, 373:7-373:12, Oct. 28, 2014)

Q Now, once Sendero was reprogrammed to recall on T+2, did you still have issues with your counterparties pushing back and citing the MSLA?

A Very little.

Q And -- and why was that? Why did that resolve that problem?

A Now that we were recalling on T2, we could buy-in at the end of the day T5.

(Hearing- Day 2, 374:21-375:3, Oct. 28, 2014)

61. The reprogramming of Sendero was done in house, and took approximately one week.

- Wetzig Testimony

Q Mr. Wetzig, did you have an understanding of how Sendero was reprogrammed?
A Yes, I did.
Q How did you gain that understanding?
A Our programmer, Matt Battaini, who worked with us in Stock Loans. It was known that he programmed Sendero so that we could see what we needed to recall on T+2.
Q All right. Do you recall how long it took Matt, Mr. Battaini, to reprogram Sendero?
A It wasn't very long. I would say, maybe, a week.

(Hearing- Day 2, 373:25-374:11, Oct. 28, 2014)

62. No one from compliance alerted Stock Loan to the provision in Rule 204's adopting release that suggested issuing recalls on T+2.

- De La Sierra Testimony

Q Mr. De La Sierra, at the time you were having these conversations with Mr. Delaney in early -- excuse me -- in late 2008 when 204T came out, were you aware of that provision of the rule?
A I was not.
Q Is there anyone at Penson you would expect to bring that to your attention?
A The compliance group.
Q And did the compliance group bring that to your attention?
A They did not.

(Hearing- Day 1, 242:14-242:24, Oct. 27, 2014)

II. THE DIVISION'S CLAIMS AGAINST RESPONDENT DELANEY

A. Delaney is not credible.

63. Delaney told conflicting stories about his knowledge and conduct in this case.

a. For instance, Delaney originally testified that he never knew about Stock Loan's practice of Rule 204 violations. Next, he admitted in his Wells submission that he knew Rule 204 close out issues might begin with Stock Loan. Finally, Delaney testified that he did learn of Stock Loan's practice of Rule 204 violations, but only when he saw the March 2011 letter to FINRA disclosing Stock Loans' violations to regulators.

- Exhibit 224 (Delaney Investigative Testimony) at pp. 90, 139

Q Were you aware of any systemic or policy level decisions from the stock loan group

that were contrary to the requirement to close out fails to deliver on long sales by the open market T plus 6?

A Not systemic, no, sir.

(Delaney, Tom- INV vol I, 90:12-90:16, Apr. 4, 2012)

Q My question is for the stock loan department. During the time that you were the CCO of Penson Worldwide or PFSI, were you aware that the stock loan department had a policy of closing out Rule 204 close-outs after market?

A I was not aware of that.

(Delaney, Tom- INV vol I, 139:23-140:2, Apr. 4, 2012)

- Exhibit 157 (Delaney Wells Submission) at p. 16

For example, when asked about the close out requirements in Rules 204T and 204, Mr. Delaney knew that the close out issue might begin with Stock Lending, which was the only group at PFSI that could have direct financial incentives not to close out some sales on time, but that several other business units, including the Operations Unit and the Trading and Execution Desk, clearly had a direct role in compliance with the close-out rules.³³ Because of its incentives, Stock

- Exhibit 224 (Delaney Investigative Testimony) at pp. 489 – 490

Okay. So was it in the course of drafting this March 2011 letter to FINRA that you first learned that as a matter of practice Stock Loan group was not closing out fails-to-deliver of long sales in accordance with Rule 204A?

A It was in the process of making that response. Drafting the letter may have taken a couple of days. There would have been stuff in front of that. It could have been a couple of days but it was around -- generally around that time that I -- that I recall learning of this.

(Delaney, Tom- INV vol III, 489:22-490:5, July 31, 2013)

b. In addition, Delaney told conflicting stories about the March 2011 letter to FINRA (Exhibit 89), which finally disclosed Stock Loan's Rule 204 violations to regulators. In his original testimony he said that he did not recall being concerned about the disclosure. In contrast, he later testified that the disclosure was a big deal, and that the Compliance department was greatly alarmed by the disclosure.

- Exhibit 224 (Delaney Investigative Testimony) at pp. 266 – 268; 491 – 492

Q Can you read that paragraph into the record for me please?

A "With regards to the timing of loan fail close-outs, the firm does not believe it is industry practice to close out long sales prior to the market open on T plus 6, nor once has the firm ever had a borrow closed out by a lender counterparty at the open.

Conversely, the firm's borrowing counterparties will not accept a close-out price on a stock loan at the market open. "Thus, the firm executes close-outs versus long sales at the conclusion of DTCC trading window at approximately 3:00 EST daily as is universally practiced. Closing out loans at the market open would put the firm at a competitive disadvantage and ultimately hinder the firm's ability to cover its customers' delivery obligations."

Q Were you aware that it was Penson's policy to close out long sales at the conclusion of the DTCC trading window instead of the open market?

A No, sir.

Q Were you aware of this claim that Penson believed it was industry practice not to close out long sales prior to the open market?

A I'd heard -- I'd heard comments, what the individual believed, but what the rule stated and what individuals believed were obviously, in my opinion, different.

Q In your opinion, this approach violates the rule, is that right?

A If it was 3:00 EST the day before, it would be fine. If it's 3:00 EST the day of, that would appear to violate the rule, yes, sir.

Q Do you recall being concerned about this, this response?

A I don't recall being concerned.

(Delaney, Tom- INV vol II, 266:18-268:2, Aug. 29, 2012)

Q The drafting was in February and March, right?

A It would have been around February, so it would have been right around -- right before sending this letter when Holly would have come in to me with this can you believe this is what they're saying at this point in time. So in and around that time, either I had given notice or I was planning on giving notice. I had certainly already had my substantive interviews with the firm, had known that I was going to be leaving. And so at that point in time a conversation shortly therefore with Holly had -- where -- where she made -- when I had let her know that I was leaving the firm and that I was going to be going on, and the comment Holly had made to me was, "Well, don't ever let me find you in a dark alley alone because I'm going to leave you dead and laying in the ditch." Because I think she understood the challenges that a disclosure like this now was going to start to create. This obviously -- this was a disclosure that befuddled the Compliance Department. This was something that we had had -- we hadn't really had any opportunity to get our hands around prior to the -- really this drafting of this response, and now this was going to be something that was going to be a meaningful disclosure out to the regulators and informing the regulators, what -- this is something that we're doing beforehand.

Q This March 2011 letter to FINRA disclosing that Penson's Stock Loan Department was not following Rule 204A, that's a big deal for the firm, right?

A It would be a big deal for the firm.

(Delaney, Tom- INV vol III, 490:25-492:4, July 31, 2013)

c. Delaney also told conflicting stories about his escalation of Stock Loan's Rule 204 violations to Yancey. He originally testified that he did not escalate the issue to Yancey. Next, in his Wells submission, he claimed that he raised the issue with Yancey "many times – both routinely and extraordinarily." Finally he testified, again, that he did not tell Yancey about Stock Loan's violations, even as he was authorizing disclosure of those violations to be made to regulators.

- Exhibit 224 (Delaney Investigative Testimony) at p. 270

Q Do you know was Mr. Yancy aware that Penson was executing long sales at the conclusion of the DTCC trading window at approximately 3 Eastern Time instead of the open market?

A I don't know what Mr. Yancy knew or didn't know.

Q Did you ever escalate that issue to him?

A Not specifically. I don't recall specifically escalating this particular issue.

(Delaney, Tom- INV vol II, 270:15-270:23, Aug. 29, 2012)

- Exhibit 157 (Delaney Wells Submission) at p. 32

All of these issues were raised many times – both routinely and extraordinarily – with Mr. Yancey, who was responsible at PFSI to deal with the issues and concerns Compliance escalated. Even though Mr. Yancey was well aware of all the challenges of complying with Rules 204T, 203, and 204 at PFSI, he did not take steps to encourage, much less require, changes to PFSI's, and particularly Stock Lending's, practices.

- Exhibit 224 (Delaney Investigative Testimony) at pp. 492 – 493

Q Did you raise with Yancey, look, we're about to tell FINRA that we know what the rule is and we're not following it?

A I believe -- I believe there had been a conversation around that. I don't know if Holly made that disclosure up to Bill or if I would have made that disclosure at that point. Certainly in the context of letting Bill or Bart know that there had been a -- that we were getting ready to make a big disclosure here, that would have been part of the process of -- of -- the disclosure would have been one of those -- one of those folks having to sign the -- sign the document at that point in time pursuant to our deal. So I don't specifically recall walking up to Bill and saying, Bill, I'm making this disclosure. We certainly circulated out those -- we certainly circulated these responses amongst multiple members of executive management.

(Delaney, Tom- INV vol III, 492:24-493:15, July 31, 2013)

64. Delaney attempted to repudiate admissions made by him in his Wells submission.

a. For instance, after saying that he understood a Wells submission to be, "a response to an invitation by the SEC to -- to respond to a -- their intent to file a lawsuit," he said, "I believe my lawyers crafted a -- a response -- and I don't know what they -- I don't know what their -- what their purpose was at that point in time."

- Delaney Testimony

Q And what do you understand a Wells submission to be?

A A Wells submission is a response to an invitation by the SEC to -- to respond to a -- their intent to file a lawsuit.

Q And who -- who submitted a Wells response on your behalf?

A My lawyers.

Q And who wrote it?

A My lawyers.

(Hearing- Day 5, 1228:1-1228:10, Oct. 31, 2014)

Q But you also said that you understood that the Wells submission process was an invitation for you to go to the Commission and tell your side of the story; isn't that right?

A I don't remember if that was my -- the exact words. I think it was -- it was an invitation by the Commission. I -- I don't know if those were my exact words or not.

Q Okay. But it was an invitation from the Commission?

A It was an invitation to tell us why not to sue you.

Q Right. To set forth your side of the story; isn't that right?

A I'm -- I'm not nuanced enough to make a legal opinion as to what telling my side of the story versus crafting a cogent legal argument to have somebody not sue you. I'm just not skilled enough to be able to reconcile those -- those two notions.

Q Okay. Well, let me ask it this way: Do you believe that your lawyers told your story in the best light to try to get the Commission to understand that there was no reason to bring a case against you?

A I believe my lawyers crafted a -- a response -- and I don't know what they -- I don't know what their -- what their purpose was at that point in time. They certainly crafted a response. I -- I would be speculating at best.

Q Okay. You didn't know that the purpose was to not have the Commission bring a lawsuit against you?

A I think that was the overall -- I understood overall purpose, but I -- in terms of what their specific motives were --

(Hearing- Day 5, 1407:9-1408:17, Oct. 31, 2014)

b. Delaney admitted that he reviewed his Wells submission before it was sent to the Commission and approved it being sent on his behalf.

- Delaney Testimony

Q Okay. I would like you to take a look at Exhibit 157, if you would, please. Exhibit

157 is your Wells submission; is that correct?

A That appears to be so, yes.

Q And you reviewed this document before it was sent to the Securities and Exchange Commission; isn't that correct?

A I did.

Q And you approved it being sent on your behalf; isn't that correct?

A I did.

(Hearing- Day 2, 573:5-573:15, Oct. 28, 2014)

c. Although Delaney admitted reading his Wells submission and approving its submission, he disclaimed the admissions made therein.

- Delaney Testimony

Q And did you see anything in the final Wells submission that you felt was incorrect or untrue? Well, let me ask it this way: If you saw something in the Wells submission that you knew to be incorrect or untrue, you would have brought that to the attention of your lawyers, I presume; isn't that right?

A I think the challenge was, for me in particular, my attorneys having drafted the document really with a lot of limited information. I have since been privy to tons of information to be able to put context to things.

(Hearing- Day 5, 1409:7-1409:17, Oct. 31, 2014)

d. Delaney even tried to distance himself from admissions in his Wells submission as to things he, himself, had supposedly said or done, saying, "it was prepared by my attorneys. I read it. I signed it. I counted on my -- relied on my attorneys to do a competent job."

- Delaney Testimony

Q Okay. So can we agree, at least as to the things that you did and the things that you said, that if there was anything in this document that was untrue, that you would have brought that to the attention of your counsel?

A I may -- again, this was -- this was really -- it was just -- it was prepared by my attorneys. I read it. I signed it. I counted on my -- relied on my attorneys to do a competent job.

(Hearing- Day 5, 1410:12-1410:20, Oct. 31, 2014)

e. Finally, however, Delaney was forced to admit that he could not repudiate admissions concerning his own actions and words.

- Delaney Testimony

Q Okay. So can we agree, at least as to the things that you did and the things that you said, that if there was anything in this document that was untrue, that you would have brought that to the attention of your counsel?

A I may -- again, this was -- this was really -- it was just -- it was prepared by my attorneys. I read it. I signed it. I counted on my -- relied on my attorneys to do a competent job.

Q Okay. Well, tell me this: You said that your attorneys -- or you -- I presume that you meant your attorneys, as well -- were not provided all of the information in the Commission's files before you did your Wells submission. Where did they get their information?

A Where did they get their information?

Q Yeah.

A I guess I'm not understanding your question. I'm assuming they have a research staff and they have a group of folks and -- that helps them get information. I wasn't -- I wasn't -- I had retained them to write -- to write the letter at that point, so I'm --

Q Okay.

A -- I'm not sure, really, what you're asking.

Q Did they interview you before they wrote their Wells submission?

A I think we -- we had been -- had a couple of testimonies prior to the -- to the -- based on -- anyway, on your earlier question, assuming that my Wells came between my second and third testimony. So at least they've been there through one of my -- one of testimonies. So there would have been that opportunity to -- to interview -- to interview me.

Q Okay. Did they talk to you about your Wells submission?

A I think they crafted it and sent it to me by -- via e-mail.

Q Okay. So let's just look at a particular paragraph. So look at Page 16 of Exhibit 157, if you would. And what I would like you to look at is the very last paragraph on that page, and it says, "Mr. Delaney set up procedures to generate reports and testing specifically designed to address issues by regulators concerning timely closing out short and long sale transactions." And that's something that you did, right, at Penson?

A Yes.

Q So presumably, either your lawyers asked you about that or you looked at that and said, Yes, I agree that's something I did; is that right? Is that fair?

A It's fair. They -- they wrote -- they wrote this.

Q Okay. And you read it and you didn't say, I didn't do that, right?

A I did -- I did not say that, yes.

Q Okay. "Mr. Delaney set up procedures to generate reports and testing specifically designed to address issues raised by regulators concerning timely closing out short and long sale transactions." And regulators were in your offices all the time; isn't that right?

A Yes, ma'am.

Q And, in fact, during much of this time period, OCIE was doing an exam specifically targeted at Rule 204, right?

A Yes, ma'am.

Q "For example, when asked about the close-out requirements in Rules 204T and 204, Mr. Delaney knew that the close-out issues might begin with Stock Lending, which

was the only group at PFSI that could have had direct financial incentives not to close-out some sales on time. But several other business units, including the operations unit and trading and execution desk, clearly had a direct role in compliance with the close-out rule." Did I read that correctly?

A Yes, ma'am.

Q If you look at Page 21, there's a heading Number 3, "Mr. Delaney escalated Regulation SHO issues internally and externally to improve compliance with Rules 203 and 204." You didn't tell your lawyers not to put that in there, right?

MR. WASHBURN: Objection, Your Honor. That's privileged.

MS. ATKINSON: Okay. That's fair.

BY MS. ATKINSON: Q After you read and reviewed this document, it was left in the document that went to the Securities and Exchange Commission, isn't that true?

A Yes, ma'am.

(Hearing- Day 5, 1410:12-1414:1, Oct. 31, 2014)

65. Delaney was evasive in his testimony at the hearing in this matter. For instance:

a. Despite the clear language in Ex. 89, and later stipulations by his counsel, Delaney denied that it was the practice of PFSI's Stock Loan department to closeout long sales at market close rather than market open.

- Delaney Testimony

Q And if you look at the next page, Page 32 of 38. If you look at the second paragraph at the top of the page, that section says, "With regards to the timing of long-sales closeouts, the Firm does not believe it is industry practice to close-out long sales prior to the market open on T+6. Not once has the Firm ever had a borrow closed out by a lending counterparty at the open. Conversely, the Firm's borrowing counterparties will not accept a closed out price on a stock loan at the market open. Thus, the Firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced."

Do you see where I was reading?

A Yes, ma'am.

Q And you would agree with me that that was the practice of Penson's Stock Loan department from late 2008 through 2011; isn't that right?

A I don't know if I would agree that I know that's the practice. What that was, was a draft that had been presented to me by the subject matter experts --

Q Mr. Delaney?

A -- responsible for that.

(Hearing- Day 2, 571:22-572:19, Oct. 28, 2014)

b. Despite having previously testified that he read the release for Rule 204T, at the hearing Delaney quibbled about whether he had seen the release in the same exact format as that in the exhibit used at the hearing and during his testimony.

- Delaney Testimony

Q Would you please look at Page 92 of your investigative testimony.

Q You see about middle of the page where it says, "SEC Exhibit No. 67 was marked for identification"?

A Yes, I have it.

Q Would you read the rest of that page to yourself, please.

Does that refresh your recollection that you saw the adopting release for Rule 204T?

A Not necessarily. I think what I was maybe intending to say is, I don't know if I specifically read it from the Federal Register as an adopting release, but I was certainly familiar with the rule as it was -- as it was coming out at that time.

Q Mr. Delaney, you were asked, "Take a look at Exhibit Number 67 here. You have in front of you there Exhibit 67 --" Are you -- take a look at Exhibit Number 67 here, and Exhibit 67 is the one that we're discussing; is that right?

A I'm not sure.

Q Well, take look at Exhibit 67 that's in front of you.

A Oh, I'm sorry. I was looking at the book. I apologize.

Q You see Exhibit 67 in front of you?

A I do.

Q All right.

A That's the same 67 that's here?

Q It is, yeah.

A Okay.

Q And you were asked, "You have in front of you there Exhibit 67 is the adapting release for rule 204T from October 2008. Have you ever seen this adopting release before?"

"I believe I have."

"In what context did you see it?"

"Around the time of the -- around the time of the release of the rule."

Do you see that?

A I do.

Q Did you -- were you asked those questions and did you give those answers?

A I believe I was.

Q So you've seen Exhibit 67. You've seen the adopting release for Rule 204T; is that correct?

A I said that here, but I stand my by answer that I think my intention was that I don't know if I specifically saw it off the Federal Register. But I certainly would have seen it in some other context of the rules being released.

(Hearing- Day 2, 574:15-576:18, Oct. 28, 2014)

c. Although ultimately admitting that there was only one test of Stock Loan's Rule 204 procedures, Delaney originally denied that fact.

- Delaney Testimony

Q In fact, Mr. Delaney, the test in December of 2009 is the only test that tested Stock

Loan's compliance with Rule 204; isn't that right?

A I don't know that.

Q Do you know of any other testing as you sit here today that tested Stock Loan's compliance with Rule 204?

A That was a long time ago. There may have been a lot of testing in the quality control that was going on.

Q As you sit here today, do you know of any other testing that showed that stock -- Stock Loan's compliance with Rule 204? It's just yes or no. Yes, you do know, or no, you don't know.

A As I -- right now in my present recollection, I don't know.

Q Okay. I think you testified yesterday that you, over the course of preparing for this case, have looked at thousands of documents. Is that what you said?

A I don't know if I said thousands, but it may have been hundreds.

Q Lots and lots of documents?

A Lots of documents.

Q Did you see anything in those documents that showed any other testing of Stock Loan's Rule 204 compliance?

A I may have.

Q Do you remember seeing any documents that showed that?

A As I sit here today, I don't have a recollection of any other testing.

Q Okay. Do you think if there was other testing, your counsel would have brought that to your attention?

A I don't know what my counsel would do.

(Hearing- Day 3, 637:3-638:11, Oct. 29, 2014)

B. The predicate elements of 15(b) and 21C have been proven.

66. Delaney is associated with a registered broker-dealer.

- Stipulated Finding of Fact 1

67. PFSI violated Rule 204T/204.

- See *infra* Section I.E.ii.

C. Delaney's knowledge concerning PFSI's violations of Rule 204T/204.

68. Delaney was Penson's CCO when Rule 204T was implemented in September 2008.

- Stipulated Finding of Fact 12

69. Delaney participated in Penson's efforts to implement procedures in response to Rule 204T in October 2008 and to Rule 204 in July 2009. Delaney knew at

all relevant times that Rule 204T/204 required Penson to close-out CNS failures to deliver resulting from long sales by market open T+6.

- Stipulated Finding of Fact 14

70. When a new rule, such as Rule 204T or Rule 204, is adopted, the Chief Compliance Officer is responsible for designing a program for complying with the rule.

- Yancey Testimony

Q When a new rule is adopted such as Rule 204T or when it comes further, in the case of 204, who at Penson is responsible for designing a program for complying with the rule?

A The Compliance Chief.

Q Anyone else?

A And his -- and his staff.

(Hearing- Day 7, 1868:3-1868:9, Nov. 4, 2014)

71. PFSI's Compliance department should have determined whether PFSI's policies and procedures complied with Rule 204.

- Exhibit 224 (Delaney Investigative Testimony) at p. 101

Q When Rule 204 was issued in July 2009, did you have an expectation that someone in your compliance group would review the rule?

A Review the rule in general, yes.

Q And make determinations about whether Penson's policies and procedures complied with the rule?

A I believe that would have been an expectation, yes.

(Delaney, Tom- INV vol I, 101:18-101:24, Apr. 4, 2012)

72. If a rule is complex, it is reasonable for a registered person to consult FINRA, the SEC, or another regulator; consult interpretive guidance; and/or consult with industry groups, such as SIFMA. Then one should identify and manage the related critical control points.

- Gover Testimony

Q Let's talk -- just let's talk for just a minute about complexity. If a regulation is complex, what do you, as a person who has worked at a broker-dealer, what do you do about that?

A There's a couple of pieces. One is getting an understanding of the regulation, so in its complexity, and you would -- for new regs, you would submit questions to your SROs. You would look for any interpretive guidance that might be out there. You would kind of read the tea leaves from AWCs that you might see firms where they're getting

dinged for things. You would develop a hypothesis of here's how we believe this reg reads and how it might be implemented. You might reach out to outside counsel. You might use some of the industry groups, like SIFMA. So in short, you leverage your resources. And then from an implementation standpoint, you -- you identify the critical control points on here, what -- what these components have to be in; and you break it down into discrete tasks that you have controls around to make sure that you're -- you're doing what you need to do.

(Hearing- Day 1, 191:23-192:19, Oct. 27, 2014)

i. Delaney admits knowing that PFSI was violating Rule 204T/204

73. Beginning in November 2008, the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted a review of PFSI's Rule 204T procedures.

- Stipulated Finding of Fact 28.

74. Delaney admits that regulators raised issues about Rule 204 closeouts for long sales. Delaney also admits that he knew, at the time regulators were raising the issue, that Rule 204 closeout issues "might begin" with Stock Loan.

- Exhibit 157 (Delaney Wells Submission), p. 16

For example, when asked about the close out requirements in Rules 204T and 204, Mr. Delaney knew that the close out issue might begin with Stock Lending, which was the only group at PFSI that could have direct financial incentives not to close out some sales on time, but that several other business units, including the Operations Unit and the Trading and Execution Desk, clearly had a direct role in compliance with the close-out rules.³³ Because of its incentives, Stock

75. Delaney admits that he knew that stock lending personnel could and did cause delays in buy-ins in that he claims that he raised that issue many times with Yancey.

- Exhibit 157 (Delaney Wells Submission), p. 30, 32

(1) Stock Lending Personnel Were Financially Incentivized to Delay Close-outs, and They Could and Did Cause Delays in Buy-ins

(4) PFSI Management Ignored Failures And Did Not Support the Changes Required in PFSI's WSPs

All of these issues were raised many times -- both routinely and extraordinarily -- with Mr. Yancey, who was responsible at PFSI to deal with the issues and concerns Compliance escalated. Even though Mr. Yancey was well aware of all the challenges of complying with Rules 204T, 203, and 204 at PFSI, he did not take steps to encourage, much less require, changes to PFSI's, and particularly Stock Lending's, practices.

76. Delaney admits knowing that there was a “gap” between the requirements set forth in the WSPs and stock lending’s practices concerning timely buy-ins that he was “working to close.”

- Exhibit 157 (Delaney Wells Submission) at p. 32

Mr. Yancey’s approach to compliance with Regulation SHO’s rules flew in the face of his duties at PFSI and turned a blind eye to the gap that Mr. Delaney was working to close between PFSI’s WSPs and Stock Lending’s practices concerning timely buy-ins. There is no excuse for this failure and the consequences that it had on compliance.

77. Delaney admits knowing that Stock Loan was having issues with compliance with Rule 204T and Rule 204.

- Exhibit 157 (Delaney Wells Submission), p. 31

It was no secret that any efforts to comply with Rules 204T, 203, and 204 were not well received by PFSI’s customers. There are multiple email references that are part of the record from Stock Lending stating that their customers would be unhappy with a strictly enforced buy-in policy. As a result, Stock Lending had by far the most to lose by complying in terms of eroding profitability and customer base and, consequently, diminished income for Michael Johnson and those working beneath him.

- ii. Delaney also recklessly disregarded PFSI’s violations and his role in furthering them.

78. Rule 204 was one of the most major rule changes during Delaney’s fifteen year career.

- Delaney Testimony

Q All right. Were there any -- during your career as a compliance professional, have there been any major rule changes that you can think of?

A Yes.

Q Okay. And -- and it’s going to be tough to identify what’s a major one and what’s a minor one, I take it?

A I mean, there are a lot of minor -- minor changes. There are certainly sort of big -- big changes that -- that strike me anyway.

Q And so describe for us the big changes that you recall.

A An example might be when the Patriot Act was -- was implemented, and for the first time we saw -- we started seeing the broker-dealer industry, the AML regime that was created under the Bank Secrecy Act to be carried over into -- into the broker-dealer world. Traditionally, before that, there was a very light responsibility for AML on the

broker-dealer side. And the Patriot Act really, really took those more robust program requirements that banks had traditionally been doing under the Bank Secrecy Act. This was shortly after -- shortly after 911. 911 events happened, and imposed a lot to the broker-dealer community creating a -- really a sea change to within the broker-dealer community on how to deal with -- with these type of issues.

Q Did that -- in your experience, was that -- create any upheaval within broker-dealers?

A Upheaval -- defining upheaval as a lot of energy and attention in resources and money being spent to deal with -- with those sort of issues, yes.

Q Okay. Any other major -- major rule changes that you recall during your career?

A I would certainly say the changes that started -- that were associated with the 2008 market crash. And as we saw, the emergency orders coming from the SEC developing the 204T and then -- and then that rule become permanent, I would -- I would classify that as a -- as a big change.

Q Did the financial crisis -- we're focused here a lot on Rule 204. Were there other components to rule changes at -- at about that time as well that you recall?

A I -- I don't -- I'm sorry. I don't understand the question.

Q Any other rules or -- or changes in -- in the way business was done associated with the financial crisis that you recall?

A I'm -- I'm sure there were all sorts of -- all sorts of changes happening, *but what's focused in my memory at this point is really the stuff around 204.*

(Hearing- Day 5, 1228:20-1230:20, Oct. 31, 2014)

Q Why not?

A The -- this -- this -- *this rule again strikes me as being a -- a rule that was one of these sea changes that was in a moment -- moment in time where -- one of these historical moments in time.* And so certainly just relying or reading a rule and then trying to rely on -- on interpreting it myself there, I certainly felt that while I was a -- I was competent, I certainly would -- would be -- it would be a dereliction of my responsibility not to go and consult people who are a whole lot smarter than me on the issue.

(Hearing- Day 5, 1240:20-1241:5, Oct. 31, 2014)

- Exhibit 302 at pp. PFSI2190936, PFSI2190939

SEC Emergency Order Release 34-58572 (Effective: 12:01 AM, Thursday, September 18, 2008 until 11:59 EST, October 1, 2008 -- unless otherwise extended)

- **Hard Settlement Date Close-Out Requirement; Penalties for Violation Include Prohibition of Further Short Sales, Mandatory Pre-Borrow (Rule 204T)**

These are historic times in the marketplace. Penson, as your partner, will endeavor to keep you informed of material changes where, this is not substitute for keeping yourself informed as well. Please continue to monitor developments on the SEC website (<http://www.sec.gov>) to ensure that your firm has the most current information.

79. Delaney knew Rule 204 was an important Rule.

- Delaney Testimony

Q And you felt that Rule 204 was important; isn't that right?

A As important as any regulatory rule.

Q Would you look at Page 416 of your testimony, please, Exhibit 224. And at Line 6, you said, "Reg SHO, in and of itself, as its own particular item was certainly highlighted as a compliance concern." And then you went on to say a couple of lines further, "And in the future it was significant to the level of attention that compliance was putting into the Reg SHO area.

Did I read that correctly?

A Those -- those lines, yes.

Q And if you look at Page 446 -- I'm sorry -- Page 447 at Line 3, you were asked, "As CCO of Penson, did you pay extra attention to Stock Loan group's Regulation SHO compliance, given their unique financial incentives to violate Regulation SHO?" And you said, "As the CCO of the firm, I gave specific attention to Regulation SHO compliance in general. I gave specific guidance out. Probably I gave out more specific guidance-related Regulation SHO than I did any other matter that was out there in terms of my own direct participation and communications to the firm."

Did you give that testimony?

A It appears so.

(Hearing- Day 3, 692:4 -693:4, Oct. 29, 2014)

- a. In late 2008, Johnson told Delaney that Stock Loan could not figure out how to comply with Rule 204T and asked for guidance

80. Because of the push-back Stock Loan got from counterparties when it initially attempted to buy them in at market-open T+6 in order to close-out fails to deliver, Johnson and De La Sierra had discussions with Tom Delaney about the issues Stock Loan was having with complying with Rule 204.

- De La Sierra Testimony

Q ... As a result of the pushback that you got from your counterparties, did Stock Lending make any decision about how it would handle buy-ins on T6?

A No. That's when my -- I started having conversations with Tom Delaney.

(Hearing- Day 1, 227:5-227:10, Oct. 27, 2014)

- Johnson Testimony

Q In those conversations, did you discuss with Mr. Delaney resistance that Stock Lending was getting to trying to buy-in, in the morning of T6?

A I believe so.

Q And what do you believe you discussed with Mr. Delaney on that point?

A I believe we talked about Lindsey Wetzig calling counterparties trying to get a definition of when to do this, and they said it was industry practice, and by us not doing it the old way, we were violating our MSLA agreement.

(Hearing- Day 2, 518:20-519:5, Oct. 28, 2014)

81. These conversations occurred at approximately the time Rule 204T was implemented.

- De La Sierra Testimony

Q And you may have said this in part, and if you did, approximately when did those conversations occur?

A Right -- right at the inception of 204T.

Q Do you recall about when that was?

A October, I think.

Q October 2008?

(Hearing- Day 1, 237:8-237:13, Oct. 27, 2014)

- Johnson Testimony

Q Yes, sir. The conversations with Mr. Delaney that we were just discussing, do you recall, when in time, thinking about the adoption of Rule 204, those conversations occurred?

A I think we had conversations with Mr. Delaney and others at the inception of the -- what you just said, the -- prior to the rule becoming official, there were Saturday morning meetings, et cetera, on all of this.

(Hearing- Day 2, 520:13-520:20, Oct. 28, 2014)

Do you recall if the interpretation from Mr. Delaney was roughly around the time that the rule became a permanent rule?

A I remember putting pressure for answers. So it had to be around when the rule changed, because I was concerned about complying with the rule.

(Hearing- Day 2, 524:21-525:1, Oct. 28, 2014)

82. At the time of these conversations, Stock Lending personnel did not believe they could close-out at market-open, as required by Rule 204T, because the terms of the MSLA did not allow PFSI to buy-in the borrowing counterparty until the afternoon of

the third day after the recall was issued, which, because PFSI issued recalls on T+3, meant the afternoon of T+6.

- De La Sierra Testimony

Q Was there any complexity to the time of when the close-out had to happen?

A Yes.

Q Describe the complexities.

A Well, we -- Penson, and probably a majority of the street, before this rule would deal in settlement, so we would deal with T3. To -- to buy-in before the -- by the open of T6, you would have to have some view of future settlement.

Q So help us understand what that means. If you recall on T+3, what does it mean for three days later, for T+6?

A So we would not be in a time line -- a proper time line to be able to buy morning of T6, part of the recall letter. The recall letter when we send it out would say if it's not returned by the close of business T3, then we can close-out. By trying to buy-in the morning of T6, our counterparties were saying to us that we were in violation of the -- the letter. And also the MSLA of the standard loan agreement also gives that same time line of three days after the recall.

Q I see.

So if the recall happens on settlement date trade date plus 3, how long does the counterparty have to return the shares to you?

A They have three days.

Q The beginning of the day, end of the day?

A By the close of business of T3.

(Hearing- Day 1, 225:11-226:13, Oct. 27, 2014)

- Johnson Testimony

Q And what do you believe you discussed with Mr. Delaney on that point?

A I believe we talked about Lindsey Wetzig calling counterparties trying to get a definition of when to do this, and they said it was industry practice, and by us not doing it the old way, we were violating our MSLA agreement.

Q And you said, "by us not doing it the old way." What is that reference, sir?

A It's what you just said in this box that's sticking out. That's the way the industry has done it for years.

Q So by you not buying in the afternoon of T6; is that what you mean, sir?

A By buying in, we would always buy-in when -- when -- when -- when -- when -- when it was at the end of market.

(Hearing- Day 2, 518:24-519:15, Oct. 28, 2014)

Q And explain what you mean by "the window problem," Mr. Johnson.

A The rule, for 40 years, said buy-in at 3:00 p.m. The new rule said in the morning, by 9:00 a.m., at the open.

(Hearing- Day 2, 521:15-521:19, Oct. 28, 2014)

Q And I want to make sure that the record is clear that when you are pressing for answers from Mr. Delaney, was it clear what the problem was -- what the problem Stock Loan was having was?

A Yes.

(Hearing- Day 2, 525:2-525:6, Oct. 28, 2014)

83. Johnson was a vocal and direct personality; he was not afraid to raise issues and was direct if he needed something.

- McCain Testimony

Q You also discussed with Ms. Addleman Mike Johnson, right?

A Yes.

Q I want to talk for a minute about Mr. Johnson. You mentioned -- I think the terms you used, and if I'm putting words in your mouth, please correct me, but he was crass and crude; is that fair?

A Yes.

Q Was he quiet or meek?

A No.

Q Did he seem afraid to share his opinion if he had one?

A Never.

Q Did he often have opinions?

A Always.

Q Did he seem afraid to raise issues?

A Not that I know of.

Q He was vocal and direct; is that fair?

A Yes.

Q If fair to say if he wanted something, he would let you know?

A He would.

(Hearing- Day 9, 2226:11-2227:7, Nov. 6, 2014)

84. During his conversations with Delaney, Johnson made it clear to Delaney the problem Stock Loan was having.

- Johnson Testimony

Q And I want to make sure that the record is clear that when you are pressing for answers from Mr. Delaney, was it clear what the problem was -- what the problem Stock Loan was having was?

A Yes.

Q And was it clear -- did you make it clear to Mr. Delaney what the problem Stock Loan was having was?

A Yes.

(Hearing- Day 2, 525:2-525:9, Oct. 28, 2014)

85. During those conversations, Johnson informed Delaney that there was a conflict between the Rule and the historic practice of buying in borrowing counterparties on the afternoon of T+6, three days after a recall was issued on T+3, based on the terms of the MSLA. Johnson further informed Delaney that PFSI's counterparties were not accepting buy-ins at market-open T+6.

- Johnson Testimony

Q All right. Well, let me ask you this: Did you have any conversations with Mr. Delaney, Mr. Johnson, about Rule 204?

A Yes.

Q Describe for the Court those conversations, please.

A I was looking for help on interpreting it, on what to do with Rule 204. Industry practice, whatever, has been what you've showed me prior. That's the way the whole industry operated, the three o'clock in the afternoon, for 40 years. 204 presented a new light in those, and I was searching for interpretation and guidance on how to comply.

Q And as you sit here today, in substance, what were the conversations between you and Mr. Delaney? What did you say to him?

A I don't know. They were fast.

Q Okay. And what do you mean by "fast"?

A Hallway conversations, quick conversations. I ran Global; so they were fast in coming, looking for support.

Q In those conversations, did you discuss with Mr. Delaney resistance that Stock Lending was getting to trying to buy-in, in the morning of T6?

A I believe so.

Q And what do you believe you discussed with Mr. Delaney on that point?

A I believe we talked about Lindsey Wetzig calling counterparties trying to get a definition of when to do this, and they said it was industry practice, and by us not doing it the old way, we were violating our MSLA agreement.

Q And you said, "by us not doing it the old way." What is that reference, sir?

A It's what you just said in this box that's sticking out. That's the way the industry has done it for years.

Q So by you not buying in the afternoon of T6; is that what you mean, sir?

A By buying in, we would always buy-in when -- when -- when -- when -- when -- when it was at the end of market.

Q All right. Do you believe you communicated with Mr. Delaney that your practice was to buy-in at the end of market?

A I believe we communicated we had a conflict between those two.

Q Between the rule and the industry practice?

A Yes, sir.

(Hearing- Day 2, 517:24-519:22, Oct. 28, 2014)

Q And do you believe in those conversations you communicated the conflict between the rule and industry practice to Mr. Delaney?

A Yes.

(Hearing- Day 2, 520:21-520:24, Oct. 28, 2014)

- De La Sierra Testimony

Q ... Now you mentioned at the beginning of our conversation that you understood Mr. Delaney was aware that Stock Loan was not closing out at market open T+6. Do you recall that?

A Yes.

Q How do you know that?

A Mike had gone over to talk to him, and then Tom had come back to our group and there was an open discussion there. And then I think Mike and, you know, Tom had gone into their -- into Mike's office to discuss further.

Q When were the conversations that you observed between -- Mike Johnson?

A Correct, Mike Johnson.

Q -- and Mr. Delaney, approximately when did those conversations occur?

A When this rule -- when -- when 204T went into effect.

Q And, in substance, what were those conversations?

A We notified them that our counterparties were not accepting our recalls.

Q **Your recall --**

A I'm sorry. Not our recalls. Our -- our morning -- our market open buy-ins on T6.

Q So with the conversations that you personally observed between Mr. Johnson and Mr. Delaney, tell me again -- I'm sorry, my train of thought was interrupted -- what was the substance of that conversation.

A We notified Tom, or Mike notified Tom, that our counterparties were not accepting our morning buy-ins. That they were stating that it was contradictory to the recall letter and -- and the MSLA, the Stock Loan agreement.

Q Did you personally observe those conversations?

A I did.

Q How often -- how many could you say you observed?

A Just a couple.

(Hearing- Day 1, 235:13-237:19, Oct. 27, 2014)

A ... [Delaney] knew we weren't buying in at the open.

Q How -- when you say he knew we weren't buying in at the open, what do you mean?

A Mike had told him already that we -- our counterparties were not accepting morning buy-ins, and we were -- we were going -- we were -- we were the [sic]

lost counterparties if we tried to buy-in against the recall letter or the MSLA, the securities loan agreement.

(Hearing- Day 1, 272:9-272:17, Oct. 27, 2014)

86. In his conversations with Delaney, Johnson sought guidance from Delaney on how to comply with Rule 204.

- Johnson Testimony

Q All right. Well, let me ask you this: Did you have any conversations with Mr. Delaney, Mr. Johnson, about Rule 204?

A Yes.

Q Describe for the Court those conversations, please.

A I was looking for help on interpreting it, on what to do with Rule 204. Industry practice, whatever, has been what you've showed me prior. That's the way the whole industry operated, the three o'clock in the afternoon, for 40 years. 204 presented a new light in those, and I was searching for interpretation and guidance on how to comply.

(Hearing- Day 2, 517:24-518:11, Oct. 28, 2014)

87. Stock Loan sought guidance from Delaney because he was the Chief Compliance Officer and they wanted to make him aware that there was a conflict between the Rule's requirements and counterparties stating that Stock Loan could not execute close-outs at market-open based on the terms of PFSI's recall letters.

- De La Sierra Testimony

Q Mr. De La Sierra, why were you talking with Mr. Delaney about this issue you were having with being able to buy-in at market open T+6?

A The particular conversation I had with him or why was Mike going to Tom? Q Yeah, let me ask more generally. Why -- why go to Mr. Delaney with this issue?

A Mike would have gone directly to Tom Delaney because he was the Chief Compliance Officer.

Q Why would you go to the Chief Compliance Officer?

A So he was aware that we had a contradictory situation with our counterparties telling us that we can't comply with this rule based on our recall letters.

Q And what were you looking for compliance to do?

A To give us guidance.

(Hearing- Day 1, 239:14-240:4, Oct. 27, 2014)

88. Part of the role of a compliance officer is to give guidance on rules.

- Alaniz Testimony

Let me first -- we've had some witnesses talk about this, but I want to ask, what -- what

do you understand the compliance function in a broker-dealer to be?

A The rule of compliance of a broker-dealer is to create a semblance of -- create a framework of compliance, give guidance on rules, take rules and apply them to your business -- your business products and services, help alleviate any questions from any rules that arise throughout the process of your job. That's my understanding of compliance.

(Hearing- Day 3, 725:17-726:2, Oct. 29, 2014)

89. Poppalardo would have expected a CCO asked for guidance to provide assistance.

- Poppalardo Testimony

Q Okay. If a -- if a business line person were to come to a CCO and say, We can't figure out how to comply with this new rule, what would you expect the CCO to do?

A Pull together a working group, figure out, you know, what needed to be done, whether it was revising an automated -- reprogramming an automated system or, you know, working within the firm to make sure that you were able to comply.

Q Would you expect the CCO to take steps to understand what the problem was?

A I think that if the problem is clear on its face and it was something that was programmed into an automated system, you don't need to know all of the details; you just need to know that you have an IT problem and you need to get that fixed. But, you know, it really -- it depends on the situation.

Q Okay. But it sounds like you would expect the CCO to take some steps; is that right?

A I would expect the CCO, to the extent that it came to his attention, he became aware of it, once you become aware of something, you've got to do something. So to work with the business line and to figure out how to fix -- address the problem.

(Hearing- Day 8, 2029:9-2030:7, Nov. 5, 2014)

90. Stock Loan took guidance from compliance seriously, and followed that guidance when it was given.

- De La Sierra Testimony

Q Mr. De La Sierra, did you take compliance seriously at Penson?

A Yes, we did.

Q Were there ever instances where the Compliance department gave you guidance and you complied?

A Yes.

(Hearing- Day 1, 240:9-240:14, Oct. 27, 2014)

91. Rather than provide guidance to Stock Loan on how it could comply with Rule 204, Delaney told Johnson to "call your Congressman" if he had problems with the rule.

- Delaney Testimony

Q Okay. We'll talk about some of those conversations in detail. But for present purposes, did you ever have a conversation with Mike Johnson?

A I did.

Q What do you recall about that conversation, including the time, if you can give us your best estimate?

A It was around the time when we were communicating out the 204T requirements. Mike Johnson had expressed some concern that he was getting counter-party pushback, and -- and -- and he was just voicing his -- his concern and frustration with me about that.

Q Did you understand what he meant by "counter-party pushback"?

A I believe I understood it at the time, yes.

Q Okay. Did you give any response?

A I did.

Q What -- what was your response?

A If -- if you know Mike Johnson personally, he's -- he's a pretty interesting character; and I think I recollect my response being something like, Mike, if you don't like the rule, you need to go to Congress and/or write your congressman.

Q Why did you say that?

A His complaint about the rule, to me -- I had no ability to change the rule from a compliance standpoint. And so, at that point, I -- I -- he was expressing some frustration, and that really -- the rule is the rule, and this is really what he -- his avenue would be to go through whatever legislative process he could in order to affect a rule change.

(Hearing- Day 5, 1192:12-1193:18, Oct. 31, 2014)

- De La Sierra Testimony

Q What did you observe Mr. Delaney saying in response to Mike Johnson saying, we can't do buy-ins at the market open?

A He said he understood and he'd get back to Mike.

Q And did you ever personally observe him getting back to Mr. Johnson?

A I did not.

(Hearing- Day 1, 237:20-238:2, Oct. 27, 2014)

Q And at that point in time when these conversations occurred, did you receive any guidance from compliance?

A We did not.

(Hearing- Day 1, 240:5-240:8, Oct. 27, 2014)

92. At approximately the same time that Johnson and Delaney were discussing Stock Loan's compliance issues, Delaney and Rudy De La Sierra had a conversation in which Delaney asked whether Stock Loan was still having issues with market-open buy-ins, and De La Sierra confirmed that Stock Loan had not resolved the issues.

- De La Sierra Testimony

<p>Q Did you personally have any conversations with Mr. Delaney regarding Stock Lending and closing out at market open of T+6?</p> <p>A I did.</p> <p>Q Tell us about those.</p> <p>A It was at one of the -- Bill Yancey's meetings. We just happened to be sitting next to each other, and he had asked me if we'd -- if we were still having issues with the morning buy-in.</p> <p>Q And what did you say?</p> <p>A I said yes, we were. We're -- we're not getting any headway.</p> <p>Q And what did Mr. Delaney say in response?</p> <p>A He said okay.</p> <p>Q He said okay?</p> <p>A Yes.</p> <p>Q Approximately what time or when -- excuse me. Approximately when did the conversations occur where you again told Mr. Delaney you weren't able to buy-in at market open?</p> <p>A This would have been in the first couple weeks of the 204T.</p> <p>(Hearing- Day 1, 238:3-238:24, Oct. 27, 2014)</p>

93. In response to De La Sierra confirming that Stock Loan was still not able to buy-in at the market open on T+6, Delaney simply said "okay." Delaney did not instruct De La Sierra that Stock Loan had to comply with the market-open requirement of Rule 204 regardless of any counterparty resistance.

- De La Sierra Testimony

<p>Q And what did Mr. Delaney say in response?</p> <p>A He said okay.</p> <p>Q He said okay?</p> <p>A Yes.</p> <p>...</p> <p>Q In that conversation that you had with Mr. Delaney, did he say, in sum or substance, tough luck, you have to comply?</p> <p>A No.</p> <p>Q In sum or substance, did he say you have to stop doing market afternoon buy-ins?</p> <p>A No.</p> <p>(Hearing- Day 1, 238:15-239:6, Oct. 27, 2014)</p>
--

94. Stock Loan did not hide from Delaney the fact that it was not closing out fails to deliver at market-open T+6.

- De La Sierra Testimony

Q Mr. De La Sierra, did you hide the fact that Stock Loan was not closing at market open T+6 for Mr. Delaney?

A We did not.

Q Did you ever manipulate a report to conceal violations from Mr. Delaney?

A We did not.

(Hearing- Day 1, 239:7-239:13, Oct. 27, 2014)

95. Stock Loan told Tom Delaney that Stock Loan's practice was to close-out fails to deliver on long sales on the afternoon of T+6.

- De La Sierra Testimony

Q And if you can look at the second paragraph from the top, Mr. De La Sierra. And that paragraph, in response to Exception 13 about Rule 204, says, "With regard to the timing of long sale close-outs, the firm does not believe it is industry practice to close-out long sales prior to the market open on T+6."

And a couple of sentences down, it says, "**Thus, the firm executes close-outs versus long sales at the conclusion of the DTCC trading window at approximately 3 o'clock Eastern Time daily.**"

Do you see where I read?

A I do see that.

Q **Mr. De La Sierra, was that, in fact, the practice of Stock Lending at Penson?**

A **It was the practice.**

Q And how long had that been the practice of Stock Lending at Penson Financial?

A From the inception of this rule, 204T.

...

Q We'll come back and talk about this more in a moment. But **did Tom Delaney know what Stock Lending's practice was?**

A **He did.**

(Hearing- Day 1, 201:13-202:18, Oct. 27, 2014)

Q You also talked, I -- I believe, with Mr. Lebenta or Mr. Washburn yesterday about your conversations, both that you overheard between Mr. Johnson and Mr. Delaney and that you personally had with Mr. Delaney regarding Stock Lending's practices when Rule 204T came out. Do you recall generally that testimony?

A Yes.

Q **In -- in those conversations, did you or Mr. Johnson make it clear to Mr. Delaney that Stock Loan was not closing out at market open?**

A **Yes.**

...

Q In the conversations, did Mr. Delaney ever ask whether Penson was still buying in for its own account even though the counterparties wouldn't take the buy-in?

A No, he never asked that.

Q In the conversations, did you or Mr. Johnson ever suggest that Penson was still buying in at the opening even though the counterparties wouldn't take it?

A No, we never told him that.

...

Q ... Based on your overhearing those conversations and participating in the conversations themselves, was there any doubt in your mind that it was clear that Stock Lending was not complying with the rule?

A We were not complying at the open of T6?

Q Correct.

A Correct.

(Hearing- Day 2, 337:2-338:17, Oct. 28, 2014)

Q And was there any ambiguity that Mr. Delaney knew that Stock Loan was not closing out at market open T+6?

A No.

(Hearing- Day 2, 339:2-339:5, Oct. 28, 2014)

- b. Delaney received guidance about Rule 204T/204 both before and after his conversations with Johnson and DeLaSierra.

96. On September 21, 2008, Delaney received and read guidance that the Commission had issued an emergency order requiring close-out at market open T+6 of all fails to deliver due to long sales.

- Stipulated Finding of Fact 84
- Ex. 422a at pp. 1, 6

24. What is the close-out requirement for long sales?

If a clearing broker can demonstrate on its books and records that a fail-to-deliver position resulted from a long sale, the broker has until the third settlement day following settlement date to close out the fail without becoming subject to the borrowing penalty.

- Delaney Testimony

Q Okay. Well, let's just ask that question: Do you know if you looked -- and the document you're looking at is marked as Exhibit 422A; is that right?

A It is.

Q Do you know if you looked at that exhibit at the time?

A It's always -- this is the practice for what often happens. And so to the extent that it has always been my custom when I get these, to -- to look at that link, I -- I'm sure I did. I don't know specifically, as I sit here today, if I can tell you I actually looked at this one, but that was absolutely my custom.

(Hearing- Day 5, 1245:17-1246:3, Oct. 31, 2014)

97. In October 2008 Morgan Lewis issued additional guidance about Rule 204T. It was Delaney's practice to review Morgan Lewis's guidance carefully. This guidance specifically discussed the impact of Rule 204T on securities lending. The guidance also linked to the Rule 204T adopting release.

- Exhibit 255 at p. 4, 5

11. How will the interim rules affect securities lending practices?

In footnote 70 of its release, the SEC noted that if a person that has loaned a security to another person sells the security and a *bona fide* recall of the security is initiated within two business days after trade date, the person that has loaned the security will be "deemed to own" the security for purposes of Regulation SHO and the sale will not be treated as a short sale for purposes of Interim rules. In those cases, the close-out requirements for long sales will apply.

Additionally, while the interim rules do not prohibit the use of locates in connection with short sales where the clearing broker is not subject to the borrowing penalty, it is possible that clearing firms may insist on receiving pre-borrows on all short sales if traditional stock lenders withdraw from the market. Stock lending agents and clearing brokers that rely on borrowings from those lenders may want to discuss the mechanics around borrowings in light of the new rules to ensure that there will be available borrowing to satisfy trade orders. In addition, securities lending firms may want to take steps to lock up the locates or pre-borrows they have given so that they are able to fulfill all of their commitments to lend.

To view the SEC's release, please visit: <http://www.sec.gov/rules/final/2008/34-58773.pdf>.

- Delaney Testimony

Q Okay. You -- Mr. Washburn specifically asked you about Morgan Lewis. You said that you had gone to the Morgan Lewis website and had reviewed their guidance and had looked at it carefully; is that right?

A Yes, ma'am

(Hearing- Day 5, 1400:16-1400:20, Oct. 31, 2014)

98. Delaney also read the adopting release for Rule 204T.

- Delaney Testimony

Q So you've seen Exhibit 67. You've seen the adopting release for Rule 204T; is that correct?

A I said that here, but I stand my by answer that I think my intention was that I don't know if I specifically saw it off the Federal Register. But I certainly would have seen it in

some other context of the rules being released.

(Hearing- Day 2, 576:12-576:18, Oct. 28, 2014)

99. Delaney was aware of the tension between the close-out requirements of Rule 204T and securities lending practices.

- Exhibit 224 (Delaney Investigative Testimony) at p. 404

Q Were you aware of any tension between Rule 204T's closeout requirements and securities lending practices?

A I was generally aware that there was discussions out there of potential for that but not specific to Penson. It was more of an industry discussion.

(Delaney, Tom- INV vol III, 404:1-404:5, July 31, 2013)

100. On December 13, 2008, Delaney received comments about Rule 204T. The e-mail noted that "Rule 204T applies to long sales, not just short sales. Unfortunately, the timelines set by the rule do not match the timelines in the securities lending markets" and asked PFSI to write a comment letter to the Commission concerning adoption of the rule.

- Exhibit 160, at pp. PFSI2325526 – 27

---Original Message---From:

Phil Pendergraft

To: Andy Koslow; Mike Johnson; Tom Delaney; Bill Yancey

Sent: Sat Dec 13 16:32:51 2008

Subject: Fw: SEC Rule 204T- Comments needed

Mike & I are writing you regarding the SEC's interim final temporary Rule 204T (the "hard close-out rule"). While the rule has had some positive effects in reducing fails to deliver, it also has had significant negative unintended consequences on broker-dealer financing and stock market volatility. We think that these negative effects can be largely mitigated by a few simple clarifications to the rule, as detailed below and in the attached letter. In furtherance of these clarifications, which we believe are critical to the efficient functioning of the securities lending market, we have spoken to the SEC about our concerns and written a comment letter on the Rule as well (attached). We urge you to do the same before the expiration of the comment period next Tuesday, December 16.

Rule 204T applies to long sales, not just short sales. Unfortunately, the timelines set by the rule do not match the timelines in the securities lending markets, and this contradiction leaves brokers with an unattractive choice: either risk violating the rule or curtail securities lending. Since the Rule became effective in late September, the broad securities lending market has shrunk by 50%, reducing cash liquidity to the finance industry when the industry needs it most – broker-dealers with excess cash balances hoard their cash and refuse to lend, while broker-dealers who have cash needs draw on bank lines (concentrating counterparty risk and reducing credit availability to other bank customers).

101. On December 15, 2008, Delaney received a comment letter concerning Rule 204T written by the Securities Industry and Financial Markets Association ("SIFMA"). This letter contained a whole section on the impact of Rule 204T on stock

lending. Among other things, the letter discussed the conflict between stock lending practices and Rule 204T.

- Exhibit 541 at pp. PFSI1842604, 613-614

<p>To: Tom Delaney[TDelaney@PENSON.COM] From: John Kenny Sent: Mon 12/15/2008 7:49:55 AM Importance: Normal Subject: FW: Rule 204T Draft Comment Letter <u>Rule 204T Comment Letter.doc</u></p> <p>Tom,</p> <p>A comment letter from SIFMA on rule 204T is attached.</p>
<p style="text-align: center;">3. <i>Instability in the Securities Lending Market</i></p>
<p>The sale of securities on loan is considered a long sale, a fact reaffirmed by the SEC in an FAQ issued with respect to the series of emergency orders issued earlier this year.¹³ Thus, the close-out requirement for long sales under Rule 204T would apply to sales of such securities. The longer delivery period permitted for long sales is critical for entities that lend securities given the recall process that applies to securities on loan. Both as matters of contract under the Master Securities Lending Agreement and market practice, a borrower has the standard settlement period that applies to a loaned security to return the securities once they have been recalled. This period is necessary because the borrower may actually need to purchase the securities in order to return them should other borrowable shares not be available. However, as discussed in Section II.B. above, due to the difficulty that broker-dealers have in decomposing their net CNS delivery requirements into the portion that are attributable to long sales, as opposed to short sales, the lenders of shares are often being threatened with buy-in as if the sale was executed as a short sale.</p>

102. In July and August, 2009, Delaney reviewed additional guidance from PFSI's legal advisors. This guidance provided a link to the adopting release for Rule 204. Delaney testified that it was his practice to review the links in such guidance.

- Exhibit 424 at p. 1

Additional Materials

- Rule 204: Amendments to Regulation SHO (Release No. 34-60388)

- Exhibit 425(a) at p. 3

The SEC's Adopting Release is available at <http://www.sec.gov/rules/final/2009/34-60388.pdf>.

- Delaney Testimony

Q And I remember there being a little back and forth about whether you'd seen a

particular document that ended being the adopting release. Do you remember that?

A I do.

Q And what did you tell Ms. Atkinson about where you got the document releases?

A I don't -- I don't specifically remember my answer, what I -- what I told her. Well, let me ask you this: Within Exhibit 424 --

MR. WASHBURN: If you can scroll down there, Mike.

BY MR. WASHBURN:

Q -- is there a reference to that adopting release?

A There is.

Q And where would we find that?

A There's going to be a -- there's going to be links. And many of the lawyers' communications, with the associated adopting releases, you'll find that they will put those links to the -- to the adopting releases right in their communications.

Q And so here, for example, do you see a release number on there?

A I do.

MR. WASHBURN: And if we could, Mike, go to Exhibit 301, and I believe it's Page 24 of that exhibit. And if you can keep them both up, those last two. I apologize. I should have described that to you.

BY MR. WASHBURN:

Q Mr. Delaney, just in case you don't remember rule -- or Exhibit 301 is -- is Mr. Alaniz's binder that he used for his testing. Do you see the release number there in Rule 301?

A I do.

Q And is it the same -- this adopting release that Mr. Alaniz had in his binder, is that the same number as the one referenced here?

A It is.

Q So this e-mail here that we're seeing in -- in Exhibit 424, is that the kind of e-mail that might alert you to an adopting release?

A Very typically, yes.

(Hearing- Day 5, 1252:12-1254:4, Oct. 31, 2014)

Q Okay. Well, let's just ask that question: Do you know if you looked -- and the document you're looking at is marked as Exhibit 422A; is that right?

A It is.

Q Do you know if you looked at that exhibit at the time?

A It's always -- this is the practice for what often happens. And so to the extent that it has always been my custom when I get these, to -- to look at that link, I -- I'm sure I did. I don't know specifically, as I sit here today, if I can tell you I actually looked at this one, but that was absolutely my custom.

(Hearing- Day 5, 1245:17-1246:3, Oct. 31, 2014)

103. The adopting release for Rule 204 specifically discussed the "effect of the requirements of temporary Rule 204T on securities lending" and noted the conflict between the "completion of the securities lending cycle" and the requirements of the

rule. Nonetheless, in the next paragraph the Commission reiterated that despite the impact on securities lending, the Commission would keep the closeout requirements.

- Exhibit 69 at p. 38270

Commission extend the close-out requirement for fails to deliver resulting from all sales to five settlement days after the fail to deliver position occurs.⁵³ These commenters stated that the additional time to close out fails to deliver would allow the majority of trades to clear and settle on their own within a few days following the regular settlement date (*i.e.*, T+3).⁵⁴

Some commenters expressed concerns about the effect of the close-out requirements of temporary Rule 204T on securities lending.⁵⁵ For example, one commenter stated that the compressed time-frame for closing out fails to deliver under temporary Rule 204T “has generated over-buying and borrowing of securities that would otherwise settle in the normal course, thus impairing liquidity by tying up shares that would otherwise be available to natural buyers and sellers.”⁵⁶ This commenter also noted that in practice fails to deliver resulting from sales of securities on loan, which are considered “long” sales, are often closed out in accordance with the time-frames for fails to deliver resulting from short sales rather than long sales because temporary Rule 204T does not provide sufficient time to determine whether or not a fail to deliver position resulted from a long or short sale.⁵⁷ According to this commenter, such purchasing activity acts as a disincentive to lending and causes institutions to question their participation in lending programs.⁵⁸

Other commenters stated that where the holder of a long position sells

securities that have been financed through a securities loan, the close-out requirements of temporary Rule 204T may not provide sufficient time for the securities to be recalled and delivered in time for settlement of the sale transaction.⁵⁹ These commenters stated, among other things, that temporary Rule 204T’s requirement that securities be delivered by no later than the beginning of regular trading hours does not allow for the completion of the securities lending cycle, which may not occur until the close of the DTC settlement window on the third settlement day after settlement date (*i.e.*, T+6).⁶⁰

As noted above, the close-out requirements of temporary Rule 204T are advancing our goal of further reducing fails to deliver, as evidenced in part by preliminary results from OEA regarding its impact on the number of fails to deliver.⁶¹ Thus, we are adopting as a permanent rule the structure of the close-out requirements of temporary Rule 204T. Specifically, Rule 204(a) provides that a participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours⁶² on the settlement day⁶³

104. In August 2010, Compliance Officer Eric Alaniz sent Delaney an e-mail attaching guidance concerning Rule 204. The guidance repeated a portion of the August 2009 adopting release, and two of the nine paragraphs in the guidance discussed the conflict between the securities lending practices and Rule 204’s requirements.

- Exhibit 328 at pp. 1, 3

From: Eric Alaniz
Sent: Friday, August 20, 2010 11:27 AM
To: Alan Zablouil
Cc: Jimmy Glasgow; Thomas Textor; Tom Delaney
Subject: Buy-Ins Per Rule 204
Importance: High

Some commenters expressed concerns about the effect of the close-out requirements of temporary Rule 204T on securities lending.⁵⁵ For example, one commenter stated that the compressed time-frame for closing out fails to deliver under temporary Rule 204T “has generated over-buying and borrowing of securities that would otherwise settle in the normal course, thus impairing liquidity by tying up shares that would otherwise be available to natural buyers and sellers.”⁵⁶ This commenter also noted that in practice fails to deliver resulting from sales of securities on loan, which are considered “long” sales, are often closed out in accordance with the time-frames for fails to deliver resulting from short sales rather than long sales because temporary Rule 204T does not provide sufficient time to determine whether or not a fail to deliver position resulted from a long or short sale.⁵⁷ According to this commenter, such purchasing activity acts as a disincentive to lending and causes institutions to question their participation in lending programs.⁵⁸

Other commenters stated that where the holder of a long position sells securities that have been financed through a securities loan, the close-out requirements of temporary Rule 204T may not provide sufficient time for the securities to be recalled and delivered in time for settlement of the sale transaction.⁵⁹ These commenters stated, among other things, that temporary Rule 204T’s requirement that securities be delivered by no later than the beginning of regular trading hours does not allow for the completion of the securities lending cycle, which may not occur until the close of the DTC settlement window on the third settlement day after settlement date (i.e., T+6).⁶⁰

c. Testing by the Compliance Department put Delaney on notice that PFSI was have Rule 204 compliance issues

105. In December 2009, PFSI’s Compliance department did testing pursuant to FINRA Rule 3012 of PFSI’s compliance with Rule 204 (the “Rule 204 Test”).

- Ex. 70 at 1

3012 Test Results	
To:	Brian Hall & Rudy De La Sierra
From:	Eric Alaniz
Date:	December 21, 2009
Audit:	Securities Lending Department
Subject:	SEC Rule 204

- Alaniz Testimony

Q Does Exhibit 70 basically summarize the results of your testing of Rule 204 in late 2009?

A Yes.

Q And do you recall when that testing -- when you did that testing?

A December of 2009. I usually start my testing four to six weeks before I write the letter, so that would be somewhere around October, November 2009.

(Hearing- Day 3, 704:23-705:5, Oct. 29, 2014)

106. Alaniz discussed the December 2009 testing with Delaney before doing the testing.

- Alaniz Testimony

Q Okay. How did this audit come about? What caused this audit to occur?

A My basic -- basic way I come up with any audit is that I had a process. I reviewed FINRA sites, SEC sites. I would check in to our regulatory compliance area. I would ask to see what the regulators were asking about. And then from there, I would gather a list of topics. From that point, I would take it to Tom Delaney. We'd create a list. And then from there, we'd go have that list augmented or add to it if there were anything that needed to be added to it from Bill Yancey. And then from there, we'd develop what we would test throughout the year.

(Hearing- Day 3, 705:6-705:19, Oct. 29, 2014)

107. The December 2009 audit results related only to the Buy-Ins department.

- Stipulated Finding of Fact 78.

108. Delaney claimed that his "procedures formed the basis of compliance testing at PFSI that reliably determined whether, and to what extent, PFSI was in compliance with Rule 204T, 203, and 204."

- Exhibit 157 (Delaney Wells Submission) at p. 4

The procedures Mr. Delaney implemented cannot be questioned. Indeed, Delaney's procedures formed the basis of compliance testing at PFSI that reliably determined whether and to what extent PFSI was in compliance with Rules 204T, 203 and 204. The procedures, then,

109. Delaney admits, however, that the December 2009 compliance testing did not test whether Stock Loan was closing out long sales of loaned securities in compliance with Rule 204.

- Delaney Testimony

Q Okay. Did this 3012 testing, did it test the close-outs of long sales when a stock loan was out?

A I don't believe -- I don't believe that the testing ends -- ends up doing that.

Q Okay. So it did not test whether Stock Loan was closing out in compliance with Rule 204?

A It was intended to test that, but I think at the end, and as we look through it now, it does not appear that it did.

(Hearing- Day 2, 608:6-608:14, Oct. 28, 2014)

- De La Sierra Testimony

Q And tell us generally, what -- what is this document about, what does this reflect?

A Eric was telling us that we were not fully compliant with the 204 regarding the penalty box requirement and also the arranged portion or the -- we were using arranged language for a borrow when it had to actually be in possession before the open of a T4.

Q So as to Stock Lending, it sounds like there were two issues that this 3012 test dealt with. The first was the penalty box, correct?

A Correct.

Q And then the second was arranged borrows?

A Yes.

Q Do you recall whether this audit had anything to do with whether Stock Lending was closing out at market open on T+6 fails related to long sales?

A No, that wasn't in this meeting.

Q That wasn't in this meeting. Do you recall from looking at the audit whether the audit had anything to do with that issue?

A It did not mention it, no.

(Hearing- Day 1, 244:25-245:20, Oct. 27, 2014)

110. Alaniz wrote a report summarizing the results of the December 2009 testing of Rule 204.

- Exhibit 70
- Alaniz Testimony

Q Does Exhibit 70 basically summarize the results of your testing of Rule 204 in late 2009?

A Yes.

(Hearing- Day 3, 704:23-704:25, Oct. 29, 2014)

111. The Rule 204 Test results showed that close-outs of short sales occurred between 30 minutes and 1 hour and 15 minutes after market open, close-outs of long sales occurred between 4 hours from market open to up until 11 minutes of the market close, and, of the 113 securities transactions tested, 112 failed to comply with Rule 204.

- Exhibit 70 at 2

Review of the T+4 query/reports

During the weeks of November 16th through the 20th and December 7th through the 11th there were a total of 62 required buy-ins as a result of "fail to deliver" positions ("FTDs") on the T+4 query/report. The Buy-In Department bought in 47 of the "FTD" positions while the other 15 were given to the correspondent to close out.

The 47 buy-ins placed by the Buy-In Department resulted in orders placed anywhere from 30 minutes to a 1 hour and 15 minutes after the market open.

Review of the T+6 reports (EXT816)

In the case of the T+6 (long sales) reports the Buy-In Department was required to close-out 51 "FTD" positions in the same time frame.

The 51 buy-ins placed by the Buy-In Department resulted in orders placed anywhere from 4 hours from the market open to up until 11 minutes of the market close.

Final Result - The failure to comply with the close-out requirement placed 112 out of 113 securities in the "Penalty Box".

112. This was one of the most significant occurrence of failures PFSI's compliance department had ever seen in its Rule 204 testing.

- Alaniz Testimony

Q Do you recall what the results of your testing were?

A Yes. I believe out of 113, 112 of those items that I reviewed had failed. They had not met the requirement of the rule.

Q Do you think that was a significant failure?

A For that time frame that I had tested, in that window, compared to my other audits, I would say it was probably one of the more significant ones out of my whole testing procedures, for items that I tested.

(Hearing- Day 3, 708:7-708:16, Oct. 29, 2014)

113. Delaney characterized these failures as "massive," "profound," and "anomalous."

- Stipulated Finding of Fact 21.

114. No other testing show similar failures.

- Delaney Testimony

Q Do you recall any other testing during that -- during this time period, the cycle that would have fed into this Summary Report, that showed a 99 percent failure rate?

A Just with respect to the -- the matter at hand or -- or for anything.

Q Any -- any 3012 testing that Penson performed from -- from -- I guess it would have been April 2009 through March of 2010. Did I do that right? Through March -- through April of 2009 through March of 2010 that would have showed a 99 percent failure rate.

A I don't think so.

Q Anything that showed a profound failure in the testing?

A Other than -- other than -- other than Eric's testing with respect to those 113 items, I don't -- I don't recall there being anything else that had a testing result that came out like that.

(Hearing- Day 5, 1383:6-1383:23, Oct. 31, 2014)

115. Gover came to believe that some of the failures were attributable to PFSI's Stock Loan department.

- Gover Testimony

Q What I'm trying to -- let me -- actually, let me go back to a different topic if I can shift a little bit here. You were shown Exhibit 70, and this is a 3012 report. And I would like to go to that, if I can. There was a section -- and I honestly missed it a little bit. But there was a section that you said you didn't think related to your buy-ins department. I think it's on the next page, if we can go there. Which section was it?

A Just a moment.

A In the sentence that starts with, In the case of the T+6 (long sales) report, the buy-in department was required to close-out 51 FTD positions in the same time frame. The 51 buy-ins placed by the buy-in department resulted in orders placed anywhere from four hours from the market open until 11 minutes of -- until 11 minutes of the market close.

Q Okay. So that's the section where you said you don't think that related to buy-ins?

A I don't -- roughly, correct.

Q Okay. Ms. Atkinson didn't ask. I will. What did it relate to?

A A part of the problem with the not closing out items, there's a couple of -- couple of items around Reg SHO, but one of them was hitting the market open. What we'd seen when we audited the buy-ins functions is that we were missing the market open by, you know, five minutes, 15 minutes. We weren't missing the market open by a day.

Q Okay. So again, I -- I apologize. Do you attribute that to any particular part of Penson other than buy-ins?

A Yeah. I mean, at the end of the day Penson is responsible for the close-outs.

Q I get that. I'm just trying to figure out if -- if wasn't buy-ins --

A What I think was happening was that Stock Loan was recalling the shares. So they were coming back and saying, hey, so let me take a back -- a step back. It might be helpful to understand the process.

Q Well, let me -- instead, let me go here. So you think this relates to that Stock Loan's -- whether they were buying in for market open?

A I think it re- -- I think it relates to, when Stock Loan was recalling the shares, as to whether those shares were being recalled in time for the open or if they were getting recalled and they were coming into the close.

Q Okay. So that's what you think those sales came from?

A I think some of those sales would be attributable to that.

(Hearing- Day 1, 152:5-154:21, Oct. 27, 2014)

- d. In early 2010, Delaney was notified by Brian Gover that Stock Loan was violating Rule 204.

116. Between March 2010 and June 2010, Gover had a conversation with Delaney and Johnson. In that meeting, they discussed that CNS fails attributable to PFSI's Stock Loan department were not to be closed out. They also discussed the conflict between the buy-ins contemplated by the MSLA and required by Rule 204.

- Gover Testimony

Q Well, tell us -- why don't you tell us about those conversations, the conversations between you and --

A Sure.

Q -- Mr. Delaney --

A Yeah.

Q -- about Rule 20- -- 204 and Stock Loan.

A Well, I think the one that is probably germane to this conversation, or one of them anyways, we encountered an issue where we had a CNS obligation. We -- we -- we were short to CNS. And when we looked at our stock record, there were no -- there were no customers that were selling short that we could buy-in, and all of the excess stock was on loan. So it showed in a location of being stock on loan on the Stock Loan box. So we were presented with a situation where we had an obligation to buy-in, but the only party that we could buy-in would have been the Stock Loan department.

Q And so what happened?

A It was escalated to me by the buy-ins group, and we had a conversation -- had requested a conversation with compliance and Stock Loan. And it was basically -- the - - the message we were getting from Stock Loan is that you don't buy-in Stock Loan. And I'm looking at what I thought were our obligations under Reg SHO from my buy-ins group and saying, well, that kind of puts us in a bad position because I have an obligation to buy-in, but I've also got Stock Loan saying, you can't buy us in and there's nobody else that could buy-in. So that precipitated a discussion around the rule.

(Hearing- Day 1, 102:25-104:3, Oct. 27, 2014)

Q Okay. And how was the problem presented in that conversation?

A I am paraphrasing. But it was, okay, Stock Loan is saying they don't get bought in, and then here's me holding 204 and saying I've read the reg, and I don't see anywhere it gives -- where it gives me an out for that. So there were some discussions about, well, in order to have the shares for a loan sale, they should -- they would have to be recalled to -- they have to be recalled earlier. They have to have -- we have to have the shares -- if we've got shares, this is really -- this is -- gets really complicated. So if I need to clarify, please stop me.

Q Okay.

A All right. So then it all ties back into like margins and hypothecation. So let's say you -- you're that customer that had a \$5,000 margin debit with Penson and we had lent your shares out because somebody else thought IBM was going to go down in value. So you -- you bought the shares. They're yours. You don't have to pre-clear

selling them because they're on a loan. But somebody else thought IBM was going to go down, so they wanted to borrow shares. And because we as a firm could make money on them, we'd lend the shares out to that party. You sell your shares. You -- you sell all \$10,000 worth, however many shares that is. In order for us to make delivery, we have to recall those shares from whoever we lent them to. In order to have those shares in hand in time to make the -- the Reg SHO requirement of at the open, we would need to recall them earlier. Where the -- where the point of discussion was, the Stock Loan compliance and buy-ins was -- I think Stock Loan maintained that that wasn't industry practice and that the Stock Loan agreements, the MSLAs, weren't -- didn't support that. And so that's where we had a conflict.
(Hearing- Day 1, 104:15-106:1, Oct. 27, 2014)

Q And you spoke earlier about a conversation that you had with Tom Delaney and Mike Johnson. Can you put that into a time frame for us? You took over buy-ins in August or September and --

A I will attempt.

Q Okay.

A And I do it -- you know, there's kind of like there -- I can put time frames around issues around when I think that happened. I believe that we -- that we had a couple of conversations, one when I first took over buy-ins, which would have been, to my recollection, third quarter of 2009. I also believe that there was another conversation that occurred in -- sometime in the spring of 2010. And, you know, it's kind of like, well, okay, I know I took buy-ins about when I -- you know, about a couple of months after I took Stock Loan. I know I hired a VP at Stock Loan in August. So, you know, it's within that range.

And I can also -- you know, as I move through the continuum of my career progression at -- at Penson, I can say, okay, I know that I wasn't -- well, you know, I wasn't -- I wasn't focused on buy-ins during, you know, the latter half of 2010 because I was focused more on margins because we were -- so is that helpful? I mean, I -- I can't say on, you know, July 29th we had this meeting.

Q Sure.

A But to my recollection, that it was within the first six to nine months after my taking buy-ins that we had the conversations and the conflict on the Stock Loan over when the shares were recalled.

(Hearing- Day 1, 117:16-118:21, Oct. 27, 2014)

Q Okay. And the last thing I want to ask you about is the meeting that you had with Mr. Delaney and Mr. Johnson, and I just wanted to kind of circle back around and say, is there anything that you heard on cross-examination that has changed your mind about when you think that meeting occurred?

A Not substantially, no. I mean, it was -- it felt chronologically like it was pretty close to when I had took over the team. I know that I had a lot of other things that started to get -- you know, grabbing my attention beginning late summer of 2010. And, you know, based on the exhibits that I had seen that accompanied my -- my declaration and then some of the other e-mails that I had seen, it seems pretty consistent with my

recollection that it was, you know, somewhere between March and June of 2010.

(Hearing- Day 1, 197:4-197:19, Oct. 27, 2014)

- e. Delaney received additional red flags that Stock Loan was not complying with Rule 204 both before and after his conversation with Gover.

117. Delaney was responsible for ensuring that PFSI's WSPs reflected relevant regulatory guidance in Stock Loan's close-out practices.

- Hasty Testimony

You believe that Mr. Delaney was the compliance person responsible to ensure that Stock Loan's WSPs reflected relevant regulatory guidance in actual close-out practices; is that right?

A Yes.

(Hearing- Day 7, 1774:9-1774:13, Nov. 4, 2014)

118. On January 25, 2010, Delaney asked Compliance Officer Eric Alaniz to review certain WSPs to see how they reconciled with his testing. Among other things, Alaniz recommended that "as much as they can, I'd recommend to consolidate them and include how Sendero will adjust for T +4's and T+6's close-out requirement " of Rule 204 and to "include close-out requirement procedures in the WSPs."

- Exhibit 82, Exhibit 166

From: Eric Alaniz <EAlaniz@PENSON.COM>
Sent: Monday, January 25, 2010 2:14 PM
To: Tom Delaney
Subject: RE: ROOR- 2D Stock Borrow and Stock Loan- For Approval
Attachments: Regulation SHO.pdf

Tom,

I just reviewed it and they don't address Reg SHO at it pertains to 204. I found some WSPs they may have overlooked (attached).

- As much as they can, I'd recommend to consolidate them and include how Sendero will adjust for T+4's and T+6's close-out requirement.
- Include close-out requirement procedures in the WSPs and how Sendero/Security Lending dept. will handle any subsequent "Penalty Box" securities. Include how they are notified by the Buy-In department of any "penalty box" securities.
- Include who and how they will handle "Penalty box" securities and any procedures for borrowing or arranging to borrow when a security is in the "box" regardless if they do not allow it.
- I am recommending they include how they reconcile all borrowed and arranged to borrow securities at the end of the day. Include that any failures to deliver will result in a ticket for buy-ins the next morning if not sooner and then the security placed in the "box" the following day.
- Recommend that all securities placed in the "box" be sent out to all our correspondents on a daily basis requiring them to borrow or arrange to borrow through us. Possibly eliminating the executing away of short positions violating our borrowing requirement while a security is in the "box".
- Want to know how they will handle any short positions executed away from us while in the "penalty box". Do we move them to an error account, etc?

I'd like to see them consolidate and address Rule 204 completely in the WSPs. What do you think about the recommendations above?

Eric

From: Tom Delaney
Sent: Monday, January 25, 2010 11:55 AM
To: Eric Alaniz
Subject: FW: ROOR- 2D Stock Borrow and Stock Loan- For Approval

Can you take a look through this and see how it reconciles with your testing. Unfortunately I need it by this afternoon.

Tom

119. Although Delaney claimed that he was "working to close" "the gap" "between PFSI's WSPs and Stock Loan's practices concerning timely buy-ins," Delaney admits that PFSI's March 31, 2010 WSPs, which Delaney specifically reviewed and approved, did not contain procedures for closing-out long sales.

- Exhibit 157 (Delaney Wells Submission) at p. 32

Mr. Yancey's approach to compliance with Regulation SHO's rules flew in the face of his duties at PFSI and turned a blind eye to the gap that Mr. Delaney was working to close between PFSI's WSPs and Stock Lending's practices concerning timely buy-ins. There is no excuse for this failure and the consequences that it had on compliance.

- Exhibit 188 at p. PFSI2289436

Penson Financial Services
BD Written Supervisory Policies and Procedures
3/31/2010 to Current

- Delaney Testimony

Q Mr. Delaney, have you had a chance to look through Exhibit 188?

A I have. Thank you.

Q And what we were talking about when we took a break was, there is language on Bates Page 89762 of Exhibit 188 that sets forth some procedures and steps in a broad way that will be taken to close-out short sales in compliance with Rule 204; is that basically correct?

A Yes.

Q And what I asked you was: Where does it talk about that process, those steps for long sales?

A Other than that general description we talked to above that talks about the T+6, there is -- I -- I don't see anything in these pages here that speak to that.

(Hearing- Day 3, 659:22-660:11, Oct. 29, 2014)

- Exhibit 191

To: Ken Belter[KBelter@penson.com]
From: Tom Delaney
Sent: Thur 4/1/2010 8:47:08 AM
Importance: Normal
Subject: 3/31/2010 WSPs

Ken,

I have reviewed and approved the WSPs published 3/31/2010. Please retain this email as evidence of my review and approval.

Thank you.

Tom

- Exhibit 188 at PFSI2289762

PROCEDURES ADOPTED IN ACCORDANCE WITH RULE 204.

In accordance with SEC Rule 204, A participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity. Accordingly PFSI adopted the following procedures:

PFSI will continue to provide an easy to borrow list each morning based on information received from our securities lending partners.

The methods by which correspondents and their clients can receive locates have not changed. Clients have the following three options to obtain locates:

1. API Access
2. Web Access
3. Short Sale Hot Line (214) 765-1151

Penson does not typically accept third party attestation letters. All Short Sales must either be on the easy to borrow list, or be approved through our Securities Lending desk in one of the aforementioned three manners. Any exceptions to this policy would need to be approved by Senior Management and documentation would need to be maintained by the Stock Loan Department.

If one of PFSI's correspondent clients is short a security, and PFSI has a fail to deliver in this security, the PFSI will remove this security from the easy to borrow list; until the fail to deliver is resolved, any Short Sales in this security will require pre-borrowing, if available.

If a correspondent client is short a security and PFSI is unable to make delivery, the correspondent client will be bought in on the first business day after settlement date (T+4), even if the security was on the easy to borrow list or was located through the Securities Lending Desk. PFSI will notify the Correspondent via email before the open on the day after settlement date that they will be bought in that day. All such buy-ins will be executed by PFSI at the open.

If PFSI is able to pre-borrow, PFSI may charge a pre-borrow fee.

120. Nor did PFSI's December 30, 2010 WSPs contain procedures for closing-out long sales.

- Exhibit 211 at p. PFSI1469407.3

Penson Financial Services
BD Written Supervisory Policies and Procedures
12/30/2010 to Current

PROCEDURES ADOPTED IN ACCORDANCE WITH RULE 204

In accordance with SEC Rule 204, A participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity. Accordingly PFSI adopted the following procedures:

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2. Web Access
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Person does not typically accept third party attestation letters. All Short Sales must either be on the easy to borrow list, or be approved through our Securities Lending desk in one of the aforementioned three manners. Any exceptions to this policy would need to be approved by Senior Management and documentation would need to be maintained by the Stock Loan Department.

If one of PFSI's correspondent clients is Short a security, and PFSI has a fail to deliver in this security, the PFSI will remove this security from the easy to borrow list; until the fail to deliver is resolved, any Short Sales in this security will require pre-borrowing, if available.

If a correspondent client is Short a security and PFSI is unable to make delivery, the correspondent client will be bought in on the first business day after settlement date (T+4), even if the security was on the easy to borrow list or was located through the Securities Lending Desk. PFSI will notify the Correspondent via email before the open on the day after settlement date that they will be bought in that day. All such buy-ins will be executed by PFSI at the open.

If PFSI is able to pre-borrow, PFSI may charge a pre-borrow fee.

121. In fact, the procedures identified as "PROCEDURES ADOPTED IN ACCORDANCE WITH RULE 204" in the WSPs primarily dealt with Rule 203, not Rule 204.

- Exhibit 188 at 89762

PROCEDURES ADOPTED IN ACCORDANCE WITH RULE 204.

In accordance with SEC Rule 204, A participant of a registered clearing agency must deliver securities to a registered clearing agency for clearance and settlement on a long or short sale in any equity security by settlement date, or if a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in any equity security for a long or short sale transaction in that equity security, the participant shall, by no later than the beginning of regular trading hours on the settlement day following the settlement date, immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity. Accordingly PFSI adopted the following procedures:

PFSI will continue to provide an easy to borrow list each morning based on information received from our securities lending partners.

The methods by which correspondents and their clients can receive locates have not changed. Clients have the following three options to obtain locates:

1. API Access
2. Web Access
3. Short Sale Hot Line (214) 765-1151

Person does not typically accept third party attestation letters. All Short Sales must either be on the easy to borrow list, or be approved through our Securities Lending desk in one of the aforementioned three manners. Any exceptions to this policy would need to be approved by Senior Management and documentation would need to be maintained by the Stock Loan Department.

If one of PFSI's correspondent clients is Short a security, and PFSI has a fail to deliver in this security, the PFSI will remove this security from the easy to borrow list; until the fail to deliver is resolved, any Short Sales in this security will require pre-borrowing, if available.

If a correspondent client is Short a security and PFSI is unable to make delivery, the correspondent client will be bought in on the first business day after settlement date (T+4), even if the security was on the easy to borrow list or was located through the Securities Lending Desk. PFSI will notify the Correspondent via email before the open on the day after settlement date that they will be bought in that day. All such buy-ins will be executed by PFSI at the open.

If PFSI is able to pre-borrow, PFSI may charge a pre-borrow fee.

• Delaney Testimony

Q Okay. And the last paragraph on that page, what's the heading there?

A "Procedures Adopted in Accordance with Rule 204."

Q And as I read that paragraph, that paragraph basically states the rule; is that correct?

A Yes, ma'am.

Q And then if you go to the top of the next page, it says, "Accordingly PFSI adopted the following procedures." Do you see where I'm reading?

A I do.

Q And the very first thing that it says under that is, "PFSI will continue to provide an easy to borrow list each morning based on information received from our securities lending partners." Do you see where I'm reading?

A Yes, ma'am.

Q The easy to borrow list isn't addressed in Rule 204, is it?

A I don't believe so.

Q That's a Rule 203 requirement; is that right?

A I believe that's correct.

Q Okay. The next paragraph says, "The methods by which companies and their clients can receive locates have not changed. Clients have the following three options to obtain locates." Rule 204 doesn't talk about locates; isn't that correct?

A I don't believe it does.

Q That's a Rule 203 requirement; is that right?
A That's as my recollection serves, that's what I believe.
Q Okay. The next paragraph talks about attestation letters. Penson does not typically accept third party attestation letters. That's not a Rule 204 requirement, right?
A I don't believe it is.
Q That's Rule 203?
A That may be. I'm not sure about that, but that's where I would assume that would be in, is 203.
Q Okay. And then, "If one of PFSI's correspondent clients is short a security and PFSI has a fail to deliver in the security, PFSI will remove a security from the easy to borrow list." Is that Rule 204?
A I don't believe that is.
Q So the last paragraph there says, "If a correspondent client is short a security and PFSI is unable to make delivery, the correspondent client will be brought" -- "bought in on the first business day after settlement, T+4, even if the security was on the easy to borrow list or was located through the securities lending desk." Now that's talking about Rule 204, T+4?
A T+4 is -- it appears to be talking about Rule 204, yes, ma'am.
Q Okay. "PFSI will notify the correspondent via e-mail before the open on the day after settlement date that they will be bought in that day. All such buy-ins will be executed by PFSI at the open." Did I read that correctly?
A It appears so.
Q So that basically sets forth the procedures that are going to be followed if there is a short sale and there is a T+4 obligation; is that right?
A It appears to be describing a process.
Q Yeah, in broad terms.
A In broad terms.

(Hearing- Day 3, 643:4-645:22, Oct. 29, 2014)

Q Okay. And then if you look at the page that is Bates marked PFSI2289762 -- and actually, I'm sorry. Can I -- can I move you back to the page that ends Bates Number 59? So back up three pages. Yeah. So you see that at the top again, that says, "Penson Financial Services BD Supervisory Policies and Procedures 3/31/2010 to Current"?
A I do.
Q And at the top it says, "Reg SHO" -- or sorry. "Regulation SHO Supervisory Structure"?
A I do.
Q And then now if we can go to Page 62, the page that's Bates marked 62. Okay. So, "Close-out requirements for fail to deliver." Do you see where I'm reading?
A I do.
Q And it goes on to say, "SEC Rule 10b21 Regulation SHO Rule 204"?
A I see that.
Q And about the middle of the page it says, "Procedures adopted in accordance with Rule 204." Do you see where I'm at?

A I do.
Q And that paragraph again basically sets forth the rule; is that correct?
A It does.
Q And it says, "Accordingly, PFSI adopted the following procedures." Are you with me?
A Yes, ma'am.
Q Then it says, "PFSI will continue to provide an easy to borrow list." Rule 203, right?
A Yes, ma'am.
Q "The methods by which correspondents and their clients can receive locates have not changed." That's the same language we just looked at, right, Rule 203?
A Yes, ma'am.
Q "Penson does not typically accept third party attestation letters." That's Rule 203?
A Yes, ma'am.
Q And then, "If one of PFSI's correspondent clients is short a security," neither one of us were sure whether that was Rule 204 or 203 or rule something else, is that correct, but it didn't appear to be Rule 204?
A It doesn't. The easy to borrow list would signal to me that it's potentially not Rule 204.
Q Okay. And so then we look down at the next paragraph, and it says, "If the correspondent client is short a security and PFSI is unable to make delivery..." It goes on and talks about T plus four settlement. And the paragraph ends with, "All such buy-ins will be executed by PFSI at the open." That's the language we saw before, right?
A Yes, ma'am.

Hearing- Day 3, 648:20-650:23, Oct. 29, 2014)

122. On May 17, 2010, Delaney received notice that FINRA had detected that PFSI had not closed out long sales in compliance with Rule 204.

- Exhibit 168

From: Kimberly Miller <kmiller@PENSON.COM>
Sent: Monday, May 17, 2010 3:08 PM
To: Brian Gover
Cc: Tom Delaney; Holly Hasty
Subject: Reports for audit

Here is the initial response regarding the fails that we discussed this morning.



KIMBERLY MILLER | Compliance Officer

Penson Financial Services, Inc.
1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201
P: 214.953.3363 | F: 214.217.5090
www.penson.com

Building the Best Clearing and Execution Services Firm in the World

From: Ratanchandani, Karan [<mailto:Karan.Ratanchandani@finra.org>]
Sent: Monday, May 17, 2010 4:02 PM
To: Kimberly Miller
Cc: Hill, Marvin
Subject: FW: Reports for audit

Kimberly,

As per the supporting documentation provided by the firm, the 8 items selected are all CNS fails to deliver from Long Sales. The firm did not close out these fails out by T+6 pursuant to Rule 204.

Therefore, we have potential issues with the close out process for these CNS fails to deliver created by long sales.

123. Delaney did nothing to follow-up on the notice in Exhibit 168 that FINRA had detected that PFSI had not closed out long sales in compliance with Rule 204.

- Delaney Testimony

Q Okay. What did you do to follow up on what Ms. Miller told the FINRA person?

A I may be missing, but I don't see where I'm being requested to follow up on anything.

Q So do I take that to mean you did nothing to follow up on this; is that right?

A I don't know if I -- if I'd done anything. I don't see anything here that says that I followed up on it.

Q So you --

A Whether I did or didn't, I don't know.

Q You don't have any recollection of following up on this?

A No.

(Hearing- Day 2, 597:23-598:11, Oct. 28, 2014)

124. On July 26, 2010, Delaney received an e-mail indicating that fails attributable to PFSI's Stock Loan department were not to be closed out.

- Exhibit 158 at p. 1, 3

From:	Eric Alaniz </O=PENSON/OU=PENDAL01/CN=RECIPIENTS/CN=EALANIZ>
Sent:	Monday, July 26, 2010 7:40 AM
To:	Summer Poldrack <SPoldrack@PENSON.COM>
Cc:	Tom Delaney <TDelaney@PENSON.COM>; Brian Gover <BGover@PENSON.COM>; Jerry Reilly <JReilly@PENSON.COM>; Holly Hasty <HHasty@PENSON.COM>
Subject:	RE: ***REG SHO***-

The issue I am having is when the only short on our books is STOCK LOAN.

So far in this process - We have been notifying stock loan of the short--and ask them to be sure the stock is on recall.

Stock loan states that "Stock Loan isn't to be bought in. These names will go into the penalty box, and the loans will be bought in upon maturity of the recall if they're not returned"

But- Stock loan executes against our customers at market open to satisfy their loan's REG SHO requirements- but they are not allowing us to do the same.

- Gover Testimony

Q So then she goes on to say, "Stock Loan is our only short they have on recall." What does that mean, "Stock Loan is our only short"?

A That when we look at the control locations, where -- where we have -- where we have stock, there -- there are no customers that are -- that sold short, that we could buy-in for a short sale. So the only other place we'd have a deficit was Stock Loan had the shares on loan, and Stock Loan had already recalled the shares.

(Hearing- Day 1, 114:17-115:1, Oct. 27, 2014)

Q Okay. Then the next one -- the next e-mail is from Clearing Reg SHO to Marc McCain. Who is Marc McCain?

A Marc was one of the Stock Loan analysts.

Q Okay. So who did he work for? A I don't know who he directed or reported to, but it was -- he probably reported to Lindsey Wetzig, who reported to, I believe, Rudy, who reported to Brian, who reported to Mike Johnson, I think.

Q Okay. But he worked for stock --

A He worked for Stock Loan.

(Hearing- Day 1, 115:7-115:17, Oct. 27, 2014)

Q And then he goes on to say, "It's my understanding that Stock Loan isn't to be bought in." What did you understand Mr. McCain to mean by that?

A You mentioned what it says on the face, and you -- buy-ins cannot buy-in Stock Loan.

(Hearing- Day 1, 117:2-117:7, Oct. 27, 2014)

125. On October 13, 2010, Brian Gover again elevated the issue of Stock Loan's closeouts of long sales.

- Exhibit 26 at PENSON0009044-45

From: Brian Gover
Sent: Wednesday, October 13, 2010 1:18 PM
To: Mitch Mintz
Cc: Conti, Anthony; Rudy De La Sierra; Mike Johnson; Brian Hall; Joe Gagliardi; Barillo, Joe; Tom Delaney; Thomas Textor; Jerry Reilly; Summer Poldrack; Tracie Pittman
Subject: RE: REG SHO 204 Notification

Mitch- Bringing Compliance (Tom Delaney and Tom Textor) into the discussion. If I am getting this correct, we are essentially saying that for Ridge Customers although we can borrow to cover a failing long sale, we will not do so unless the correspondent contacts Stock Loan to arrange the borrow and agree the rate. Is that accurate?

Thanks
Brian



From: Rudy De La Sierra [mailto:RDelasierra@PENSON.COM]
Sent: Wednesday, October 13, 2010 1:02 PM
To: Clearing, REG SHO 204
Cc: Mike Johnson; Brian Hall
Subject: RE: ***REG SHO***-AUMN

The language I've highlighted needs to be reviewed. We do not borrow for long sales. If the short is due to a long sale then we'll just wait for shares to be received rather than incur the cost of borrowing. Please advise who we should speak with to have this removed.

Thanks
Rudy

126. On October 21, 2010, Delaney received a FINRA examination report that informed him that PFSI was violating Rule 204 with respect to closeouts of long sales of loaned securities.

- Exhibit 40 at pp. PENSON0624660, PENSON0624668

From: Tom Delaney
Sent: Thursday, October 21, 2010 6:46 PM
To: Bill Yancey; Bart McCain; John Kenny; Mary Smith; Jay Hanville; Brian Gover; Holly Hasty; Mark Bell; Robert Mendelson; Phil Pendergraft; Carl Gilmore
Subject: Fwd: 2010 Penson Exit Meeting Report

Sent from my iPhone

Begin forwarded message:

From: "Li, Yue Ling" <Yue.Ling.Li@fina.org>
To: "Tom Delaney" <TDelaney@PENSON.COM>, "Kimberly Miller" <kmiller@PENSON.COM>
Subject: 2010 Penson Exit Meeting Report

Hi Tom & Kim,

Attached is the 2010 Penson Exit Meeting report.

Thanks,

Yue Ling

9. The firm was not in compliance with Regulation SHO SEC Rule 204, and NASD Conduct Rule 3010.

b) A review of ten CNS FTD's February 1, 2010 through March 31, 2010 whereby the quantity amounts had changed, disclosed the following:

- 1) The firm failed to recall securities from stock loan or borrow securities to close out all 10 of these fails, which resulted in the fails being consistently outstanding beyond Trade date +4 for short sale FTD's and Trade date +6 for long sale FTD's.

f. Delaney recklessly disregarded his role in furthering the violations.

127. Delaney was the compliance person responsible for Rule 204.

- Hasty Testimony

Q Well, in fact, Mr. Delaney was the person who was responsible for Rule 204; isn't that right?

A Yes.

Q And he was the one who you expected would have the responsibility to review the adopting release, for instance, that accompanied Rule 204, and work with the business units to make sure that the information contained in the adopting release was being properly implemented; isn't that correct?

A Yes.

(Hearing- Day 7, 1769:25-1770:9, Nov. 4, 2014)

128. Delaney was compliance person responsible for interfacing with Stock Loan.

- Hasty Testimony

Q It's true also, isn't it, that Stock Loan's principal interface with Compliance was with Mr. Delaney?

A Yes.

Q And that Michael Johnson's principal interface with -- with Compliance was with Mr.

Delaney?

A Yes.

(Hearing- Day 7, 1770:10-1770:16, Nov. 4, 2014)

129. Often when new rules came out PFSI's Compliance department would have meetings, analyze technologies, and develop a road map to ensure compliance.

- Hasty Testimony

Q Ms. Hasty, what -- if you recall, can you discuss the steps that Penson's Compliance Department took when new rules and regulations were issued or changed?

A So typically new rules and regulations would come to us in a variety of different ways. Many of us were signed up for different types of alerts that came from the regulators themselves. Most of the SROs have the ability for you to sign up for a news feed or something along that line. And there are lots of different publications that come out on a regular basis that provide that information. So it was pretty well circulated. Once we received something and we had a chance to review it, oftentimes we would set off -- set up meetings with the different business owners that we felt like these particular rule changes or new rules would touch, and we would start working through the process of determining what procedures may need to be changed, what development effort, you know, the technology resources or people resources might be required, and -- and really try to lay out the road map for how we were going to meet certain compliance deadlines and making sure that we would be compliant at the time those rules came into effect. It wasn't uncommon for us to use working groups or put together, you know, groups of folks who met regularly that covered a lot of different business areas, just to make sure that everybody understood and was onboard with how we were going to implement a new rule or regulation.

(Hearing- Day 7, 1707:11-1708:16, Nov. 4, 2014)

Q I think that's what I wrote down. What is a working group? Can you explain that for us?

A So it was not uncommon at Penson for us to put together working groups of people from all various business units, including legal, including technology, including the business unit and compliance, to really focus on a particular issue. So if there was a new rule that might come out and we knew that we had a six-month implementation date we, would get a group of both dedicated business owners, oftentimes we would have a legal representative, there would be someone from compliance, there would be folks from technology, to really work through what updates the procedures needed to be made, what development or IT resources would be needed, what reports might need to be created, whether there was staffing that needed to be addressed, if there were forms or notifications to any of our documents that needed to be made. All of those things were things that we worked through in these working group.

(Hearing- Day 7, 1714:20-1715:14, Nov. 4, 2014)

130. In contrast, Delaney does not recall any meetings about the implementation of Rule 204.

- Delaney Testimony

Q When 204T was implemented, do you remember if I had any meetings with people up the chain from you at the time that Rule 204T was implemented?

A Yes.

Q Yes, you did have meetings?

A I believe we had meetings, yes.

Q Do you recall any of those meetings?

A Not a -- not meetings in specific, but I know, again, there was lots of -- there was communications going around. We were -- there was coordinating those communications and things of that nature.

Q Okay.

A Not -- and then again, notwithstanding the -- the earlier meeting that I had mentioned where -- around 204T where Mike Johnson and I -- not really -- I wouldn't classify as a meeting; much more as a hallway conversation about his -- his concern about the resistance to counter-parties.

THE COURT REPORTER: I'm sorry. About the what?

A Resistance from counter-parties.

BY MR. WASHBURN:

Q But did you have more formal meetings than just that kind of hall walk-by that you described with Mr. Johnson?

A With Mr. Johnson, no.

Q Okay. With anyone?

A I may have. I don't -- I'm not specifically remembering.

(Hearing- Day 5, 1238:15-1239:18, Oct. 31, 2014)

131. No technology was designed or modified to enable Stock Loan to comply with Rule 204T/204.

- Poppalardo Testimony

Q Okay. So your expectation that, if this was embedded in the automated system, would be that the automated system would do these recalls in a timely fashion so that the fail to deliver could be satisfied; is that right?

A I would think so.

Q Okay. Do you know whether that's true at PFSI?

A Well, I know from all of the documentation that I read in connection with the case that they weren't recalling early enough.

Q Okay. So you know that the automated system was, in fact, not recalling in sufficient time to close out those fails to deliver?

A Right.

(Hearing- Day 8, 2028:1-2028:15, Nov. 5, 2014)

132. The Compliance department never gave effective guidance to Stock Loan on how to comply with Rule 204.

- Delaney Testimony

Q Okay. So let's talk for just a minute about when Mr. Johnson came to you. Mr. Johnson came to you shortly after the rule came out and said, "We're getting major pushback from our clients around Rule" -- and you understood this was a Rule 204 problem; is that right?

A If I didn't understand 204, certainly a Reg SHO. I don't know if -- at the time if I understood it specifically to be a 204 problem or just a Reg SHO problem, but I was certainly associating it with all the activity at that point.

Q Okay. And you did not discuss with him this guidance that you had received from Morgan Lewis about how it affects lending practices, right?

A No.

Q And you said, "Write your congressman about it"?

A That's what I recall. It was --

Q Okay.

A It was a -- in response to his question to me about pushback, I had said, "Well, Mike, you're just going to have to go write your congressman."

Q So did you, at some point, circle back around with Mr. Johnson and tell him that you were in receipt of a letter that SIFMA was going to send to the Securities and Exchange Commission about the rule?

A No.

Q Did you circle back around with him and tell him that -- that securities organizations, and specifically those who were dealing with securities lending, were -- were -- had concerns about the rule, too, and were trying to figure out how to work with it?

A Nope.

(Hearing- Day 5, 1404:14-1405:20, Oct. 31, 2014)

- De La Sierra Testimony

Q Mr. De La Sierra, did you feel like you ever got effective guidance from compliance on how to follow Rule 204?

A No.

(Hearing- Day 1, 242:25-243:3, Oct. 27, 2014)

133. In approximately August 2009, Delaney sent an e-mail out regarding Rule 204.

- Ex. 125

From: Tom Delaney <TDelaney@PENSON.COM>
Sent: Monday, August 10, 2009 9:31 AM
Subject: Adoption of Reg SHO Rule 204.

A broker-dealer has until the third settlement day following settlement date (T+6) to close out the fail position without becoming subject to the borrowing penalty if: (1) the broker-dealer can demonstrate on its books and records that a fail position resulted from a long sale; or (2) the fail position is attributable to bona fide market-making activities by

134. The e-mail (Exhibit 125) simply referenced that close-outs needed to occur on T+6; it did not specify at what point during the day the close-out must occur.

- Delaney Testimony

Q Where in Exhibit 125 does it talk about the close-out -- the requirement that the close-out be at or before market open?
A May I take a moment to read that?
Q Of course.
A In the first paragraph, there appears to be a reference to market open as -- third -- second sentence -- third -- third sentence.
Q "As adopted, Rule 204 requires that broker-dealers close-out most fail positions at the beginning of the first settlement day following the Settlement Date, generally T+4"?
A Correct.
Q Does that same language appear in the next paragraph where it talks about T+6?
A It does not.

(Hearing- Day 2, 586:19-587:9, Oct. 28, 2014)

135. The e-mail (Exhibit 125) did not discuss the conflict between the securities lending cycle and the rule. Nor did it provide any guidance on how Stock Loan should comply with the Rule's requirement to close-out at market-open T+6 in the face of counterparty refusal to be bought in at market-open T+6.

- Delaney Testimony

Q Does this document anywhere talk about the issue raised in the adopting release that the requirement that securities be delivered by no later than the beginning of regular trading hours does not allow for the completion of the securities lending cycle?
A I don't know if there's any reference to a lending cycle in this document.

(Hearing- Day 2, 587:16-587:22, Oct. 28, 2014)

- De La Sierra Testimony

Q And, Mr. De La Sierra, this may also be in your book, but if you can see it on the screen, do you recognize Exhibit 125?

A I do.
Q What is it?
A It's stating that the adoption of Reg SHO is not -- it's permanent now.
Q And did you receive an e-mail like this on or around August of 2009?
A Probably so, yes.
Q And who is the e-mail from, Mr. De La Sierra?
A From Tom Delaney.
Q Did you recall reading this e-mail, you know, in or around August of 2009? A
Probably so, yes.
Q And take a look, if you want, at the body of those first couple of paragraphs under "All." But I guess my question is: Why isn't Exhibit 125 effective guidance from compliance?
A It's just forwarding the rule on -- I mean, at this point Tom was already aware that we were buying in the afternoon of T6. This is not giving -- it's not even giving us any further guidance on how to buy-in the morning of T- -- at the open of T6.
...
Q And did this e-mail, Exhibit 125, give you any guidance on how to reconcile the rule with this master Stock Lending agreement?
A It did not, no.

(Hearing- Day 1, 243:8-244:15, Oct. 27, 2014)

- Johnson Testimony

Q Mr. Johnson, did you ever ask Mr. Delaney for an interpretation of how to resolve that conflict between the rule and industry practice?
A Yes.
Q And did Mr. Delaney provide you with any such interpretation?
A Yes.
...
Q All right. Do you recall what guidance he provided you?
A I think there's an e-mail that says T6 and doesn't go into any specifics to explain the window problem that we were experiencing.
Q And explain what you mean by "the window problem," Mr. Johnson.
A The rule, for 40 years, said buy-in at 3:00 p.m. The new rule said in the morning, by 9:00 a.m., at the open. So in Tom's e-mail, the one I saw, it went through that and said T6. So, therefore, that gap went along with what Morgan Lewis said and why we did what we did.
(Hearing- Day 2, 520:25-521:22, Oct. 28, 2014)

Q Where it says, "A broker-dealer has until the third settlement day following settlement day T+6 to close-out the fail position without becoming subject to the borrowing penalty if: (1) the broker-dealer can demonstrate on its books and records that a fail position resulted from a long sale."
Do you see where that is?
A Yes, sir.

Q Is that the sort of interpretation you were referring to --
A Yes, sir.
Q -- earlier from Mr. Delaney?
A Yes, sir.
Q And help us understand why this didn't provide guidance to you on the -- I think you referred to it as the "window problem."
A I think because it says, "settlement date of T6." It doesn't say morning or afternoon. It says, "T6." And after doing the rule for 30 years, T6 to me means in the day.

(Hearing- Day 2, 523:5-523:24, Oct. 28, 2014)

- Ex. 125

From: Tom Delaney <TDelaney@PENSON.COM>
Sent: Monday, August 10, 2009 9:31 AM
Subject: Adoption of Reg SHO Rule 204.

A broker-dealer has until the third settlement day following settlement date (T+6) to close out the fail position without becoming subject to the borrowing penalty if: (1) the broker-dealer can demonstrate on its books and records that a fail position resulted from a long sale; or (2) the fail position is attributable to bona fide market-making activities by

136. At the time of the August 2009 e-mail, Delaney was aware that Stock Loan was not buying in to close-out fails to deliver until the afternoon of T+6.

- De La Sierra Testimony

Q ... Why isn't Exhibit 125 effective guidance from compliance?
A It's just forwarding the rule on -- ***I mean, at this point Tom was already aware that we were buying in the afternoon of T6.*** This is not giving -- it's not even giving us any further guidance on how to buy-in the morning of T- -- at the open of T6.
Q ***So at the time this e-mail came out in August of 2009 -- you may have just said this -- was Mr. Delaney aware of Stock Loans's practice of buying in in the afternoon?***
A ***Yes.***

(Hearing- Day 1, 243:23-244:11, Oct. 27, 2014)

137. Delaney claimed that he paid close attention to Stock Loan's compliance with Rule 204. He claimed that "We tested. We tested and tested and tested and tested."

- Exhibit 224 (Delaney Investigative Testimony) at p. 446, l 14 – 19

14 A Well, we paid close attention, right? We tested.
15 We tested and tested and tested and tested. So it wasn't a
16 -- by no means blind-to-ignorance to the operations of
17 what's occurring there. We had specific testing that was
18 being put in place to check for it at T+6 and in the event
19 we were complying with T+6.

138. Delaney admitted that, in fact, the December 2009 testing was the only test testing Stock Loan, that the December 2009 testing did not test Stock Loan's compliance with the close-out requirements of Rule 204, and that the follow-up testing in June 2010 did not test Stock Loan at all.

- Delaney Testimony

Q In fact, Mr. Delaney, the test in December of 2009 is the only test that tested Stock Loan's compliance with Rule 204; isn't that right?

A I don't know that.

Q Do you know of any other testing as you sit here today that tested Stock Loan's compliance with Rule 204?

A That was a long time ago. There may have been a lot of testing in the quality control that was going on.

Q As you sit here today, do you know of any other testing that showed that stock -- Stock Loan's compliance with Rule 204? It's just yes or no. Yes, you do know, or no, you don't know.

A As I -- right now in my present recollection, I don't know.

Q Okay. I think you testified yesterday that you, over the course of preparing for this case, have looked at thousands of documents. Is that what you said?

A I don't know if I said thousands, but it may have been hundreds.

Q Lots and lots of documents?

A Lots of documents.

Q Did you see anything in those documents that showed any other testing of Stock Loan's Rule 204 compliance?

A I may have.

Q Do you remember seeing any documents that showed that?

A As I sit here today, I don't have a recollection of any other testing.

Q Okay. Do you think if there was other testing, your counsel would have brought that to your attention?

A I don't know what my counsel would do.

Q Okay. And, in fact, as we've looked at rule -- at Exhibit 70 -- and you can look back at it, of course -- that didn't test Stock Loan's close-out compliance with Rule 204; isn't that right?

A It did not. To be more precise, it didn't test that process within Stock Loan that closes out. Whether it tested close-outs that came from -- that Stock Loan was involved in, I'm not sure. But I don't think this -- this particular matter at issue, of the process of the actual close-out that was happening in Stock Loan, was tested in this particular test.

(Hearing- Day 3, 637:3-638:22, Oct. 29, 2014)

Q The follow-up test that you were just looking at, at Exhibit 85.
A It appears to have tested the buy-in department, yes.
Q Okay. It didn't test the Stock Loan department?
A Now, I'm sorry. We're back to 85?
Q The follow-up testing, yes.
A The test is to Summer, Jerry and Brian, which are just in the buy-in department.

(Hearing- Day 3, 636:2-636:11, Oct. 29, 2014)

139. At the time of the December 2009 audit of Rule 204 compliance issues, Delaney was aware that Stock Loan was not buying in to close-out fails to deliver until the afternoon of T+6.

- De La Sierra Testimony

Q All right. And in December of 2009, was Mr. Delaney aware of Stock Lending's practice not to buy-in at market open T+6?
A Yes, he was.

(Hearing- Day 1, 245:21-245:24, Oct. 27, 2014)

140. Follow-up Rule 204 testing performed in June 2010 tested only Rule 204 compliance with close-outs of short sales, not long sales.

- Alaniz Testimony

Q At some point you did some follow-up testing. Do you remember that?
A Yes.
Q And do you remember what it was that you tested in your follow-up testing?
A It was T+4.
Q You didn't test the T+6 in the follow-up testing?
A No, I did not.
Q Going back to -- and do you remember when that follow-up testing was?
A I believe it was the following summer of 2010, June.
Q Okay.
A Around June.

(Hearing- Day 3, 709:7-709:21, Oct. 29, 2014)

141. The follow-up testing should have tested a larger sample and tested the long sales which had the most problematic results.

- Poppalardo Testimony

Q Okay. You did testing and a small sample showed a huge failure rate. Would you test a larger sample?

A Absolutely.

Q Okay. And you would make sure that you tested the part that was most problematic, wouldn't you?

A Yes.

(Hearing- Day 8, 2035:14-2035:21, Nov. 5, 2014)

D. Delaney's participation in PFSI's violations of Rule 204/204T.

142. Delaney's was responsible to make sure that PFSI had policies and procedures designed to prevent or detect violations of rules.

- Delaney Testimony

The company had registered principals for which it employed in order to detail out the supervisory responsibilities. My job, and in administrating a compliance program, would be making sure that the company had policies and procedures designed to prevent or detect violations of rules, working with those -- those persons who had supervisory authority to ensure that they were -- and to test those rules and report that to the CEO to the extent that those rules aren't being -- that those rules weren't being followed.

(Delaney, Tom- INV vol III, 352:15-352:24, July 31, 2013)

143. It was important for Delaney to be honest and forthcoming with Yancey.

- Yancey Testimony

Q You would rely on Mr. Delaney to help ensure the firm's compliance with rules and regulations?

A Yes, sir.

Q In fact, you specifically relied on Mr. Delaney to help ensure compliance with Reg SHO?

A Yes, sir.

Q And as I think we can all agree, Reg SHO includes Rule 204, correct?

A Yes, sir.

Q All right. Mr. Yancey, would you consider it important for Mr. Delaney to be honest with you?

A Yes, sir.

Q Forthcoming with you?

A Yes, sir.

Q Not mislead you?

A Yes, sir.

(Hearing- Day 3, 879:19-880:9, Oct. 29, 2014)

144. If Delaney learned that associated personnel were not following the securities laws, he was required to take reasonable steps to investigate and report his findings to members of senior management where those persons reported.

- Stipulated Finding of Fact 13.

145. Delaney had a duty to inform Yancey if Delaney knew that PFSI was following industry practice rather than Rule 204.

- Yancey Testimony

Q And whether PFSI was choosing to follow industry practice instead of the law would have been important to you as a CEO, wouldn't it?

A Yes, sir.

Q If you had known that Penson was following industry practice instead of the law, you would have taken that seriously, correct?

A Yes, sir.

Q You would have wanted to follow up on it?

A Yes, sir.

Q It's something you would try to put a stop to; is that fair?

A Certainly try to provide clarity and resources to make sure it was done properly.

Q And to make sure that Penson was following the law rather than industry practice, correct?

A Yes. That's fair.

Q Now, Mr. Yancey, if Tom Delaney knew that Penson was following a perceived industry practice that was contrary to the requirements of Rule 204, that's something you would have expected him to tell you; is that right?

A Yes, sir.

(Hearing- Day 4, 940:20-941:17, Oct. 30, 2014)

146. Delaney never informed Yancey that PFSI was following a perceived industry practice rather than Rule 204.

- Yancey Testimony

Q Now, Mr. Yancey, if Tom Delaney knew that Penson was following a perceived industry practice that was contrary to the requirements of Rule 204, that's something you would have expected him to tell you; is that right?

A Yes, sir.

Q And Mr. Delaney never told you that, did he?

A He did not.

(Hearing- Day 4, 941:12-941:19, Oct. 30, 2014)

Q All right. And to close-out this conversation, Mr. Delaney did not tell you in March of 2011 that this was stock lending's practice, this practice in Exhibit 89?

A No.

(Hearing- Day 7, 1926:21-1926:25, Nov. 4, 2014)

- Exhibit 224 (Delaney Investigative Testimony)

Q Do you know was Mr. Yancy aware that Penson was executing long sales at the conclusion of the DTCC trading window at approximately 3 Eastern Time instead of the open market?

A I don't know what Mr. Yancy knew or didn't know.

Q Did you ever escalate that issue to him?

A Not specifically. I don't recall specifically escalating this particular issue.

[Exh. 224 at 270:15-23]

147. Delaney claimed that after the December 2009 Rule 204 testing, he "required that representatives from each of the business units involved with closing out short sales were present to discuss the results and create accountability."

- Exhibit 157 (Delaney Wells Submission) at p. 21

After Mr. Alaniz's Rule 3012 testing, Mr. Delaney required that representatives from each of the business units involved with closing out short sales were present to discuss the results and create accountability.

148. In fact, Delaney admitted that he told Yancey that Stock Loan did not need to attend the first meeting discussing the December 2009 Rule 204 testing.

- Delaney Testimony

Q Okay. You said, There were specific meetings right following the testing. When we do quarterly, we would do the CEO certifications. And Mr. Alaniz and myself were in a - were in the office with Mr. Yancey briefing him on the specific findings. He, at that point, had made mention of the fact that well, this was something we needed to get Mike Johnson in the office for when he saw those particular findings. We, at that point in time, had explained that we didn't think at this point that there was a Stock Loan issue, that this was really appearing to be a buy-in issue.

Did you give that testimony?

A I believe I did.

MS. ATKINSON: That's at Page 329, from Line 14 to Line 24.

(Hearing- Day 2, 614:7-614:23, Oct. 28, 2014)

149. Delaney met with Yancey again on August 2, 2010 to discuss testing of PFSI's compliance with Rule 204.

- Exhibit 92; 169

From: Eric Alaniz <EAlaniz@PENSON.COM>
Sent: Monday, August 02, 2010 3:22 PM
To: Bill Yancey
Cc: Tom Delaney; Erin Jones
Subject: 2010-2011 Quarterly Annual Certification Meeting

Importance: High

Hi Bill,

Re: 2010-2011 Quarterly Annual Certification Meeting

I'd like to thank you today for the time you spent with Tom and me discussing our Compliance departments quarterly progress on the 3012 testing. Just as a quick recap of our meeting I have highlighted a few areas of discussion.

The Compliance department has completed a follow-up exam of Reg SHO Rule 204, the New Accounts department and out monthly Margin testing. As we discussed, I will forward to you two requirement reports one from PFSI and one from Ridge, test third party wires and follow up on the remediation of a few of the items discussed (i.e. cash straddles).

150. It was important for Delaney to be honest and forthcoming with regulators.

- Yancey Testimony

Q Would you also agree that, in your view, it's important for Mr. Delaney to be honest with regulators?

A Yes, sir.

Q To be forthcoming with regulators?

A Yes, sir.

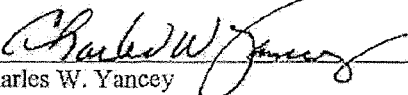
Q To not mislead regulators?

A Yes, sir.

(Hearing- Day 3, 880:10-880:16, Oct. 29, 2014)

151. On March 31, 2010, Yancey signed an "Annual Certification of Compliance and Supervisory Processes" for PFSI.

- Exhibit 135 at p. PFS/1384375

Annual Certification of Compliance and Supervisory Processes Penson Financial Services, Inc. <i>FINRA Rule 3130 in accordance with the April 1, 2010 deadline</i>	
 Charles W. Yancey President and Chief Executive Officer	<u>3/31/2010</u> Date

152. The Certification signed by Yancey attached a "NASD Rule 3012 Summary Report" ("Annual Report").

- Exhibit 135
- Yancey Testimony

Q Do we agree that Compliance would prepare an annual compliance report for you, the CEO?

A Yes.

(Hearing- Day 3, 887:15-887:17, Oct. 29, 2014)

Q All right. And Mr. Yancey, there was also an annual report prepared by the Chief Compliance Officer; is that correct?

A Yes, sir.

(Hearing- Day 3, 887:24-888:2, Oct. 29, 2014)

Q It was, if I understand, attached, appended to that CEO certification that you would personally sign each year, correct?

A I think it accompanied that document.

(Hearing- Day 3, 890:8-890:11, Oct. 29, 2014)

153. The Annual Report, per Penson's WSPs, was to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010.

- Stipulated Finding of Fact 21.

154. The Annual Report was also supposed to summarize the testing that had been conducted and the gaps found by that testing that had been presented to the CEO.

- Exhibit 135 at PFSI1384375.000002

NASD Rule 3012 Summary Report

March 31, 2010

Background

This report was prepared in accordance with NASD Rule 3012 to summarize the extensive testing of the Penson Financial Services, Inc. ("PFSI") Written Supervisory Procedures for the time period of April 1, 2009 through March 31, 2010. A risk

- Exhibit 172 at p. 1

Frequently Asked Questions - Rule 3012 Report - FINRA



Industry Professionals > Industry Issues > Supervisory Control

Frequently Asked Questions

Rule 3012 Report

Q: Do the designated principals have any reporting requirements once they have completed testing and verifying the member's supervisory procedures?

A. Yes. Rule 3012 requires the designated principals to submit, no less frequently than annually, a report to the member's senior management that details the firm's system of supervisory controls, the summary of the test results and any additional or amended supervisory procedures that have been created in response to those results.

The Rule 3012 report:

1. details the manner, method and review for testing and verifying that a firm's system of supervisory policies and procedures are designed to achieve compliance with applicable rules and laws;
2. provides a summary of the test results and the gaps found; and
3. identifies the changes a firm made or will need to make to its supervisory procedures.

- Exhibit 224 (Delaney Investigative Testimony) at pp. 519-520

Q "In contrast the Rule 3012 report is not a work plan except to the extent it identifies amendments that need to be made but rather is the work product of the result of the testing and verification of the sufficiency of the firm's scheme of supervisory policies and procedures. The Rule 3012 report and other things" -- I'm focusing now on .2 -- "provides a summary of the test results of the gaps found." Do you see that?

A I do.

Q Is that consistent with your understanding of the purpose of the Rule 3012 report?

A Yes.

Q Did you hold that understanding during your tenure as CCO of Penson?

A Yes, sir.

(Delaney, Tom- INV vol III, 520:10-520:24, July 31, 2013)

- Delaney Testimony

Q I want to talk for just a minute about the 3012 report that Chief Compliance Officers do. What is that?

A This report was born out of a -- as I -- as I recollect, was born out of -- was born out of a requirement for CEOs to begin to certify that the firm has a supervisory system and that that supervisory system has been tested. And in order for a CEO to make those sort of certifications, the 3012 report was the summary, if you will, of the testing that would have been conducted and presented to -- to the CEO.

(Hearing- Day 3, 671:19-672:3, Oct. 29, 2014)

- Yancey Testimony

Q All right. Well, I want to look at some of the things that are in the report itself. And if we can stay on Page 1 first, and just the very first sentence under "Background," the very first thing the report says is, This report was prepared in accordance with NASD Rule 3012 to summarize the extensive testing of the Penson Financial Services, Inc. Written Supervisory Procedures for the time period of April 1st, 2009 through March 31st, 2010.

Is that right?

A Yes, I see that.

Q The very first sentence in the report, right?

A Yes, sir.

Q And we discussed yesterday that one of the things that was tested, in fact, was 3012 tested, during this period was Rule 204; is that right?

A Yes, it was.

(Hearing- Day 4, 936:17-937:8, Oct. 30, 2014)

Q Beginning on the second page of this Exhibit 135 is the Summary Report, CEO Summary Report. Do you see that?

A Yes, ma'am.

Q Do you know what the process is for preparing that document?

A The process is -- as it says, was prepared in accordance with NASD Rule 3012 to summarize the extensive testing of Penson Financial Services WSPs for this stated time period.

(Hearing- Day 7, 1886:7-1886:16, Nov. 4, 2014)

155. Delaney was responsible for the Annual Report.

- Exhibit 135 at p. PFSI1384375.000002

This report was prepared to accompany the 2010 Annual Certification of Compliance and Supervisory Processes as required by FINRA Rule 3130. Tom Delaney, the CCO of PFSI is the individual responsible for ensuring that the report meets the requirements of the rules. Tom Delaney is furthermore the individual who has been designated as having the responsibility to review and monitor the compliance with NASD Rule 3012 and FINRA Rule 3130 to ensure that the requirements under these rules are met.

- Delaney Testimony

Q Okay. And at Penson, you were responsible for contents of the 3012 report; isn't that right?

A I was.

(Hearing- Day 3, 673:18-673:20, Oct. 29, 2014)

- Yancey Testimony

Q Who prepares it?

A The Chief Compliance Officer.

Q At this time, who was the Chief Compliance Officer?

A Tom Delaney.

Q And who decides what to include on this Summary Report?

A Tom Delaney.

Q Is it his judgment alone about what to include?

A I believe that Tom takes input from the staff, from the department heads, so ultimately, it is his decision, but I think he take inputs.

(Hearing- Day 7, 1886:17-1887:4, Nov. 4, 2014)

156. The Annual Report was a key document in FINRA examinations.

- Delaney Testimony

Q Okay. Would you look at Exhibit 224, Page 221, Line 2. And you say --

A I'm sorry. What -- on what page?

Q 221. And you say, "And typically the 3012 reports were always subject to examination from FINRA" -- "from" -- maybe it's supposed to be "when FINRA would come in."

"That was one of the key documents we would be turning over."

Did I read that correctly?

A You did.

Q And is that what you testified?

A I have no reason to believe that the court reporter didn't take my words down correctly.

(Hearing- Day 3, 672:22-673:10, Oct. 29, 2014)

157. The Rule 3012 Summary Report contained a section describing “[t]he firm’s key compliance efforts to date.”

- Ex 135 PFSI1384375.000003

• The firm’s compliance efforts to date

158. The Rule 3012 Summary Report also contained a section noting “[t]he identification of any significant compliance problems.”

- Ex 135 PFSI1384375.000004

• The identification of any significant compliance problems

159. Alaniz created the template for the Annual Report, and would put in a few items for discussion. Alaniz would then send the Annual Report to Delaney to complete. Delaney determined what would be listed as significant compliance problems.

- Alaniz Testimony

Q Okay. I would like you to look, if you would, please, at Exhibit 135. And I would like you to look at the report that is attached to it. And I just want you to tell me if you see your testing that was -- your Rule 204 testing that you did at the end of 2009, whether you see that in the report, the 3012 Summary Report.

A I do not.

Q Who decided what was put into that report?

A Initially, I would create the template. I would put in a few items that we would discuss. And from there, I would send it to Tom Delaney to complete.

Q Okay. So who was it that decided whether items would be listed as significant compliance problems?

A I would ask Tom Delaney on that.

(Hearing- Day 3, 719:2-719:15, Oct. 29, 2014)

160. Delaney’s March 31, 2010 Annual Report appended to Yancey’s certification did not reference ongoing, willful Rule 204(a) violations relating to long sales of loaned securities by Stock Loan.

- Stipulated Finding of Fact 22

161. Delaney’s March 31, 2010 Annual Report appended to Yancey’s certification did not reference the Rule 204 testing conducted by Eric Alaniz in December 2009, the results of which Delaney later characterized as “massive,” “profound” and “anomalous.”

- Exhibit 135
- Stipulated Finding of Fact 21

162. Delaney's March 31, 2010 Annual Report appended to Yancey's certification did not reference Rule 204 at all.

- Exhibit 135

163. Delaney would have expected some reference to Rule 204 to be in the Annual Report.

- Delaney Testimony

Q Can you look at your -- can you look at Exhibit 224, please. And would you look at Page 526, please.

A I'm sorry. What page?

Q 526. I think it's Line 19.

Q Okay. The question is that: "Can you help me understand why you have this profound failure and massive failure, anomalous result, extraordinary effort and it's just not reflected in the Summary Report that goes to FINRA?"

And your answer: "I -- I have no explanation as to -- as it's presented here on here as to why that wouldn't be -- why a test of from December 2009 had a -- on Reg SHO wouldn't have been -- wouldn't have been on here. I would have -- I would have -- I would have expected -- I would have expected there to be some reference to it, yes, albeit a testing item, not necessarily -- maybe too soon to talk about the remediation efforts and things like that that had happened, but certainly as a testing item or a specific compliance problem."

Did I read that correctly?

A It appears so.

(Hearing- Day 3, 677:25-679:4, Oct. 29, 2014)

164. Other topics that were the subject of compliance testing at PFSI were discussed in the Annual Report.

- Delaney Testimony

Q It's Exhibit 135.

A I'm at that exhibit.

Q Okay. And you said that there was no testing disclosed in this document; is that correct?

A No.

Q Is that what you said?

A I -- I think my testimony was there was no specific results of the testing that had been disclosed in the document.

Q Okay. But there were -- the subjects of some of the testing that had been performed at Penson, that was in here; isn't that right?

A I think there were some -- some overarching subject matter that was in there, but not the specific results of the testing that had been disclosed on -- in this report based on any of those.

Q But the general topic and problems of the testing, that was disclosed?

A Some of it, yes.

(Hearing- Day 5, 1382:12-1383:5, Oct. 31, 2014)

165. All of the items in the Rule 3012 Summary Report's identification of significant compliance problems are items that were being remediated.

- Ex. 135 at pp. 5-6

- The identification of any significant compliance problems

- **INSITE Remediation Efforts:** In early 2009, PFSI began sending automated e-mail notifications to multiple personnel on a daily basis regarding the transmission status of the INSITE upload. These notifications ensure that personnel within the firm are notified of any problems with the transmission by 9:00 am, giving the Firm ample time to correct any technical issues and upload the file once more. In addition, in the FIRM's continuing effort to improve its processes and data integrity, a complete review of MPID coding for all offices have been reviewed for accuracy. Finally, the FIRM is in the process of finalizing the coding for reports detailing all of the information transmitted for each of the 23 data points.
- **Retama Development Corporation Series B municipal bonds Remediation Efforts:** PFSI has agreed to no longer allow margin value to its customers for the Retama bond, and issued a maintenance call to the affected clients.
- **Renaissance Securities Ltd. A foreign broker/dealer Remediation Efforts:** PFSI will be terminating its relationship with this non-US broker-dealer entities affiliated with Renaissance by the end of the first quarter of 2010.
- **Cycle Examination #20080116158 Remediation Efforts:** PFSI takes all Regulatory Examinations as significant and as such will remediate as required by the Securities industry.

- Yancey Testimony

Q I want to look at the Summary Report itself. It's a couple of pages in. And, Mr. Yancey, I specifically want to look at the third page of the Summary Report. It's Bates Number 004 at the bottom. And you see a bullet point that says: The identification of any significant compliance problems. Do you see where I am?

A Yes, I do.

...

Q So we can agree that this report's identification of significant compliance problems, all of them are things that are being remediated, things where there are remediation efforts; fair?

A Fair.

(Hearing- Day 7, 1921:15-1922:18, Nov. 4, 2014)

166. The Annual Report referenced "exception and remediation tracking." In May, 2010, FINRA requested the remediation tracking logs related to the CEO certification. The log provided to FINRA did not mention Rule 204T, Rule 204, or Alaniz' testing of Rule 204 compliance.

- Ex. 135 at p. PFSI1384375.000006

The PFSI testing plan consists of three components that were executed throughout the certification year. Those components are:

1. Identification, scope and prioritization of issues and areas to be tested (attached)
2. Execution and documentation of testing (available in the Compliance dept.)
3. Exception and remediation tracking (attached)

- Ex. 194 ¹

¹ Exhibit 194 attaches a 40 page log. There is no mention of Rule 204T or Rule 204 in the log. Because the citation is to the entire 40 page log, the Division has not excerpted the cited material.

To: 'Hill, Marvin '[Marvin.Hill@finra.org]
From: Kimberly Miller
Sent: Tue 5/11/2010 2:15:52 PM
Importance: Normal
Subject: FINRA Request - CEO Certification Records
Operational's Remediation Tracking Log Updated 03-30-2010.docx
2009-2010 AML Remediation Tracking Log Updated 4-27-2010.doc

Attached are the logs requested below. The binders have been put in your conference room.



logo-for-signature-2

Person Financial Services, Inc.
1700 Pacific Avenue, Suite 1400 | Dallas, TX 75201
P: 214.953.3363 | F: 214.217.5090
www.person.com

Building the Best Clearing and Execution Services Firm in the World

From: Eric Alaniz
Sent: Tuesday, May 11, 2010 1:01 PM
To: Kimberly Miller
Subject: RE: FINRA Request

Here is the following info for bullet point one. These are update periodically.

- Per CEO certification Please provide listing of internal and external audits tracked by the compliance department.

For bullet point 2 I'll bring over in a few minutes.

Eric

From: Kimberly Miller
Sent: Tuesday, May 11, 2010 11:32 AM
To: Eric Alaniz
Cc: Tom Delaney
Subject: FINRA Request

FINRA has requested the following items relating to the CEO Certification...

- Per CEO certification Please provide listing of internal and external audits tracked by the compliance department.
- Per CEO certification report, please provide the binders with noted exceptions.

167. On March 31, 2010, Delaney met with Yancey to discuss Yancey's annual certification of Person's compliance testing procedures. As part of that certification, Person's Compliance department prepared and presented an Annual Report that, per Person's WSPs, was to discuss Person's "key compliance problems" for the period

April 1, 2009 through March 31, 2010. At the March 31, 2010 meeting, an item of discussion was the results of the December 2009 audit showing the Rule 204(a) violation rate resulting from Buy-ins' procedures – a compliance failure that Delaney later characterized as “massive,” “profound” and “anomalous.”

- Stipulated Finding of Fact 21

168. Beginning in November 2008, OCIE conducted a review of PFSI's Rule 204T procedures. In October 2010, OCIE issued Penson a deficiency letter reporting that OCIE had found Rule 204T(a) violations. The findings reported to Penson in the deficiency letter included findings that Penson had violated Rule 204T in connection with short sales.

- Stipulated Finding of Fact 28

169. The OCIE exam concerned close-outs of long sales as well as short sales.

- Ex. 539

From: Magyar, Laura J. <MagyarL@sec.gov>
Sent: Thursday, March 5, 2009 1:47 PM
To: Doug Gorenflo <DGorenflo@PENSON.COM>
Cc: Holly Hasty <HHasty@PENSON.COM>; Stephen Worcester <SWorcester@PENSON.COM>; Michael White <mwhite@PENSON.COM>

Staff's questions for the 3/5/09 call concern those documents provided to Staff in response to its January 1, 2009 document request, #2, Exhibit B.

19) #14: Account appears to buy 50000 net shares long on 10/13/2008 (100000 long/50000 short). Explain trading that supports buy-in. Also, note on 643 indicates “have stok will DTC tomorrow morning.” Explain.

22) #40: Explain trading on 10/27/08 for buy-in of 17,196 shares of RBCAA by account 16030413 (account appears to buys long and short)

- Exhibit 756



Penson Financial Services.

Member FINRA and SIPC

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April 23, 2009

U.S. Securities and Exchange Commission
Office of Compliance Inspections and Examinations
100 F Street NE, Mail Stop 7041
Washington, D.C. 20549
Attn: Laura Magyar

Re: Examination Regarding Regulation SHO

Dear Ms. Magyar:

Please find the enclosed documents per the request letter to Penson Financial Services, Inc. dated April 13, 2009:

- 1) Please explain the time parameters (such as T+6) of the EXT 816 report. Please also state what the column "age" represents. For example, if age is 7, does this mean T+6+7? Additionally, please confirm that all the items on the report are long positions.

The column age represents the number of days settled with the number "1" being the actual settlement date. On day 1, the buy-in is issued and on day 3, the execution is done for buy-in. All items on the report show the amount of shares for each CUSIP for which there is a fail to deliver to CNS. The report is worked to identify the accounts that are long sales in type 1 or inventory accounts.

- 2) In the firm's March 20, 2009 response #2, the firm indicated that items 3 and 9 were long sales and the customer delivered the physical securities. Please confirm whether these were closed in compliance with T+6 requirements or provide an explanation for not closing out within T+6.

In the March 20, 2009 letter response #2 item (3) was a prospectus sale done by the customer. The customer A/C# 16180457 was long 904,500 of OriginOil, Inc which were restricted shares. A letter was sent to the transfer agent, Computershare on 10/27/2008 to transfer 16,000 shares via DWAC from certificate # ZQ00000014 in the amount of 400,000 shares and return a restricted certificate for 384,000 shares. On 11/5/2008 16,000 shares were received via DWAC for the customer account.

In the March 20, 2009 letter response #2 item (9) there were 2,316 shares that were held in the vault in the name of Penson Financial Services, Inc. These shares were physically delivered to DTCC on 10/29/2008 and were received by DTCC on 10/30/2008. This cleared the CNS fail. No customer account was short shares that could be bought in.

- 3) In the March 20, 2009 response, #3, the firm responded that it has concluded that the trades of Bank of America stock were entered and executed as long sales as opposed to short sales. Staff notes that the customer account statement provided by the firm for Alchemy Ventures, Inc. (11540002) for October 2008, shows a short sale in the account for 1300 shares at 26 and 1000 shares at 27.40 on 10/7/09 (page 16055 of 24834). Please explain this discrepancy.

As explained in the Firm's March 20, 2009 response to Staff, Penson Financial Services, Inc. margin accounts and short accounts are identified by the use of an account type. Type 2 indicates general margin and account type 3 indicates short positions. As a result of the large number of transactions processed on any given day, the trade file upload and trade posting process distributes trades across multiple processing servers which in turn post the trades via an overnight batch process to our back office system, Phase3. At times, the sequence of trades may be processed in different order from the way they were executed because of multiple processing servers acting in parallel. This creates situations where trades that are actually buys to cover hit the type two margin account type while the original short sale remains short in the type 3 account. This also happens in reverse where a sale processes first to type 3 and the original purchase processes to type 2. In instances where this occurs, a straddle "flatten" process is done on settlement to balance any straddles that exist due to offsetting positions in different account types.

4) In the March 20, 2009 response to #1, the firm responded that for items #6, 7, 8 and 9 that the referenced trades were long sales. However, the confirmations provided by the firm for these transactions reflect short sales. Please explain this discrepancy. Additionally, please provide the October 2008 account statements for the following accounts:

- a) Account Number [REDACTED]
- b) Account Number [REDACTED]
- c) Account Number [REDACTED]
- d) Account Number [REDACTED]

Please refer to the file labeled "Item #4" on the enclosed disk.

The trade file upload and trade posting process described in Item #3 above applies to Items #'s 6, 7, 8 and 9 of the Firm's March 20, 2009 response to Item #1. Trade confirmations are created T+1 for dissemination to the party of the trade. Trade confirmations reflect the manner in which the trade information was posted to the account on trade date. Should a straddle exist, the flatten straddle process looks across account types and positions and offsets the position so that it resides in the appropriate account type on settlement date.

- Exhibit 203 at p. 20-21



Penson Financial Services,

Member FINRA and SIPC

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August 5, 2009

U.S. Securities & Exchange Commission
Office of Compliance Inspections and Examinations
100 F Street NE, Mail Stop 7041
Washington, D.C. 20549
Attn: Laura Magyar, Branch Chief

Re: Examination Regarding Regulation SHO

Please find the following explanations and applicable attachments for the inquiry from your office dated July 17, 2009. The enclosed disk has been encrypted. Please e-mail me at dgorenflo@penson.com for the key once this package is received.

2. In the firm's March 20, 2009 response #1, Penson stated that "[i]tems #6, 7, 8 and 9 represent instances where the referenced trades reflect long sales. In these instances no locate was required. Supporting documentation evidencing the long sale status has been provided on the enclosed spreadsheet.Penson Financial Services, Inc. cash, margin and short accounts are identified by the use of an account type. Type 1 indicated cash, type 2 indicates general margin and account type 3 indicates short positions. The trade file upload process distributes trades across many processing servers which in turn post the trades via an overnight batch process to our back office system, Phase3. At times, the sequence of trades may be processed in different order from the way they were executed because of multiple processing servers acting in parallel. This creates situations where trades that are actually buys to cover hit the type two margin account type while the original short sales remains short in the type 3 account. This also happens in reverse where a sale processes first to type 3 and the original purchase processes to type 2 as an

170. Moreover, PFSI represented to OCIE that there was no report that monitored close-outs of long sales of loaned securities.

- Exhibit 204 at p. 13

▪ What report monitors sales that are marked long in type 2 accounts?

There is no specific report for this.

171. On November 15, 2010, Kim Miller sent Delaney a draft of a response to deficiency letter arising from an OCIE exam.

- Exhibit 206 at pp. 1, 6 and 7– 8 of 11

To: Tom Delaney[TDelaney@PENSON.COM]
From: Kimberly Miller
Sent: Mon 11/15/2010 2:31:22 PM
Importance: Normal
Subject: DRAFT RegSHO Reponse
[DRAFT - RegSHO Response.doc](#)

5. Close-Out Requirements Pursuant to Rule 204T

Response: Penson feels that the processes and procedures employed to close out positions that were in violation of rule 204T were effective and performed as designed. Our current procedures as they relate to Rule 204 are effective and designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1. Additionally, Penson has updated the WSP's relating to Rule 204, the use of PFS642 & PFS643 reports. We have elaborated on the criteria used for buy in allocations and the procedures detailing how buy-ins are executed.

172. On November 19, 2010, Delaney replies to Miller, saying "attached is my redraft...."

- Exhibit 208

To: Kimberly Miller[kmiller@PENSON.COM]
From: Tom Delaney
Sent: Fri 11/19/2010 3:11:50 PM
Importance: Normal
Subject: DRAFT - RegSHO Response
DRAFT - RegSHO Response.doc

Kim,

Attached is my re-draft with a couple of additional notes:

The locate and delivery requirement provides a uniform rule requiring an executing broker-dealer (in this case the correspondent or PFSI if a direct account) to locate securities available for borrowing prior to effecting a short sale. The diligence required for accepting the short sale is the burden of the executing broker-dealer. (This is complicated where in the case of direct accounts where PFSI is both the executing broker-dealer and the clearing firm – especially when it comes to reliance on the ETB list and there is a pattern of unexplained fails – I don't think that is the case here because when a stock is failing at CNS, it is removed from the ETB list).

173. Delaney reviewed and edited PFSI's response to Item No. 5.

- Compare Exhibit 206, pp. 6 and 7– 8 of 11, with

5. Close-Out Requirements Pursuant to Rule 204T

Response: Penson feels that the processes and procedures employed to close out positions that were in violation of rule 204T were effective and performed as designed. Our current procedures as they relate to Rule 204 are effective and designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1. Additionally, Penson has updated the WSP's relating to Rule 204, the use of PFS642 & PFS643 reports. We have elaborated on the criteria used for buy in allocations and the procedures detailing how buy-ins are executed.

- Exhibit 208

5. Close-Out Requirements Pursuant to Rule 204T

Response: Penson feels that the reasonable processes employed to close out positions that were allegedly in violation of rule 204T were effective and performed as designed. Our current procedures as they relate to Rule 204 are effective and reasonably designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1. Additionally, Penson has updated the WSP's relating to Rule 204, the use of PFS642 & PFS643 reports. We have elaborated on the criteria used for buy in allocations and the procedures detailing how buy-ins are executed.

174. The language as edited by Delaney appeared in the letter submitted to OCIE on November 24, 2010. The letter did not disclose that PFSI's Stock Loan was not able to comply with Rule 204, nor did it acknowledge the disastrous Rule 204 test results from December 2009 and June 2010. Instead the letter averred that "the processes employed to close-out positions that were allegedly in violation of rule 204T were effective and performed as designed."

- Exhibit 101 at p. 6 – 8

5. Close-Out Requirements Pursuant to Rule 204T

Staff found that Penson failed to close out of 15 of 50 (30%) security positions sampled in violation of Rule 204T. Staff found that in two of the 15 positions the Firm conducted further short sales on T+4 without pre-borrowing the securities as required by and in violation of Rule 204T.

Staff found that through its marking review that Penson did not close out nine fail to deliver positions in accordance with Rule 204T.

Staff found that although the Firm established unwritten protocols and procedures to respond to the emergency short selling orders, these procedures are not reflected in the Firm's written supervisory procedures contrary to NASD Conduct Rule 3010. Specifically, the following procedures are not described in the Firm's written supervisory procedures: i) the Firm's use of its PFS642 and PFS643 report; ii) the criteria developed for the Firm's random allocation model; and iii) how the Firm executes buy-ins.

Staffs found the execution of buy-ins are not always done at the market open contrary to Rule 204T.

Response: Penson believes that the reasonable processes employed to close out positions that were allegedly in violation of rule 204T were effective and performed as designed. The Firm's current procedures as they relate to Rule 204 are effective and reasonably designed to ensure that all short sales and sales not long are covered either through stock borrow or market action prior to the open on S+1. Additionally, Penson has updated its Written Supervisory Procedures ("WSPs") relating to Rule 204 and the use of the PFS642 & PFS643 reports. The criteria used for buy-in allocations and the procedures detailing how buy-ins are executed are provided below:

175. Delaney admitted that the language in the OCIE letter was inconsistent with the Rule 204 testing Alaniz conducted in December 2009 and June 2010.

- Delaney Testimony

Q Okay. Would you look at your testimony, please, Exhibit 224, Line 247?

Q And if you look at Line 16, "I'm trying to understand how, in" –

the question was asked: "I'm trying to understand how, in light of what the two 3012 tests showed in the end of 2009 through June 2010, with the significant failure rates in closing out -- or to Rule 204T, how Penson could say that to the SEC that it believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule" -- "Rule 204T were effective and performed as designed. Can you explain that to me?"

Answer: "I can't explain that as I sit here, no, sir."

Question: "Does that appear inconsistent to you as you sit here today?"

Answer: "In reference to the items that you cited, that would appear to me to be -- it would appear to me to be inconsistent. Yes, sir."

Did I read that correctly?

A It appears so.

Q And is that the testimony that you gave?

A I have no reason to say it is not.

(Hearing- Day 3, 688:17-689:17, Oct. 29, 2014)

176. It is not possible to reconcile the statement concerning Rule 204 in the letter to OCIE with Alaniz' Rule 204 testing.

- Hasty Testimony

Q Okay. Let me ask you to look at Exhibit 101, and that is the letter from Penson to the U.S. Securities and Exchange Commission in November of 2010. We talk about some specific language at the top of Page 8 of that document. "Penson believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule 204T were effect and performed as designed." In your view, that statement is not complete and accurate; isn't that correct?

A I'm sorry. Ask your question again.

Q In your view, that statement is not complete and accurate; isn't that true?

A No. I don't have any reason to believe that it's not accurate.

Q Okay. Let me ask you to take a look at your investigative testimony again at Page 185, so that's the second volume of the investigative testimony.

A Okay.

Q You were asked this question: Okay. So let's go to Penson's response on the next page, Penson 0722236. It's in bold response. Do you see that? Response: Penson believes that the reasonable processes employed to close-out positions that were allegedly in violation of Rule 204T were effective and performed as designed. Do you see that?

A Yes.

Q Question: In your view, is that statement complete and accurate? Answer: In light of what I know now, no. At the time this was written, I don't know.

A Okay.

Q Do you see where I read?

A Yes.

Q And, in fact, you are unable to reconcile this statement with the testing results we saw in Exhibit 70 and Exhibit 85; isn't that correct?

A Yes, that's correct.

(Hearing- Day 7, 1775:10-1776:24, Nov. 4, 2014)

III. THE DIVISION'S CLAIMS AGAINST RESPONDENT YANCEY

177. Supervision is an important part of a compliance program.

- Delaney Testimony

Q Let me ask you about the reporting structure at Penson. As -- as Chief Compliance Officer, was it important to you to understand who reported to whom?

A Yes.

Q Why?

A Supervision is an -- an important part of -- of -- of -- of a compliance program.

(Hearing- Day 5, 1215:4-1215:10, Oct. 31, 2014)

- Exhibit 213 at p. 7/9

The duty of a Broker/Dealer to maintain and enforce adequate standards of supervision extends to every aspect of the Broker/Dealer's activities. Customers dealing with Penson Financial Services are entitled to be confident of fair treatment. They should be able to rely upon the firm to have systems of supervision and internal control in place to provide safeguards against inadvertent violation of laws, rules and regulations, most particularly against those employees who may be tempted to engage in improper or fraudulent conduct.

The Securities and Exchange Commission (SEC) has stated that "...where the failure of a securities firm and its responsible personnel to maintain and diligently enforce a proper system of supervision and internal control results in the perpetration of fraud upon a customer or in other misconduct in willful violation of the Securities Act or the Exchange Act, for purposes of applying the sanctions provided under the securities laws, such failure constitutes participation in such misconduct, and willful violations are committed not only by the person who performed the misconduct but also by those who did not properly perform their duty to prevent it."

178. Yancey was hired as CEO because PFSI was growing too large for founders Pendergraft and Son to continue to manage.

- Pendergraft Testimony

Q Okay. And what was Mr. Yancey's relationship with PFSI?

A Mr. Yancey was hired in -- I believe in 2005 as president and chief executive offer of PFSI.

Q Why did you decide to hire a CEO at that time?

A The Penson organization had grown significantly since its founding. The company was considering a public offering, and the responsibilities that Dan Son and I had carried out at PFSI would have been impossible -- becoming more difficult to carry out in view of the growing organization. And it was envisioned that as the organization continued to grow and were public, that it would be impossible to continue to carry out those responsibilities, so we needed to expand our management team in order to effectively manage the growing business.

(Hearing- Day 6, 1456:22-1457:13, Nov. 3, 2014)

A. Yancey failed to supervise Delaney.

179. Yancey was the CEO of PFSI and was a registered person.

- Stipulated Finding of Fact 2
- Ex. 758 at 3

CHARLES W. YANCEY
CRD# 1173660

Report Summary for this Broker



Registration History

This broker was previously registered with the following securities firm(s):

PENSON FINANCIAL SERVICES, INC.
CRD# 25866
DALLAS, TX
09/2005 - 02/2012

180. Delaney was a registered person associated with PFSI.

- Stipulated Finding of Fact 102

181. Yancey had supervisory responsibility for Delaney.

- Stipulated Finding of Fact 112

182. Yancey received and reviewed the Rule 204 Test results in December 2009.

- Yancey Testimony

Q And you saw a document, either this document or a document like this, while you were CEO of Penson Financial Services; is that right?

A I did.

Q Do you recall if you saw it in connection with those quarterly meetings we were just discussing?

A I believe that I did.

Q Okay. And is it fair to say that if you were given the 3012 test results, it's a document you would have reviewed?

A Just a point of clarification.

Q Yes.

A I believe that I received it in December of 2009.

Q You believe --
A Is that helpful?
Q You believe you received it in December of 2009?
A I do.
Q All right.
A I saw it, I should say.
Q Okay. And would you have reviewed it when you received it?
A Yes, I would have reviewed it with the people that presented it to me.
Q And who do you recall presented it to you?
A Mr. Delaney and Mr. Alaniz.

(Hearing- Day 3, 897:7-898:8, Oct. 29, 2014)

183. Yancey met with the Compliance department quarterly to discuss its Rule 3012 testing, which was part of the process of preparing Yancey to sign and certify Person's Annual Certification of Compliance, also referred to as the CEO certification.

- Yancey Testimony

Q All right. And can we also agree -- I think we discussed this earlier -- that you, the CEO, would meet once or more annually with the Chief Compliance Officer to review compliance matters that were the subject of the annual certification; does that sound accurate?

A Yes, sir.

(Hearing- Day 3, 887:18-887:23, Oct. 29, 2014)

Q It sounded like one of the things you would do, you would meet quarterly with the Compliance group, correct?

A The Compliance group and any other people they thought might be relevant to our conversations in preparation for the certification.

Q Okay. And we may have covered this, I apologize, but one of the things you would talk about in those quarterly meetings was their testing findings, correct?

A Yes, sir.

Q And we've heard the term 3012 testing in this hearing; is that right?

A We have.

Q The 3012 testing is what we're talking about when we say the testing findings in these quarterly meetings, correct?

A Yes, sir.

(Hearing- Day 3, 890:19-891:11, Oct. 29, 2014)

- Ex. 197 at p.240

14.6.1 Meetings Between CEO And CCO

The CEO meets once or more annually with the CCO to review compliance matters the subject of the annual certification.

184. Issues would be raised at these quarterly meetings only if they were significant enough to warrant Yancey's attention.

- Yancey Testimony

Q All right. And at these quarterly meetings, you would be advised by people in your reporting chain if there were issues that were significant enough to be raised to your level; is that right?

A I think that's right.

Q And Mr. Yancey, you relied on people to identify things that might have warranted your intervention or being involved; is that right?

A Yes, sir.

(Hearing- Day 3, 891:12-891:20, Oct. 29, 2014)

185. On January 28, 2010, Delaney and Alaniz had a quarterly meeting with Yancey. In that meeting, the Rule 204 Test was one of only two items discussed with Yancey. Delaney and Alaniz explained the results of the Rule 204 Test and pointed out that 112 out of 113 items tested failed.

- Exhibit 134

From: Eric Alaniz <EAlaniz@PENSON.COM>
Sent: Thursday, January 28, 2010 12:56 PM
To: Bill Yancey
Cc: Tom Delaney; Eric Alaniz
Subject: 2009-2010 Quarterly Annual Certification Meeting

Importance: High

Bill,

Again, I'd like to thank you for the time you spent with Tom and me today reviewing our departments quarterly progress on the Annual 3012 Testing. Just as a quick recap of our meeting I have highlighted some areas discussed today.

Currently the Compliance department has tested, among other areas, SEC Rule 204 and the Transmittal of Funds. These two areas are now the focus of prompt remediation. The Compliance department will continue to review practices in areas of high regulatory concern and continually update our "Risk Based" testing approach including but not limited to areas identified during last years certification process, areas highlighted during regulatory examinations as well as those areas regulators have indicated will be areas of focus as we proceed throughout the year.

- Alaniz Testimony

Q Okay. And going back to Exhibit 70, the testing results that are there, did you ever

report those findings to Mr. Yancey?

A Yes.

Q And explain that. When did that happen?

A I can't recall the exact date. I know we tried to see him every quarter to review the testing for that time period, and I believe that must have been sometime in January.

Q Okay. And what did you discuss with Mr. Yancey at that time?

A We discussed a few items. One item was Reg SHO.

Q And did you explain the results of that testing?

A Yes.

Q Did you explain to him that there was a 99 percent failure rate?

A I'm not sure if we used that exact language, but we did point out that, out of 113, 112 did fail.

(Hearing- Day 3, 709:22-710:16, Oct. 29, 2014)

- Yancey Testimony

Let's look at -- at January of 2010, Mr. Alaniz says, "Just as a quick recap of our meeting, I've highlighted some areas discussed today. Currently the Compliance department has tested, among other areas, SEC Rule 204 and the transmittal of funds." That's what Mr. Alaniz says to you, correct?

A It is.

Q And as you sit here today, do you recall anything else discussed in the January 2010 meeting other than Rule 204 and transmittal of funds?

A You know, I don't have a recollection of anything else.

(Hearing- Day 3, 895:6-895:17, Oct. 29, 2014)

186. The Rule 204 Test was discussed in the March 31, 2010 quarterly 3012 CEO certification meeting, which was held on the same day that Yancey signed the 2010 Annual CEO Certification. At the meeting, the December 2009 Rule 204 testing was one of ten items discussed.

- Stipulated Finding of Fact 113
- Alaniz Testimony

Q At the March 31st, 2010 meeting, did you discuss the processes that you had tested in the 31 -- or the 3012 Rule 204 testing?

A We typically start off with 3012 testing. Tom Delaney usually spearheads that. From there, we choose the topic of -- I believe we might have chosen 10 items. And then from there, we would go down, indicating what we had found. If they needed more information, I did have booklets, kind of like this (indicating) here, with all the information and the details if they wanted to review it.

Q Okay. And was your 3012 204 testing, was that one of the 10 items that was discussed?

A Yes.

(Hearing- Day 3, 714:21-715:9, Oct. 29, 2014)

187. At the March 31, 2010 meeting Alaniz did not tell Delaney or Yancey that the Stock Loan remediation steps would solve the Rule 204 problem.

- Alaniz Testimony

Q But in that meeting in March, did you express that opinion that you just told us here, that you believed this remediation step would resolve the problems that you identified in your testing?

A No.

Q You didn't tell Mr. Delaney or Yancey that you thought these remediation steps would solve the problem?

A No.

(Hearing- Day 3, 772:1-772:8, Oct. 29, 2014)

188. Yancey and Delaney met to discuss and review the Annual Report.

- Yancey Testimony

Q All right. And the CCO would prepare that report and the WSP goes on to say, "The CCO will meet with the CEO to discuss and review the report." That's a meeting that occurred?

A Yes, sir.

Q It occurred annually?

A Yes, it did.

(Hearing- Day 3, 888:19-888:25, Oct. 29, 2014)

- Ex. 197 at p. 240

14.6.2 Annual Report To CEO

[FINRA Rule 3130]

The CCO will prepare and provide the CEO (or equivalent officer) with an annual report that includes a review of PFSI's supervisory system and procedures and key compliance issues. The CCO will meet with the CEO to discuss and review the report and will meet at other times, as needed, to discuss other compliance matters. If PFSI has designated multiple CCOs, each CCO will meet with and prepare a report for the CEO annually.

189. As part of the process of signing and certifying the 2010 Annual CEO Certification, Yancey carefully reviewed the Annual Report, which he considered an important document.

- Yancey Testimony

Let me ask you: The annual report that the Chief Compliance Officer prepared, you would review it, correct?

A Yes.

(Hearing- Day 3, 889:8-889:11, Oct. 29, 2014)

Q Okay. And we can agree, Mr. Yancey, that that annual Chief Compliance Officer's Summary Report was an important document?

A Yes, sir.

(Hearing- Day 3, 890:4-890:7, Oct. 29, 2014)

Q Okay. Now, you would have reviewed this report before you signed your certification; is that right?

A Yes.

Q What did your review entail?

A It involved discussions with the CCO, and it involved some discussions with personnel of the firm. It -- it involved me asking the same question I always ask: Is there any -- any reason that I should not or could not sign this truthfully? And to which I was told there's no reason at all, sir.

Q Okay. I take it you also would have -- would have read the report itself; is that right?

A Yes, sir.

Q It looks to me to be one, two, three, four, five, about six pages long; is that right?

A Yes, sir.

Q All right. And you would have read this report carefully, correct?

A Yes. I would have worked with the people mentioned to go with this report. Q Sure. And in your personal reading of it, though, you would have made sure to read it carefully?

A Yes. I think I would.

Q All right. Because again, you knew this was going to Pension's regulators, correct?

A I did.

(Hearing- Day 4, 935:16-936:16, Oct. 30, 2014)

190. Yancey personally signed the Annual CEO Certification; it was an important document.

- Stipulated Finding of Fact 114
- Yancey Testimony

So this is the 2010 CEO certification; is that right?

A Yes, sir.

Q And that is for 2009 to 2010, that's the cycle, correct?

A Yes, sir.

Q All right. And again, if we look at the bottom, that is your personal signature,

correct?

A It is.

Q You -- you put pen to paper and signed that document?

A Yes, sir.

Q Now, you took that certification seriously, didn't you?

A Yes, sir.

(Hearing- Day 3, 884:21-885:10, Oct. 29, 2014)

191. Yancey was aware that the CEO Certification and Summary Report were sent to regulators.

- Stipulated Finding of Fact 115

192. Yancey does not know why the results of the Rule 204 Test were not included in the Rule 3012 Summary Report.

- Yancey Testimony

Q Okay. Now, Mr. Yancey, you don't know why the results of the SEC Rule 204 testing are not listed among the significant compliance problems in Exhibit 135, do you?

A No, sir.

Q You do not know?

A I do not know.

(Hearing- Day 4, 938:22-939:3, Oct. 30, 2014)

193. Yancey did not have any discussion with anyone, including Delaney, about omitting the Rule 204 testing from the Rule 3012 Summary Report.

- Yancey Testimony

Q And, Mr. Yancey, you did not have any discussions with Tom Delaney about omitting discussion of the Rule 204 testing from the annual report, did you?

A No, sir.

Q And you did not have any discussions with anyone else about omitting discussions of the Rule 204 audit results from the report, did you?

A I did not.

Q And I -- this may be the flip side of that same question; but you didn't have any discussions with anyone about whether the 204 testing should be included in the report, did you?

A Not that I recall.

(Hearing- Day 4, 939:4-939:16, Oct. 30, 2014)

Q Did you have any discussion with Mr. Delaney or anyone else about not including the 204 testing on this Summary Report?

A No.

(Hearing- Day 7, 1888:1-1888:4, Nov. 4, 2014)

194. Yancey knew that it was important to be as accurate as possible in communications with regulators, and that honesty in communications with regulators are the very fabric of a compliance program.

- Yancey Testimony

Q If Tom Delaney were misleading regulators, that's something that would have been important to you?

A Yes, sir.

Q And why is that? Why would that be important to you?

A I think the very fabric of the Compliance program revolves around honesty and integrity.

Q Including honesty and integrity in communicating with regulators?

A Yes, sir.

(Hearing- Day 3, 880:20-881:4, Oct. 29, 2014)

195. If Delaney were misleading regulators in communications with those regulators, that is something that would have been important to Yancey.

- Yancey Testimony

Q If Mr. Delaney were misleading regulators, that's something you would want to know about?

A Yes, sir.

Q If Tom Delaney were misleading regulators, that's something that would have been important to you?

A Yes, sir.

Q And why is that? Why would that be important to you?

A I think the very fabric of the Compliance program revolves around honesty and integrity.

Q Including honesty and integrity in communicating with regulators?

A Yes, sir.

(Hearing- Day 3, 880:17-881:4, Oct. 29, 2014)

196. If Yancey saw a red flag that suggested Delaney was not being honest with regulators, he had a duty to follow up on it.

- Yancey Testimony

Q And let me ask you: If you saw a red flag that suggested that Mr. Delaney wasn't being honest with regulators, can we agree that you would have had a duty to follow up

on that?

A To the extent I had detected a red flag, I would have followed up on it.

Q That's fair, sir.

So to be sure it's clear, if you had detected something that was a red flag, that you considered a red flag, we can agree that you would have a duty to follow up on it?


A Yes, sir.

(Hearing- Day 3, 882:11-882:22, Oct. 29, 2014)

B. Yancey failed to supervise Johnson.

197. Yancey was the CEO of PFSI and was a registered person.

- Stipulated Finding of Fact 2.
- Ex. 758 at 3

CHARLES W. YANCEY CRD# 1173660	Report Summary for this Broker	
Registration History		
This broker was previously registered with the following securities firm(s):		
PENSON FINANCIAL SERVICES, INC. CRD# 25866 DALLAS, TX 09/2005 - 02/2012		

198. Johnson is a registered representative associated with PFSI.

- Stipulated Finding of Fact 102.
- i. The Stock Loan department was a core function of PFSI, and Johnson played a key role in that department.

199. Stock loan, as well as the other functional groups within PFSI, reported up to Yancey.

- Gover Testimony

Q You've talked about several different teams. Were they -- at PFSI, were they grouped together in any way?

A Yeah. Well, some iTeams, the structure is generally there would be a manager. So you've got a number of analysts, specialists, you know, people who were actually doing the work on the teams. Each team would have a manager. I would generally have like-typed functions grouped together under a director. And then the directors would roll up

to me. All of my teams were operations teams. There were other functions within Penson, but I was Operations Manager.

Q What other silos were there at PFSI while you were there?

A Finance, which is going to be the fin- -- CFO and treasury relationship management, kind of like customer service, onboarding were at various times bundled together. Stock Loan was by itself. You'd have -- accounting was generally a part of the finance silo, and then there's the support kind of silos like HR and legal.

Q And did those all roll up to someone?

A Yeah. They rolled up to the CEO.

(Hearing- Day 1, 95:18-96:15, Oct. 27, 2014)

- Johnson Testimony

Q So those were folks that were part of the PFSI Stock Lending team, correct?

A Yes.

Q And did you interact with them on Stock Lending matters?

A I sat in the division. They reported to me dotted line; they reported directly to Bill Yancey.

(Hearing- Day 2, 528:18-528:24, Oct. 28, 2014)

200. PFSI's Stock Loan department lent shares owned by PFSI customers to earn borrow charges, used that stock as collateral for financing purposes, lent stock for financing purposes, and borrowed stock for PFSI's to cover PFSI customer's short sales.

- Gover Testimony

Q And what did they do? What did PFSI's Stock Lending department do?

A There's -- there's a couple of functions of Stock Loan. One is that they're maximizing the utility of the balance sheets. So if there are shares that -- goes back to the hypothecation agreement. So we have shares that somebody had a loan with Penson, and that loan is collateralized by the shares. Under the hypothecation agreement, Penson can lend the shares out, and for a couple functions. So one of the - - one of the functions of Stock Loan was if we had shares that we were -- they were -- the term is "access," access available to loan, that we would lend those shares out to parties who wanted to borrow them. And in exchange for that, you get borrow charges.

A The other function would be as a part of financing functions, clearing firms can finance the business in a couple ways. You can borrow money from banks and put up generally stock as collateral. You can also lend securities out to other parties. You can get cash for the lending of the stock, and that can also be used to finance the firm's operations.

Q Did they also engage in stock borrowing, the PFSI Stock Lending department?

A Yes. They would borrow stock.

Q And why -- why would they do that?

A I think in general if -- if Penson has a fail and we do not have the shares to make delivery, Stock Loan -- and so those would result from short sales. Stock Loan could recall the shares or borrow shares to make a delivery. So that's -- there's a couple reasons that you can borrow. The primary is because you -- you let somebody -- you gave approval. You gave a locate for a customer to sell short. And that customer sold short, and then you need to borrow -- borrow shares to cover the short. The other would be it's really a pure financing function. If you have a fail, so a fail that there's no obligation to buy-in, but it would be advantageous to be able to borrow the shares so that you can make delivery and get the cash. And it's -- it's -- the other piece is just pure really cash management, managing your -- your daily cash flows.

(Hearing- Day 1, 90:22-92:19, Oct. 27, 2014)

201. Stock Loan supported PFSI customers' short selling by providing "locates" on shares -- affirmative determinations that the shares would be available -- before the customer engaged in the short sale.

- De La Sierra Testimony

Q ... You said one of the things you did was short locates; is that right?

A Correct.

(Hearing- Day 1, 205:13-205:15, Oct. 27, 2014)

A On trade date, short sellers are required to get a locate before they place a short sale order, so --

Q Was it -- I'm sorry. What does it mean to get a locate?

A Locate, calling your brokerage firm, and they -- they're required to get affirmative termination to make sure the shares are there to approve this short sale. So when a customer comes in, it's a locate. We approve that locate for the customer. They then can do whatever they want. It's not a short sale until they place the short sale order. At that point, it's just a locate before they place a trade.

Q And you talked about placing a short sale. What is a short sale?

A A short sale is the opposite of a long sale. Short sellers will profit when the security goes down in price. Since they don't own the securities, they have to get a locate.

(Hearing- Day 1, 205:17-206:9, Oct. 27, 2014)

- Wetzig Testimony

Q We've heard a little bit about it, but I want to unpack those things. When you say they "did locates," what does it mean to do a locate?

A So for a broker to be able to short sell stock, he has to receive a locate on that security. So we will have to see some sort of inventory or feed from another broker-dealer in order to give them a locate.

Q And that's something that Penson Financial Services would give?

A Correct.

(Hearing- Day 2, 346:13-346:22, Oct. 28, 2014)

202. Stock Loan also supported PFSI customers' short selling by borrowing securities to satisfy the obligation to settle the short sale trade on T+3.

- De La Sierra Testimony

Q ... I think you also said that you would borrow securities?

A Correct.

Q Explain what that means.

A So once the short sale settles on T-3, if there's a delivery obligation, we would then go to our various counterparties and try to borrow the short sale.

Q What do you mean by a delivery obligation?

A If we owe CNS. One -- if Penson was not long in shares -- we approve a certain amount of shares, 1,000 shares of Amazon or something like that -- on settlement, if we don't have in our box 1,000 shares, now we have a delivery obligation to the street. We have to go borrow that from the street to satisfy that delivery.

Q You said if Penson doesn't have the shares in its box. What do you mean by that?

A Right. If we don't have other customers long, that will create a delivery obligation.

Q And whose box are you talking about? What is the box?

A Penson's box is our -- all of our customers, margin, securities, and that essentially creates our inventory.

Q I see. So who would you borrow from if you're borrowing on T-3?

A Various counterparties. We were on -- you know, CitiGroup, Merrill Lynch, BNP, Goldman.

Q And why do you borrow? What's the reason?

A To cover -- to make a delivery obligation to CNS so that Penson is not short these securities.

(Hearing- Day 1, 206:17-207:23, Oct. 27, 2014)

203. Stock Loan also lent securities from PFSI customers' margin accounts to its counterparties so they could meet their customers' delivery obligations.

- De La Sierra Testimony

Q ... You also said that you lent securities out of your box. Can you explain what that means?

A So just as we're trying to borrow for our delivery obligations, our counterparties also have delivery obligations. They -- we would come in every morning and there's a list from whoever, you know, our counterparties are, the names that they are looking for for their delivery obligations. We would check our box and, you know, decide who to lend it to you, know based, on the best market terms we can get.

(Hearing- Day 1, 208:2-208:13, Oct. 27, 2014)

204. Providing locates, borrowing securities, and lending securities, were functions of PFSI's Stock Loan department rather than Penson Worldwide.

- Stipulated Finding of Fact 116

205. Stock Loan was a significant profit center for PFSI.

- De La Sierra Testimony

Q But was Penson's Stock Lending a profit center to the firm?

A Yes, it was.

Q Was it a large profit center, a small profit center?

A I believe it was a significant portion.

(Hearing- Day 1, 212:25-213:5, Oct. 27, 2014)

- Wetzig Testimony

Q You talked a moment ago about the mechanics of Stock Lending, locates, borrows, recalls. I want to talk about kind of how stock lending fit into the broker-dealer business model, in the Penson Financial Services business model. So to the extent you have an understanding, what did stock lending do for Penson Financial Services, the broker-dealer?

A So Stock Loan was a large revenue producer for Penson.

(Hearing- Day 2, 354:9-354:17, Oct. 28, 2014)

206. Stock Loan generated revenue by lending out securities to counterparties, who generally paid a "rebate" to borrow the securities, and by borrowing securities to assist with customer short selling and charging a mark-up to customers for the cost of the borrow.

- De La Sierra Testimony

Q All right. Was Stock Lending a profit center at Penson Financial Services?

A Yes, it was.

Q How were those profits generated?

A Through the lending of the collateral, the margin accounts. And we also profited from the short selling as well.

Q How would you profit from the short selling?

A So once the real estate -- excuse me -- the rate interest environment went to zero, Fed funds went to zero in about 2008, generally it turned every borrow that we did with our counterparties to a cost to the firm. So Penson, because we didn't have the box to support that, we had to create a mechanism to recoup that cost, and we did that. So we would charge our customers back the cost to the firm, plus a fee.

Q I see.

So in borrowing, there's both passing the cost to the customer and then a markup on

top of it?

A Correct.

Q So that's how you would profit from the borrowing.

It may be obvious, but how do you profit from the lending of the collateral?

A So in the same time frame, the interest rates being where they were, just about every loan we put out that was not a financing loan was a premium rate. So we would lend our shares, get the money, and also earn interest on this collateral.

(Hearing- Day 1, 211:18-212:21, Oct. 27, 2014)

- Wetzig Testimony

Q So that's the funding bucket we talked about. I want to -- you also mentioned the revenue bucket. Help us understand how Stock Lending made revenue for Penson Financial Services.

A So when we would lend out securities, we would be paid rebates on any securities. So essentially, these are names that are in demand from other broker-dealers. So they would essentially pay us a negative rebate on -- on these shares, and which is income, revenue.

Q And, yeah, and help us understand a negative rebate rate. What does that mean? Is it, are you paying them money? They're paying you money?

A So they're essentially paying us a rebate on those loan shares. So we receive any collateral from the loan and they would pay us an interest rate, depending on how difficult the security was on those shares.

Q You also mentioned that the Stock Lending group at Penson Financial Services borrowed shares. Did that have any revenue generation involved with it?

A So when we would borrow securities, that was actually a cost to Penson. Q And did Penson absorb that cost of borrowing securities?

A We would pass that charge along to the customer. It was essentially short those securities that was causing us to have to borrow.

Q And are you aware of whether there was any additional costs, other than just Penson's cost to borrow? Was there a markup or --

A We did have a standard 200 basis point markup on our borrows.

(Hearing- Day 2, 355:18-356:23, Oct. 28, 2014)

- Yancey Testimony

Is it right, sort of in general terms, that -- that one way Stock Lending generates revenue is if there are hard to borrow stocks, Penson Financial can loan them out and receive revenue for those loans, interest for those loans?

A Well, that is one way.

Q Correct. So that would be one way, right?

A Yes, sir.

Q Another way Penson's Stock Lending department could generate revenue, or did generate revenue, was borrowing securities on behalf of correspondent brokers and

charging a markup; is that right?

A That's true, particularly after the -- sort of the financial crash when rates essentially disintegrated.

Q All right. So if we're thinking about the period of late 2008 through 2011, that's after the financial crisis; is that right?

A That's -- it includes it, too.

Q Sure.

A Yes. But I think we're on the same page.

Q All right. So particularly during and after the financial crisis, that borrowing and markup process would generate revenue for Penson Financial Services, right?

A Yes, one element.

(Hearing- Day 4, 944:17-945:16, Oct. 30, 2014)

207. Stock Loan also financed PFSI. Financing through Stock Loan was advantageous compared to financing through bank loans because PFSI got more value for the stock pledged as collateral, and because PFSI paid a lower interest rate on the loan.

- De La Sierra Testimony

Q You also said, I believe, in your list of the things that Stock Lending did for Penson Financial Services something about financing the firm; do you recall that?

A Yes.

(Hearing- Day 1, 209:23-210:2, Oct. 27, 2014)

Q So if I understand, I think I heard you talk about two advantages of using stock lending finance instead of a bank.

The first is you get more value for your collateral, 100 percent instead of 80 percent; is that a fair summary?

A That's correct.

Q And the second was that it's also cheaper to do financing through stock lending than a bank, correct?

A Yes, that's correct.

(Hearing- Day 1, 211:8-211:17, Oct. 27, 2014)

- Yancey Testimony

Q Okay. Stock Lending is used, in part, for financing purposes; is that right?

A Can be.

Q It can be. And how does Stock Lending help finance a firm?

A Sure. When the customers open a margin account and they sign a hypothecation agreement and they take a loan out against their collateral, the securities are eligible to be lent or used for financing their margin debits.

Q And at Penson Financial Services, between 2008 and 2011, did you all use Stock

Lending to help finance the firm?

A Yes.

(Hearing- Day 4, 943:15-944:3, Oct. 30, 2014)

Q Tell me about firm financing and how the Stock Loan and financing worked together.

A Okay. So if a customer deposited stock in a margin account and signed a margin agreement or a hypothecation agreement and then ultimately borrowed money from that account, the firm could pledge the collateral to a bank sufficient to not have to tie up their money for the purpose of the loan to the -- to the investor, or to the extent that there was an excess of any security, could use that excess in Stock Loan for a firm -- what they call firm financing.

Q What was firm financing? How did it get used in firm financing?

A Firm financing is really -- in a pledge relation program at a bank, where you pledge up the securities, the normal haircut is 20 percent, or that's an industry term, haircut. That means the loan to value is approximately 80 percent. In the Stock Loan world, the loan to value could be 100 percent.

So in order to maximize the balance sheet, you often use Stock Loan for the purpose of financing.

(Hearing- Day 7, 1831:7-1832:2, Nov. 4, 2014)

- McCain Testimony

Q I think it might be helpful, Mr. McCain, if you spent a moment explaining how, first, financing fits into stock lending, since you have some understanding.

A The component of stock lending that I understand is -- it's related to the financing of the firm -- is a broker-dealer has basically two ways to finance the business. One is through a bank loan, where they can go to the bank, pledge up collateral and -- to the bank, and the bank will advance approximately 80 percent of the market value. The other way is that -- and really a more efficient way is for Stock Loan to lend out securities to other counterparties, and they get an advance rate of about 98 percent, and the interest rate is much, much lower than what a bank would charge.

(Hearing- Day 9, 2165:12-2166:2, Nov. 6, 2014)

208. Stock Loan's firm financing function was important to PFSI.

- Wetzig Testimony

Q I want to talk a little bit more about each of those buckets. Let's go in the reverse order, talking first about funding the firm's day-to-day operations. Help us understand what you mean by that. How did Stock Lending do that?

A So we would -- when we loan out any security, you were getting back the cash collateral -- excuse me -- cash collateral that's -- those shares are worth. And like any other business, it needs cash to operate, so that helped fund the day-to-day

operations.

Q And was that function important to Penson Financial Services, the broker-dealer?

A Yes, it was.

Q Why?

A There were times where we would be asked to, essentially, do what's called financing. So we would loan out names not to necessarily make income, but for cheaper financing to fund the firm.

(Hearing- Day 2, 354:25-355:17, Oct. 28, 2014)

- Yancey Testimony

Q So in order to maximize the balance sheet, you often use Stock Loan for the purpose of financing.

Q Why did you need financing on a daily basis of Penson?

A To settle all the customer trades and -- and to be -- to have cash sufficient to loan to customers who wanted to take money out, borrow money.

Q Was this a core component of Penson, or how would you describe this cash financing component?

A Sure, it's core. It's a utility that was provided by clearing firms.

(Hearing- Day 7, 1832:1-1832:11, Nov. 4, 2014)

209. Stock Loan was a necessary and integral part of PFSI's business model.

- Yancey Testimony

Q Okay. So I interrupted your answer. I apologize. You were talking about how Penson clears for introducing brokers.

A Right. And as such, Stock Loan was useful to the correspondents and was an integral part of a clearing firm's process.

Q Sure. So Stock Loan is an integral part of a clearing firm's process?

A It's certainly a component part of it, yes.

Q Would you agree that it's an integral part? I thought I heard you just say integral.

A I did, and -- and I -- I suppose it's integral.

Q And we can at least agree that, or we can also agree that it's a necessary part of any clearing firm's capabilities; fair?

A Yes, sir, I think so.

(Hearing- Day 4, 942:24-943:14, Oct. 30, 2014)

And would you also agree with me, Mr. Yancey, that Stock Lending was used to meet the needs of Penson Financial Services diverse mix of clients?

A Yes.

Q Okay. So fair to say that Stock Lending at Penson was an important part of the business?

A It was an important part.

(Hearing- Day 4, 946:11-946:18, Oct. 30, 2014)

210. PFSI could not have existed without Stock Loan.

- De La Sierra Testimony

Q Could a broker-dealer exist without a stock lending function, if you know?

A Not a firm like Penson, no.

(Hearing- Day 1, 213:6-213:8, Oct. 27, 2014)

211. Because Stock Loan was a core function of PFSI it is not surprising that the supervisory matrices show Johnson reporting to Yancey, the CEO.

- Delaney Testimony

Q Okay. And can you look at Exhibit 201. And we looked at Exhibit 201 before as well. If you look at the fourth page of the attached letter, if you look at Number 11, in response to FINRA's request that Penson provide a description of Penson's supervisory chain identifying each supervisor's direct reports, as well as the individual to which each supervisor reports, Ms. Miller attaches a Supervisory Matrix; isn't that right?

A Yes, that's right.

Q And if you look at the last page of that document -- oops, it's not the last page of the document. I guess it's Page 19, maybe, the Supervisory Matrix that's attached to that document. Do you see the Supervisory Matrix?

A Yes, ma'am.

Q And that shows a grid with Bill Yancey at the head of it, Mike Johnson under Bill Yancey, and it says that Bill Yancey is Mike Johnson's regulatory supervisor and pi org chart supervisor; is that right?

A That's what it says, yes, ma'am.

Q Okay. And when you were asked in your third testimony with this counsel representing you whether you were surprised that Mike Johnson was under Bill Yancey on a Supervisory Matrix, you said, "It may not surprise me if it's there because I would think what those Supervisory Matrices were trying to show was that this is a broker-dealer function and, therefore, the CEO is responsible for all issues of the broker-dealer."

Question: "You're thinking of the business units to report to the CEO?"

Answer: "Yes, sir. So while functionally that may -- from an HR standpoint, there might not have been a -- there might not have been a reporting relationship from an HR standpoint, **it certainly would have been my expectation from a compliance standpoint that a core function of the broker-dealer would report into from a supervisory standpoint. The supervisory in a broker-dealer context would have reported in through the CEO.** So what we were really trying to show in supervisory procedures wasn't necessarily -- wasn't necessarily reporting relationships as far as HR relationships go, more so in terms of from a pure supervision of the broker-dealer

standpoint, how would that have flown or how would that -- how would that -- the flow of that look."

Do you remember giving that testimony?

A I -- I don't remember giving that testimony. I remember -- I remember giving a third testimony, and I'm not disputing that those were the words that I said; I just don't remember giving that.

Q You don't doubt that you gave that testimony?

A No.

(Hearing- Day 5, 1391:11-1393:12, Oct. 31, 2014)

212. Johnson was initially hired to head the Stock Loan department at PFSI.

- Johnson Testimony

Mr. Johnson, at any point in your career, were you employed by Penson Financial Services?

A Yes.

Q What was your title and job?

A I think for Penson Financial Services, it was Vice President of Securities Lending.

(Hearing- Day 2, 513:17-513:22, Oct. 28, 2014)

213. Johnson was a very involved supervisor of PFSI's Stock Loan department throughout the time period relevant to this case. He was the "big boss"; the leader of PFSI's Stock Loan group.

- De La Sierra Testimony

Q ... Who was Mike Johnson?

A Mike Johnson was the Senior Vice President of Securities Lending. He was my boss.

Q He was your boss?

A Yes.

Q How would you describe Mr. Johnson as a boss, as a supervisor? Was he involved, detached?

A He was very involved.

(Hearing- Day 1, 217:4-12, Oct. 27, 2014)

Q Now, you were the Vice President, am I getting your title right, the Vice President of PFSI Stock Lending?

A Yes.

Q And how many direct reports did you have?

A Just Lindsey.

Q Okay. And how many people were below Lindsey?

A Lindsey, four.

Q Okay. Did you feel that they kind of all rolled up to you, that you were the leader of that group?

A No. I felt like that Mike was.

Q Mike was the leader of that group?

A Right.

(Hearing- Day 1, 309:11-309:23, Oct. 27, 2014)

- Wetzig Testimony

Q Okay. Now, you mentioned -- you mentioned Mr. Johnson, Mike Johnson. I want to talk a little bit about Mr. Johnson. Could you describe his involvement in Penson Financial Services, the broker-dealers Stock Lending operations.

A So Mike was obviously the big boss. He was, you know, the guy in the corner office, and he was hired from LoanNet.

(Hearing- Day 2, 350:17-350:24, Oct. 28, 2014)

Q I think the question was generally about Mr. Johnson and his involvement in Penson Financial Services Stock Lending group.

A So, yes, Mike knew the -- the stock loan business well, and he was involved in, you know, everything that we did. If we had any questions or issues, we would -- we felt free to come talk to him.

(Hearing- Day 2, 351:15-351:21, Oct. 28, 2014)

Q And I know you mentioned Mr. Johnson's knowledge of Stock Lending. Talk to us about his -- his involvement in the Penson Financial Services Stock Lending group. Was he hands on, hands off? How would you describe it?

A I would -- I would say that he was hands on.

(Hearing- Day 2, 352:8-352:13, Oct. 28, 2014)

Q Was he a hands-on or a hands-off manager of the PFSI Stock Loan department?

A He -- he was hands-on.

(Hearing- Day 2, 415:24-416:1, Oct. 28, 2014)

- Johnson Testimony

Q Were you generally involved in, you know, substantive issues in conversations with the PFSI Stock Lending team?

A Yes.

(Hearing- Day 2, 528:25-529:3, Oct. 28, 2014)

214. Johnson was personally involved in borrowing securities for PFSI customers, locating shares for PFSI customers, and in financing activities for PFSI.

- De La Sierra Testimony

Q How would you describe Mr. Johnson as a boss, as a supervisor? Was he involved, detached?
A He was very involved.
Q What makes you say that?
A Well, he -- he was on the phones. He had accounts he dealt with that he would -- you know, first thing in the morning, 6:00 a.m., whenever we were up, he was loaning securities. He would get involved if we needed to borrow, if we needed to finance.
Q The accounts that Mr. Johnson dealt with, were those accounts at Penson Financial Services, the broker-dealer?
A Yes.
Q The borrows Mr. Johnson dealt with, were those borrows for Penson Financial Services customers?
A Yes, they were.
Q And I think you also mentioned doing locates. Or did I mishear you? I'm sorry.
A I didn't mention it, but he would get involved in locates. If there was something really hard or none of us could find them, he would also get involved.
Q And was that also something, again, for Penson Financial Services, the broker-dealer?
A Yes.
Q Okay. At what point in time did Mr. Johnson become your direct boss? A When he started in, I think, 2004 or -5.
Q And was he always your supervisor at Penson Financial Services Stock Lending?
A He was.

(Hearing- Day 1, 217:4-218:14, Oct. 27, 2014)

- Wetzig Testimony

A ...[Johnson] liked loaning securities. So every morning he would come in, participate in the -- the lending of the securities with his relationships.
Q And when you say "the lending of securities," are we talking about Penson Financial Services's securities?
A Yes.

(Hearing- Day 2, 352:14-352:20, Oct. 28, 2014)

215. Johnson was involved in substantive issues regarding PFSI Stock Loan, including issues related to Rule 204.

- Johnson Testimony

Q Were you generally involved in, you know, substantive issues in conversations with the PFSI Stock Lending team?

A Yes.

Q Okay. On -- on issues including Rule 204?

A Yes.

(Hearing- Day 2, 528:25-529:5, Oct. 28, 2014)

216. Sometime prior to the implementation of Rule 204T, Johnson became the PWI Senior Vice President for Global Stock Lending, responsible for all of Penson's worldwide stock lending operations.

- Stipulated Finding of Fact 117

217. Johnson's interactions with the PFSI Stock Loan department did not significantly change after his promotion. He remained a highly-involved, hands-on manager over PFSI Stock Loan.

- De La Sierra Testimony

Q Do you know whether there came a time where Mr. Johnson was -- his employment changed from Penson Financial Services to Penson Worldwide? A Yes, it did.

Q Describe for us how his interaction with you changed once he changed employment at Penson Worldwide?

A I saw little change.

Q What do you mean by that?

A He was involved with PFSI as he was before.

Q And what were the ways that you saw Mr. Johnson remain engaged with PFSI Stock Lending?

A He was still lending securities, borrowing. He still had his few contacts that he was dealing with. He still maintained a relationship with them where he was the primary contact for them. It didn't change.

Q Before Mr. Johnson was moved into a PWI employee, how often did you and Mr. Johnson interact?

A Daily.

Q How about afterwards; how often did you and Mr. Johnson interact?

A Also daily.

(Hearing- Day 1, 218:15-219:14, Oct. 27, 2014)

- Wetzig Testimony

Q All right. And in practical terms, describe how his involvement with the Penson Financial Services Stock Lending group changed when his title changed. A I don't

think his involvement changed very much. I mainly think it was a title upgrade and he -- whether he was a Vice President or Senior Vice President, he ran all of the Stock Loan; so our Canadian office, our London office, our Australian office and our Dallas office.

(Hearing- Day 2, 353:5-353:13, Oct. 28, 2014)

Q All right. I think when you started talking about Mr. Johnson, you described him as the "big boss." Was that true both before and after his promotion?

A Correct.

(Hearing- Day 2, 354:5-354:8, Oct. 28, 2014)

- Yancey Testimony

Q Tell me a little bit now about the Stock Loan department at PFSI and who -- let's start with who headed Global Stock Lending?

A Mike Johnson.

Q And was he responsible for stock lending in the U.S. as well as global?

A Yes, ma'am.

Q Who reported to him?

A Rudy De La Sierra, Brian Hall, Lindsey Wetzig. Mark McCain, Dawnia Robertson, Logan Satterwhite. I think it's Dawnia Robertson.

(Hearing- Day 7, 1830:14-1830:24, Nov. 4, 2014)

218. After his promotion, Johnson remained associated with PFSI.

- Stipulated Finding of Fact 9
- Stipulated Finding of Fact 41
- Stipulated Finding of Fact 102

219. After his promotion, Johnson continued to engage in stock lending activity for PFSI.

- De La Sierra Testimony

Q Do you know whether there came a time where Mr. Johnson was -- his employment changed from Penson Financial Services to Penson Worldwide? A Yes, it did.

...

Q Describe for us how his interaction with you changed once he changed employment at Penson Worldwide?

A I saw little change.

...

Q And what were the ways that you saw Mr. Johnson remain engaged with PFSI Stock Lending?

A He was still lending securities, borrowing. He still had his few contacts that he was dealing with. He still maintained a relationship with them where he was the primary contact for them. It didn't change.

(Hearing- Day 1, 218:15-219:8, Oct. 27, 2014)

- Wetzig Testimony

Q All right. And in practical terms, describe how his involvement with the Penson Financial Services Stock Lending group changed when his title changed.

A I don't think his involvement changed very much....

...

And then he would also -- when he was on the road, he would also loan securities out while he was at different offices.

Q And again, are these securities at Penson Financial Services, the broker-dealer?

A Correct.

(Hearing- Day 2, 353:5-354:4, Oct. 28, 2014)

220. Pendergraft considered Johnson one of the best technicians on Wall Street.

- Johnson Testimony

Q Okay. Do you ever recall Mr. Pendergraft saying things like he thought you were one of the best technicians on Wall Street?

A Yes.

(Hearing- Day 2, 529:15-529:18, Oct. 28, 2014)

ii. Yancey Did Not Clearly and Completely Delegate Supervision of Johnson to Pendergraft.

221. As President and CEO of PFSI, a broker-dealer, supervision rested with Yancey unless and until he reasonably delegated supervisory responsibility to another qualified individual.

- Yancey Testimony

Q Now, Mr. Yancey, from 2008 to 2011, you were the President and CEO of Penson Financial Services; is that correct?

A Yes, sir.

Q And Penson Financial Services was a broker-dealer, correct?

A Yes, sir.

Q Would you agree with me that at a broker-dealer like Penson Financial Services, supervision rests with the CEO unless and until he reasonably delegates supervisory

responsible -- responsibility -- excuse me -- by assigning experienced, qualified individuals to supervise the business activities of the firm? A Yes, sir.

(Hearing- Day 3, 877:23-878:11, Oct. 29, 2014)

Q Let me ask you, Mr. Yancey: If Mr. Pendergraft was -- was telling the truth and you had never delegated regulatory or compliance supervision from Mr. Johnson to him, can we agree that that responsibility would have rested and remained with you as the CEO?

A No.

Q Well, I thought you agreed with me last week that responsibility for supervision rests with the CEO unless and until he delegates that supervision; is that right?

A I believe your question was if that were the facts, and I didn't want to speculate. He reported to Phil Pendergraft.

Q If, in fact, you never delegated supervision to Mr. Pendergraft, we can agree that the responsibility would remain with you?

A If that had occurred.

Q Correct.

A It would have not, yes.

Q It would have remained with you?

A Yes.

(Hearing- Day 7, 1927:25-1928:21, Nov. 4, 2014)

- Delaney Testimony

Q Okay. You've seen, I take it, some documents that list Mr. Pendergraft as Mr. Johnson's supervisor. Does that surprise you? Or not Mr. Pendergraft. Rather, Mr. Yancey as Mr. Johnson's supervisor, does that surprise you?

A In the -- in the big sense, it doesn't surprise me.

Q Explain what you mean by "in the big sense."

A Bill -- Bill Yancey is the Chief Executive Officer of Penson Financial Services, Inc., the broker-dealer. And -- and as -- and in an essence, Bill Yancey sits as the supervisor of -- of everybody in -- of all the associated persons of that broker-dealer.

(Hearing- Day 5, 1218:11-1218:23, Oct. 31, 2014)

- Ex. 828 (Poppalardo Expert Report) at 6

In a financial services firm, supervision rests, initially, with the CEO, unless and until he reasonably delegates supervisory responsibility by assigning experienced, qualified individuals to supervise the business activities of the firm.¹⁰ The roles and responsibilities of a CEO in a

222. As President and CEO of PFSI, Yancey was responsible for compliance with the securities laws and other requirements imposed on the firm unless and until he reasonably delegated those functions to another qualified individual.

- Yancey Testimony

Q And I think we can also agree that the President of a broker-dealer is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates functions to another person in the firm and neither knows nor has reason to know that such a person's performance is deficient; would you agree with that statement?

A I would, sir.

(Hearing- Day 3, 878:12-878:19, Oct. 29, 2014)

223. As President and CEO of PFSI, the buck stopped with Yancey.

- Yancey Testimony

Q All right. Mr. Yancey, have you heard the phrase "the buck stops here"?

A Sure.

Q Would you agree that as President and CEO, the buck stops with you?

A I think as a general principle, yes.

(Hearing- Day 3, 878:20-878:25, Oct. 29, 2014)

224. If there is confusion about who is supervising an individual at a broker-dealer, the president of the broker-dealer retains the supervisory responsibility.

- Poppalardo Testimony

Q Okay. And you would agree with me, wouldn't you, that the law is that if a president testifies that he has delegated responsibility but there is confusion about that delegation, the president retains the responsibility for supervision?

MS. ADDLEMAN: Objection, calls for a conclusion, legal conclusion.

JUDGE PATIL: Overruled.

A I think that -- I think you're right, but I don't think there was any confusion in this case. BY MS. ATKINSON:

Q But you would agree with me that the law is that if there is confusion, then the president retains the responsibility?

A If there is confusion, yes.

(Hearing- Day 8, 2038:16-2039:5, Nov. 5, 2014)

225. Until Johnson was promoted to PWI Senior Vice President for Global Stock Lending, Yancey was Johnson's supervisor.

- Stipulated Finding of Fact 118

226. Pendergraft or another PWI executive directed Johnson with respect to his global responsibilities, but did not supervise Johnson as to regulatory and compliance

issues. Responsibility for supervision as to regulatory and compliance issues would have remained at PFSI.

- Pendergraft Testimony

Q Explain that. What's the difference between direction and supervision?

A **Mr. Johnson reported to me or to somebody else at the Penson Worldwide level with respect to his global responsibilities. That meant he largely took his direction from a global executive. When I think of supervision, I think of regulatory and compliance oversight, which would largely have been a function of the local operating company, the regulated entity.**

Q Okay. So as you define that responsibility over regulatory oversight, is that a fair characterization of what you just said?

A Compliance and regulatory oversight.

Q Okay. As to compliance and regulatory oversight, did you have that responsibility for Mr. Johnson as it related to PFSI's stock lending operations?

A Well, I think compliance is everybody's responsibility. But I was not in the Penson Financial Services regulatory control framework, **I did not have any direct regulatory reporting responsibility in the broker-dealer.**

Q **Okay. And who would have had that, over Mr. Johnson?**

A **Somebody in the Penson Financial Services executive team.**

Q To the extent that Penson's Stock Loan had the duty or responsibility to comply with regulations, did you have supervisory responsibility over Mr. Johnson with regard to that?

A I think Mr. Johnson had responsibility for supervision of Penson Financial's compliance with rules. I did not have regulatory supervisory responsibility over Mr. Johnson for rules compliance.

Q Okay. So you said that Mr. Johnson had responsibility for -- I'm going to just characterize this, and you tell me if this is right -- Mr. Johnson had supervisory responsibility over Penson Financial Stock Loan's, PFSI's Stock Loan's compliance with regulations; is that approximately what you said?

A Yes. Mr. Johnson, I believe, was the supervisor of the Penson Financial Services stock lending business.

Q And did you have supervisory responsibility over Mr. Johnson as to that responsibility of Mr. Johnson?

A From a regulatory perspective, no, I was not in the regulatory supervisory matrix.

(Hearing- Day 6, 1462:18-1464:15, Nov. 3, 2014)

Q Is there a difference between reporting and supervising?

A Well, again, I think it depends on your definition. For the purposes of the -- I have viewed supervision as being a regulatory component, and reporting could include that but does not necessarily include that. So the distinction that I have tried to make is that I certainly directed Mr. Johnson's activities. **He reported to me during some period of his time, and I direction his -- not his daily activities, but I directed his activities. I did not supervise him from a regulatory perspective. Nor did I -- I didn't supervise his supervision of the Stock Lending department from a**

regulatory perspective.

Q Because as you were just talking with Mr. Washburn, the compliance and regulatory issues were at the local levels; is that right?

A Yes, ma'am.

Q So at the PFSI level?

A Yes, ma'am.

(Hearing- Day 6, 1590:6-1590:25, Nov. 3, 2014)

227. Pendergraft does not believe that Yancey delegated supervision of Johnson to Pendergraft.

- Pendergraft Testimony

Q Okay. I want you to assume that Mr. Yancey had some supervisory responsibility over Mr. Johnson as it related to PFSI Stock Loan.

A Yes, ma'am.

Q And specifically over PFSI Stock Loan's compliance with regulations. Okay?

A Yes, ma'am.

Q All right. Assuming that, did you ever come to the understanding that that responsibility had been delegated to you?

A No, I don't believe I ever had that understanding.

Q Did you ever see a document that delegated that responsibility of Mr. Yancey's to you?

A I don't have any recollection of seeing a document like that.

(Hearing- Day 6, 1465:5-1465:20, Nov. 3, 2014)

228. It would not be inappropriate to split out regulatory and compliance supervision from operational supervision.

- Miller Testimony

Q As a compliance person, do you think that it's appropriate to split out regulatory and compliance duties from operational duties?

A I don't know that it's inappropriate. It would have to be in writing, it would have to be a clear delineation. It's certainly possible, it's something that could be done, but, I mean, it would have to be something that would need to be written down and very clear as to whose responsibilities were what.

(Hearing- Day 11, 2598:17-2599:1, Nov. 10, 2014)

229. As a practical matter, employees who had responsibilities at both PFSI and PWI could be supervised by a PWI executive for certain matters and a PFSI executive for other matters.

- McCain Testimony

Q When you were interim treasurer of PWI, did you still have duties with PFSI? A I did.

Q And during that time period, you were still supervised by Bill Yancey, correct?

A As it related to the broker-dealer items, that my other areas reported to Bill, yes. With financing, I felt like I reported to Phil.

Q For the PWI interim treasurer role, did you report to Phil? Is that what you said, Mr. Pendergraft?

A Yes.

Q All right. So at that point in time, you reported both to Mr. Pendergraft for purposes of PWI issues and Mr. Yancey for purposes of PFSI issues?

A I reported to Phil as it relates to the items or the responsibilities as it related to the financing in the firm, and my focus was on broker-dealer.

(Hearing- Day 9, 2202:14-2203:6, Nov. 6, 2014)

230. It would not necessarily have been obvious to PFSI employees if there had been a split in Johnson's supervision between Yancey and Pendergraft.

- Miller Testimony

Q If there had been a split in the supervision, if Bill had part of Mike and Phil had part of Mike, is that the kind of thing in your position that you think you would have been aware of?

A I'm not sure that I would have been aware of that.

(Hearing- Day 11, 2588:3-2588:8, Nov. 10, 2014)

231. Numerous witnesses had different understandings of Johnson's supervision after Johnson became Senior Vice President of Stock Lending for Penson Worldwide.

a. Yancey testified that, in August 2008, Pendergraft wanted to make Stock Loan a global product line and make Johnson the Senior Vice President for Securities Lending for PWI, and that that time Yancey fully delegated all supervisory responsibility for Johnson and for PFSI's Stock Loan department to Pendergraft.

- Yancey Testimony

Q [I]t is your position that you did not have a duty to supervise Mike Johnson, the head of Stock Lending, because you had delegated that duty to Phil Pendergraft?

A After August of 2008?

Q After August of 2008.

A Yes, sir.

Q How did that delegation occur, how did you do that?

A In the summer of 2008, Mr. Pendergraft came to me and cast a big vision for developing a global security lending Senior Vice President role. Securities were lent in the United States through Penson Financial Services. In Canada, through Penson

Financial Canada; and in London, through Penson Financial U.K. And his vision was that all of those similar business lines would benefit from someone that could help them with technology, with efficiencies and deep domain knowledge. And so he -- he really cast a big vision for this role that he had decided he wanted to build.

Q And was there anything else in terms of delegating your supervision of Mike Johnson to Mr. Pendergraft?

A Yes, sir.

Q What was that?

A So Mr. Pendergraft cast this vision, and he said, and I want Mike Johnson to run that group. Mike has indicated an interest to me on a number of occasions of wanting some international opportunities, and I want to use him in that way. I want to put him under me, he said. And I said, Phil, in light of your background, strong operational background, in light of the fact that you have a Series 27 and I do not, in -- in light of the fact that you previously had supervised this group and built this group at this firm, I think that's probably a -- a good idea. You have close proximity; both of you are on the 19th floor, you're involved in firm financing. So this seemed entirely logical to me. And so I said, so you want to move him under you. And I said, is he going to continue to be engaged in Penson Financial Services matters? And he said, oh, yes. And I said, so you're going to move that department? You're going to let him continue to supervise there? Yes. Then you're going to move that department under your supervision? And he said, yes. And I said, so you become the supervisor for this whole area? And he said, yes, without any limitations.

(Hearing- Day 4, 946:22-948:17, Oct. 30, 2014)

b. Pendergraft testified that, while he directed Johnson's activities as Senior Vice President for Global Stock Lending, he did not have supervisory responsibility over Mr. Johnson for regulatory or compliance issues, and that supervisory responsibility for those issues lay with someone at PFSI rather than Penson Worldwide.

- Pendergraft Testimony

Q Explain that. What's the difference between direction and supervision?

A Mr. Johnson reported to me or to somebody else at the Penson Worldwide level with respect to his global responsibilities. That meant he largely took his direction from a global executive. When I think of supervision, I think of regulatory and compliance oversight, which would largely have been a function of the local operating company, the regulated entity.

Q Okay. So as you define that responsibility over regulatory oversight, is that a fair characterization of what you just said?

A Compliance and regulatory oversight.

Q Okay. As to compliance and regulatory oversight, did you have that responsibility for Mr. Johnson as it related to PFSI's stock lending operations?

A Well, I think compliance is everybody's responsibility. But I was not in the Penson Financial Services regulatory control framework, I did not have any direct regulatory reporting responsibility in the broker-dealer.

Q Okay. And who would have had that, over Mr. Johnson?

A Somebody in the Penson Financial Services executive team.

Q To the extent that Penson's Stock Loan had the duty or responsibility to comply with regulations, did you have supervisory responsibility over Mr. Johnson with regard to that?

A I think Mr. Johnson had responsibility for supervision of Penson Financial's compliance with rules. I did not have regulatory supervisory responsibility over Mr. Johnson for rules compliance.

Q Okay. So you said that Mr. Johnson had responsibility for -- I'm going to just characterize this, and you tell me if this is right -- Mr. Johnson had supervisory responsibility over Penson Financial Stock Loan's, PFSI's Stock Loan's compliance with regulations; is that approximately what you said?

A Yes. Mr. Johnson, I believe, was the supervisor of the Penson Financial Services stock lending business.

Q And did you have supervisory responsibility over Mr. Johnson as to that responsibility of Mr. Johnson?

A From a regulatory perspective, no, I was not in the regulatory supervisory matrix.

(Hearing- Day 6, 1462:18-1464:15, Nov. 3, 2014)

Q Is there a difference between reporting and supervising?

A Well, again, I think it depends on your definition. For the purposes of the -- I have viewed supervision as being a regulatory component, and reporting could include that but does not necessarily include that. So the distinction that I have tried to make is that I certainly directed Mr. Johnson's activities. He reported to me during some period of his time, and I directed his -- not his daily activities, but I directed his activities. I did not supervise him from a regulatory perspective. Nor did I -- I didn't supervise his supervision of the Stock Lending department from a regulatory perspective.

Q Because as you were just talking with Mr. Washburn, the compliance and regulatory issues were at the local levels; is that right?

A Yes, ma'am.

Q So at the PFSI level?

A Yes, ma'am.

(Hearing- Day 6, 1590:6-1590:25, Nov. 3, 2014)

c. Johnson testified that he reported to Pendergraft, but that PFSI's Stock Loan department was supervised by Yancey.

- Johnson Testimony

Q So those were folks that were part of the PFSI Stock Lending team, correct?

A Yes.

Q And did you interact with them on Stock Lending matters?

A I sat in the division. They reported to me dotted line; they reported directly to Bill Yancey.

(Hearing- Day 2, 528:18-528:24, Oct. 28, 2014)

d. De La Sierra testified that he believed Johnson reported to Dan Son.

- De La Sierra Testimony

A I don't -- I really don't know who -- I thought -- I thought Mike reported to Dan Son.

(Hearing- Day 1, 286:21-286:22, Oct. 27, 2014)

232. No one other than Yancey and Pendergraft was present for the August 2008 conversation where Yancey purportedly delegated all supervisory responsibility for Johnson and for PFSI's Stock Loan department to Pendergraft.

- Yancey Testimony

Q Your conversation where you delegated to Mr. Pendergraft was sometime in August of 2008. That's your memory?

A To the best of my recollection.

Q Was anybody else in the room when that conversation happened?

A Not that I recall.

(Hearing- Day 4, 989:15-989:21, Oct. 30, 2014)

233. Pendergraft does not recall the August 2008 conversation.

- Pendergraft Testimony

Q Do you recall ever coming to Mr. Yancey's office at some time in 2008 with the purpose of talking about whether to promote Mr. Johnson to a global head over all of the Stock Loan entities in PWI and effectively put him under you as the PWI CEO and out from under Mr. Yancey as the PFSI CEO?

A I don't recall a conversation like that. And I'm not -- while I don't remember, I'm not entirely sure that 2008 was when the global product group was established, and I don't remember that I was the -- when it was established, that I was the person that Mr. Johnson reported to. There are kind of a number of assumptions there that I don't -- I'm not sure are entirely correct.

(Hearing- Day 6, 1511:18-1512:6, Nov. 3, 2014)

234. Pendergraft recalls that stock lending was made a global product unit in approximately 2007.

- Pendergraft Testimony

A Well, I think Mr. Johnson -- actually I think what I'm saying is the opposite, that it could be that Mr. Johnson had become head of global Stock Loan prior to this date,

which is -- I mean, I don't remember the date, but I thought it was earlier than 2008. And the payroll, this may be just catching up with the payroll. I'm not -- I don't know --

Q I understand.

A -- that for a fact.

Q Do you think it was within a matter of weeks of this date, months of this date?

A I really don't know.

Q You think it was in 2008?

A That is not my very vague recollection, but it certainly could have been.

Q What is your very vague recollection?

A More the 2007 time period, but again, I don't have a --

(Hearing- Day 6, 1545:22-1547:15, Nov. 3, 2014)

235. Pendergraft's interaction with the PFSI Stock Loan department did not materially change after Johnson's promotion from Vice President to Senior Vice President; Pendergraft was always fairly involved in what PFSI Stock Loan was doing.

- Wetzig Testimony

Q When Mr. Johnson got his promotion, did -- did Mr. Pendergraft's interaction with the Securities Lending department change in any material degree?

A Not that I'm aware of. He was always pretty involved in what we were doing.

(Hearing- Day 2, 423:11-423:15, Oct. 28, 2014)

236. Pendergraft interacted with Johnson with respect to Reg SHO issues in 2005, which was during the time period that Johnson was Vice President for PFSI Stock Loan and did not report to Pendergraft.

- Johnson Testimony

Q Mr. Johnson, one of the things that Mr. Yancey's counsel was asking you about was prior testimony that you gave, and the question and answer was: Question: Tell me about the communications with Mr. Pendergraft about Reg SHO.

The answer was: I think that Reg SHO was, quote, hey, Phil, I'm sitting here and you're not doing anything about it. Do you know the rules? So I need a check for 150,000 to do something with it, to try to work with Jill Zacha and other people -- it wasn't all me -- and to put some in place to comply with Reg SHO.

Do you recall discussing that with Mr. Yancey's counsel?

A Yes.

Q Do you recall the context of this conversation with Mr. Pendergraft and asking for 150,000?

A Yes.

Q What was it?

A Jill Zacha, at that time, ran Legal and Compliance for PFSI, and I was just hired in. And at this point, I reported to Rich Hart; Mr. Yancey wasn't there, I don't believe. They -- I said, what are you doing? Because I just came from SunGard, and I said,

what are you doing for the -- it was to go live January 3rd of that year, and nobody knew anything about it.

So I'm trying to get the firm into compliance with this rule and build a system with a gentleman named Rob Sammons, which we completed and got in on that date.

Q And was that system called Sendero?

A I'm not sure if it was at that time, but it was what was the catalyst for Sendero.

Q I see. And you said, I think, Reg SHO was to come in on January 3rd of that year. Do you recall which year?

A I think 2005 would be the January 3rd, because I think I started August or September 1st of 2004. And this was a big rule; it was to give locates, et cetera, and there was nothing done when I got there.

Q And at the time of this conversation, who, again, did you say you reported to?

A I reported to Richard Hart, who ran operations.

(Hearing- Day 2, 564:6-565:21, Oct. 28, 2014)

237. There is no document evidencing that Yancey delegated full supervisory responsibility from Johnson to Pendergraft.²

238. The August 2008 e-mail transferring Johnson's payroll from PFSI to PWI does not mention supervision.

- Exhibit 608

² Because this proposed finding is based on an absence of evidence, the Division cannot cite to any particular exhibit or testimony.

Dawn Gardner

608

A.P. No. 3-15873

From: Phil Pendergraft
Sent: Thursday, August 14, 2008 10:02 AM
To: Dawn Gardner
Subject: RE: Mike Johnson

Yes

From: Dawn Gardner
Sent: Thursday, August 14, 2008 10:01 AM
To: Phil Pendergraft
Subject: RE: Mike Johnson

Phil,

If we move Mike to the PWI payroll now, he will reset on his Social Security taxes. Since these are two different tax id's, we cannot transfer him with YTD information. Is it ok to move his payroll expenses via interoffice transfer through 12/31/08?

Thanks,
Dawn

From: Phil Pendergraft
Sent: Thursday, August 14, 2008 9:32 AM
To: Dawn Gardner
Subject: Mike Johnson

Dawn:

Effective with the 8/31 payroll, Mike Johnson should be moved to PWI payroll, and his salary adjusted to 600k per year.

Thanks

Phil

239. Several witnesses testified that PFSI's organizational charts clearly showed that Johnson was supervised by Pendergraft

- Yancey Testimony

Q You also looked with Ms. Addleman at a few org charts. Do you recall that?

A Yes.

Q And I think you said something along the lines of the org charts are clear. It shows a hard line to the supervisor. Does that sound right?

A Yes.

(Hearing- Day 7, 1916:20-1917:1, Nov. 4, 2014)

Could anyone by looking at this org chart tell that Mike Johnson reported to Phil Pendergraft?

A I could.

(Hearing- Day 7, 1917:23-1917:25, Nov. 4, 2014)

Q The cover page here [of Exhibit 513] shows an e-mail from Hillary Hinson to Eric Alaniz dated June 29th, 2009. Do you see that?

A I do.

Q And if you will go to the PWI page with Phil, Rocky, and Dan at the top. Do you see that?

A Yes, ma'am.

Q To whom does Mike Johnson report on this page?

A To Phil Pendergraft.

(Hearing- Day 7, 1853:7-1853:18, Nov. 4, 2014)

- Delaney Testimony

Q And was Mike Johnson at that time transitioned from the broker-dealer, PFSI, to the PWI parent entity?

A Yes.

Q And how do you know that?

A Well, I've certainly seen my fair share of org charts and -- but it was common knowledge.

Q Okay. Did you understand that with that transition, that Mr. Yancey and Mr. Pendergraft had agreed that Mr. Pendergraft would be the supervisor for Mr. Johnson?

A Yes.

(Hearing- Day 5, 1331:22-1332:7, Oct. 31, 2014)

Q And I think that you said that the reason that you knew that Mr. Johnson reported to Mr. Pendergraft was because of these org charts; is that right?

A I believe it was that and that it was just widely understood.

(Hearing- Day 5, 1396:22-1397:1, Oct. 31, 2014)

- McCain Testimony

Q In your mind, is this org chart clear?

A It is.

Q Is it confusing in any way?

A Not that I can see, no.

(Hearing- Day 9, 2194:5-2194:8, Nov. 6, 2014)

Q Mr. McCain you, discussed this org chart, Exhibit 622, with Ms. Addleman, and I

would like to again go to the page that showed the PWI structure.

...

Q Mr. McCain, do you believe someone just looking at this org chart could tell that Mike Johnson reported to Phil Pendergraft?

A I think anybody within Penson that saw this org chart would see this and understand that Mike reports to Phil Pendergraft.

Q And how would they know that from this org chart?

A They just know it.

Q Like water is wet?

A Yes. Everybody knew that. I cannot make that more clear. That is the way it was.

Q We could agree that this org chart says that Mr. Johnson reports to Son, correct?

A I see that -- the parenthetical in Mike's box there. But, again, when you're in Penson, you know really what all of that means.

(Hearing- Day 9, 2209:4-2210:1, Nov. 6, 2014)

240. PFSI's organizational charts, which were maintained by the Human Resources department, show Johnson reporting to Dan Son.

- Delaney Testimony

Q 513.

A 513. Got it.

Q Okay. And that's at -- you see that that's an e-mail to Eric Alaniz from Hillary Hinson --

A I do.

Q -- in June of 2009? And you recognize -- do you recognize Hillary Hinson as an HR person?

A Yes, ma'am.

Q Okay. And it's attaching the PFSI org chart; is that what it says?

A Yes, ma'am.

Q All right. What I would like to ask you to do, if you would, is look at Page PFSI2120425. And do you see Mike Johnson on that page somewhere?

A Yes, ma'am.

Q And what does it say underneath him?

A "Reporting to Son."

Q Okay. And right next to that is Bryce Engel. Do you see a Mr. Engel?

A Yes, ma'am.

Q And what does it say underneath his name?

A "Reporting to Pendergraft."

Q And do you see next to him Simon Raphael?

A Yes, ma'am.

Q What does it say under his name?

A "Reporting to Pendergraft."

Q And if you go next to him, you see Andy Koslow?

A Yes, ma'am.

Q And what does it say under him?

A "Reporting to Pendergraft."

Q And I think that you said that the reason that you knew that Mr. Johnson reported to Mr. Pendergraft was because of these org charts; is that right?

A I believe it was that and that it was just widely understood.

Q Okay. Let's look at Exhibit 588, if you would. And again, Exhibit 588 is an e-mail from Hillary Hinson -- are you with -- I'm sorry. Are you there?

A I'm there. Thank you.

Q Okay. From Hillary Hinson to Eric Alaniz. This one is in March of 2010?

A Yes, ma'am.

Q Hillary Hinson is still an HR person, right?

A Yes.

Q Okay. And again, she attaches a PFSI org chart; is that right?

A Yes.

Q And if you look at PFSI2123862 and find Mike Johnson, that says -- under Mike Johnson's name, it says, "Reporting to Son," right?

A It does.

Q And if you look at page -- or excuse me, Exhibit 570, and this is a -- I'm sorry.

A I'm there. Thank you.

Q Okay. And you'll see that the top of 570 is an e-mail from Sue Redhair to Kimberly Miller. And do you recognize Sue Redhair is an HR person?

A Yes, ma'am.

Q Okay. And she's attaching a PI org chart. And if you look at the bottom of that page, you'll see that there's a beginning of an e-mail from Kim Miller to Person Dallas HR; do you see where I'm talking about?

A Yes.

Q Okay. And this is -- this all is in May of 2010, right?

A Yes, ma'am.

Q And Ms. Miller, if you go to the top of the next page, says, "Can someone please send me an org chart showing the entities as well as an updated employee chart? Thanks." She's not asking for anything about supervisors, right?

A She's not -- she's not -- she didn't state the word "supervisors" in her -- in her -- in her e-mail there. I'm not sure what she actually is wanting other than what she's stating there.

Q Right. That's what we're going by is what she's stating. And if you look at PFSI2227557, do you see Mike Johnson there?

A I do.

Q Now, what does it say underneath his name?

A "Reporting to Son."

Q Okay. And if you look at Exhibit 677, the top of 677 is an e-mail from Hillary Scheurich; is that how you would say that?

A Yes, ma'am.

Q Okay. -- to Kimberly Miller in August of 2010. And you recognize Hillary Scheurich as an HR person?

A That's Hillary Hinson. She got married and changed her name.

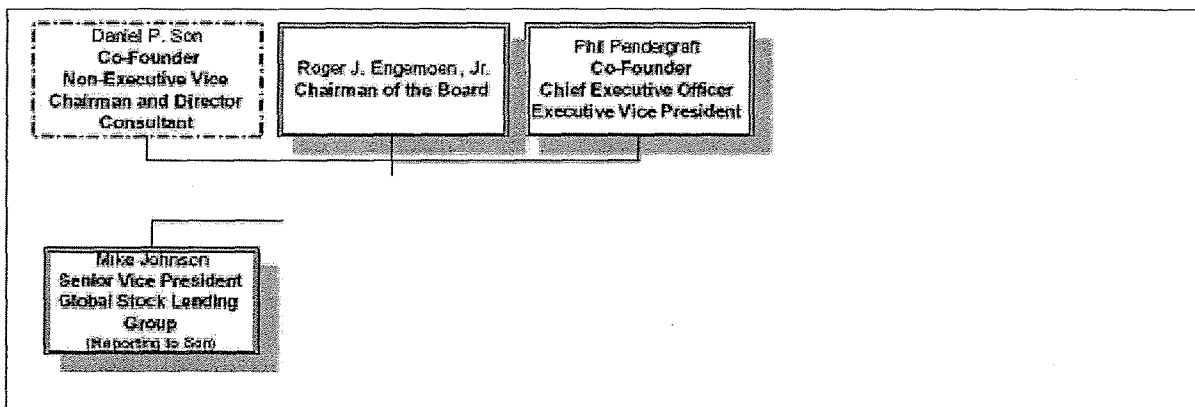
Q Oh, I see.

A So it's one and the same.

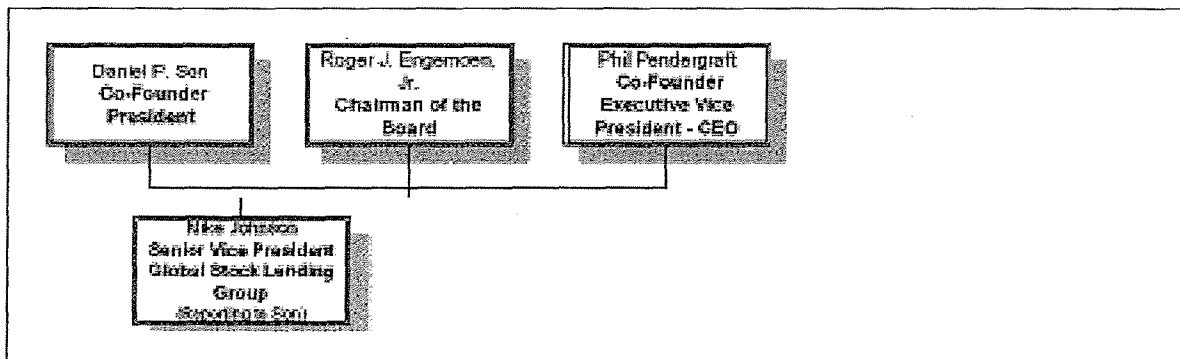
Q Oh, okay.
 A Yes, ma'am.
 Q So she's still in HR?
 A She is.
 Q And if you look at PFSI2163233, you see Mike Johnson's name there?
 A I do.
 Q And what does it say underneath his name?
 A "Reporting to Son."

(Hearing- Day 5, 1395:16-1399:20, Oct. 31, 2014)

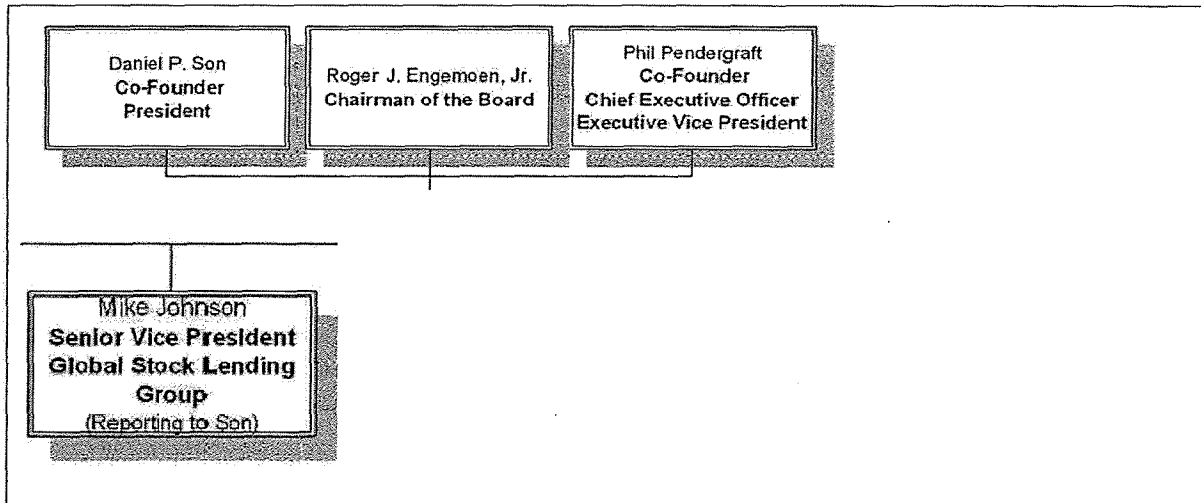
• Ex. 503



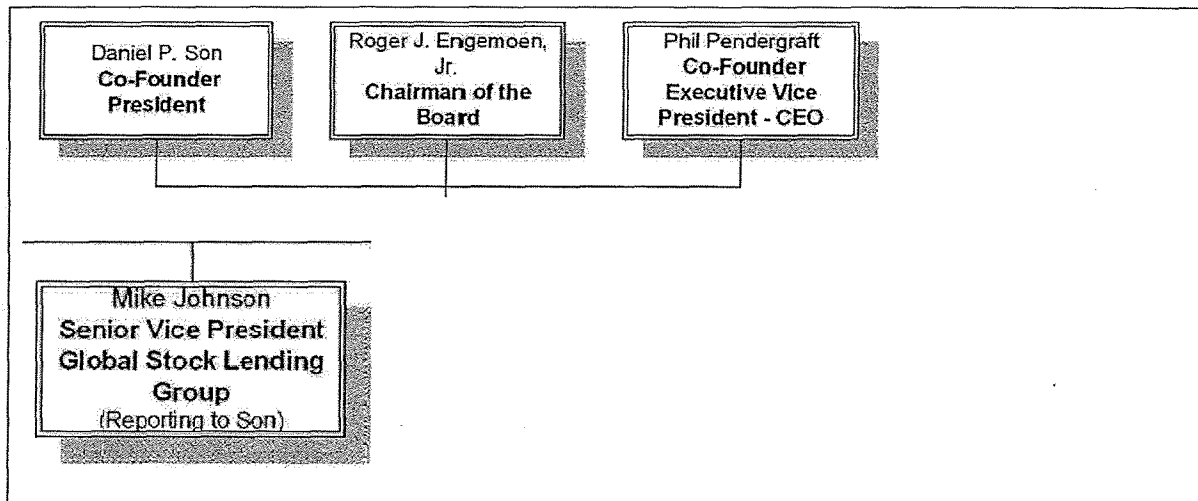
• Ex. 513



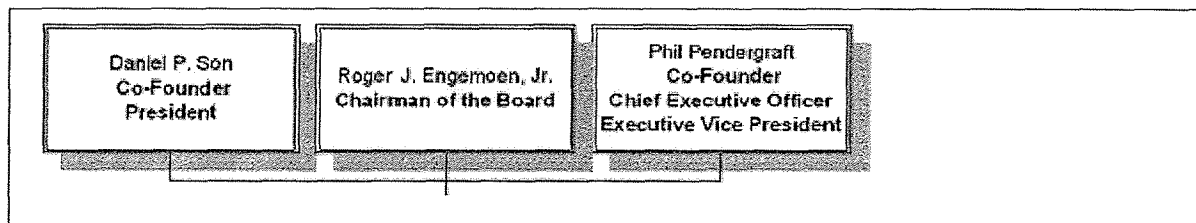
• Ex. 514

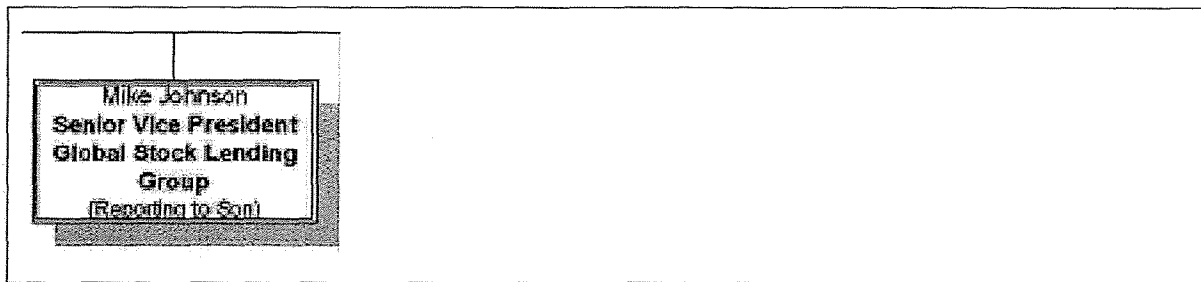


• Ex. 520

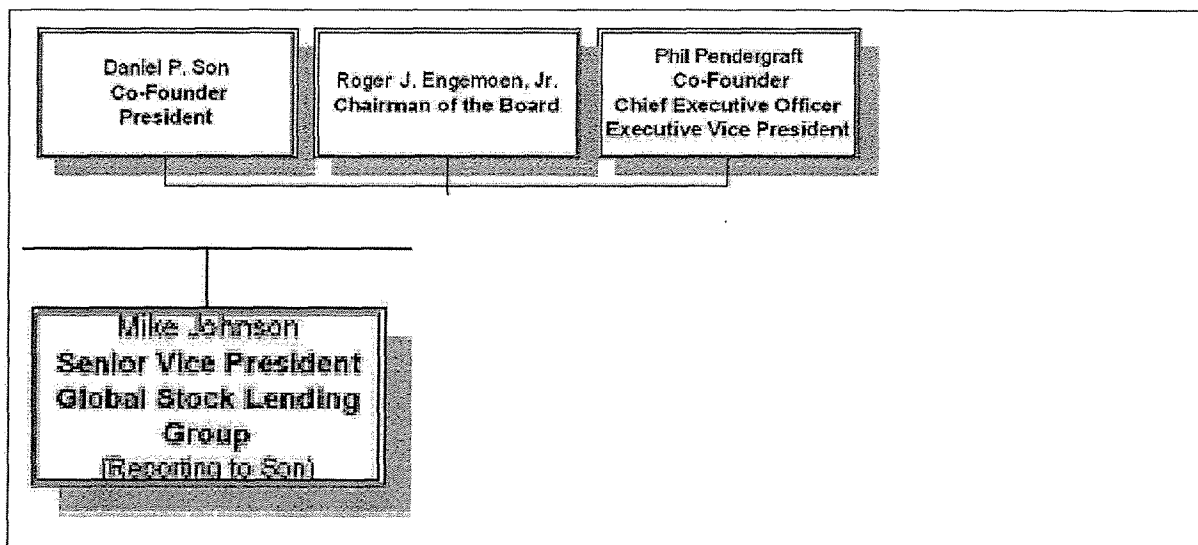


• Ex. 570

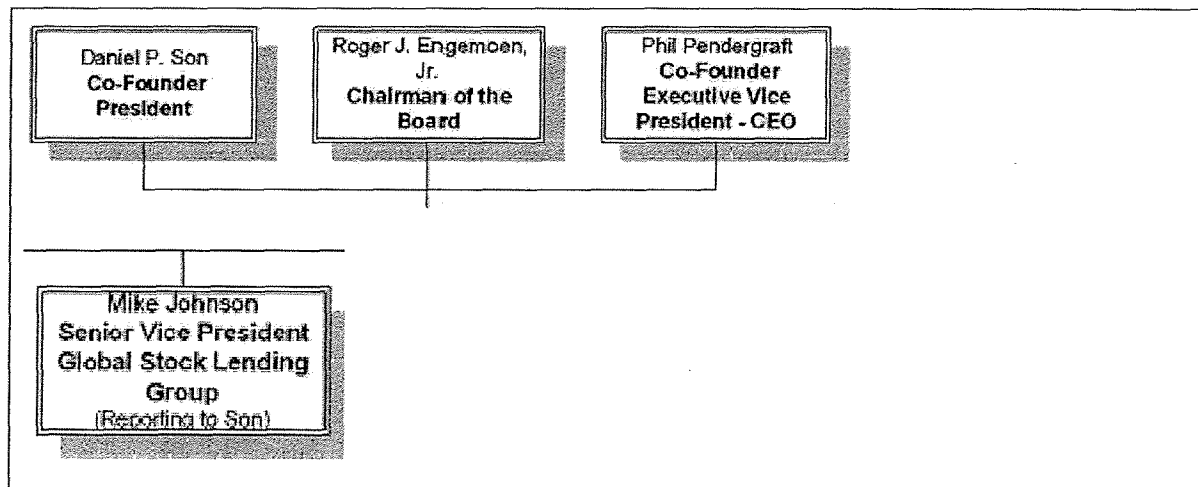




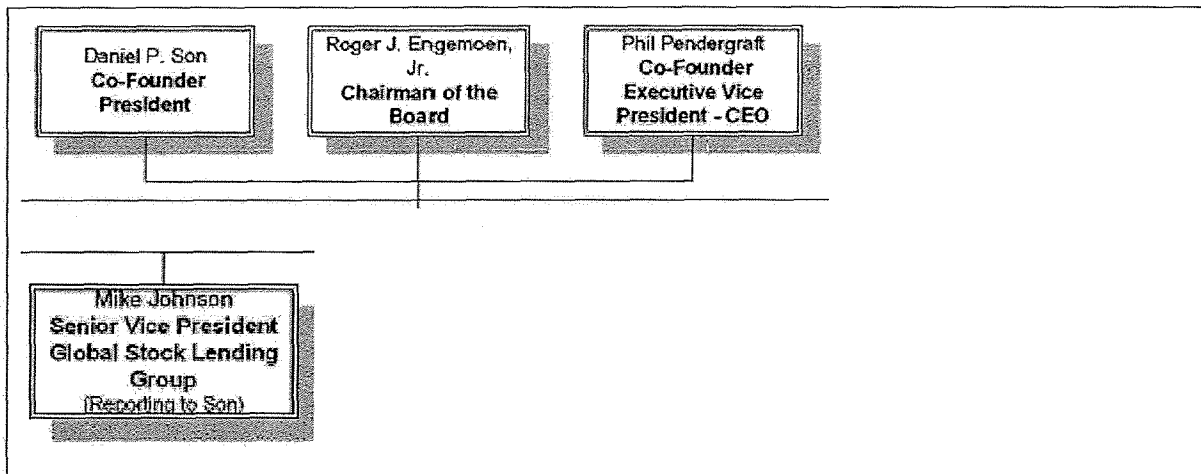
• Ex. 588



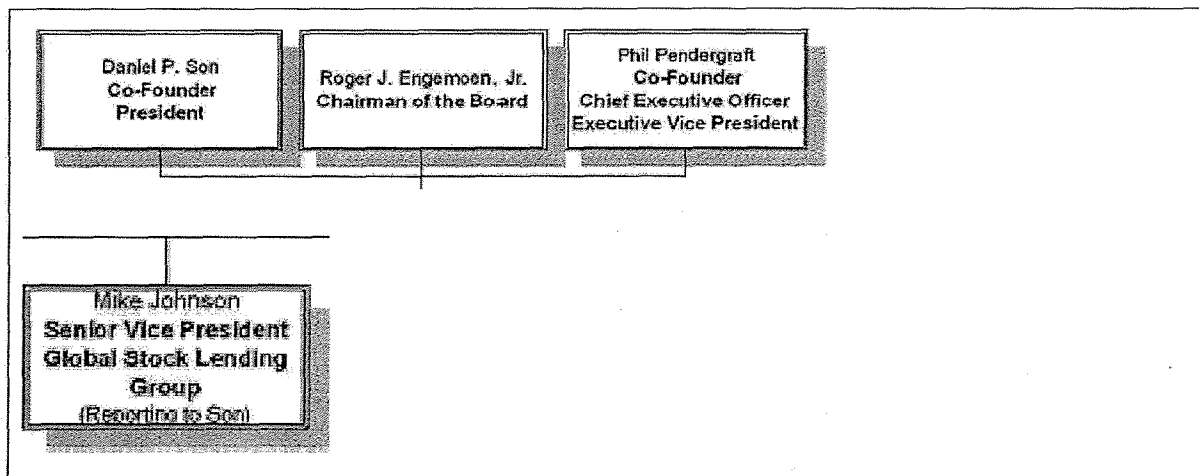
• Ex. 629



• Ex. 644



• Ex. 677



241. The organizational charts do not clearly show that Johnson was supervised by Pendergraft.

• Yancey Testimony

Q It's an org chart, as you see, dated January 9th, 2009. Do you recognize this?

A I recognize the cover.

...

Q And where do you see Mike Johnson there?

A I see him in the lower left part of the diagram.

Q And he was reporting up to -- *it looked like he was reporting up to all three people there, Dan Son, Rocky Engemoen, and Phil Pendergraft; is that correct?*

A No.

Q *Tell me what's wrong with that.*

A *Not a great illustration, perhaps.* There was one person of those three at the top

who was widely recognized as doing the vast, vast majority of the -- of the jobs associated with those positions, and it was Phil Pendergraft.

(Hearing- Day 7, 1846:25-1847:19, Nov. 4, 2014)

Q And to answer my question, it's very simple. Could anyone by looking at this org chart tell that Mike Johnson reported to Phil Pendergraft?

A I could.

Q Could anyone without intimate knowledge of PFSI tell that?

A I don't know.

Q How could you tell from this org chart that Mike Johnson reported to Phil Pendergraft?

A Because I knew it was reporting to him.

Q You would agree with me that this org chart says he reports to Mr. Son, correct?

A I see there's a notation in his box like that.

(Hearing- Day 7, 1917:22-1918:10, Nov. 4, 2014)

- Gardner Testimony

Q Okay. I note that on the org chart that we were just looking at it, it does not say that Mike Johnson reports to Phil Pendergraft. Did you make note of that?

A Yes.

(Hearing- Day 4, 1168:2-1168:6, Oct. 30, 2014)

242. Even after Yancey became CEO of PFSI, Pendergraft remained very active in PFSI issues and interacted with PFSI employees that he did not supervise.

- Pendergraft Testimony

Q We saw a number of e-mails, and there were a number that had Bart McCain on them. Who is Bart McCain?

A Bart McCain was an executive officer of Penson Financial Services and became an executive officer of Penson Worldwide, I think after this time frame.

Q Okay. After 2011?

A I believe that's correct.

Q Okay. While Mr. McCain was at PFSI, did you have occasion to exchange e-mails with Mr. McCain?

A Yes, ma'am.

Q About what kinds of things, about PFSI business?

A It would have generally been about PFSI's business, but it could have been about almost anything. He had fairly extensive responsibilities, and so it could have been a large number of subjects.

Q Okay. When he was at PFSI, did he report to you?

A No, ma'am.

Q Okay. We also saw of course some e-mails between you and Mr. Delaney. Did

you have occasion to exchange e-mails with Mr. Delaney on occasion?

A Yes, ma'am.

Q And Mr. Delaney didn't report to you; is that right?

A Well, I --

Q Or after he moved to PFSI, he didn't report to you?

A After he moved to PFSI, he did not report to me.

Q Okay. We saw some e-mails between you and John Kenny. Who is John Kenny?

A John Kenny was the operations -- the senior vice president for operations, and I believe later the chief operating officer for Penson Financial Services.

Q Did you have occasion to exchange e-mails with Mr. Kenny?

A Yes, ma'am.

Q About what kinds of things, about Penson's -- about PFSI business?

A Yes. It would have been -- with Mr. Kenny, it would likely have been primarily about operational questions or issues. But most of the -- I think all of the operations of the business rolled up through Mr. Kenny, and so it could have been about a lot of different facets of the firm's operation.

Q Do you know who Mr. Kenny reported to?

A I believe he reported to Mr. Yancey.

Q Your offices were at -- in the same building at PFSI's; is that correct?

A Yes, ma'am.

Q Did you have occasion, while you were in the office at -- in PFSI's office, to interact with PFSI staff?

A Well, Penson had multiple floors in the building. The Penson Worldwide executive offices were on one floor, the same floor as Stock Loan and the trading department and compliance, and -- but the firm's operations, PFSI operations was on a different floor. And so I would -- yes, any day I was in the office, I would likely be -- have business on all of the floors and walking around visiting with people.

Q Okay. Mr. Delaney testified that people would frequently come to you for advice and things like that; is that a fair characterization?

A Yes, probably so.

(Hearing- Day 6, 1593:22-1596:15, Nov. 3, 2014)

- Delaney Testimony

Q And you would agree with me, wouldn't you, that Mr. Pendergraft was interested and involved in PFSI?

A My dealings with Mr. Pendergraft, he seemed to be interested and engaged in PFSI.

Q And it wasn't unusual for all kinds of people to go into Mr. Pendergraft's office for advice; isn't that true?

A I don't know that -- I don't know specific -- I -- I very rarely went into Mr. Pendergraft's office. It was generally on invitation. I -- I don't know how often others went in to get advice from him.

Q Would you look at your -- at Exhibit 224, please, Page 441, Line 10. You say -- well, in background, you say, "Phil Pendergraft originally was the CEO of the broker-dealer.

He never fully was able to extract himself from some of the day-to-day issues of the broker-dealer." And then you go on to say, "So, for example, it wasn't uncommon for a broker-dealer issue to arise and for folks to go into Phil's office to get direction from Phil as to how to proceed on something." Does that refresh your recollection that people would go into Mr. Pendergraft's office for advice?

A I was maybe -- I don't know if they physically went into his office. They could have picked up the phone and called. They could have sent e-mails. So I may have been overly generalizing in that testimony.

Q Okay. So people interacted with Mr. Pendergraft a lot about the business of the broker-dealer and asking for advice and telling him what was going on; is that a fair characterization?

A I think that happened, yes.

(Hearing- Day 3, 695:7-696:13, Oct. 29, 2014)

- Gover Testimony

Q Okay. You said that Mr. Pendergraft was very involved in the broker-dealer; is that what you said?

A Yes.

Q What do you mean by that?

A I mean that Phil Pendergraft was very active and he had a voice in very discrete, specific pieces of the running of the broker-dealer.

Q Okay.

A I can provide -- I could say examples probably across a multitude of my teams where you would get a call from Phil saying, "I want to do this," or "I got an escalation from a customer and he said you made this policy change" or -- just very, very hands-on and very active in making decisions.

Q Okay. And how often would he do that?

A You know, my interactions with him, it would really kind of vary depending on what the functions were. But there were times during 2011, 2012 when I had most of the treasury functions where it was an every day thing. But he was -- you know, he didn't just swoop in occasionally. Phil would -- Phil knew the business.

Q And was he engaged with others at the -- do you know whether he was engaged with others at the broker-dealer --

A You mean in a similar kind of manner?

Q Yeah.

A I'm sure he was.

(Hearing- Day 1, 196:2-197:3, Oct. 27, 2014)

- Wetzig Testimony

Q And was Mr. Pendergraft involved in the business during the whole time that you worked at Penson?

A Mr. Pendergraft was always interested in our P&L.

Q Was he always interested in the business of Penson? Was he an active participant in the business of Penson?

A Yes, I would say that is accurate.

(Hearing- Day 2, 412:3-412:10, Oct. 28, 2014)

- De La Sierra Testimony

Q Were you ever in conversations with Phil Pendergraft?

A Regarding financing is the about the only conversations I ever had with Phil Pendergraft.

Q I see. Regarding financing. How about -- were you ever copied on e-mails? I think we saw some copied on e-mails with Phil Pendergraft.

A Yes, I was.

Q Would -- did those involve financing issues?

A Occasionally, yes.

Q All right. Now, was Phil Pendergraft your supervisor?

A He was not.

(Hearing- Day 2, 334:14-335:1, Oct. 28, 2014)

- Yancey Testimony

Q You also spoke with Ms. Addleman about your observations of Mr. Pendergraft speaking to Mr. Johnson when they were both in the office. Do you recall that?

A Yes.

Q Was Mr. Pendergraft the only person you -- excuse me. Was Mr. Johnson the only person you ever saw Phil Pendergraft talking to?

A No.

Q Did he talk to lots of PFSI employees?

A Yes.

Q Did you observe him talking to other PSI employees?

A From time to time.

Q And I don't think it's your testimony, but you're not saying that Mr. Pendergraft was the supervisor of everyone he talked to, are you?

A No.

(Hearing- Day 7, 1919:21-1920:12, Nov. 4, 2014)

- McCain Testimony

Q I think you said to Ms. Addleman that Mr. Pendergraft was very active in PFSI issues. Is that fair?

A He was very active in PFSI, yes.

Q In fact, at PFSI, the culture was very Phil centered; is that fair?

A Phil was heavily involved.

Q Would you agree with me that the culture was very Phil centered?

A I would agree that -- that Phil was actively involved in many areas. If you want to call that Philcentric, you can call it Philcentric. But his -- when it comes to PFSI, my recollection of him being involved was largely focused on Stock Loan and finance, and the rest of his time was on the other operating companies.

Q When you said a minute ago if I wanted to call it Philcentric, do you recall in your prior investigative testimony that you called it Philcentric?

A Vaguely. I mean, that was almost two years ago.

Q Let's take a look at that testimony. It might help refresh your memory. ...

Q Mr. McCain, look at Page 26 of your prior testimony. Just tell me when you're there. Starting on Line 4.

A Okay.

Q So this is your answer beginning at Line 4. You say: You asked me a minute ago why I wish I hadn't come to Penson. Phil mentioned to me before I joined that Penson was a difficult place to work. I interpreted that to mean -- I interpreted that to mean that it was just a lot of hard work. I'm not afraid of hard work, always have put in long hours. That's no big deal. What he meant by that was that the culture was very Phil centered. Phil had always run it for years and years and years. And when Bill came in and tried to implement some changes, then Bill would run into resistance from the people he asked to make those changes. They would need to go check with Phil first to make sure it was okay. So even though Phil was at the parent level, if he wanted to do something, it would -- people carry it out. That's just the way it was. That was part of the culture. Question: Was that the case throughout your tenure with Penson? Answer: Pretty much.

Did I read that correctly, sir?

A Yes.

Q And is that a fair characterization of Mr. Pendergraft's involvement at PFSI?

A I think it was a fair characterization of the way Phil ran the business, particularly when I first joined the firm.

(Hearing- Day 9, 2212:16-2214:24, Nov. 6, 2014)

Q You did your best to be truthful and honest and accurate in your prior testimony. Is that fair?

A Yes.

(Hearing- Day 9, 2215:9-2215:12, Nov. 6, 2014)

I'll be happy to agree that I'm going to have routine conversations or discussions with Mr. Pendergraft on a variety of topics. So I'm sure over the time that I was there, you're going to find a number of these examples.

(Hearing- Day 9, 2224:20-2224:24, Nov. 6, 2014)

243. Pendergraft was involved in the supervision of all aspects of PFSI.

- McCain Testimony

Q And he was not sending it to you because he was your supervisor; is that fair?
A That's correct.
Let me make -- let me make another comment here.
Q Yes, sir.
A Phil was not my direct supervisor, but ***Phil was involved in the supervision of all aspects of the operating company, all operating companies, not just PFSI***, but London, Canada, Australia, Nexa. So it wouldn't be unusual at all for him to ask this question of a senior manager, and I would be surprised if he didn't.
Q It wouldn't be unusual for him to ask that question whether he their direct supervisor or not; isn't that fair?
A Yes.

(Hearing- Day 9, 2219:19-2220:10, Nov. 6, 2014)

244. Pendergraft gave final approval for bonuses at all PFSI departments, not just the Stock Loan department.

- McCain Testimony

Q Mr. McCain, you spoke with Ms. Addleman briefly about an e-mail, and I apologize, I don't recall the exhibit, but it was about Phil approving bonuses for Stock Lending. Do you recall generally that conversation?
A I do, yes.
Q Do you recall if Mr. Pendergraft had to approve commissions or bonuses for other PFSI departments, not just Stock Lending?
A Generally, all of the bonus recommendations were, once they were approved by Phil, by Bill, and then they would be -- copies would be given to Phil for his review.
Q And would he be the final approver?
A I would expect that he would be, yes.

(Hearing- Day 9, 2225:21-2226:10, Nov. 6, 2014)

245. Pendergraft had personal relationships with PFSI customers and would converse with various PFSI and Penson Worldwide employees, including Mike Johnson, with questions related to those relationships.

- Johnson Testimony

Q And can you describe, did Mr. Pendergraft have personal relationships with lots of people on the street?
A Lots of people on the street, as well as lots of the -- you'll have to remember, before Bill Yancey, Phil -- this was his company before he went public, so, therefore, these customers didn't care about me or Bill. They go to him; they went to Phil Pendergraft.
Q Did you see that happen often?
A All the time.

Q All the time?

A Yes, sir.

Q All right. And would Phil occasionally come to you to ask you to follow up on something for one of these personal relationships that Phil had?

A Yes.

Q Did that happen all the time?

A Yes.

(Hearing- Day 2, 566:10-567:1, Oct. 28, 2014)

Q This is from yourself to Phil Pendergraft, dated May 18, 2010, and it says, Bob Jersey wants to know when and rate on all borrows we do not -- sorry -- we do that cover his short positions.

And then in the last sentence there, you say, "We only allocate HTB, and he receives that. Let me know how to proceed."

Do you see that?

A Yes.

Q "HTB" is hard to borrow fees?

A Yes.

Q And does that necessarily relate to Reg SHO issues?

A No.

Q Does it relate to 204 issues?

A No.

Q Does it related to PFSI issues?

A Yes.

Q Does it relate to PWI Global issues?

A Yes.

Q In what context were you communicating with Mr. Pendergraft in this e-mail?

A **Bob Jersey was a personal relationship with Phil**; he went to Rudy De La Sierra asking for this information. Rudy came to me; he was uncomfortable giving it out because this is corporate P&L stuff. And I went to Phil saying, well, this is your guy. What do you want to do?

(Hearing- Day 2, 548:9-549:11, Oct. 28, 2014)

Q Mr. Johnson, this is an e-mail between yourself and Lindsey Wetzig, Rudy De La Sierra and Brian Hall. And it says, "For Irene's list I am taking a conservative approach. Please get the list done nightly. Have someone stay to do it. It is required per Phil."

Do you see that?

A Yeah.

Q Do you recall the context at all of this e-mail?

A **I just recall the customers would go directly to Phil, regardless of his title**, and then I would get it, rather than him go to Rudy.

(Hearing- Day 2, 552:12-552:23, Oct. 28, 2014)

Q You say in the top e-mail -- you write back, and now you copy Rudy. And you say, "We have and they seem not to meet our regulatory criteria." What -- do you know what that refers to?

A Yes.

Q Can you elaborate?

A Yes. Those various rules to build a need to borrow, an ETB list. And we were very stringent and strict because we tried to follow all regulatory rules. **And this customer went above us to Phil Pendergraft, because of the relationship of this -- they had a big financial relationship, Lightspeed and PWI and PFSI.** And he's trying to get more items on the list, which Rudy would do, but they were yelling at him, so he bumped it to Global for me to take care of it.

Q Okay. So Phil -- and then Phil was then downstreaming it back to you?

A Yes.

(Hearing- Day 2, 559:12-560:4, Oct. 28, 2014)

- McCain Testimony

Q And do you know why MB Trading would be sending this to Mr. Pendergraft? A They would be sending them to Phil because it was not unusual for a customer that was unhappy to go straight to Phil. These customer -- this customer predated the time that I joined the firm and the time that Bill joined the firm, so they felt -- had a comfort with going directly to Phil.

Q When you say a customer, you mean a PFSI customer?

A Yes.

(Hearing- Day 9, 2218:20-2219:5, Nov. 6, 2014)

246. Johnson received approximately 300 e-mails per day when he was Senior Vice President for Global Stock Lending.

- Stipulated Finding of Fact 119

247. Pendergraft sent others, including Bart McCain, e-mails on topics including PFSI firm financing, revenue, and regulatory issues.

- McCain Testimony

Q All right. Now, you talked a lot with Ms. Addleman about the interactions between Mr. Yancey and Mr. Pendergraft and Mr. Johnson and Mr. Pendergraft. I want to talk for a minute about your interactions with Mr. Pendergraft.

You would communicate with Mr. Pendergraft about business issues; is that fair? A It is, when it was something that related to the areas that I interacted with him on.

Q And you would communicate with Mr. Pendergraft about things like firm financing; is that fair?

A It is.

(Hearing- Day 9, 2215:13-2215:25, Nov. 6, 2014)

- Ex. 265

To: Brian Gover[BGover@PENSON.COM]; Mark Fawver[MFawver@PENSON.COM]; Bart McCain[bmccain@PENSON.COM]; Tom Delaney[TDelaney@PENSON.COM]
From: Phil Pendergraft
Sent: Wed 8/12/2009 8:32:34 AM
Importance: High
Subject: Ren call

Guys

I would like to push this call back until early tomorrow or Friday morning so that I can participate. Do you think this will be a big deal to them? Have we committed to the regulators that we will do this today? Please let me know asap.

Thanks

Phil

- McCain Testimony

Q The subject Ren Call doesn't ring a bell?

A Ren call, Renaissance was a customer of the broker-dealer, but -- and they were a large customer.

(Hearing- Day 9, 2217:5-2217:7, Nov. 6, 2014)

- Ex. 266

From: Phil Pendergraft <ppendergraft@penson.com>

Date: November 12, 2009 9:45:58 PM CST

To: Bart McCain <bmccain@PENSON.COM>

Subject: Fw: blue sheet

Bart

Can you look at this and let me know your thoughts?

Thanks

Phil

Hi Phil,

We are getting billed due to regulatory requests to pull blue sheets at \$25 per request. This has caused MBT to get billed about 5-6k per month from these charges. This has gone on for several months. I certainly don't have an issue with an actual cost of the resource to do this but this is now becoming really expensive. At this rate we can just hire someone full time to only handle the MBT requests for less than we are paying now. Would you consider a reduction in this blue sheet charge to \$5 per request? Thanks for your consideration and hope all is well.

Regards,

Steve

- McCain Testimony

Q And do you know why MB Trading would be sending this to Mr. Pendergraft?

A They would be sending them to Phil because it was not unusual for a customer that was unhappy to go straight to Phil. These customer -- this customer predated the time that I joined the firm and the time that Bill joined the firm, so they felt -- had a comfort with going directly to Phil.

Q When you say a customer, you mean a PFSI customer?

A Yes.

Q All right. Now, on the first page of the document Mr. Pendergraft forwards it to you and says: Bart, can you take a look at this and let me know your thoughts? Do you see

that?

A I do.

Q Do you know why he was sending this to you for your thoughts?

A Well, I was in senior management with PFSI. I thought -- I think I thought at the time that he was sending it to me because this was -- you might consider this an administrative issue or something about billing, or trying to look into what was causing those charges.

(Hearing- Day 9, 2218:20-2219:18, Nov. 6, 2014)

- Ex. 267

Bart

Can we get a revenue estimate for BPS for yesterday?

Thanks

Phil

- Ex. 268

>
> From: Bart McCain
> Sent: Friday, November 19, 2010 1:27 PM
> To: Phil Pendergraft
> Cc: Bill Yancey; Kevin McAleer
> Subject: Pinnacle
>
> Phil,
> Wanted to give you a heads up that Pinnacle wants to have a call with you, Bill or me regarding our financial status. Mike Paciorek is claiming that Pinnacle has lost some customers as a result of our Q3 earnings and wants to know how to address it with any future customers that may make similar inquiries. I am trying to set up a call at 4:30 this afternoon with Mike, Kevin and me to address his concerns.
>
> If you would like to participate, let me know.
>
> Bart

- McCain Testimony

Q And the correspondent, again, is a PFSI correspondent?

A Yes.

(Hearing- Day 9, 2223:4-2223:6, Nov. 6, 2014)

- Ex. 269

From: Phil Pendergraft <ppendergraft@penson.com>
Date: Tue, 7 Dec 2010 13:54:30 -0600
To: Bart McCain <bmccain@penson.com>, John Kenny <jkenny@penson.com>
Subject: 80010317

Gents

This is a Penson Financial account with a negative equity of about 400k....can you look at this please?

Thanks

Phil

- McCain Testimony

Q Again, this is a PFSI customer?

A Yes.

(Hearing- Day 9, 2224:1-2224:15, Nov. 6, 2014)

- Ex. 270

From: Bart McCain <bmccain@PENSON.COM>
Sent: Friday, December 10, 2010 7:11 PM (GMT)
To: Phil Pendergraft <ppendergraft@penson.com>; John Kenny <JKenny@PENSON.COM>
Subject: Response to FINRA - Important

Phil,

We have to respond to FINRA today on a matter but want to get your feedback before doing so. Is there a time that works for you, bearing in mind that John has to leave for the airport by 2? He'll be available by cell until his flight leaves at 4.

We're in the planning meeting in the learning center so either all my cell or respond, and we'll call you.

Bart

248. Pendergraft did not send these e-mails to Bart McCain as McCain's supervisor.

- McCain Testimony

Referencing Ex. 265:

Q And this e-mail in August of 2009, at this time Mr. Yancey was your supervisor, right?

A Yes.

Q Mr. Pendergraft is not sending this to you because he's your supervisor, right?

A That's correct.

(Hearing- Day 9, 2217:11-2217:16, Nov. 6, 2014)

Referencing Ex. 266:

Q Do you know why he was sending this to you for your thoughts?

A Well, I was in senior management with PFSI. I thought -- I think I thought at the time that he was sending it to me because this was -- you might consider this an administrative issue or something about billing, or trying to look into what was causing those charges.

Q And he was not sending it to you because he was your supervisor; is that fair?

A That's correct.

(Hearing- Day 9, 2219:11-2219:21, Nov. 6, 2014)

Referencing Ex. 267:

Q And, again, Mr. Pendergraft is not sending this to you because he's your supervisor, right?

A Not in this context, no.

(Hearing- Day 9, 2221:25-2222:2, Nov. 6, 2014)

Referencing Ex. 268:

Q You're not raising it with Mr. Pendergraft because he's your supervisor, right?

A No, he is not -- in this role, he is not my direct supervisor.

(Hearing- Day 9, 2223:13-2223:16, Nov. 6, 2014)

Referencing Ex. 269:

Q All right. And you were not communicating with Mr. Pendergraft on this issue because he's your supervisor, right?

A I'm not.

(Hearing- Day 9, 2224:16-2224:19, Nov. 6, 2014)

249. Pendergraft was not Bart McCain's supervisor for purposes of Bart McCain's PFSI responsibilities; Yancey was Bart McCain's supervisor for such purposes.

- Yancey Testimony

Q And who -- I'm not sure if we talked about it. Who is Bart McCain?

A Bart McCain was the Chief Administrative Officer of the firm.
 Q Was he a direct report to you?
 A Yes.
 Q Okay. You didn't delegate the supervision of Mr. McCain to Phil Pendergraft, right?
 A I'm sorry?
 Q You did not delegate supervision of Mr. McCain to Phil Pendergraft; is that right?
 A I did not.

(Hearing- Day 4, 952:14-952:25, Oct. 30, 2014)

Q And I guess, for clarity, when we were talking about Mr. McCain, he was CAO of PFSI, correct?

A He was.

(Hearing- Day 4, 953:4-953:7, Oct. 30, 2014)

- McCain Testimony

Q Let's talk about the supervision structure at Penson Financial. You mentioned you reported to Bill Yancey; is that correct?

A Yes.

(Hearing- Day 9, 2177:21-2177:24, Nov. 6, 2014)

250. Johnson communicated with others, including Bart McCain, on topics including Stock Loan revenues, firm financing, travel schedule, and expense approval.

- Ex. 338

From: Mike Johnson
Sent: Thursday, December 02, 2010 11:02 AM
To: Daniel Son; Rocky Engemoen; Bill Yancey; Bart McCain; Kevin McAleer; Bryce Engel; John Skain; Clive Triance; Michael Gallian; Phil Pendergraft
Subject: As of Last Night Close

DAILY GLOBAL P&L		MTD
Dallas 234	37,159.87	37,156.23
Dallas 158	9,950.80	9,950.80
New York	6,298.88	6,298.88
London 80/20	3,128.07	3,128.07
Toronto (USD)	6,754.07	6,754.07
Total Daily Global P&L	63,291.69	63,288.06

- Ex. 271

From: Mike Johnson <mjohnson@PENSON.COM>
Date: July 26, 2010 8:59:30 AM EDT
To: Bill Yancey <BYancey@PENSON.COM>, Bart McCain
<bmccain@PENSON.COM>

I am estimating NYC to come in around 222K for July

I am estimating the income for Dallas to be 1,135,000

- Ex. 272

From: Bart McCain <bmccain@PENSON.COM>
Sent: Monday, October 25, 2010 9:45 PM
To: Mike Johnson <mjohnson@PENSON.COM>; Brian Hall
<BHall@PENSON.COM>
Subject: Firm financing

Were we able to pull back on financing today?

- Ex. 273

From: Bart McCain
Sent: Sunday, November 14, 2010 9:36 AM
To: Mike Johnson
Subject: Re:
Importance: High

MJ,
How much of PFSI's capital does London use each day?

On Nov 14, 2010, at 8:59 AM, Mike Johnson wrote:

I know that you have been asked to adjust the split with London on the business at hand. We currently do 80 percent to them and 20 to PFSI. I do not want to change it as we are still repairing things and until I see it running correctly I don't think we should change.

- Ex. 274

From: Mike Johnson <mjohnson@PENSON.COM>
Sent: Monday, October 25, 2010 5:26 PM
To: Bart McCain <bmccain@PENSON.COM>
Cc: Lindsey Wetzig <LWetzig@PENSON.COM>; Rudy De La Sierra <RDelasierra@PENSON.COM>
Subject:

Bart,

May I have approval for a quick dinner under 400.00 and four tickets to the Dallas stars game? Our largest client Bank of America is coming to visit TD Ameritrade and they have asked us to take them to the Stars. The Stars tickets will be under 75.00 each. (4) total expense of 700.00

- Ex. 275

From: Bart McCain <bmccain@PENSON.COM>
Sent: Wednesday, January 12, 2011 3:29 PM
To: Mike Johnson <mjohnson@PENSON.COM>
Subject: Re: Re: RE:

Will do, Mike. Safe travels!

On Jan 12, 2011, at 8:53 AM, "Mike Johnson" <mjohnson@PENSON.COM> wrote:

I am enroute to nyc I can see avatar tomorrow if needed. Please see rudy to understand the ridge issues and regulatory guidelines we are following.

M

251. Bart McCain was not Johnson's supervisor, and none of the e-mail communications on topics including Stock Loan revenues, firm financing, travel schedule, and expense approval made McCain Johnson's supervisor.

- Yancey Testimony

We can agree that -- that Bart McCain had no responsibility for Securities Lending; is that right?

A That is correct

(Hearing- Day 4, 952:11-952:13, Oct. 30, 2014)

- McCain Testimony

Q Now, you never supervised Mike Johnson, right?

A Correct.

Q We talked earlier, but just to make sure, but you never supervised the Stock Lending department at all, right?

A Right.

(Hearing- Day 9, 2227:8-2227:14, Nov. 6, 2014)

Q Do you know why Mike Johnson was sending you Stock Loans' P&L, daily P&L?

A Why specifically he was sending it to me?

Q Yes, sir.

A Again, I presume because I was one of the senior executives within PFSI. All of other people here are the people that were typically on the Monday morning call.

Q On the Monday morning call with Mr. Pendergraft you discussed earlier?

A Yes.

Q All right. And Mr. Johnson is not sending this to you because you're his supervisor, right?

A Right.

(Hearing- Day 9, 2228:5-2228:18, Nov. 6, 2014)

Q So this e-mail where you're communicating with Mr. Johnson about firm financing, it's not because you're his supervisor; fair?

A Correct.

(Hearing- Day 9, 2231:3-2231:6, Nov. 6, 2014)

Q Do you recall why Mr. Johnson is sending this request to you?

A I routinely fielded any kind of questions or approvals as it relates to spending firm money. This is going to be charged to PFSI's income statement. And I typically approved a large number of expense reports, and regardless, it was related to PFSI, then it would typically find its way to me at some point in the approval chain.

Q So just because you're approving Mr. Johnson's expense request, does that make you his supervisor?

A It does not.

(Hearing- Day 9, 2233:1-2233:13, Nov. 6, 2014)

Q Sure. And you agree with me that just because Mr. Johnson is sending you an e-mail that, among other things, updates you on his travel plans, that doesn't make you his supervisor, right?

A It does not make me his supervisor; that's correct.

(Hearing- Day 9, 2234:14-2234:19, Nov. 6, 2014)

252. If Yancey personally communicated with regulators about information within his knowledge, he was confident that it was accurate.

- Yancey Testimony

Q And Mr. Yancey, if you personally were communicating with regulators, you would strive to be accurate; isn't that fair?

A Yes.

Q And you would strive to be honest?

A Sure.

Q In your time as CEO of Penson, do you believe you were honest in your communications with regulators?

A Yes, sir.

Q Do you believe you were accurate in your communications with regulators?

A To the extent of my knowledge.

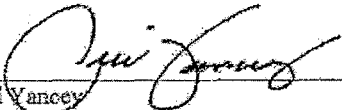
Q All right. If you knew something and you told it to regulators, it was something within your knowledge, you were confident it was accurate?

A Yes, sir.

(Hearing- Day 3, 881:20-882:10, Oct. 29, 2014)

253. In March 2011, Yancey personally signed PFSI's 2011 CEO Certification. Attached to that certification was the annual summary report, prepared by the Compliance department. Yancey knew this was an important report that was going to regulators, and he reviewed it before signing the certification.

- Ex. 216 at p.2

Annual Compliance and Supervision Certification Penson Financial Services, Inc. <i>NYSE Rule 342.30(e)/FINRA Rule 3130(b)/NSX Rule 5.7</i>	
The undersigned is the Chief Executive Officer of Penson Financial Services, Inc. (the "Member"). As required by NYSE Rule 342.30(e), FINRA Rule 3130(b) and NSX Rule 5.7, the undersigned makes the following certification:	
 _____ Bill Yancey President and Chief Executive Officer Penson Financial Services, Inc.	<u>3/29/11</u> _____ Date

- Yancey Testimony

Q Let's look at the certification itself. If you'll turn to the second page. Now, Mr. Yancey, this looks very similar to that document we looked at before that was the 2010 certification; is that right?

A It does.

Q And again, this is your personal signature on this document, correct?

A Yes.

Q You -- you picked up a pen and you signed and dated this document?

A I did.

Q And just like the last year's certification, the 2010 certification, there's a report attached to it; isn't that right?

A Yes, I see that.

Q And as we talked about before, you would have reviewed that report before you signed this, right?

A You know, I think so.

Q You would have read it?

A I believe it would have been reviewed with me. I -- whether I read every word of this document is really very, very hard for me to recall.

Q All right. When we talked before, we agreed that the report is an important document, right?

A Yes.

Q It goes to the regulators, right?
A It's important.
Q You know it's going to the regulators, correct?
A Yes.
Q And you are personally signing the certification that attaches the report that's going to the regulators, right?
A Yes.

(Hearing- Day 4, 976:5-977:12, Oct. 30, 2014)

254. Bart McCain believed the 2011 annual summary report was accurate.

- McCain Testimony

Q Mr. McCain, this is an e-mail dated March 29, 2011 to Bill Yancey, Phil Pendergraft, Rocky Engemoen, and Bart McCain from Tom Delaney. Do you see that?
A I do.
Q What is this document?
A This is an e-mail from Tom to the directors of PFSI. It has the 3012 and 3130 report from 2010 attached to it.
Q As a member of the board, do you recall receiving this report?
A I do.
...
Q When you received this report, did you believe that it was accurate?
A Of course.

(Hearing- Day 9, 2167:20-2168:22, Nov. 6, 2014)

255. In the report attached to the 2011 CEO Certification, Johnson is listed as the supervisor of PFSI's Stock Loan department, and is described as being part of the "senior directors team" that meets weekly to report to Yancey.

- Ex. 216 at p. 9

FUNCTIONAL DEPARTMENT DESCRIPTIONS

The firm is comprised of the following departments, business units and supervisors:

8. Securities Lending (Mike Johnson)

Each of these departments and business units are properly managed by individuals with the appropriate experience for their particular area. These department heads are part of the "Senior Directors Team" of the firm and meet weekly to report to the CEO and the other members of the Team on matters affecting each department and the general business of the firm.

- Yancey Testimony

Q All right. Do you see the section that begins "Functional Department Descriptions"?

A I see that.
Q Okay. It says, "The firm is comprised of the following departments, business units and supervisors."
And could you just read Number 8, please.
A "Securities Lending (Mike Johnson)."
Q All right. And if we go back to the top, that first sentence, "The firm," the firm here is PFSI, right?
A I believe it is.

(Hearing- Day 4, 977:18-978:2, Oct. 30, 2014)

Q And this is a report that went out under your personal signature; is that right?
A It accompanied my certification document.
Q That you personally signed?
A I did.
Q And that you knew was going to the regulators?
A I did.

(Hearing- Day 4, 978:18-978:24, Oct. 30, 2014)

iii. PFSI's Written Supervisory Procedures Designated Yancey as Johnson's Supervisor.

256. PFSI's Written Supervisory Procedures ("WSPs") were an important document, and a source of information for PFSI's regulators.

- Yancey Testimony

Q Would you also agree that WSPs were a source of information for regulators about Penson's processes?
A Yes, sir.

(Hearing- Day 3, 886:11-886:13, Oct. 29, 2014)

Q They were an important document?
A They were.

(Hearing- Day 3, 886:17-886:18, Oct. 29, 2014)

- Delaney Testimony

Q Okay. And WSPs are important?
A They are.

(Hearing- Day 5, 1387:7-1387:8, Oct. 31, 2014)

257. It was important to Yancey that PFSI's WSPs be as accurate as possible.

- Yancey Testimony

Q And it was important to you as CEO that the WSPs be as accurate as possible; is that fair?

A Yes, sir.

(Hearing- Day 3, 886:14-886:16, Oct. 29, 2014)

258. PFSI's WSPs contained a section designating supervisors. That section was at the very front of the WSPs. The section of the WSPs designating supervisors referenced and incorporated PFSI's supervisory matrix.

- Ex. 213

Penson Financial Services
BD Written Supervisory Policies and Procedures
12/30/2010 to Current

DESIGNATION OF SUPERVISORS

Background

DESIGNATION OF SUPERVISORS

The Penson Financial Services Supervisory Matrix is a separate document and located on the Penson Intranet Pi site. Click on Compliance and scroll down and click on Supervisory Matrix, scroll down again and click on Registered Representative Supervisory Matrix.

- Yancey Testimony

Q This designation of supervisor's page in the WSPs says, The Penson Financial Services Supervisory Matrix is a separate document and located on the Penson intranet Pi site.

And then it gives some instructions on how to get there: "Click on Compliance and scroll down and click on Supervisory Matrix, scroll down again and click on Registered Representative Supervisory Matrix."

So, Mr. Yancey, we can agree, this part of the WSPs is telling us how to locate the Registered Representative Supervisory Matrix; is that right?

A That's my reading.

(Hearing- Day 4, 956:5-956:16, Oct. 30, 2014)

Q And that section right at the beginning of WSP says Designation of Supervisors. The Penson Financial Services supervisory matrix is a separate document and located

on the Penson Internet Pi site.

Do you see that, sir?

A Yes, I see that.

Q So right at the very beginning of the WSP, it gives us that information; fair?

A Yes, sir.

(Hearing- Day 7, 1913:12-1913:20, Nov. 4, 2014)

- Poppalardo Testimony

Q Okay. So Exhibit 213, if you go to Page -- MS. ATKINSON: 728, Pat.

BY MS. ATKINSON: Q It's the third page -- well, let's just go to the next page of the document. Okay. So you recognize this as PFSI's written supervisory procedures, right?

A Yes.

Q Okay. And let me ask you to look, if you would, at the page at the bottom that says 9 and 11. You see the designation of supervisors. And this is the 3010(a)(5) designation of supervisors; is that right?

A I presume so.

(Hearing- Day 8, 2015:13-2015:25, Nov. 5, 2014)

259. PFSI's WSPs did not incorporate any org chart.

- Poppalardo Testimony

Q And it sounds to me like you have looked at a lot of WSPs for PFSI; is that right?

A Yes.

Q Or did you only look at one set?

A No, actually, I -- you know, in making an assessment of their supervisory system, I felt compelled to review most of them.

Q Okay. And at least as far as the exhibits that have been offered by Mr. Yancey, no WSP incorporates an org chart; isn't that true?

A That's true.

(Hearing- Day 8, 2028:16-2029:1, Nov. 5, 2014)

260. The purpose of PFSI's supervisory matrix was to identify the supervisor for each of PFSI's registered employees.

- Miller Testimony

Q How did that relate to your job of keeping the matrix document up-to-date, if at all?

A Anytime a new employee would come on or anytime someone would obtain a new license, I would try to update that document so that it identified the person that was managing them and, you know, sort of --

...

Q And we talked about it briefly in the beginning. This document, this registered representative supervisory matrix, you -- that's a document you know? A Yes, sir.

Q It's a document that you kept?

A Uh-huh. Yes.

Q Tell us what -- why you kept it and what it was used for within Penson.

A **We're required to designate a supervisor and identify that supervisor for each of our registered employees. So we maintain that matrix in order to try to keep track of that.**

(Hearing- Day 11, 2589:5-2590:11, Nov. 10, 2014)

261. PFSI's supervisory matrix listed employees under various executives.

- E.g., Ex. 177 at 3.

Employee Name	Company	Department
Bill Yancey		
Bart McCain	Penson US	Executives
Thomas Delaney	Penson US	Executives - Global COO
John Kenny	Penson US	Executives - Operations
Mike Johnson	Penson US	Executives - Securities Lending
Doug Throckmorton	Penson US	Institutional Client Services
Don Weingarten	Penson US	Marketing
Jack Boyle	Penson US	Marketing
Peter Wind	Penson US	Marketing
Sean Malloy	Penson US	Marketing
Amy McLean	Penson US	Relationship Management
James Côté	Penson US	Relationship Management
Cass Smith	Penson US	Relationship Management
Frank Hess	Penson US	Relationship Management
James Scaplen	Penson US	Relationship Management
Karen Snow	Penson US	Relationship Management
Michael Scaplen	Penson US	Relationship Management
Scott Wood	Penson US	Relationship Management
Anne Maxey	Penson US	Strategic Development

262. For the time period relevant to this case, Johnson was always listed under Yancey in PFSI's supervisory matrix.

- Ex. 177 (February 2009)

Employee Name	Company	Department	PI Org Chart	Regulatory Supervisor
Phil Pendegrast	Penson Worldwide	Executives		
Bill Yancey				
Bart McCain	Penson US	Executives	Bill Yancey	Bill Yancey
Thomas Delaney	Penson US	Executives - Global COO	Bill Yancey	Bill Yancey
John Kenny	Penson US	Executives - Operations	Bill Yancey	Bill Yancey
Mike Johnson	Penson US	Executives - Securities Lending	Phil Pendegrast	Bill Yancey

Employee Name	Company	Department	PI Org Chart	Regulatory Supervisor
Bill Yancey	Person US	Executives	Phil Pendergraft	Phil Pendergraft
Daniel Son	Person US	Executives	Phil Pendergraft	Phil Pendergraft
Richard Anapacher	Person US	Futures	Phil Pendergraft	Phil Pendergraft

- Ex. 175 at 1-4 & Ex. 178 (May 2009)

Employee Name	Company	Department	PI Org Chart	Regulatory Supervisor
Bill Yancey				
Amy McLean	Person US	Relationship Management	Lynal Carey	Bill Yancey
Cass Smith	Person US	Relationship Management	Lynal Carey	Bill Yancey
Frank Hess	Person US	Relationship Management	Lynal Carey	Bill Yancey
James Coit	Person US	Relationship Management	Lynal Carey	Bill Yancey
James Scapion	Person US	Relationship Management	Lynal Carey	Bill Yancey
Karen Snow	Person US	Relationship Management	Lynal Carey	Bill Yancey
Michael Scapion	Person US	Relationship Management	Lynal Carey	Bill Yancey
Scott Wood	Person US	Relationship Management	Lynal Carey	Bill Yancey
Dan Weingarten	Person US	Marketing	Bill Yancey	Bill Yancey
Jack Boyle	Person US	Marketing	Kellar Raki	Bill Yancey
Peter Wind	Person US	Marketing	Phil Pendergraft	Bill Yancey
Sean Malloy	Person US	Marketing	Bill Yancey	Bill Yancey
Doug Throckmorton	Person US	Executives - Online Person Project	Bill Yancey	Bill Yancey
Mike Johnson	Person US	Executives - Securities Lending	Phil Pendergraft	Bill Yancey

Employee Name	Company	Department	PI Org Chart	Regulatory Supervisor
Phil Pendergraft				
Bill Yancey	Person US	Executives	Phil Pendergraft	Phil Pendergraft
Daniel Son	Person US	Executives	Phil Pendergraft	Phil Pendergraft
Richard Anapacher	Person US	Futures	Phil Pendergraft	Phil Pendergraft
Bryce Engel	Person US	Executives	Phil Pendergraft	Phil Pendergraft
Anne Maxey	Person WW	Strategic Development	Simon Raphael	Phil Pendergraft
Robert McBey	Person US	Executive - Operations	Phil Pendergraft	Phil Pendergraft

- Ex. 182 (January 2010)

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Phil Pendergraft	Person WW	Dallas, Texas	Executives		
Thomas Chao	Person US	Dallas, Texas	Chief Scientist	Sleeve Zhang	Bill Yancey
Cass Smith	Person US	New York, New York	Customer Development	Lynal Carey	Bill Yancey
Bart Mc Cain	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Thomas Robinson	Person US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey
John Kenny	Person US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey
Mike Johnson	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Phil Pendergraft	Bill Yancey

Employee Name	Company	Location	Department	Reporting Supervisor	Regulatory Supervisor
Anna Mosley	Parsons WW	Dallas, Texas	Strategic Development	Simon Raphael	Phil Pendergraft
Bill Yancey	Parsons US	Dallas, Texas	Executives, President - CEO	Phil Pendergraft	Phil Pendergraft
Byron Engel	Parsons WW	Dallas, Texas	Executives, EVP	Phil Pendergraft	Phil Pendergraft
David Son	Parsons WW	Dallas, Texas	Executives, PMW	Phil Pendergraft	Phil Pendergraft
Richard Anspacher	Parsons GHCO	Dallas, Texas	Futures - SVP	Phil Pendergraft	Phil Pendergraft
Robert McBay	Parsons WW	Dallas, Texas	Executive - SVP, Operations	Phil Pendergraft	Phil Pendergraft
Peter Wind	Parsons WW	Chicago, Illinois	Sales - SVP	Phil Pendergraft	Phil Pendergraft
Mark Robinson	Parsons Canada	Montreal, Canada	Executives, VP PFSC	Robert McPherson	Bert McCain

• Ex. 196 (May 2010)

Employee Name	Company	Location	Department	Reporting Chart	Regulatory Supervisor
Phil Pendergraft	Parsons WW	Dallas, Texas	Executives		
Thomas Chao	Parsons US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey
Cass Smith	Parsons US	New York, New York	Customer Development	Lynal Carey	Bill Yancey
Bert McCain	Parsons US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Thomas Delaney	Parsons US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey
John Kenny	Parsons US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey
Mike Johnson	Parsons WW	Dallas, Texas	Executives - SVP, Securities Lending	Phil Pendergraft	Bill Yancey
Anna Mosley	Parsons WW	Dallas, Texas	Strategic Development	Simon Raphael	Phil Pendergraft
Bill Yancey	Parsons US	Dallas, Texas	Executives, President - CEO	Phil Pendergraft	Phil Pendergraft
Byron Engel	Parsons WW	Dallas, Texas	Executives, EVP	Phil Pendergraft	Phil Pendergraft
David Son	Parsons WW	Dallas, Texas	Executives, PMW	Phil Pendergraft	Phil Pendergraft
Mark Robinson	Parsons Canada	Montreal, Canada	Executives, VP PFSC	Robert McPherson	Bert McCain
Richard Anspacher	Parsons GHCO	Dallas, Texas	Futures, SVP	Phil Pendergraft	Phil Pendergraft
Robert McBay	Parsons WW	Dallas, Texas	Executive, SVP, Operations	Phil Pendergraft	Phil Pendergraft

• Ex. 199 (August 2010)

Employee Name	Company	Location	Department	Reporting Chart	Regulatory Supervisor
Pendergraft, Phil	Parsons WW	Dallas, Texas	Executives		
Chao, Faming (Thomas)	Parsons US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey
Smith, Charles (Cass)	Parsons US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McBay, Robert	Parsons WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
McCain, Bert	Parsons US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Delaney, Thomas	Parsons US	Dallas, Texas	Compliance - Chief Compliance Officer	Bill Yancey	Bill Yancey
Konshan, Andy	Parsons US	Dallas, Texas	MIS - Senior Vice President, CIO	Bill Yancey	Bill Yancey
Kenny, John	Parsons US	Dallas, Texas	Operations - EVP, COO	Bill Yancey	Bill Yancey
Johnson, Michael	Parsons WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey
Mosley, Anne	Parsons WW	Dallas, Texas	Global Trading - Research Analyst	Phil Pendergraft	Phil Pendergraft
Yancey, Charles (Bill)	Parsons US	Dallas, Texas	Executives - President/CEO	Phil Pendergraft	Phil Pendergraft
Engel, Byron	Parsons WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, David	Parsons WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Parsons Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Parsons GHCO	Dallas, Texas	Futures, SVP	Dea Miller	Phil Pendergraft

• Ex. 200 at 672-675 (September 2010)

Employee Name	Company	Location	Department	Fl Org Chart	Regulatory Supervisor
Pendergraft, Phil	Penion WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO Penion Northvolt</i>					
Yancey, Charles (Bill)	Penion US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Penion WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Penion WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Penion Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Penion GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO Penion Financial</i>					
Chao, Taming (Thomas)	Penion US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Penion US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Penion WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Penion US	New York, New York	Customer Development - Manager	Llynd Carey	Bill Yancey
McCain, Bart	Penion US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Penion WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 202 at 430-433 (October 2010)

Employee Name	Company	Location	Department	Fl Org Chart	Regulatory Supervisor
Pendergraft, Phil	Penion WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO Penion Northvolt</i>					
Yancey, Charles (Bill)	Penion US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Penion WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Penion WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Penion Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Penion GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO Penion Financial</i>					
Chao, Taming (Thomas)	Penion US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Penion US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Penion WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Penion US	New York, New York	Customer Development - Manager	Llynd Carey	Bill Yancey
McCain, Bart	Penion US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Penion WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 205 at 15-18 (November 2010)

Employee Name	Company	Location	Department	Fl Org Chart	Regulatory Supervisor
Pendergraft, Phil	Penion WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO Penion Northvolt</i>					
Yancey, Charles (Bill)	Penion US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Penion WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Penion WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Penion Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Penion GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO Penion Financial</i>					
Chao, Taming (Thomas)	Penion US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Penion US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Penion WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Penion US	New York, New York	Customer Development - Manager	Llynd Carey	Bill Yancey
McCain, Bart	Penion US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Penion WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 207 (November 2010)

- Poppalardo Testimony

Q You talked a little about NASD Rule 3010(a)(5), and I believe that you said FINRA requires the assignments of each registered person to an appropriately registered principal who shall be responsible for supervising that person's conduct.

A Right.

(Hearing- Day 8, 2008:17-2008:22, Nov. 5, 2014)

- Miller Testimony

Q Then what did the Regulatory Supervisor column mean, in your words?

A That would be the person that was responsible for regulatory supervision of that individual.

(Hearing- Day 11, 2591:9-2591:13, Nov. 10, 2014)

And the Regulatory Supervisor column was the column that dealt with the NASD Rule 3010 supervisor, right?

A Correct.

(Hearing- Day 11, 2607:3-2607:6, Nov. 10, 2014)

- Hasty Testimony

Q I want to direct your attention to two columns, one -- I guess the fourth and fifth column. PI org chart and regulatory supervisor. Do you know what those columns mean or what those terms mean?

A I didn't author this document, and I didn't update it. But typically these particular columns, in a typical scenario, these would be designed to delineate who was responsible for supervising somebody with certain types of licenses.

(Hearing- Day 7, 1748:16-1748:25, Nov. 4, 2014)

266. The purpose of Rule 3010(a)(5) is to protect investors.

- Poppalardo Testimony

Q You talked a little about NASD Rule 3010(a)(5), and I believe that you said FINRA requires the assignments of each registered person to an appropriately registered principal who shall be responsible for supervising that person's conduct.

A Right.

Q And that's that rule, right --

A Right.

Q -- 3010(a)(5). Why does FINRA require that?

A Because at each -- in each registration category you have a certain minimum competence level. I mean, that you take an examination and you're tested, and a

Series 7 test is a little different than what a manager would take, a Series 24. They've got more knowledge of the requirements and the products that are offered than, say, a 27, who has a different kind of expertise, which goes more to customer protection, segregation requirements, books and records, that kind of thing, but it's to ensure a minimum level of competence.

Q Okay. And does that fit into the scheme of policing associated persons?

A I think so.

Q And that's for the protection of investors?

A Yes.

(Hearing- Day 8, 2008:17-2009:16, Nov. 5, 2014)

267. The "Regulatory Supervisor" column identified a person's supervisor from a compliance standpoint.

- Gardner Testimony

Q The -- looking at the columns that -- that you just discussed with Ms. Atkinson, do you see a column that says "regulatory supervisor"?

A Yes.

Q Do you have any idea what that column means?

A I don't know the definition of it. I would assume that it's from a compliance standpoint who the supervisor is.

(Hearing- Day 4, 1162:24-1163:6, Oct. 30, 2014)

268. The "Pi Org Chart Supervisor" designated a person's "boss" from a Human Resources perspective.

- Miller Testimony

Q And when you say it had a column for who their direct supervisor was, what does that mean?

A The person that they reported to day in and day out.

Q Is that the same as that person's boss?

A Yes.

Q Who -- between those two columns, who's the person that would direct the activities of the subordinate?

A It would be the Pi manager.

(Hearing- Day 11, 2590:24-2591:8, Nov. 10, 2014)

- Delaney Testimony

Q Okay. And when you were asked in your third testimony with this counsel representing you whether you were surprised that Mike Johnson was under Bill Yancey on a Supervisory Matrix, you said, "It may not surprise me if it's there because I would

think what those Supervisory Matrices were trying to show was that this is a broker-dealer function and, therefore, the CEO is responsible for all issues of the broker-dealer."

Question: "You're thinking of the business units to report to the CEO?"

Answer: "Yes, sir. So while functionally that may -- from an HR standpoint, there might not have been a -- there might not have been a reporting relationship from an HR standpoint, it certainly would have been my expectation from a compliance standpoint that a core function of the broker-dealer would report into from a supervisory standpoint. The supervisory in a broker-dealer context would have reported in through the CEO. So what we were really trying to show in supervisory procedures wasn't necessarily -- wasn't necessarily reporting relationships as far as HR relationships go, more so in terms of from a pure supervision of the broker-dealer standpoint, how would that have flown or how would that -- how would that -- the flow of that look."

Do you remember giving that testimony?

A I -- I don't remember giving that testimony. I remember -- I remember giving a third testimony, and I'm not disputing that those were the words that I said; I just don't remember giving that.

Q You don't doubt that you gave that testimony?

A No.

(Hearing- Day 5, 1391:11-1393:12, Oct. 31, 2014)

269. For the time period relevant to this case, Yancey was always listed as Johnson's Regulatory Supervisor in PFSI's supervisory matrix.

- Stipulated Finding of Fact 37.

270. From May 2010 forward, Yancey was also listed as Johnson's Pi Org Chart supervisor in PFSI's supervisory matrix.

- Ex. 201 at 4, 19

11. With respect to the period between May 1, 2010 and August 31, 2010, provide a description of Penson's supervisory chain identifying each supervisor's direct reports as well as the individual(s) to which each supervisor reports. List the name and title of each individual.

Please refer to the attached Supervisory Matrix.

Supervisor Name	Supervisor Title	Supervisor Location	Supervisor Department	Supervisor Reporting To	Supervisor Reporting To Title
Chris Tucker (Thames)	Foreign US	Dallas, Texas	Client Services - Client Services Specialist	Bill Yancey	Bill Yancey
Diane, Hester	Foreign US	Dallas, Texas	Compliance - VPE, Chief Compliance Officer	Bill Yancey	Bill Yancey
Mickey, Hester	Foreign WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Scott, Charles Niosi	Foreign US	New York, New York	Customer Development - Manager	Bill Yancey	Bill Yancey
Yolanda, Ray	Foreign US	Dallas, Texas	Executive - VPE, C&A	Bill Yancey	Bill Yancey
Robert, Michael	Foreign WW	Dallas, Texas	Executive - VPE, Sales/Fin. Leadng	Bill Yancey	Bill Yancey

- Ex. 199 (August 2010)

Employee Name	Company	Location	Department	FD Org. Chart	Regulatory Supervisor
Pendergraft, Phil	Person WW	Dallas, Texas	Executives		
<i>Bill Pendergraft - CEO, Person Worldwide</i>					
Chao, Taming (Thomas)	Person US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey
Smith, Charles (Cass)	Person US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McBey, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
McCain, Bart	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Delaney, Thomas	Person US	Dallas, Texas	Compliance - Chief Compliance Officer	Bill Yancey	Bill Yancey
Kandian, Andy	Person US	Dallas, Texas	MIS - Senior Vice President, CIO	Bill Yancey	Bill Yancey
Kenny, John	Person US	Dallas, Texas	Operations - EVP, COO	Bill Yancey	Bill Yancey
Johnson, Michael	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey
<i>Bill Pendergraft - CEO, Person Worldwide</i>					
Macey, Anne	Person WW	Dallas, Texas	Global Trading - Research Analyst	Phil Pendergraft	Phil Pendergraft
Yancey, Charles (Bill)	Person US	Dallas, Texas	Executives - President/CEO	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Person WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Person WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Person Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Person GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft

- Ex. 200 at 672-675 (September 2010)

Employee Name	Company	Location	Department	FD Org. Chart	Regulatory Supervisor
Pendergraft, Phil	Person WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO, Person Worldwide</i>					
Yancey, Charles (Bill)	Person US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Person WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Person WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Person Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Person GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO, Person Financial</i>					
Chao, Taming (Thomas)	Person US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Person US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Person US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McCain, Bart	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 202 at 430-433 (October 2010)

Employee Name	Company	Location	Department	FD Org. Chart	Regulatory Supervisor
Pendergraft, Phil	Person WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO, Person Worldwide</i>					
Yancey, Charles (Bill)	Person US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Person WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Person WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Person Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Person GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO, Person Financial</i>					
Chao, Taming (Thomas)	Person US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Person US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Person US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McCain, Bart	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 205 at 15-18 (November 2010)

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Pendergraft, Phil	Peiron WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO Peiron Worldwide</i>					
Yancey, Charles (Bill)	Peiron US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Peiron WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
San, Daniel	Peiron WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Peiron Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Amspacher, Richard	Peiron GHCO	Dallas, Texas	Finances, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO Peiron Financial</i>					
Chao, Taming (Thomas)	Peiron US	Dallas, Texas	Client Services - Client Services Specialist	Sueo Zhang	Bill Yancey
Delaney, Thomas	Peiron US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McCoy, Robert	Peiron WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Case)	Peiron US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McCain, Bart	Peiron US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Peiron WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 207 (November 2010)

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Pendergraft, Phil	Peiron WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO Peiron Worldwide</i>					
Yancey, Charles (Bill)	Peiron US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Peiron WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Peiron Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Amspacher, Richard	Peiron GHCO	Dallas, Texas	Finances, SVP	Ben Miller	Phil Pendergraft
Koschew, Kalin	Peiron US	Dallas, Texas	Credit and Market Risk - Market Risk Analyst	Robert Crain	Phil Pendergraft
<i>Bill Yancey - President/CEO Peiron Financial</i>					
Chao, Taming (Thomas)	Peiron US	Dallas, Texas	Client Services - Client Services Specialist	Sueo Zhang	Bill Yancey
Delaney, Thomas	Peiron US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McCoy, Robert	Peiron WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Case)	Peiron US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McCain, Bart	Peiron US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Peiron WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Ex. 175 at 10-15 & Ex. 217 (April 2011)

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Pendergraft, Phil	Peiron WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO Peiron Worldwide</i>					
Yancey, Charles (Bill)	Peiron US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Peiron WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Peiron Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Amspacher, Richard	Peiron GHCO	Dallas, Texas	Finances, SVP	Ben Miller	Phil Pendergraft
Koschew, Kalin	Peiron US	Dallas, Texas	Credit and Market Risk - Market Risk Analyst	Robert Crain	Phil Pendergraft
<i>Bill Yancey - President/CEO Peiron Financial</i>					
Chao, Taming (Thomas)	Peiron US	Dallas, Texas	Client Services - Client Services Specialist	Sueo Zhang	Bill Yancey
Hasty, Holly	Peiron US	Dallas, Texas	Compliance - VP Chief Compliance Officer	Tom Delaney	Tom Delaney
McCoy, Robert	Peiron WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Case)	Peiron US	New York, New York	Customer Development - Manager	Lynal Carey	Bill Yancey
McCain, Bart	Peiron US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Peiron WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

271. PFSI's supervisory matrix did not remain static, but rather was updated frequently.

- Ex. 198

To: Joseph Ross[JRoss@penson.com]
From: Kimberly Miller
Sent: Fri 8/13/2010 8:36:23 AM
Importance: Normal
Subject: RE: Supervisory Matrix

I put it out there for you and yes, I update it about 1 time per month.

- Exhibit 177 (attaching matrix)

To: Bart McCain[bmccain@PENSON.COM]; Bill Yancey[BYancey@PENSON.COM]; Tom Delaney[TDelaney@PENSON.COM]
Cc: Mike Johnson[mjohnson@PENSON.COM]
From: Kimberly Miller
Sent: Thur 2/26/2009 12:43:02 PM
Importance: Normal
Subject: Supervisory Structure Update
Registered Representative Supervisory Matrix.xls

Mike Johnson passed his Series 24 exam this morning. I have updated the supervisory structure to move the stock loan employees from Bill to Mike. A copy of the amended structure is attached. Please let me know if you feel I need to make additional changes before posting.

- Exhibit 175 (attaching matrix)

Kim

A couple of things:

- 1) Terry Bourne is no longer with PWI and should be USD;
- 2) I don't know who Mark Robinson is – operating company folks who are licensed would report to either Bill or Bart;
- 3) Al and Herb report to Doug;
- 4) Who does Warren Bunting report to?;

Thanks,
Tom

From: Kimberly Miller
Sent: Thursday, May 14, 2009 10:06 AM
To: Tom Delaney
Subject: Matrix

Per our conversation, I have attached the updated supervisory Matrix.

Division's Exhibit

175

- Exhibit 196 (attaching matrix)

From: John Kenny
Sent: Wednesday, May 26, 2010 5:40 PM
To: Kimberly Miller; Bill Yancey; Bart McCain; Andy Konchan
Subject: RE: Supervisory Matrix

Kim,

I do not see Ardy on the attached chart and have attached a list of changes. Please let me know if you have any questions

To: John Kenny[JKenny@PENSON.COM]
Cc: Bill Yancey[BYancey@PENSON.COM]; Bart McCain[bmccain@PENSON.COM]
From: Kimberly Miller
Sent: Wed 5/26/2010 5:49:50 PM
Importance: Normal
Subject: RE: Supervisory Matrix
Registered Representative Supervisory Matrix 5-2010.pdf

I sent the 09 chart this morning...my apologies. This is the updated chart...

I will compare w/what you provided already to make sure those changes are made...

- Exhibit 199 (attaching matrix)

To: Eric Alaniz[EAlaniz@PENSON.COM]
From: Joseph Ross
Sent: Mon 8/23/2010 8:23:44 AM
Importance: Normal
Subject: Supervisory Matrix
Registered Representative Supervisory Matrix 9-1-2010.xlsx

Eric:

Tom explained to me that one of the items you discuss w/Bill Yancey when you meet with him on a quarterly basis is the Supervisory Matrix (per attached). I am just

- Exhibit 277

To: Brian Gover[BGover@PENSON.COM]
From: Kimberly Miller
Sent: Wed 4/14/2010 11:23:06 AM
Importance: Normal
Subject: RE: Series 27

OK, I will change it to list you as his Regulatory Supervisor

From: Brian Gover
Sent: Wednesday, April 14, 2010 11:20 AM
To: Kimberly Miller; Gary Wiedman
Subject: RE: Series 27

Correct except that Gary continues to report to me.
Clay continues to report to me as well.
Thanks

From: Kimberly Miller
Sent: Wednesday, April 14, 2010 9:43 AM
To: Brian Gover; Gary Wiedman
Subject: Series 27

As a result of this promotion and since Gary has not passed his 24, the regulatory supervisory matrix now reads as follows. Let me know ASAP if this needs to be changed in any way.

Thank you,

272. Kim Miller was the compliance department employee charged with maintaining the supervisory matrix.

- Miller Testimony

Q And we talked about it briefly in the beginning. This document, this registered representative supervisory matrix, you -- that's a document you know?

A Yes, sir.

Q It's a document that you kept?

A Uh-huh. Yes.

(Hearing- Day 11, 2589:24-2590:5, Nov. 10, 2014)

273. Miller attempted to make the matrix as accurate as possible, and relied on business unit leaders to advise them if the matrix was incorrect or needed revisions. (Miller, exhibits)

- Miller Testimony

Q And as a general matter, Ms. Miller, when you would update the supervisory matrix, you would do your best to make sure it was accurate; is that fair?
A Yes. Obviously, I wanted to be accurate, but I would typically update it because a new employee was hired, and I would add someone or remove someone if they returned. I didn't redo the entire firm each month.
Q That's fair. Let me ask you this: If you had noticed an error on the matrix, you would have tried to correct it, right?
A Yes, of course.
Q And one of the things you would do when updating it is that you would go to business units and ask for their input on whether certain persons reported -- or where a certain person reported in their business unit; is that fair?
A Yes.

(Hearing- Day 11, 2609:18-2610:10, Nov. 10, 2014)

I mean, you weren't always aware of changes made in operational area at Penson, right?

A That's correct.
Q And among other things, you would look to executives in those areas to tell you whether the matrixes was correct or in error; is that fair?
A Yes, that's fair.

(Hearing- Day 11, 2615:22-2616:4, Nov. 10, 2014)

- Ex. 277

To: Brian Gover[BGover@PENSON.COM]
From: Kimberly Miller
Sent: Wed 4/14/2010 11:23:06 AM
Importance: Normal
Subject: RE: Series 27

OK, I will change it to list you as his Regulatory Supervisor

From: Brian Gover
Sent: Wednesday, April 14, 2010 11:20 AM
To: Kimberly Miller; Gary Wiedman
Subject: RE: Series 27

Correct except that Gary continues to report to me.
Clay continues to report to me as well.
Thanks

From: Kimberly Miller
Sent: Wednesday, April 14, 2010 9:43 AM
To: Brian Gover; Gary Wiedman
Subject: Series 27

As a result of this promotion and since Gary has not passed his 24, the regulatory supervisory matrix now reads as follows. Let me know ASAP if this needs to be changed in any way.

Thank you,

274. If an executive alerted Miller that the supervisory matrix was incorrect, she would correct the document.

- Miller Testimony

Q That would be your practice. If someone said, Hey, this is incorrect, in fact, you should list the person under me instead of under someone else, you would make those changes?

A Sure. If it was brought to my attention, I would make that change.

(Hearing- Day 11, 2613:1-2613:6, Nov. 10, 2014)

275. At some point, Miller was instructed to move Johnson from underneath Pendergraft to underneath Yancey, and to add Yancey as Johnson's regulatory supervisor.

- Miller Testimony

Q Do you recall at some point changing this matrix to put Bill's name in as regulatory supervisor for Mike Johnson?

A Yes, sir.

Q Why did you do that?

A I was directed at some point to move people from underneath Phil onto Bill.

Q And who directed you to do that?
A I don't recall who directed me to do it.
Q When were you directed to do that?
A It would have been prior to the Ridge conversion, but I don't recall the date.
Q Do you -- Ms. Miller, do you know why you were directed to do that?
A I do not.
Q Do you recall asking any questions at the time you were directed to do that?
A Not that I recall. I don't remember the conversation. I remember doing it. I just -- I don't know what they had going on from a corporate standpoint, that they would have asked me to, but I just -- I didn't question them.

(Hearing- Day 11, 2594:22-2595:18, Nov. 10, 2014)

276. Miller presumed that Yancey was aware that she had been instructed to list Yancey as Johnson's regulatory supervisor.

- Miller Testimony

Q By the way, did you -- do you have any recollection of ever telling Mr. Yancey that someone had instructed you to put his name and not Phil Pendergraft's name in the regulatory supervisor --
A I didn't --
Q -- column for Mike Johnson?
A I didn't relay that to Bill. I assumed that whoever was directing me would have had that conversation.

(Hearing- Day 11, 2599:2-2599:11, Nov. 10, 2014)

277. Miller provided the matrix to Yancey on more than one occasion.

- Miller Testimony

Q Is this a document that you routinely provided to him?
A I think I'd given it to him a couple of times. I don't know about routinely.

(Hearing- Day 11, 2591:25-2592:3, Nov. 10, 2014)

278. In February 2009, Yancey received a copy of the supervisory matrix from Miller that specifically updated the Stock Loan supervisory structure. Yancey was asked to review the supervisory matrix to alert Miller to any additional changes needed.

- Ex. 177 at p.1

To: Bart McCain[bmccain@PENSON.COM]; Bill Yancey[BYancey@PENSON.COM]; Tom Delaney[TDelaney@PENSON.COM]
Cc: Mike Johnson[mjohnson@PENSON.COM]
From: Kimberly Miller
Sent: Thur 2/26/2009 12:43:02 PM
Importance: Normal
Subject: Supervisory Structure Update
Registered Representative Supervisory Matrix.xls

Mike Johnson passed his Series 24 exam this morning. I have updated the supervisory structure to move the stock loan employees from Bill to Mike. A copy of the amended structure is attached. Please let me know if you feel I need to make additional changes before posting.

279. Yancey had a chance to read and review the matrix.

- Yancey Testimony

Q Now, I believe you also discussed briefly with Ms. Addleman that you agreed that a matrix, the supervisory matrix had been e-mailed to you, and you didn't believe that you had a chance to read or review it. Am I remembering your testimony right?

A Not exactly. I'm not saying I didn't have a chance to. I just don't recall having done so and don't remember receiving it.

(Hearing- Day 7, 1913:21-1914:3, Nov. 4, 2014)

280. It was Yancey's practice to read e-mails from compliance department employees.

- Yancey Testimony

Q And it was your practice, I would assume, to read e-mails that Compliance was sending you and asking for input, right?

A As often as I could.

(Hearing- Day 4, 958:23-959:1, Oct. 30, 2014)

281. Delaney expected that Yancey would review documents sent to him by the Compliance department for his review.

- Delaney Testimony

Q When your Compliance Officer sends things to senior officers for their review, did you expect that they would review them?

A As a general matter, yes. That's always going to be facts and circumstances dependent.

Q But as a general matter, you would expect that?

A As a general matter.

(Hearing- Day 3, 667:16-667:22, Oct. 29, 2014)

282. Yancey specifically responded to Miller and thanked her for providing the matrix.

- Ex. 263

To: Kimberly Miller[kmiller@PENSON.COM]; Bart McCain[bmccain@PENSON.COM]; Tom Delaney[TDelaney@PENSON.COM]
Cc: Mike Johnson[mjohnson@PENSON.COM]
From: Bill Yancey
Sent: Thur 2/26/2009 12:43:23 PM
Importance: High
Subject: RE: Supervisory Structure Update

Kim

Thanks,

Bill

283. The February 2009 supervisory matrix listed Johnson under Yancey, and listed Yancey as Johnson's regulatory supervisor. Johnson was not listed under Pendergraft.

- Ex. 177 at p.3, 5

Employee Name	Company	Department	PI Org Chart	Regulatory Supervisor
Bill Yancey				
Bart McCain	Penson US	Executives	Bill Yancey	Bill Yancey
Thomas Delaney	Penson US	Executives - Global COO	Bill Yancey	Bill Yancey
John Kenne	Penson US	Executives - Operations	Bill Yancey	Bill Yancey
Mike Johnson	Penson US	Executives - Securities Lending	Phil Pendergraft	Bill Yancey
Phil Pendergraft				
Bill Yancey	Penson US	Executives	Phil Pendergraft	Phil Pendergraft
Daniel Son	Penson US	Executives	Phil Pendergraft	Phil Pendergraft
Richard Anspacher	Penson US	Futures	Phil Pendergraft	Phil Pendergraft

284. If Yancey had instructed Miller to move Johnson under Pendergraft, she would have done so. Yancey did not do so.

- Miller Testimony

Q Now, if Mr. Yancey had responded to you and said, Ms. Miller, there's an error on the document, please move Mike Johnson under Phil Pendergraft, you would have done that?

A Yes, I would.

Q If Mr. Yancey had responded to you and said, Ms. Miller, there's an error on the document, I should not be listed as Mike Johnson's regulatory supervisor, you would have made that change, right?

A Yes.

Q And you don't recall Mr. Yancey ever saying that to you, do you?

A I don't recall that he did, no.

(Hearing- Day 11, 2614:21-2615:8, Nov. 10, 2014)

285. In May 2010, Yancey again received a copy of the supervisory matrix from Miller. Yancey was asked to review the matrix for accuracy.

- Ex. 196 at p.2

From: Kimberly Miller
Sent: Wednesday, May 26, 2010 8:58 AM
To: Bill Yancey; Bart McCain; John Kenny; Andy Konchan
Subject: Supervisory Matrix

I have revised the Supervisory Matrix to include Andy Konchan. Please review for accuracy, as we are not always aware of changes made in the Operational areas.

286. After a PFSI executive altered Miller that she had attached the prior year's supervisory matrix, Miller re-sent an updated version, again to Yancey.

- Ex. 196 at 1

To: John Kenny[JKenny@PENSON.COM]
Cc: Bill Yancey[BYancey@PENSON.COM]; Bart McCain[bmccain@PENSON.COM]
From: Kimberly Miller
Sent: Wed 5/26/2010 5:49:50 PM
Importance: Normal
Subject: RE: Supervisory Matrix
[Registered Representative Supervisory Matrix 5-2010.pdf](#)

I sent the 09 chart this morning...my apologies. This is the updated chart...

I will compare w/what you provided already to make sure those changes are made...

From: John Kenny
Sent: Wednesday, May 26, 2010 5:40 PM
To: Kimberly Miller; Bill Yancey; Bart McCain; Andy Konchan
Subject: RE: Supervisory Matrix

Kim,

I do not see Ardy on the attached chart and have attached a list of changes. Please let me know if you have any questions

287. The May 2010 supervisory matrix listed Johnson under Yancey, and listed Yancey as Johnson's regulatory supervisor. Johnson was not listed under Pendergraft.

- Ex. 196 at pp. 3, 5

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Phil Pendergraft	Penson WW	Dallas, Texas	Executives		
Thomas Chae	Penson US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey
Cass Smith	Penson US	New York, New York	Customer Development	Lynal Carey	Bill Yancey
Bart McCain	Penson US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Thomas Delaney	Penson US	Dallas, Texas	Executives - SVP, CCO	Bill Yancey	Bill Yancey
John Kenny	Penson US	Dallas, Texas	Executives - SVP, CCO	Bill Yancey	Bill Yancey
Mike Johnson	Penson WW	Dallas, Texas	Executives - SVP, Securities Lending	Phil Pendergraft	Bill Yancey
Anne Moxey	Penson WW	Dallas, Texas	Strategic Development	Simon Raphael	Phil Pendergraft
Bill Yancey	Penson US	Dallas, Texas	Executives, President - CEO	Phil Pendergraft	Phil Pendergraft
Bryce Engel	Penson WW	Dallas, Texas	Executives, EVP	Phil Pendergraft	Phil Pendergraft
Daniel Son	Penson WW	Dallas, Texas	Executives, PWW	Phil Pendergraft	Phil Pendergraft
Mark Robinson	Penson Canada	Montreal, Canada	Executives, VP PF&C	Robert McPherson	Bart McCain
Richard Anspacher	Penson GHCC	Dallas, Texas	Futures, SVP	Phil Pendergraft	Phil Pendergraft
Robert McCreary	Penson WW	Dallas, Texas	Executive, SVP, Operations	Phil Pendergraft	Phil Pendergraft

288. The May 2010 supervisory matrix had been updated to amend Johnson's title to Senior Vice President, and his employer to Penson Worldwide. It also continued to designate Yancey as Johnson's regulatory supervisor.

- Ex. 177 at p.3

Employee Name	Company	Department	PI Org Chart	Regulatory Supervisor
Bart McCain	Penson US	Executives	Bill Yancey	Bill Yancey
Thomas Delaney	Penson US	Executives - Global CCO	Bill Yancey	Bill Yancey
John Kenny	Penson US	Executives - Operations	Bill Yancey	Bill Yancey
Mike Johnson	Penson US	Executives - Securities Lending	Phil Pendergraft	Bill Yancey

- Ex. 196 at p 3

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Phil Pendergraft	Person WW	Dallas, Texas	Executives		
Thomas Crao	Person US	Dallas, Texas	Client Services	Steve Zhang	Bill Yancey
Cass Smith	Person US	New York, New York	Customer Development	Lynal Carey	Bill Yancey
Bart McCain	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Thomas DeZaney	Person US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey
John Kenny	Person US	Dallas, Texas	Executives - SVP, COO	Bill Yancey	Bill Yancey
Mike Johnson	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Phil Pendergraft	Bill Yancey

- Miller Testimony

Q And I think you said earlier, when you were talking about errors in the matrix, an earlier matrix had listed Mike Johnson as a Person U.S. employee. Do you recall that?

A I do.

Q So this has now been fixed. Mike Johnson is listed as a Person Worldwide employee, right?

A Yes.

(Hearing- Day 11, 2616:13-2616:20, Nov. 10, 2014)

289. Yancey did not respond to Miller to ask her to make any changes to the supervisory matrix.

- Yancey Testimony

Q Did you reply to Ms. Miller's e-mail and say, there's a mistake, Mike Johnson shouldn't be listed under me?

A As I said, I don't remember receiving it, and I don't remember replying to it.

(Hearing- Day 4, 963:15-963:19, Oct. 30, 2014)

- Miller Testimony

Q And you don't recall Mr. Yancey ever responding and asking you to make any changes to this matrix, correct?

A Not by memory, no.

Q And again, if Mr. Yancey had said, Ms. Miller, there's an error, you need to list Mike Johnson under Phil Pendergraft, you would have made that change? A Yes, sir.

(Hearing- Day 11, 2618:10-2618:18, Nov. 10, 2014)

290. In August 2010, Joe Ross, a compliance department employee, e-mailed Eric Alaniz a copy of the supervisory matrix. Ross noted that he understood Alaniz discussed the supervisory matrix with Yancey quarterly.

- Ex. 199

To: Eric Alaniz[EAlaniz@PENSON.COM]
 From: Joseph Ross
 Sent: Mon 8/23/2010 8:23:44 AM
 Importance: Normal
 Subject: Supervisory Matrix
 Registered Representative Supervisory Matrix 9-1-2010.xlsx

Eric:

Tom explained to me that one of the items you discuss w/Bill Yancey when you meet with him on a quarterly basis is the Supervisory Matrix (per attached). I am just

291. The August 2010 supervisory matrix lists Johnson under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- Ex. 199 at pp. 2, 6

Employee Name	Category	Location	Position	Supervisor	Regulatory Supervisor
Chen, James (Thomas)	Person US	Dallas, Texas	Client Services	Steve Yancey	Bill Yancey
Smith, Charles (Case)	Person US	New York, New York	Customer Development - Manager	Steve Yancey	Bill Yancey
McBee, Robert	Person W/F	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
McDon, Bret	Person US	Dallas, Texas	Executive - HYP, CMO	Bill Yancey	Bill Yancey
Delaney, Thomas	Person US	Dallas, Texas	Compliance - Chief Compliance Officer	Bill Yancey	Bill Yancey
Kozlowski, Andy	Person US	Dallas, Texas	M&A - Senior Vice President, CMO	Bill Yancey	Bill Yancey
Kenny, John	Person US	Dallas, Texas	Operations - EVP, COO	Bill Yancey	Bill Yancey
Johnson, Michael	Person W/F	Dallas, Texas	Executive - SVP, Securities Lending	Bill Yancey	Bill Yancey
Morley, Alan	Person W/F	Dallas, Texas	Global Trading - Executive Analyst	Phil Pendergraft	Phil Pendergraft
Yancey, Charles (Bill)	Person US	Dallas, Texas	Executive - President/CEO	Phil Pendergraft	Phil Pendergraft
Engel, Bruce	Person W/F	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Scott, David	Person W/F	Dallas, Texas	Executive	Phil Pendergraft	Phil Pendergraft
Rabinow, Mark	Person Canada	Montreal, Canada	Executive, VP M&A	Phil Pendergraft	Phil Pendergraft
Amador, Richard	Person G/CO	Dallas, Texas	Executive, SVP	Don Miller	Phil Pendergraft

292. In November 2010, Miller e-mailed a copy of the supervisory matrix to Delaney. That supervisory matrix lists Johnson under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- Ex. 207 at pp. 1, 3

To: Tom Delaney[TDelaney@PENSON.COM]
 From: Kimberly Miller
 Sent: Tue 11/16/2010 11:41:19 AM
 Importance: Normal
 Subject: Supervisory Matrix
 Registered Representative Supervisory Matrix 11-1-2010.pdf

This should help...

Registration #	Company	Location	Supervisor	Supervisor	Supervisor
Registration #	Person WW	Dallas, Texas	CEO		
Yancey, Charles (Bill)	Person DS	Dallas, Texas	Insurance - Products/CPA/PPM	Bill Yancey	Bill Yancey
Good, Bruce	Person WW	Dallas, Texas	Global CFO - Executive Vice President	Bill Yancey	Bill Yancey
Blahouse, Mark	Person DS	San Francisco	Insurance - VP IT/IT	Bill Yancey	Bill Yancey
Amosder, Richard	Person DS	Dallas, Texas	Insurance - SVP	Kim Miller	Bill Yancey
Snyder, Eric	Person DS	Dallas, Texas	Global and Market Risk - Market Risk Analyst	Bill Yancey	Bill Yancey
Chao, Yancey (Thomas)	Person DS	Dallas, Texas	Client Services - Client Services Specialist	Bill Yancey	Bill Yancey
Yancey, Thomas	Person DS	Dallas, Texas	Insurance - SVP, CTR - Insurance Underwriter	Bill Yancey	Bill Yancey
Yancey, Robert	Person WW	Dallas, Texas	Global and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Scott, Lambert/Carol	Person DS	New York, New York	Insurance Development - Manager	Bill Yancey	Bill Yancey
McLain, Ben	Person DS	Dallas, Texas	Insurance - SVP, CTR	Bill Yancey	Bill Yancey
Johnson, Michael	Person WW	Dallas, Texas	Insurance - SVP, Securities Leading	Bill Yancey	Bill Yancey

293. It is important for a broker-dealer to be accurate in its communications with regulators, including documents provided to regulators.

- Yancey Testimony

Q And we can agree that especially for a broker-dealer, communications with regulators are important, correct?
 A Yes.
 Q And in communications with regulators, it's important to be accurate?
 A As possible.
 Q Accurate as possible?
 A Yes, sir.
 Q And you would personally expect Penson to be accurate in its communications with regulators?
 A Yes, sir.
 Q You would expect Penson to be honest in its communications with regulators?
 A Yes, sir.

(Hearing- Day 3, 881:5-881:19, Oct. 29, 2014)

Q But here we have a letter from Kim Miller in Compliance to FINRA. And I believe we agreed yesterday that your expectation is that communications from Penson to regulators should be accurate as best as they can, right?

A Yes, sir.

(Hearing- Day 4, 967:24-968:4, Oct. 30, 2014)

- Miller Testimony

Q Let me ask you generally: As a compliance officer, you knew it was important to be as accurate as possible in your communications with regulators, right?

A Yes.

Q You would never knowingly provide a regulator false information, right?

A Not intentionally, no.

Q You did your best to be sure that the documents that you sent were complete and accurate to the best of your knowledge, fair?

A Fair.

(Hearing- Day 11, 2619:7-2619:18, Nov. 10, 2014)

294. Regulators typically requested a copy of the PFSI supervisory matrix.

- Miller Testimony

Q Now, this is a document that you from time to time would use in responding to regulatory inquiries, is that correct, this matrix?

A Typically, the on-site examiners would ask for a copy of this so that they would – you know, it would assist them with their interview process.

(Hearing- Day 11, 2596:6-2596:11, Nov. 10, 2014)

295. Miller also sent regulators the PFSI supervisory matrix.

- Miller Testimony

Q So would you ever send this document to regulators?

A If it was requested.

Q Do you recall ever doing so?

A I'm sure I did at some point.

(Hearing- Day 11, 2596:12-2596:16, Nov. 10, 2014)

296. In September 2010, PFSI sent a regulatory response to FINRA, which was an important regulator of PFSI. In that response, PFSI instructed FINRA to reference the supervisory matrix for a “description of Person’s supervisory chain identifying each supervisor’s direct reports as well as the individual(s) to which each supervisor reports” for the time period May 2010 through August 2010. In the attached supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson’s regulatory supervisory and his “Pi Org Chart” supervisor. Johnson was not listed under Pendergraft.

- Ex. 201 at pp. 1, 4, 19

To: 'Sheridan, Ryan'[Ryan.Sheridan@finra.org]
From: Kimberly Miller
Sent: Wed 9/8/2010 3:20:14 PM
Importance: Normal
Subject: Trading Activity in Various Securities on Various Trade Dates
FINRA Response - Various Securities.pdf
Response.zip

Attached is Person's response to your inquiry dated August 26, 2010.

11. With respect to the period between May 1, 2010 and August 31, 2010, provide a description of Person's supervisory chain identifying each supervisor's direct reports as well as the individual(s) to which each supervisor reports. List the name and title of each individual.

Please refer to the attached Supervisory Matrix.

Supervisor Name	Company	Location	Department	Direct Reports	Supervisor
Yancey, Charles (Bill)	Person US	Dallas, Texas	Capital Markets - Product/CDO PPM	Phil Pendergraft	Phil Pendergraft
Egan, David	Person WW	Dallas, Texas	Chief CFO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Soo, Daniel	Person WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Person Canada	Montreal, Canada	Executives, VP PPM	Phil Pendergraft	Phil Pendergraft
Janzoch, Edward	Person GICU	Dallas, Texas	Finance, SVP	Kim Miller	Phil Pendergraft
Chen, Tianming (Thomas)	Person US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zlotoff	Bill Yancey
Hillary, Thomas	Person US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
Atcher, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Case)	Person US	New York, New York	Customer Development - Manager	Leah Carey	Bill Yancey
McLean, Ray	Person US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Yancey Testimony

Q Okay. Exhibit 201 is an e-mail from Kim Miller to Ryan Sheridan at FINRA. Do you see that?

A I see that.

...

Q Do you know who FINRA is?

A Sure.

Q What's FINRA?

A FINRA is a regulatory agency, an SRO.

Q Did they have some regulatory authority over Person Financial Services?

A Yes, they did.

Q Important regulator?

A Yes.

(Hearing- Day 4, 967:4-967:17, Oct. 30, 2014)

Q Now, Mr. Yancey, do you see your name on this matrix?

A I do.

Q All right. And do you see Mike Johnson's name listed underneath you?

A I do.
Q And the supervisors associated with Mr. Johnson in this matrix, it's you, right? Bill Yancey is listed as the regulatory supervisor?
A Yes, sir.
Q So we can agree that at least that is what Ms. Miller sent FINRA in response to their request for a description of Penson's supervisory chain identifying each supervisor's direct reports, correct?
A Yes, sir.

(Hearing- Day 4, 969:5-969:19, Oct. 30, 2014)

297. Delaney would expect that Kim Miller's submission to FINRA would contain the most accurate, complete and up-to-date information available.

- Delaney Testimony

Q Okay. Would you look please at Exhibit 201. And Exhibit 201 is an e-mail from Kim Miller to Ryan Sheridan at FINRA.org dated September 8th, 2010. And she is attaching a -- she says, "Attached is Penson's response to your inquiry dated August 26th, 2010." Do you see where I'm reading?
A Yes, ma'am.
Q Okay. And as a general matter, you would expect when the people who are working for you, when they're sending stuff to FINRA, who is one of Penson's regulatory organizations, has regulatory oversight over Penson, you would expect what they send to be correct; isn't that right?
A Certainly to the best of their abilities.
Q Sure. And you would expect them to seek out the most accurate, complete and up-to-date information available; is that right?
A That was the specific purpose of creating that division within the Compliance department to liaise with the regulators so that we could -- we could accomplish just that, yes.

(Hearing- Day 3, 667:23-668:18, Oct. 29, 2014)

298. By looking at the September 2010 supervisory matrix, FINRA would conclude that Yancey was Johnson's supervisor.

- Miller Testimony

Q And so you would agree with me that, just by looking at this document, FINRA would conclude that Bill Yancey was Mike Johnson's supervisor, fair? ...
A I would think that that's what they would think, yes.

(Hearing- Day 11, 2621:25-2622:6, Nov. 10, 2014)

- Hasty Testimony

Q Look at Exhibit 201. So Exhibit 201 is an e-mail from Kim Miller to Ryan Sheridan at FINRA. And it was Ms. Miller's job to provide to the regulators the information that they were looking for, right?

A Yes.

Q And she was to provide them with the most complete, accurate information that was available; isn't that correct?

A Yes.

Q So if you would look at the fourth page of the letter. The letter says 3 and 4, No. 11, it says: With respect to the period between May 1st, 2010 and August 31st, 2010, provide a description of Penson's supervisory chain, identifying each supervisor's direct reports as well as the individuals to which each supervisor reports. List the name and title of each individual. And you would expect Ms. Miller to provide that information to the FINRA examiner; isn't that right?

A Yes.

Q What's she -- what is her answer there?

A Please refer to the attached supervisory matrix.

Q Okay. And let me ask you to look at the attached supervisory matrix, which is Bates stamp 0261. Let me ask you to look at the top two sections there. You will see a section for Bill Yancey, CEO, Penson Financial. Do you see Michael Johnson's name under there?

A Yes.

Q And if you go across, it says Pi org chart. Do you see the column that says Pi org chart?

A Yes.

Q It says Pi org chart, Bill Yancey, it says regulatory supervisor, Bill Yancey. Do you see that?

A Yes.

Q And then if you look at the -- at Mr. Pendergraft's section. Do you see?

A It's cut off on my screen a little bit, too. I can only see the first column. I'm sorry. Say your question again.

Q Do you see Mr. Pendergraft's section?

A Yes.

Q Do you see Michael Johnson under that section?

A I do not.

Q You would agree with me that looking at this, a regulator would believe that Mr. Yancey is Mr. Johnson's supervisor; isn't that correct?

A Yes.

(Hearing- Day 7, 1785:12-1787:12, Nov. 4, 2014)

- Poppalardo Testimony

Q So from at least May 31st, 2010 through November 2010, at least for that period of time, you would agree with me that Penson is telling the regulators that -- that Mr. Yancey is Mr. Johnson's supervisor?

A Yes.

(Hearing- Day 8, 2015:1-2015:6, Nov. 5, 2014)

299. In September 2010, PFSI sent a copy of the supervisory matrix to an examiner at the National Stock Exchange. In that supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- Ex. 200 at pp. 1, 672

To: Thomas.Bartos@nsx.com[Thomas.Bartos@nsx.com]
From: Kimberly Miller
Sent: Fri 9/3/2010 4:30:24 PM
Importance: Normal
Subject: NSX Correspondence Examination
 National Stock Exchange - ETP Holder Performance Review.zip
 NSX Examination Response FINAL.pdf

Employee Name	Company	Location	Department	Pi Org Chart	Regulatory Supervisor
Pendergraft, Phil	Peason WW	Dallas, Texas	CEO		
<i>Phil Pendergraft - CEO/Peason Worldwide</i>					
Yancey, Charles (Bill)	Peason US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Peason WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Son, Daniel	Peason WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Peason Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Anspacher, Richard	Peason GHCC	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
<i>Bill Yancey - President/CEO Peason Financial</i>					
Chao, Tanning (Thomas)	Peason US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Peason US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Peason WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Peason US	New York, New York	Customer Development - Manager	Liynd Carey	Bill Yancey
McCain, Bart	Peason US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Peason WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

300. In October 2010, PFSI sent FINRA a copy of the supervisory matrix. In that supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- Ex. 202 at pp. 1, 430

To: 'Ng, Kai'[Kai.Ng@finra.org]; Holly Hasty[HHasty@PENSON.COM]
Cc: 'lkwild, Francine'[Francine.lkwild@finra.org]; 'McCluskey, Patrick'[Patrick.McCluskey@finra.org]; 'Martuscello, Christine'[Christine.Martuscello@finra.org]; 'Sit, Jason'[Jason.Sit@finra.org]
From: Kimberly Miller
Sent: Mon 10/11/2010 4:34:27 PM
Importance: Normal
Subject: RE: FINRA Matter ID: 20100219467 (NYSE Amex, BOX, PHLX, BATS)Penson Financial Services, Inc.
WSP Matrix and Documents.zip

Attached is Penson's completed WSP Matrix and attachments for our upcoming Option Exam. Please feel free to contact me w/any questions.

Employee Name	Company	Office/Location	Department	Supervisor	Regulatory Supervisor
Pendergraft, Paul	Penson W/W	Dallas, Texas	CEO		
Yancey, Charles (Dad)	Penson US	Dallas, Texas	Executive - President/CEO PFSI	Paul Pendergraft	Paul Pendergraft
Irwin, Bruce	Penson W/W	Dallas, Texas	Global COO - Executive Vice President	Paul Pendergraft	Paul Pendergraft
Son, Daniel	Penson W/W	Dallas, Texas	Executive	Paul Pendergraft	Paul Pendergraft
Robinson, Mark	Penson Canada	Montreal, Canada	Executive, VP PFSI	Paul Pendergraft	Paul Pendergraft
Azapich, Richard	Penson G/HCO	Dallas, Texas	Finance, SVP	Ben Miller	Paul Pendergraft

Employee Name	Company	Office/Location	Department	Supervisor	Regulatory Supervisor
Pendergraft, Paul	Penson W/W	Dallas, Texas	CEO		
Yancey, Charles (Dad)	Penson US	Dallas, Texas	Executive - President/CEO PFSI	Paul Pendergraft	Paul Pendergraft
Irwin, Bruce	Penson W/W	Dallas, Texas	Global COO - Executive Vice President	Paul Pendergraft	Paul Pendergraft
Son, Daniel	Penson W/W	Dallas, Texas	Executive	Paul Pendergraft	Paul Pendergraft
Robinson, Mark	Penson Canada	Montreal, Canada	Executive, VP PFSI	Paul Pendergraft	Paul Pendergraft
Azapich, Richard	Penson G/HCO	Dallas, Texas	Finance, SVP	Ben Miller	Paul Pendergraft

Employee Name	Company	Office/Location	Department	Supervisor	Regulatory Supervisor
Chao, Tuning (Theresa)	Penson US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zimm	Bill Yancey
Hilary, Thomas	Penson US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBee, Robert	Penson W/W	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Saura, Charles (Cass)	Penson US	New York, New York	Customer Development - Manager	Leonal Casey	Bill Yancey
McCain, Bart	Penson US	Dallas, Texas	Executive - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Penson W/W	Dallas, Texas	Executive - SVP, Securities Lending	Bill Yancey	Bill Yancey

301. In November 2010, PFSI sent the Chicago Board of Options Exchange ("CBOE"), which is one of the primary options exchanges in the United States, a response to a CBOE inquiry which included a copy of the supervisory matrix. In that supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- Ex. 205 at pp. 1, 15

To: 'Samardzija, Tanja[samardzija@cboe.com]; Kimberly Miller[kmiller@PENSON.COM]
From: Holly Hasty
Sent: Mon 11/1/2010 4:24:01 PM
Importance: Normal
Subject: RE: CBOE Sponsored Access Exam - Exam-In-Progress Report
Progress Report Reponse Letter FINAL.pdf
Person Progress Report Response Documents.zip

Tanja,

Please find attached the Firm's response to the Progress Report. We have one outstanding item that I expect to have the data for by no later than Thursday. All other items have been provided. If you have any questions, please let me know.

Employee Name	Company	Location	Department	CP Org Chart	Regulatory Supervisor
Pendergraft, Phil	Person WW	Dallas, Texas	CEO		
	<i>Phil Pendergraft - CEO Person Worldwide</i>				
Yancey, Charles (Bill)	Person US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Exgel, Bryce	Person WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Sen, Daniel	Person WW	Dallas, Texas	Executives	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Person Canada	Montreal Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Aaspaecher, Richard	Person GHCO	Dallas, Texas	Futures, SVP	Ben Miller	Phil Pendergraft
	<i>Bill Yancey - President/CEO Person Financial</i>				
Chao, Taming (Thomas)	Person US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Delaney, Thomas	Person US	Dallas, Texas	Compliance - SVP, Chief Compliance Officer	Bill Yancey	Bill Yancey
McBey, Robert	Person WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Person US	New York, New York	Customer Development - Manager	Lyzal Carcy	Bill Yancey
McCain, Bart	Person US	Dallas, Texas	Executives - EYP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Person WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

- Yancey Testimony

Q Do you know what CBOE is?
A I do.
Q What is CBOE?
A Chicago Board of Options Exchange.
Q And what is the Chicago Board of Options Exchange?
A It's -- it's one of the primary options exchanges in the United States.

(Hearing- Day 4, 972:2-972:9, Oct. 30, 2014)

302. By looking at the November 2010 supervisory matrix, CBOE would conclude that Yancey was Johnson's supervisor.

- Hasty Testimony

Q Let's look at Exhibit 205. Exhibit 205, the top e-mail, that's from you; is that correct?
A Yes.
Q And what is it to?
A Tanja Samardzija. Sorry, that was a terrible pronunciation.

Q It's S-A-M-A-R-D-Z-I-J-A. And where does that person work?
A CBOE.
Q And what's CBOE?
A The Chicago Board Options Exchange.
Q And that's one of Penson's regulators; isn't that right?
A Yes.
Q And you send some documents along with your e-mail; is that correct?
A Yes.
Q Let look at the document that's labeled Bates number ending 8304, PFSI 1528304. And do you recognize this as the supervisory matrix that we've been discussing?
A I do.
Q And this is the document that you sent to the Chicago Board of Options Exchange?
A I did.
Q And if you look at the section that is under Mr. Yancey's name --
A It is cut off on mine.
Q We can get you a paper copy.
A That's fine. I just wanted you to know I was going to turn my head. Yes.
Q So you Mr. Yancey's section?
A Yes.
Q Do you see Michael Johnson there?
A Yes.
Q And if you read across that row that Mr. Johnson is in, what does it say under Pi org chart?
A Bill Yancey.
Q And what does it say under regulatory supervisor?
A Bill Yancey.
Q Do you see the section that belongs to Mr. Pendergraft?
A Yes.
Q And do you see Mr. Johnson anywhere under that section?
A No.
Q So you would agree with me that the Chicago Board of Options Exchange receiving this document would understand that Mr. Yancey was Mr. Johnson's supervisor; isn't that true?
A Yes.

(Hearing- Day 7, 1787:13-1789:14, Nov. 4, 2014)

303. In April 2011, PFSI sent a response to a CBOE inquiry. In that response, PFSI instructed FINRA to reference the supervisory matrix for a description of "regulatory supervisors." In the attached supervisory matrix, Johnson was listed under Yancey, and Yancey was designated as both Johnson's regulatory supervisory and his "Pi Org Chart" supervisor. Johnson was not listed under Pendergraft.

- Ex. 175 at pp. 9, 10, 12

From: Kimberly Miller <kmiller@PENSON.COM>
Sent: Wednesday, April 20, 2011 8:33 AM
To: 'dallymonitoring@cboe.com'
Subject: Penson Financial Services, Inc. - Associated Persons Exam Sweep
Attachments: CBOE Response 4-20-11.pdf; Registered Representative Supervisory Matrix 4-2011.xlsx

Attached is Penson's response to your 4/7 inquiry.

Please refer to the attached spreadsheet which outlines individual firm registrations and their regulatory supervisors. Employees in the Proprietary Trading and Agency Trading

Employee Name	Company	Location	Department	PI Org Chart	Regulatory Supervisor
Pendergraft, Phil	Penson WW	Dallas, Texas	CRO		
<i>Phil Pendergraft - CEO Penson Worldwide</i>					
Yancey, Charles (Bill)	Penson US	Dallas, Texas	Executives - President/CEO PFSI	Phil Pendergraft	Phil Pendergraft
Engel, Bryce	Penson WW	Dallas, Texas	Global CIO - Executive Vice President	Phil Pendergraft	Phil Pendergraft
Robinson, Mark	Penson Canada	Montreal, Canada	Executives, VP PFSC	Phil Pendergraft	Phil Pendergraft
Auspacher, Richard	Penson GHCQ	Dallas, Texas	Finance, SVP	Ben Miller	Phil Pendergraft
Nonchev, Kalin	Penson US	Dallas, Texas	Credit and Market Risk - Market Risk Analyst	Robert Crain	Phil Pendergraft
<i>Bill Yancey - President/CEO Penson Financial</i>					
Chao, Taming (Thomas)	Penson US	Dallas, Texas	Client Services - Client Services Specialist	Steve Zhang	Bill Yancey
Hasty, Holly	Penson US	Dallas, Texas	Compliance - VP Chief Compliance Officer	Tom Delaney	Tom Delaney
McBey, Robert	Penson WW	Dallas, Texas	Credit and Market Risk - Senior Vice President	Bill Yancey	Bill Yancey
Smith, Charles (Cass)	Penson US	New York, New York	Customer Development - Manager	Llynn Carey	Bill Yancey
McCain, Bart	Penson US	Dallas, Texas	Executives - EVP, CAO	Bill Yancey	Bill Yancey
Johnson, Michael	Penson WW	Dallas, Texas	Executives - SVP, Securities Lending	Bill Yancey	Bill Yancey

iv. Johnson was Unsupervised with Respect to Regulatory and Compliance Issues.

304. After August 2008, Yancey did not exercise any supervision over Johnson or PFSI's Stock Loan department.

- Yancey Testimony

Q Okay. And after that time -- just to be sure the record's clear, after August of 2008, as a practical matter, you did not supervise Mike Johnson?

A Correct.

Q And you did not supervise the Stock Lending group at PFSI?

A Because it was fully supervised by Phil Pendergraft.

(Hearing- Day 4, 951:9-951:16, Oct. 30, 2014)

- De La Sierra Testimony

Q Mr. De La Sierra, I want to talk now for a minute about the interactions that you observed between Mr. Yancey and Penson Financial's Stock Lending. Did you observe interactions there?

A Not much, no.

Q What do you mean by "not much"?

A I mean Bill would come by, you know, personally and say, "Hello" and "How are

things going?" But, you know, checking in on how the business was doing, no.

Q You did not observe him checking on how the business was doing?

A No

(Hearing- Day 1, 220:15-221:1, Oct. 27, 2014)

- Johnson Testimony

Q All right. I want to talk now about your interaction, involvement with -- with Bill Yancey, Mr. Yancey. Once you became head of Global Stock Lending, describe your interactions, if any, with Mr. Yancey.

A I think limited.

(Hearing- Day 2, 529:19-529:23, Oct. 28, 2014)

Q And if I could ask you, who -- how often do you think Mr. Yancey stopped by to ask about Stock Loan issues?

A Infrequently.

(Hearing- Day 2, 530:8-530:11, Oct. 28, 2014)

305. Yancey asked Johnson not to attend his weekly meetings once Johnson was promoted to Senior Vice President.

- Johnson Testimony

Q Were you involved in meetings with Mr. Yancey after that time?

A No. No. I was not in -- I was asked not to attend the morning meetings once I went to Global; however, Bill would stop by my office when he had Stock Loan issues and ask me whatever those questions were.

Q Who is it that asked you not to attend the Monday morning meetings?

A Mr. Yancey.

(Hearing- Day 2, 529:24-530:7, Oct. 28, 2014)

306. Delaney was frustrated that Johnson did not attend the March 31, 2010 meeting with Yancey at which Rule 204 compliance was discussed, because "it was a step that [he] was taking above and beyond [his] role as the Chief Compliance Officer to try and facilitate some supervision discussion around what was happening at that time."

- Delaney Testimony

Q And at your third testimony, you said -- you were asked these questions and you gave these answers:

"This is the meeting in response to the December 2009?"

"Yeah."

"So there was the original --"

Answer: "Yeah, there was the original meeting that we had -- Eric and I had with Bill. And then in the spring of 2009, we had this larger --"

Question: "2010?"

Answer: "Oh, or -- I'm sorry. You're right. 2010. We had this larger -- this larger meeting with everyone, everybody there."

Question: "And all of this is in response to Alaniz's December 2009 3012 audit?"

Answer: "Yes, sir."

Question: "Of Rule 204?"

Answer: "Yes, sir."

Question: "Okay."

Answer: "So, interestingly, in that meeting though --"

Question: "The March?"

Answer: "The March 2009 larger meeting."

Question: "2010?"

Answer: "I'm sorry. Thank you. March 2010 larger meeting. Mike Johnson wasn't there, and I remember thinking that to be -- that to be somewhat" -- it says somewhere -- "to be somewhere remarkable that we're holding a larger meeting and that he wasn't there. I recall either Rudy or Brian being there. They weren't very participative in the meeting. So there -- so there was -- I recall it being remarkable and, frankly, frustrating that we had put this meeting together and Mike Johnson wasn't there, but that the purpose of what that meeting was to make sure that while it wasn't necessarily my job as the Chief Compliance Officer, it was a step that I was taking above and beyond my role as the Chief Compliance Officer to try and facilitate some supervision discussion around what was happening at that time."

Do you remember giving that testimony?

A I remember giving testimony.

(Hearing- Day 5, 1379:24-1381:15, Oct. 31, 2014)

307. PFSI disclosed to FINRA in March 2011 that it was violating Rule 204 by not closing out until the afternoon of T+6.

- Ex. 89 at pp. 31-32

13. Exception

The Firm was not compliance with Regulation SHO SEC Rule 204 (Close-Out Requirement) and NASD Conduct Rule 3010 (Supervision).

With regards to the timing of long-sale closeouts, the Firm does not believe it is industry practice to close out long sales prior to the market open on T+6. Not once has the Firm ever had a borrow closed out by a lending counterparty at the open. Conversely, the Firm's borrowing counterparties will not accept a closeout price on a stock loan at the market open. Thus, the Firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced. Closing out loans at the market open would put the Firm at a competitive disadvantage and ultimately hinder the Firm's ability to cover its customers' delivery obligations.

308. Even though PFSI disclosed to FINRA in March 2011 that it was violating Rule 204 by not closing out until the afternoon of T+6, and even though that sort of information was information Yancey expected should have been brought to his attention, Yancey did not learn of that practice until long after March 2011.

- Yancey Testimony

Q Okay. Okay. So sometime in the last quarter of 2011, you learned generally that there may be a conflict between industry practice for closing out loans and Rule 204?

A Yes, generally.

Q Okay. Now, Mr. Yancey, whether -- well, let me take a step back. When you learned that, did you know that in fact, Penson Financial Services was choosing to follow industry practice rather than the law?

A No, sir.

(Hearing- Day 4, 940:9-940:19, Oct. 30, 2014)

I think what you said is that you did not learn about this at the time in March of 2011; is that right?

A Yes.

Q The first time you learned about it, I think you said was long after that, right? A I believe so.

...

Q Sure. Let me ask you this. We can agree it was long after March 2011? A Yes.

(Hearing- Day 7, 1923:17-1924:12, Nov. 4, 2014)

Q So the question here reads the same language. You-all are speaking about Exhibit 89. It says: To continue that paragraph, not once has the firm ever borrowed -- ever had a borrower closed out by lending -- by a lending counterparty. Conversely, the firm's borrowing counterparties will not accept a closeout price on a stock loan after market open. Thus, the firm executes closeouts versus long sales at the conclusion of the DTCC trading window at approximately 3:00 EST daily, as is universally practiced. Closing out loans at the market open would put the firm at a competitive disadvantage, and ultimately hinder the firm's ability to cover its customers' delivery obligations. Do you see that?

Answer: Yes.

Question: Did you understand in March 2011 that Penson saw a conflict between industry practice and the requirements of Rule 204 and chose to follow industry practice?

Answer: I really didn't.

Question: Is this something you would have expected to be brought to your attention?

Answer: Yes.

Did I read that correctly, Mr. Yancey?

A You did.

(Hearing- Day 7, 1925:21-1926:20, Nov. 4, 2014)

309. Pendergraft's primary interactions with Johnson and PFSI Stock Loan were with respect to financing issues.

- De La Sierra Testimony

Q Mr. De La Sierra, did you observe any interactions between Mike Johnson and Phil Pendergraft?

A Yes, I did.

Q Describe those interactions for us. What did you see them interacting about?

A If Phil came over, it would typically be about financing.

Q Anything else that you saw Mr. Johnson and Mr. Pendergraft interact about? A

I mean, I know that they interacted about compensation, but I didn't -- you know, I wasn't involved in those.

Q Compensation for you and members of your team?

A Correct.

(Hearing- Day 1, 219:15-220:14, Oct. 27, 2014)

Q Okay. He would come by your area, meaning PFSI's Stock Loan?

A Correct. Phil Pendergraft would come by to our Stock Loan area.

Q Okay. How often would you say?

A It depended on the financing need, but maybe a couple times a month.

...

A It wasn't regular. You know, he didn't have a, you know, weekly stop by. So I can't really put a number on it, but --

Q Would you say that this occurred, though, throughout the time period of 2008 through 2011?

A Yes.

Q Okay. Who would he talk with when he stopped by?

A Primarily Mike Johnson.

Q Okay. Would he talk with anyone else?

A Myself or Brian Hall.

Q What would he talk to you about?

A If Mike wasn't there, generally speaking, any conversation I had with Phil was going to be about financing.

(Hearing- Day 1, 284:9-285:12, Oct. 27, 2014)

Q Okay. What kind of questions would he ask?

A Just what was -- what was our liquidity; could we generate 50 million, 80 million; how long terms of the -- the trades.

Q Okay. Anything else?

A No.

(Hearing- Day 1, 285:20-285:25, Oct. 27, 2014)

Q Okay. Would Mr. Johnson ever tell you Phil's on my case about this or that?

A Yes.

Q And -- and what did he say?

A Just, Phil was always asking him about the financing and conduit, and the conduit was in New York, the New York group.

(Hearing- Day 1, 288:9-288:15, Oct. 27, 2014)

- Yancey Testimony

Q And Mr. Pendergraft testified that he also had monthly business review meetings or MBRs.

A Yes.

Q And did Mr. Johnson make presentations in those MBRs?

A He did.

Q And did you have occasion to know about his presentations of those MBRs?

A I generally did not stay for his presentations at the MBR.

Q What did you hear about them?

A That they were -- they discussed all aspects of the business, including PFSI correspondent communications or PFSI challenges. But mostly about the financial reporting that would go on and he would give financial reports, is my understanding, to Phil about, you know, all of the -- all of the individual operating companies for which he had a role.

(Hearing- Day 7, 1861:3-1861:20, Nov. 4, 2014)

310. In his 12 years working at PFSI and Penson Worldwide, Johnson received only one review, and it was prior to 2008.

- Johnson Testimony

When you transitioned and became the head of Global Stock Lending, did you receive any employee reviews?

A I worked at Penson for 12 years, I think, and I had one review.

Q And do you recall approximately when that review was, sir?

A Before 2008.

(Hearing- Day 2, 526:13-526:20, Oct. 28, 2014)

311. Johnson was not generally kept in the loop on Penson matters.

- Johnson Testimony

Q Okay. Were you generally kept in the loop on decisions that Penson was making?

A No.

Q Is there any example of that?

A Yes.

Q Could you describe those, please.

A One good example was the -- the merger or acquisition of Broad Ridge. There were probably 80 people involved with that, and I was never told about it as a senior VP in the holding company or a part of it. The day before that was announced, on a Sunday, Dan Son came to my house and told me about it. I was never in the loop with anything related to Penson matters.

(Hearing- Day 2, 527:2-527:14, Oct. 28, 2014)

312. No one at PFSI supervised Johnson or the PFSI Stock Lending department with respect to regulatory or compliance issues.

- De La Sierra Testimony

Q Did you observe interactions between Mr. Johnson and Mr. Pendergraft on operational issues?

A No.

Q How about compliance issues?

A No.

Q Did you observe interactions between Mr. Johnson and Mr. Pendergraft with respect to anything regarding Reg SHO?

A No.

Q How about Rule 204?

A No.

(Hearing- Day 1, 219:15-220:14, Oct. 27, 2014)

Q Did you observe Mr. Yancey checking in on any operational issues of PFSI's Stock Lending?

A No.

Q Did you observe Mr. Yancey checking in on any compliance issues with PFSI's Stock Lending?

A No.

Q Anything specific to Reg SHO?

A No.

Q Anything specific to Rule 204?

A No.

(Hearing- Day 1, 221:2-221:11, Oct. 27, 2014)

313. After Johnson was transitioned to Senior Vice President for Global Securities Lending, PFSI Stock Loan was essentially left alone from an oversight perspective.

- Johnson Testimony

Let me ask you -- let me ask it this way: Do you recall the time when you transitioned from being a Penson Financial Services employee to a Penson Worldwide employee? Do you generally remember that?

A Yes.

Q And describe for me, once that transition happened, the level of guidance or oversight that others at Penson gave to the Stock Lending function at Penson Financial Services.

A I think that Stock Loan was left alone from -- just left alone, and that when executives or other individuals needed questions and answers on whatever subject matter that fell into Stock Loan, they would ask them.

(Hearing- Day 2, 525:23-526:11, Oct. 28, 2014)

314. PFSI Stock Loan was unsupervised; the department had to "run on the fly and make it."

- Johnson Testimony

Q And do you recall in that testimony saying something to the effect of, with respect to Penson Financial Services Stock Loan department, that there was no supervision, so you had to run on the fly and make it?

A I -- I -- I've never seen my transcript, so I don't know what I said.

Q All right. Let me ask you, does that sound like an accurate description?

A Of?

Q Of the supervision of the Stock Lending department.

A Yes.

(Hearing- Day 2, 530:18-531:4, Oct. 28, 2014)

315. Prior to the time that Rule 204T was implemented, Mike Johnson requested a compliance person be assigned to the Stock Loan desk to assist with compliance issues. That individual left before Rule 204T was implemented, and was not replaced. Although several compliance personnel sat near the Stock Loan department, they were there because of space issues and did not provide compliance-related guidance to Stock Loan.

- De La Sierra Testimony

Q ... I want to talk now about interaction with the Compliance department and Stock Lending at PFSI to the extent you observed it.

Q So was there any point in time where compliance was involved and embedded with Penson Financial Stock Lending?

A Yes.

Q Tell us about that.

A We had a -- Nick Russell worked for us in a compliance type role.

Q What do you mean "in a compliance type role"? What did Mr. Russell do? A Well, Mike wanted -- Mike Johnson wanted a compliance person. He came from compliance. He wanted that person on the desk. This was shortly before the naked short rule, and Nick's role was handling that for us. He monitored the spreadsheets and maintained those for the department to make sure that we were covering short sales that we approved on that day since we now had to pre-borrow for those securities.

Q And you said Mr. Russell came on board shortly before the naked short rule. Do you recall approximately when that was?

A 2007 possibly, -6 maybe.

Q Okay. Do you recall -- well, let me ask it this way: Did Mr. Russell stay on Stock Lending's desk?

A He did not.

Q Do you recall when he left?

A I don't know exactly when. He wasn't there when this -- when 204T went into place, he was no longer with the department -- or with the firm.

Q So Mr. Russell left Penson Financial's Stock Lending department before Rule 204T came out; is that right?

A Correct.

Q Was Mr. Russell replaced?

A He was not.

Q Was there ever a point where personnel from Compliance sat near Stock Lending at Penson Financial Services?

A Yes.

Q Describe that for us.

A We had -- the room setup?

Q Yes, sir.

A Okay. So on a -- one side of our room, Mike had his office. He had a sliding window and a door, so that was typically open. I was next to Mike. Next to my left was Brian Hall. We faced Lindsey Wetzig, Terry Ray, Dawnia Robertson, Marc McCain, Logan. Those are the operations. And then behind them was our two programmers, Matt Battaini and Dave Chen, and Dave faced the three compliance people that were in our group or in our area, I should say.

Q And who were those three compliance people?

A Holly Hasty, Kim Miller and Aaron McInerney.

Q Do you know why Ms. Hasty, Ms. Miller and -- is it Ms. McInerney?

A Mr.

Q -- Mr. McInerney sat near Stock Lending?

A I was told space.

Q *Were they there for the same reason that Mr. Russell was there?*

A *No.*

Q *Did you routinely interact with the three people you named in terms of compliance issues?*

A *No.*

Q *Did they routinely provide any sort of guidance on operational issues in Stock Lending?*

A *No.*

(Hearing- Day 1, 222:2-224:22, Oct. 27, 2014)

IV. THE DIVISION SEEKS REMEDIES AGAINST RESPONDENTS

316. Yancey currently worked in the broker-dealer industry as the managing director of clearing and execution services. He continues to supervise staff.

- Yancey Testimony

Q All right. Mr. Yancey, do you currently still work in the broker-dealer industry?

A Yes, I do.

Q What's your position? Generally, what do you do in the industry?

A Clearing and execution services.

Q And do you have a title?

A Managing director.

Q Managing director.

Do you supervise anyone?

A Two salespeople.

(Hearing- Day 4, 985:22-986:7, Oct. 30, 2014)

317. PFSI's overall annual revenue was approximately \$200 million to \$250 million during the relevant time period.

- Yancey Testimony

A I think that's a mistake. I think I -- I have a better recollection now. I think the firm -

Q Go ahead.

A It -- I think the firm earned about \$200 million in revenue annually, I believe. And I think then, therefore, that it was great -- it was substantially higher than this amount.

(Hearing- Day 4, 981:12-981:18, Oct. 30, 2014)

- McCain Testimony

Q I'm sorry. My question was really about what's the total annual revenue of PFSI? We can talk in a bit about the relationship to PWI.

A Total revenue for PFSI was 240, 250, 250 million a year.

(Hearing- Day 9, 2164:9-2164:13, Nov. 6, 2014)

318. PFSI Stock Loan's annual revenue was approximately in the range of \$20 million to \$25 million during the relevant time period, or approximately 10% of PFSI's total annual revenues.

- Ex. 239 at p.15 ¶ 49

lending client shares are often a significant source of their business revenues. The Penson Stock Loan Department generated average monthly revenues of \$1.94 million, or approximately \$23.3 million per year, during the period October 2008 to April 2012.³

- McCain Testimony

Q Okay. What was the percentage of PFSI revenue that was made up of Stock Loan or Stock Loan revenue?

A That's a hard question. My best recollection on that is that it was -- it varied from 7 to 10 percent.

(Hearing- Day 9, 2164:19-2164:24, Nov. 6, 2014)

319. Bonuses were calculated based on three components: performance of Penson Worldwide, the overall corporate entity; performance of PFSI; and Yancey's personal goals.

- Yancey Testimony

Q Okay. Did you receive any bonuses when you were CEO at Penson Financial Services?

A At times.

Q Do you recall generally how the bonuses were calculated?

A Bonuses were calculated, sort of, in three ways.

Q Okay. And what were those ways?

A Corporate performance, how the whole company did in its entirety, and then operating company performance, and then personal goals and objectives.

Q So those first two, do I understand right the first is Penson Worldwide's profitability, right?

A That's right.

Q And when you say the "operating company," that's PFSI's profitability?

A Yes.

320. From 2008 through 2010, Yancey earned bonuses totaling between approximately \$300,000 to \$1.2 million dollars.

- Yancey Testimony

Q In 2008, am I right that your bonus was somewhere greater than 100,000 and less than 500,000? Does that sound right?

A It's been six years. I think so.

Q If it would be helpful just to refresh your recollection, Mr. Yancey, if you want to look at your investigative testimony. And this will start on Page 29.

A Okay.

Q And I'm going to try to do this logically. I am looking at Line 10: "Question: Did you receive any cash bonuses in 2008?"

"Answer: Generally" -- excuse me. "I believe so."

"Question: Generally how much were those bonuses?"

"Answer: I don't recall."

"Question: Less than a million dollars?"

"Yes."

"Less than \$500,000?"

"Yes."

"More than \$100,000?"

"I think so."

Does that refresh your recollection that the bonus would have been from -- a range from somewhere more than 100,000 to less than 500,000?

A Probably in that range.

...

Q How about 2009. Is that still the same range, somewhere between 100,000 and 500,000?

A I just don't have a clear recollection at all.

Q Let's again, take a look just to see if this helps, Mr. Yancey. If you turn back one page, starting at the bottom of Page 28, Line 24.

"Question: Can you ballpark your 2009 bonus for me?"

"Answer: I can't."

"Question: More than a million dollars?"

"No."

"More than \$500,000?"

"No."

"More than \$100,000?"

"I think so."

Does that refresh your recollection that it was likely somewhere in the range of 100- to \$500,000?

A Yes, I think probably in that range.

Q Okay. And then again, since you've got the document in front of you, I think I'm doing this in the reverse order of your testimony. I apologize.

On Page 27, starting at Line 3, you were asked -- or excuse me. Your answer is:

"2011? No. 2010, yes, I think so."

"Question: So somewhere between 100 and 500 in 2010?"

Your answer was, "Probably between one and two, I would estimate." Does that help refresh your recollection that in 2010, your bonus was between 100 and 200,000?

A I don't recall, to be very honest. Perhaps.

(Hearing- Day 4, 983:8-985:18, Oct. 30, 2014)

Q ... [T]his investigative testimony that you gave, this was back in, like, I believe it's 20- -- January 2013, a little more than a year ago.

A Almost two.

Q A lot -- a lot more than a year ago. And your memory was better in time back then than it is now. Fair?

A Yes, sir.

(Hearing- Day 4, 980:11-980:19, Oct. 30, 2014)

321. From 2008 through 2011, Delaney earned bonuses totaling approximately \$40,000 dollars.

- Exhibit 224 (Delaney Investigative Testimony) at p. 12 – 13

Q So the \$20,000 figure just below the \$50,000 figure on Exhibit 77, page three, that was the annual salary, the annual bonus that Penson paid to you for fiscal year 2010. Is that right?

A I think that's correct.

Q And the line below that, another approximately \$20,000, was that for fiscal year 2009?

A Correct.

(Delaney, Tom- INV vol I, 12:21-13:3, Apr. 4, 2012)

322. While Delaney claimed he was no longer acting as a Chief Compliance Officer, his current employer testified that he is currently serving in that position.

- Delaney Testimony

Q Okay. Were you at one point the Chief Compliance Officer?

A I was.

Q When did that change?

A In June of this past year.

Q And do you have an understanding of why?

A I do.

Q What's that understanding?

A When -- when I received my Wells letter, that becomes a disclosure issue on your -- on your Form U4. And once I had disclosed it, or in advance of the disclosing of that, I had a conversation with the management and leadership team at First Command. And

we agreed that in order to -- which it would not just have been a personal disclosure, but as a Chief Compliance Officer, it also would have been a disclosure for First Command. And we -- we decided that it was best that I step down as the Chief Compliance Officer.

Q Okay. Who's -- who's your supervisor there at First Command?

A Hugh Simpson.

(Hearing- Day 5, 1212:20-1213:15, Oct. 31, 2014)

- Simpson Testimony

Q Thank you. In your current position at First Command, as the general counsel, do you lead the legal and compliance group?

A Yes, I do.

Q Presently how large is that group?

A It's 29 persons including myself. It includes the legal team, the compliance team, and also our internal audit team.

Q Do you know Tom Delaney, sitting here in the courtroom today?

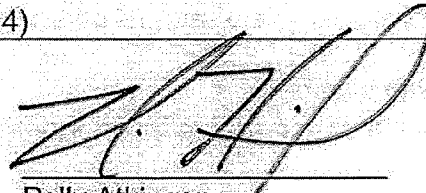
A Yes, I do.

Q And how do you know Tom?

A Tom serves as the chief compliance officer of our holding company. He joined us in early 2011 to assume that role, and of course I've known him through the recruiting process and ever since.

(Hearing- Day 6, 1447:9-1447:24, Nov. 3, 2014)

DATED: December 19, 2014.



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