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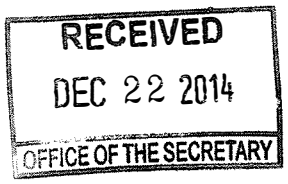
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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 BRIEF IN SUPPORT
OF ITS FINDINGS OF FACT AND
CONCLUSIONS OF LAW

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I. INTRODUCTION

For nearly three years, the Stock Loan department at Penson Financial Services, Inc. ("PFSI") violated Rule 204 each and every day. Respondent Tom Delaney, PFSI's Chief Compliance Officer ("CCO"), was aware of the violations, or at the very least recklessly disregarded them. But he failed to bring the violations to the attention of his superiors or PFSI's regulators, and indeed made misrepresentations to regulators, even though they were asking specific questions about the Rule. This is serious misconduct: "deliberate deception of regulatory authorities justifies the severest of sanctions." *Gary M. Kornman,* Rel. No. 34-59403 (Feb. 13, 2009) (Commission opinion).

Respondent Bill Yancey's violations are equally troubling. As the president and CEO of PFSI, a registered broker-dealer, he had the ultimate responsibility for compliance with the securities laws and for appropriately supervising the firm's employees. As Yancey himself admitted, the buck stopped with him. Even so, Yancey failed to exercise any supervisory control over the head of PFSI Stock Loan, creating an environment where that department violated Rule 204 hundreds, if not thousands, of times. And he failed to follow up on clear red flags that Delaney was not being forthcoming with regulators about PFSI's Rule 204 problems. Yancey should be held liable for his failure to supervise two key players in PFSI's long-running rule violations.

II. BACKGROUND

A. Penson Financial Services, Inc.

During the relevant time period, PFSI was a broker-dealer registered with the Commission. (Stipulated Finding of Fact ("Stip. FoF") 3). PFSI was also a registered clearing agency. *Id.*

B. Respondents, PFSI Departments, Employees, and Other Individuals

i. Yancey

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. (Stip. FoF 2; Division's Finding of Fact ("Div. FoF") 9).

ii. Delaney

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. (Stip. FoF 1; Div. FoF 10).

iii. PFSI's Stock Loan Department

Under the Commission's customer protection rule, PFSI was permitted, subject to certain conditions and limitations, to lend securities held in PFSI margin accounts to third parties. (Stip. FoF 7). PFSI lent margin securities according to the terms of the Master Securities Lending Agreement ("MSLA") developed by the Securities Industry and Financial Markets Association ("SIFMA"). (Stip. FoF 7). Stock Loan was a core function of PFSI, and critical to its existence. (Div. FoF 199 – 210).

During the relevant time period, Mike Johnson was the head of PFSI's Stock Loan department. (Stip. FoF 41, 55). He was also the Senior Vice President of Global Stock Lending and an employee of Penson Worldwide, Inc. ("PWI"). (Stip. FoF 9, 55, 71). Johnson was an associated person of PFSI. (Stip. FoF 41). Johnson was charged by the Commission for his role in the Rule 204 violations at issue in this matter, and settled his case. (Stip. FoF 104). Other relevant Stock Loan employees include Rudy DeLaSierra and Lindsey Wetzig. (Div. FoF 14, 16).

iv. The Compliance Department

From October 2008 through April 2011 Delaney was the CCO at PFSI. Compliance was an important department at PFSI, tasked with, among other things, providing guidance on SEC rules. (Div. FoF 88). Eric Alaniz was a compliance department employee from 2009 through 2011. (Div. FoF 18). One of Alaniz' responsibilities was to conduct compliance testing required by NASD Rule 3012. (Div. FoF 18). Holly Hasty was also a compliance officer at PFSI, as was Kim Miller. (Div. FoF 19, 20). One of Kim Miller's responsibilities was to provide information in response to requests from regulators. *Id.*

v. Other Individuals

Phil Pendergraft was one of the creators of Penson. (Div. FoF 21). From 2008 to 2011, Pendergraft was the CEO and a member of the board of directors of PWI, PFSI's parent company. (Div. FoF 22).

Bart McCain began working at PFSI in 2006. (Div. FoF 24). He was the chief administrative officer, and also served as the chief financial officer for PFSI for a time. (Div. FoF 24). McCain also served as the interim treasurer and interim chief financial officer for PWI. (Div. FoF 24). Yancey was instrumental in securing every job McCain had in the securities industry, including hiring McCain to work at PFSI. (Div. FoF 25). 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. (Div. FoF 26). In contrast to his loyalty to Yancey, McCain was hostile toward Pendergraft. (Div. FoF 27).

Brian Gover began working at PFSI in April 2007. (Div. FoF 28). Over time he managed several departments, including the Buy-ins department. (Div. FoF 28). In April

2012, Gover moved into the Compliance department at PFSI. (Div. FoF 28). He is currently the Chief Compliance Officer of Apex Clearing. (Div. FoF 28). Summer Poldrack and Angel Shofner were PFSI employees in the Buy-ins group during the relevant time period. (Div. FoF 29).

C. Rule 204T/204

i. Background of the Rule

Rule 204T became effective on September 18, 2008 and Rule 204 became effective on July 31, 2009. (Stip. FoF 4). The rule was adopted to, among other things, address prolonged fails to deliver securities. *Id.* Rule 204T/204 requires participants of a registered clearing agency to deliver equity securities to a registered clearing agency when delivery is due; that is, by settlement date. (Stip. Conclusion of Law 1). As relevant here, settlement date is generally the third day after the trade, *i.e.*, T+3. *Id.* 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 fail by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on T+4. *Id.* For long sales, if the participant has a failure-to-deliver position at the clearing agency 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. *Id.*

ii. PFSI Violated Rule 204T/204

At all relevant times, PFSI was a clearing firm, *i.e.*, a participant of a registered clearing agency and a member of the National Securities Clearing Corporation. (Stip. FoF 6). 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. (Stip. FoF 6). PFSI was the only entity in this matter that had Rule 204 close out obligations. (Div. FoF 34).

Two departments at PFSI had responsibility for Rule 204 close-outs. PFSI's Buy-ins department closed-out CNS fails caused by customers. (Div. FoF 38). The cost of the buy-in, and the attendant market risk, was borne by the customer or broker causing the fail. (Div. FoF 38). However, it was Stock Loan's obligation to close out CNS fails arising from a particular type of long sale – a long sale of loaned securities. (Div. FoF 37). In brief, long sales of loaned securities originated with securities held in customer margin accounts. (*See* Stip. FoF 7). When a margin customer sold the 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. (Stip. FoF 8). 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. (Stip. FoF 8).

From October 2008 until November 2011, PFSI routinely failed to close out CNS fails resulting from long sales of loaned securities by market open T+6. (Stip. FoF 7). PFSI violated Rule 204T/204's requirement to close out at market-open T+6 approximately 2-10 times each trading day. (Div. FoF 40). As a result, PFSI violated Rule 204T/204 at least 1,500 times during the relevant period. (Stip. FoF 49).

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

Not only did PFSI routinely violate the rule, Johnson, Stock Loan's head, knew about the violations and assisted them. To show that Johnson aided and abetted PFSI's violations, the Division must show that: 1) PFSI violated Rule 204; 2) Johnson substantially assisted PFSI's violation; and 3) Johnson knew of, or recklessly disregarded, the wrongdoing and his role in furthering it. *Eric J. Brown*, et al., Rel. No. 34-66469, 2012 WL 625874 (February 27, 2012). As it is undisputed that PFSI violated Rule 204, the only issue is Johnson's role in the violation.

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. (Stip. FoF 41; Div. FoF 50). However, in response to push back from its counterparties, Stock Loan determined that it would not close out fails to deliver until the end of the day on T+6. (Div. FoF 51-52). From October 2008 through November 2011, Johnson knew PFSI was violating Rule 204T(a)/204(a) in connection with long sales of loaned securities. (Stip. FoF 41; Div. FoF 53). And it was Johnson, as the head of the department and the individual with primary authority for its operational practices, who decided that Stock Loan would not close out until the afternoon of T+6. (Stip. FoF 41; Div. FoF 54). Johnson's role in furthering the violations cannot reasonably be disputed.

III. THE DIVISION'S CLAIMS AGAINST RESPONDENT DELANEY

Johnson and the Stock Loan employees were not the only individuals at PFSI who played a role in the violations. As explained below, Delaney caused and aided and abetted PFSI's violations of Rule 204.

A. Delaney is not credible.

A critical issue in this case is what Delaney knew, and when he knew it. And crucial to this determination is whether to credit Delaney's current claim that he knew nothing of the Rule 204 violations until March 2011. In addition to that claim being contrary to significant record evidence, Delaney's credibility is severely lacking.

Because of the importance of protecting investors, it is critical that registered persons be held to the highest standards of honesty and truthfulness. *See Gary M. Kornman,* Rel. No. 34-59403 (Feb. 13, 2009) (Commission opinion) ("the importance of honesty for a securities professional is so paramount that we have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or securities business.") In this case, Delaney has not been honest or truthful. Instead he has been evasive and inconsistent throughout the investigation and hearing in this matter.

i. Delaney has given multiple versions of his story

Delaney told conflicting stories about his knowledge and conduct in this case. (Div. FoF 63). For instance, Delaney originally testified that he never knew about Stock Loan's practice of Rule 204 violations. (Div. FoF 63.a). Next, he admitted in his Wells submission that he knew Rule 204 close out issues might begin with Stock Loan. *Id.* 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 (Exhibit 89) disclosing those violations to regulators. *Id.*

In addition, Delaney told conflicting stories about that March 2011 letter to FINRA. (Div. FoF 63.b). In his original testimony he said that he did not recall being concerned about the disclosure. *Id.* In contrast, he later testified that the disclosure was

a big deal, and that the Compliance department was greatly alarmed by the disclosure. *Id.*

Delaney also told conflicting stories about his escalation of Stock Loan's Rule 204 violations to Yancey. (Div. FoF 63.c). He originally testified that he did not escalate the issue to Yancey. *Id.* Next, in his Wells submission, he claimed that he raised the issue with Yancey "many times – both routinely and extraordinarily." *Id.* 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. *Id.*

ii. Delaney has tried to distance himself from admissions in his Wells submission

As discussed in detail below, Delaney makes critical admissions in his Wells submission about his knowledge of Stock Loan's Rule 204 violations. Delaney admits that he reviewed his Wells submission before it was sent to the Commission and approved its submission on his behalf. (Div. FoF 64.b). Nevertheless, and perhaps not surprisingly, Delaney tried to distance himself from his admissions. When asked, "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?" he did not say "yes" – he equivocated. (Div. FoF 64.c). Delaney even tried to distance himself from admissions as to things he, himself, had supposedly said or done. (Div. FoF 64.d). Only after extensive questioning did Delaney acknowledge that he could not repudiate admissions as to things he, himself, had supposedly said or done because he had read and approved those admissions. (Div. FoF 64.e).

Delaney's attempt to repudiate his Wells submission is extremely troubling. Because he read and approved the Wells submission before it was submitted to the Commission, there are only two possibilities: either the statements Delaney approved

about his knowledge and actions were lies to the Commission in his Wells submission or his repudiation of those statements are lies to the Court now. Either answer is damning to Delaney's attempt to remain in the securities industry.

iii. Delaney was untruthful or evasive during testimony

In addition to his refusal to take ownership over his Wells submission, Delaney was untruthful or evasive in his testimony at the hearing in this matter. (Div. FoF 65, 322). For instance, 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. (Div. FoF 322). In addition, despite the clear language in the March 2011 letter to FINRA admitting Rule 204 violations, and later stipulations by his counsel, Delaney denied that it was the practice of PFSI's Stock Loan department to close-out long sales at market close rather than market open. (Div. FoF 65.a). Similarly, 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. (Div. FoF 65.b). And although ultimately admitting that there was only one test of Stock Loan's Rule 204 procedures, Delaney originally denied that fact. (Div. FoF 65.c).

For all of these reasons, when faced with a choice between crediting Delaney's current story – that he knew nothing of Stock Loan's Rule 204 violations – or Delaney's prior admissions and the significant other evidence that Delaney was on notice of those violations, the Court should not credit Delaney's current version of events.

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

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). 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).

To prove its claim under Section 15(b)(6), the Division must show that Delaney was associated with a broker-dealer and that he aided and abetted PFSI's violation of Rule 204T/204. Delaney is associated with a broker-dealer. (Stip. FoF 1). PFSI violated Exchange Act Rule 204T/204. (Stip. FoF 49); 17 C.F.R. §242.204. Thus, the only issue is whether Delaney aided and abetted the violations.

Section 21C of the Exchange Act further 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). As explained below, causing is a lower standard that aiding and abetting. *See infra* Section III.D.

C. The Division has charged Respondent Delaney with willfully aiding and abetting PFSI's violations of Rule 204/204T (Exchange Act Section 15(b)).

Delaney aided and abetted PFSI's Rule 204 violations by concealing those violations from, and actively misleading, Yancey and PFSI's regulators. To prove that

Delaney aided and abetted, 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. *Eric J. Brown, et al.*, Rel. No. 34-66469, 2012 WL 625874 (Feb. 27, 2012). While the Division must show that Delany acted willfully, 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).

i. PFSI violated Rule 204/204T

As discussed above, it is undisputed that PFSI violated Rule 204T/204.

ii. Delaney knew of, or recklessly disregarded, PFSI's violations of Rule 204T/204 and his role in furthering it

The evidence shows Delaney's knowledge of the violations, or at the very least his reckless disregard of them. Recklessness may be found if Delaney encountered red flags or suspicious events creating reasons for doubt that should have alerted him to PFSI's improper conduct. *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004).

Although Stock Loan began violating Rule 204 late 2008, PFSI did not disclose those violations to its regulators until March 2011, and Yancey did not learn about them until well after that. (Stip. FoF 41, 49; Div. Ex. 307-308). As discussed below, there is significant evidence, including from Delaney's own mouth, that Delaney actually knew PFSI Stock Loan was violating Rule 204 well before PFSI finally disclosed those violations. In addition, there is also significant evidence that Delaney received substantial information constituting red flags that should have alerted him that PFSI Stock Loan was violating Rule 204.

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

In his Wells submission, Delaney made a number of admissions concerning his knowledge of Stock Loan's violations of Rule 204. Delaney admitted that the regulators raised issues about Rule 204 closeouts for long sales and that he knew, at the time regulators were raising the issue, that the Rule 204 closeout issues "might begin" with Stock Loan. (Div. FoF 74). Regulators were raising the issue early: beginning in November 2008, the Commission's Office of Compliance Inspections and Examinations ("OCIE") conducted a review of PFSI's Rule 204T procedures. (Stip. FoF 28).

In addition, Delaney claims that he raised the issue that Stock Loan could and did cause delays in buy-ins in many times with Yancey. (Div. FoF 75). Obviously, in order to raise the issue of the violations with Yancey, he must have known about them.

Delaney also claims that he was "working to close" the "gap" "between PFSI's WSPs and Stock Loan's practices concerning timely buy-ins." (Div. FoF 76). Again, his claim that he was working to close the "gap" necessitates knowledge on his part of the "gap" between the requirements of the Rule and Stock Loan's practices.

Delaney's own admissions demonstrate that he knew of Stock Loan's violations. As discussed below, given the amount of information he received warning of the difficulty of Rule 204 compliance by stock lending departments generally – and PFSI Stock Loan department specifically – his admissions are not surprising.

b. Significant evidence confirms Delaney was told about and recklessly disregarded the violations.

It is not surprising that Delaney admits knowing of Stock Loan's violations of Rule 204: he frequently received information alerting him to those violations. As a threshold matter, Delaney was acutely aware of Rule 204. Delaney testified that Rule 204 was

one of the most major rule changes during Delaney's fifteen year career. (Div. FoF 78). He described it as a "sea change" and "one of those historical moments in time." *Id.* Clearly, Delaney understood that Rule 204 was an important rule. (Div. FoF 79).

1. In late 2008, Stock Loan told Delaney that it could not comply with Rule 204T and asked for guidance.

In approximately October, 2008, around the time Rule 204T was implemented, Michael Johnson and Rudy DeLaSierra had discussions with Delaney about problems PFSI Stock Loan was having complying with Rule 204. (Div. FoF 80-81). As Rudy DeLaSierra explained, during these conversations, they made it clear to Delaney that Stock Loan was not closing out at market-open T+6. (Div. FoF 95).

Johnson told Delaney Stock Loan was getting push-back got from counterparties when it attempted to buy the counterparties in at market-open T+6 in order to close out fails to deliver. (Div. FoF 80). 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). (Div. FoF 82). Johnson made the problem Stock Loan was having clear to Delaney. (Div. FoF 84). Johnson specifically 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. (Div. FoF 85). Johnson also informed Delaney that PFSI's counterparties were refusing to accept buy-ins at market-open T+6. *Id.* Indeed, Delaney admits knowing that Stock Loan was having issues with compliance with Rule 204T and Rule 204. (Div. FoF 77).

In his conversations with Delaney, Johnson sought guidance from Delaney on how to comply with Rule 204. (Div. FoF 86). He sought guidance from Delaney because Delaney was the Chief Compliance Officer and Stock Loan wanted to make him aware that there was a conflict between the Rule's requirements and Stock Loan's practices. (Div. FoF 87). This makes sense: part of the role of a compliance officer is to give guidance on rules. (Div. FoF 88). Even Respondent Yancey's expert witness said she would have expected a CCO to provide guidance when asked. (Div. FoF 89). Rather than provide guidance to Stock Loan on how it could comply with Rule 204, however, Delaney flippantly told Johnson to "call your Congressman" if he had problems with the rule. (Div. FoF 91).

Shortly thereafter, Delaney and DeLaSierra had a conversation in which Delaney asked whether Stock Loan was still having issues with market-open buy-ins. (Div. FoF 92). DeLaSierra confirmed that Stock Loan had not resolved the issues. *Id.* In response to DeLaSierra confirming that Stock Loan was still not able to buy in at the market open on T+6, Delaney simply said "okay." (Div. FoF 93). This conversation was further confirmation that Stock Loan was not complying with the rule.

2. Delaney received guidance about Rule 204T/204 both before and after his conversations with Johnson and DeLaSierra.

The conversations Delaney had with Johnson and DeLaSierra about Stock Loan's failure to comply with Rule 204 must be viewed against the backdrop of other information being provided to Delaney. During this "historical moment in time," Delaney received and reviewed multiple emails and other documents which emphasized that Rule 204T/204 applied to long sales and pointed out the difficulty stock lending departments would have complying with Rule 204T/204. In short, Delaney was aware of

the tension between the close-out requirements of Rule 204T and securities lending practices. (Div. FoF 99).

For example, on September 21, 2008, Delaney received and read guidance from PFSI's legal advisors at Morgan Lewis. (Div. FoF 96). This guidance advised Delaney 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. *Id.*

In October 2008, at about the same time Delaney was having conversations with Johnson about Stock Loan's inability to comply with Rule 204T, Morgan Lewis issued additional guidance about Rule 204T. (Div. FoF 97). This guidance specifically discussed the impact of Rule 204T on securities lending in an FAQ titled "How will the interim rules affect securities lending practices?". *Id.* It was Delaney's practice to review Morgan Lewis' guidance carefully. (Div. FoF 102). This guidance linked to the adopting release for Rule 204T, which Delaney read. (Div. FoF 97-98).

On December 13, 2008, Delaney received comments about Rule 204T from other industry participants. (Div. FoF 100). Again, the comments highlighted the discrepancy between stock lending practices and the requirements of the rule, noting 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. *Id.* Despite Delaney's advice to Johnson that he should "write his congressman," Delaney did not discuss this letter or the idea of writing a comment letter to the Commission with Johnson. (*See* Div. FoF 132).

On December 15, 2008, Delaney received a comment letter concerning Rule 204T written by the SIFMA. (Div. FoF 101). This letter contained a whole section

concerning the impact of Rule 204T on stock lending. *Id.* Among other things, the letter discussed the conflict between stock lending practices and Rule 204T. *Id.* Again, Delaney did not discuss this letter or the idea of writing a comment letter with Johnson. (*See* Div. FoF 132).

In July and August 2009, when Rule 204T became permanent Rule 204, Delaney reviewed additional guidance from PFSI's legal advisors. (Div. FoF 102). This guidance provided a link to the adopting release for Rule 204. *Id.* 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. (Div. FoF 103). Nonetheless, in the next paragraph the Commission reiterated that despite the impact on securities lending, the Commission would keep the closeout requirements. *Id.*

In August 2010, Compliance Officer Eric Alaniz sent Delaney an email attaching guidance concerning Rule 204. (Div. FoF 104). 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. *Id.* All of the above information served to heighten Delaney's awareness of Rule 204 issues with stock lending: if he did not understand the compliance problems Stock Loan raised with him in October 2008, he was reckless in not knowing about the violations in the face of this significant guidance.

3. <u>In early 2010, Delaney was notified by Brian Gover that Stock Loan was violating Rule 204.</u>

Between March 2010 and June 2010, Brian Gover had a meeting with Delaney and Johnson about Rule 204 issues. (Div. FoF 116). In that meeting, they discussed

Stock Loan's position that CNS fails attributable to PFSI's Stock Loan department were not to be closed out, despite the requirements of Rule 204. *Id.* They also discussed the conflict between the buy-ins at the end of the lending cycle contemplated by the MSLA and the earlier close-out required by Rule 204. *Id.* Again, it is important to place this conversation in context. By this time, Delaney had received industry and regulatory guidance discussing the difficulty stock lending departments were having complying with Rule 204, and had been told by Johnson and DeLaSierra that PFSI's Stock Loan department was unable to comply with the Rule.

In short, Delaney was told repeatedly that PFSI Stock Loan was not closing out long sales of loaned securities at market-open T+6. At the very least, the information he received from Stock Loan personnel, Gover, PFSI's legal counsel, the regulators, and industry participants constituted a series of red flags that PFSI's Stock Loan department was having significant, ongoing problems with Rule 204 compliance.

4. Delaney received additional red flags that Stock Loan was not complying with Rule 204 both before and after his conversation with Gover.

In addition to conversations with Johnson, DeLaSierra, and Gover indicating that PFSI's Stock Loan department was not complying with Rule 204, and industry and regulatory guidance warning about the difficulty of stock lending compliance with Rule 204, Delaney also received additional red flags of Stock Loan's non-compliance.

On May 17, 2010, Delaney received notice that FINRA had detected that PFSI had not closed out long sales in compliance with Rule 204. (Div. FoF 122). Delaney did nothing to follow-up on that FINRA notice. (Div. FoF 123). On July 26, 2010, Delaney also received an email indicating that Stock Loan's position was that fails attributable to PFSI's Stock Loan department were not to be closed out. (Div. FoF 124). And, on

October 13, 2010, Brian Gover again elevated the issue of Stock Loan's failure to close-out long sales. (Div. FoF 125). In the email Gover sent to Delaney, Stock Loan said, "If the short is due to a long sale then we'll just wait for the shares to be received...." *Id.*

Finally, 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 because "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." (Div. FoF 126). All of these items continued to underscore that Stock Loan was not complying with Rule 204.

5. Delaney recklessly disregarded, his role in furthering the violations.

In addition to Delaney's knowledge or reckless disregard of the violations, he also knew of or recklessly disregarded, his role in furthering them. *See Brown, et al.*, 2012 WL 625874. As the CCO, Delaney's role in Stock Loan's compliance with, and violations of, Rule 204 was manifest. Delaney was the compliance person responsible for implementation of Rule 204 at PFSI. (Div. FoF 127). Delaney was also the compliance person responsible for interfacing with Stock Loan. (Div. FoF 128).

When new rules came out PFSI's Compliance department would often have meetings, analyze technologies, and develop a road map to ensure compliance. (Div. FoF 129). In contrast, although Delaney describes Rule 204 as a "sea change," he does not recall any meetings about the implementation of Rule 204. (Div. FoF 130; *see also* Div. FoF 78). And no technology was designed or modified to enable Stock Loan to comply with Rule 204T/204. (Div. FoF 131).

Not only did Delaney not work with Stock Loan on implementation of the emergency rule or Rule 204T, but he never gave them guidance about Rule 204, even when they asked for it. (Div. FoF 132). Instead, in approximately August 2009, when temporary Rule 204T became permanent Rule 204, Delaney sent out an email that 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. (Div. FoF 133). The e-mail did not address the conflict between the securities lending cycle and the rule. (Div. FoF 134-135). 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. *Id.* Although at the time of the email Delaney was aware that Stock Loan was not closing out fails to deliver until the afternoon of T+6, the e-mail did not provide any guidance to Stock Loan or indicate to Stock Loan that they should do anything differently. (Div. FoF 133-136).

Delaney's participation in PFSI's testing of Rule 204 compliance – and, specifically, his allowing Stock Loan to go untested – also furthered Stock Loan's violation of Rule 204. Delaney has claimed that he paid close attention to Stock Loan's compliance with Rule 204 by testing. (Div. FoF 137). He claimed that "We tested. We tested and tested and tested and tested." *Id.* That was simply not true. Delaney was forced to admit that, in fact, the December 2009 Rule 204 testing was the only test testing Stock Loan, and that the December 2009 testing did not test Stock Loan's compliance with the close-out requirements of Rule 204. (Div. FoF 138). Moreover, given the "profound, massive, and anomalous" results of the December Rule 204 testing, follow-up testing should have tested a larger sample and should have tested close-outs of long sales, the area showing the greatest violations. (Div. FoF 141; Stip.

FoF 21). Nevertheless, follow-up Rule 204 testing performed in June 2010 tested only Rule 204 compliance with close-outs of short sales, not long sales. (Div. FoF 140).

Delaney also 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." (Div. FoF 108). 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. (Div. FoF 109). In fact, although knowing at the time of the December 2009 audit of Rule 204 compliance issues, that Stock Loan was not buying in to close out fails to deliver until the afternoon of T+6, Delaney did not direct Alaniz to test Stock Loan's buy-ins or close-outs. (*See* Div. FoF 106-107, 139). Moreover, given PFSI's practice of daily violations of Rule 204T/204, Delaney's claim that his "compliance testing at PFSI … *reliably determined whether* " PFSI was in compliance with Rule 204T/204 is absurd.

In addition, on January 25, 2010, Delaney asked Compliance Officer Eric Alaniz to review certain WSPs to see how they reconciled with his Rule 204 testing. (Div. FoF 118). 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." *Id.* Although Delaney was responsible for ensuring that PFSI's WSPs reflected relevant regulatory guidance concerning Stock Loan's close-out practices, and 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. (Div. FoF 119). In fact,

the procedures identified as "PROCEDURES ADOPTED IN ACCORDANCE WITH RULE 204" in the WSPs primarily dealt with Rule 203, not Rule 204. (Div. FoF 121). Alaniz's suggestions were never followed. (*See* Div. FoF 119-120).

iii. Delaney's substantial assistance of PFSI's violations of Rule 204/204T.

In addition to knowing about – or being reckless in disregarding – the Rule 204 violations, Delaney substantially assisted them. In light of Delaney's admitted responsibilities at PFSI, the Division may show that Delaney substantially assisted by demonstrating that he repeatedly disregarded red flags of suspicious activity and did not disclose that activity to Yancey or regulators. *See Ronald S. Bloomfield, et al.*, Rel. No. 34-71632, 2014 WL 768828 at *17 (Feb. 27, 2014).

a. Delaney never told Yancey about Stock Loan's violations.

Delaney's conduct must be viewed through the lens of the duties required of CCOs. First, Delaney acknowledges that it was his responsibility to make sure that PFSI had policies and procedures designed to prevent or detect violations of rules. (Div. FoF 142). And, Delaney acknowledges that, if he 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. (Stip. FoF 13). In addition, it was important for Delaney to be honest and forthcoming with Yancey. (Div. FoF 143). Delaney had a duty to inform Yancey if Delaney knew that PFSI was following industry practice rather than Rule 204. (Div. FoF 145).

Despite this duty, Delaney's knowledge that Stock Loan was not complying with Rule 204T/204, and his repeated encounters with red flags of suspicious activity, Delaney never informed Yancey that PFSI was following a perceived industry practice rather than Rule 204. (Div. FoF 146). He never raised the issue with Yancey in the

ordinary course of business, but more importantly Delaney did not disclose the violations in direct conversations with Yancey about Rule 204 compliance.

In December 2009, around the same time Delaney was receiving industry comment letters discussing the difficulty of stock lending departments compliance with Rule 204T, PFSI's Compliance department did testing pursuant to FINRA Rule 3012 of PFSI's compliance with Rule 204 (the "Rule 204 Test"). (Div. FoF 105). Alaniz discussed the December 2009 testing with Delaney before doing the testing. (Div. FoF 106). Despite the notice to Delaney, both from Johnson and from industry groups, about the issues surrounding stock loan's compliance with Rule 204T, the December 2009 audit results related only to the Buy-ins department. (Stip. FoF 78). The test results for short sales found that of the 47 short sales required to be bought in, all of them resulted in violations between 30 minutes and 1 hour and 15 minutes late. (Div. FoF 111). The test results also showed that, of the 51 long sales required to be closed out, all of them resulted in violations of between 4 hours late and almost 8 hours late. *Id.* In summary, the Rule 204 Test results showed that, of the 113 securities transactions tested, 112 failed to comply with Rule 204. *Id.* This was one of the most significant occurrences of failures PFSI's compliance department had ever seen in its Rule 204 testing. (Div. FoF 112, 114). In fact, Delaney later characterized these failures as "massive," "profound," and "anomalous." (Stip. FoF 21).

On January 28, 2010, Delaney met with Yancey to review compliance testing and explain the results of the December 2009 Rule 204 testing. (Div. FoF 185). Delaney did not tell Yancey that Stock Loan had a role in the violations being discussed. (*See* Div. FoF 146). In fact, although Delaney originally 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," Delaney finally admitted that he told Yancey that Stock Loan did not need to attend the January meeting discussing the December 2009 Rule 204 testing. (Div. FoF 147-148). Delaney met with Yancey and again specifically discussed the Rule 204 testing in March 2010. (Div. FoF 167). Again, Delaney did not disclose Stock Loan's non-compliance with Rule 204 to Yancey. (*See* Div. FoF 146).

In August 2010 – just a week after Delaney received another email concerning Stock Loan's Rule 204 practices – Delaney again met with Yancey to discuss Penson's Rule 204 compliance. (Div. FoF 124, 149). And again, Delaney did not disclose Stock Loan's non-compliance to Yancey. (*See* Div. FoF 146).

And, indeed, even when PFSI finally disclosed Stock Loan's violations of Rule 204 to regulators in March of 2011, Delaney still did not tell Yancey about the violations. (Div. FoF 146, 307-308). Delaney's failure to disclose Stock Loan's non-compliance with Rule 204 to Yancey substantially assisted PFSI's violations of Rule 204T/204.

b. Delaney hid information about PFSI's violations to regulators.

It was important for Delaney to be honest and forthcoming with regulators. (Div. FoF 150). In fact, the Commission has said that "deliberate deception of regulatory authorities justifies the severest of sanctions." *Gary M. Kornman,* Rel. No. 34-59403 (Feb. 13, 2009) (Commission opinion). As the Commission explained,

> the importance of honesty for a securities professional is so paramount that we have barred individuals even when the conviction was based on dishonest conduct unrelated to securities transactions or securities business. Here, the egregiousness of [Respondent's] dishonest behavior is compounded because he made his false statement to Commission staff during an ongoing investigation into possible insider trading violations. Providing information to investigators is important to the effectiveness of the regulatory system, and the information provided must be truthful. We have

> consistently held that deliberate deception of regulatory authorities justifies the severest of sanctions.

Id. Nevertheless, in communications with regulators Delaney did not disclose Stock Loan's non-compliance with Rule 204. Indeed, he failed to disclose relevant information about Rule 204 at all.

1. The 2010 CEO Certification Report

On March 31, 2010, Yancey signed an "Annual Certification of Compliance and Supervisory Processes" for PFSI. (Div. FoF 151). The Certification signed by Yancey attached a "NASD Rule 3012 Summary Report" ("Annual Report"). (Div. FoF 152). The Annual Report was to discuss Penson's "key compliance problems" for the period April 1, 2009 through March 31, 2010. (Stip. FoF 21). The Annual Report was also supposed to summarize the testing that had been conducted and presented to the CEO. (Div. FoF 154).

Delaney was responsible for the Annual Report. (Div. FoF 155). Delaney acknowledged that the Annual Report was a key document in FINRA examinations. (Div. FoF 156). The Rule 3012 Summary Report contained a section describing "[t]he firm's key compliance efforts to date." (Div. FoF 157). The Rule 3012 Summary Report also contained a section noting "[t]he identification of any significant compliance problems." (Div. FoF 158). Delaney determined what would be listed as significant compliance problems. (Div. FoF 159). Delaney's 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. (Stip. FoF 22). Delaney's Annual Report also 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."

(Div. FoF 161). Indeed, the Annual Report did not reference Rule 204 at all. (Div. FoF 162). Delaney admits that it is surprising that there is no reference to Rule 204 in the Annual Report. (Div. FoF 163). In fact, Delaney acknowledges that other topics that were the subject of compliance testing at PFSI were discussed in the Annual Report. (Div. FoF 164). Delaney's failure to disclose PFSI's Rule 204 compliance issues, which were a "significant compliance problem," substantially assisted PFSI's violations of Rule 204.

2. The November 2010 OCIE letter

Delaney continued to conceal Stock Loan's Rule 204 violations as 2010 went on. As previously discussed, beginning in November 2008, OCIE conducted a review of PFSI's Rule 204T procedures. (Stip. FoF 28). On October 27, 2010, one week after Delaney had received a FINRA deficiency letter informing him of Rule 204 violations in long sales of loaned securities, OCIE sent a deficiency letter to Delaney reporting that it too had found Rule 204T(a) violations (Ex. 203; Stip. FoF 28)). The OCIE exam concerned close-outs of long sales as well as short sales. (Div. FoF 169). And during the exam, PFSI had represented to OCIE that there was no report that monitored close-outs of long sales of loaned securities. (Div. FoF 170).

On November 15, 2010, Kim Miller sent Delaney a draft of a response to the deficiency letter. (Div. FoF 171). On November 19, 2010, Delaney replied to Miller, saying "attached is my redraft…." (Div. FoF 172). Delaney reviewed and edited PFSI's response to Item No. 5, which concerns "Close-Out Requirements Pursuant to Rule 204T." (Div. FoF 173). The language as edited by Delaney appeared in the letter submitted to OCIE on November 24, 2010. (Div. FoF 174).

Despite Delaney's knowledge that Stock Loan was not in compliance with Rule 204, and the recent notice he had received from FINRA about Rule 204 violations arising from long sales of loaned securities, PFSI's letter to OCIE did not disclose that PFSI's Stock Loan was not complying with Rule 204. (Div. FoF 174). Nor did it acknowledge the disastrous Rule 204 test results from December 2009 and June 2010. *Id.*. 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." *Id.* Delaney admitted that the language in the OCIE letter was inconsistent with the Rule 204 testing Alaniz conducted in December 2009 and June 2010. (Div. FoF 175). Indeed, it is not possible to reconcile the statement concerning Rule 204 in the OCIE letter with the Rule 204 testing. (Div. FoF 176). By misrepresenting PFSI's Rule 204 compliance to OCIE, Delaney again substantially assisted PFSI's Rule 204 violations.

D. The Division has charged Respondent Delaney with causing PFSI's violations of Rule 204/204T (Exchange Act 21C).

A finding that one willfully aids and abets a violation necessarily makes that person a "cause" of those violations. *Sharon M. Graham*, Rel. No. 34-40727, 1998 WL 823072 at n. 35 (Nov. 30, 1998). However, the Division need not prove aiding and abetting to prove causing. The burden of proof for causing is substantially less - to prove that Delaney caused PFSI's violations, the Division must show: 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. *Robert M. Fuller*, Rel. No. 34-48406, 2003 WL 22016309 at *3 (Aug. 25, 2003); *see also* 15 U.S.C. §78u-3(a). 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).

i. PFSI violated Rule 204/204T

Again, it is undisputed that PFSI violated Rule 204T/204.

ii. An act or omission by Delaney contributed to PFSI's violation

As discussed above, Delaney contributed to PFSI's violations by failing to disclose Stock Loan's violations to Yancey, by failing to disclose Stock Loan's violations to regulators, and by minimizing the extent of PFSI's Rule 204 violations in representations made to regulators.

iii. Delaney knew, or should have known, that his conduct would contribute to PFSI's violation

The Division has discussed above Delaney's admitted knowledge of Rule 204 violations by PFSI's Stock Loan department. The Division has also discussed red flags and other information encountered by Delaney that should have alerted him to PFSI's wrongdoing. Finally, the Division has shown that Delaney knew or recklessly disregarded his role in furthering PFSI's violations. This evidence shows that Delaney was at the very least negligent in contributing to PFSI's Rule 204 violations.

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

Proper supervision is critical at a regulated broker-dealer like PFSI. The Commission has called it the "touchstone to ensuring that broker-dealer operations comply with the securities laws and NASD rules, and also a "critical component to ensuring investor protection." *Dennis S. Kaminski*, Rel. No. 34-65347, 2011 WL 4336702 (September 16, 2011). (*See also* Div. FoF 177). As both Yancey and his expert agreed, in a broker-dealer like PFSI, all supervisory responsibility rests, initially,

with the CEO, unless and until he reasonably and effectively delegates that responsibility. (Div. FoF 221-222). *See also Johnny Clifton*, Rel. No. 34-69982, 2013 WL 3487076 at *12 & n.81 (July 12, 2013). As Yancey conceded, as president and CEO, the buck stopped with him. (Div. FoF 223).

Yancey is charged both with failing to supervise Johnson and with failing to supervise Delaney. To prove that Yancey failed to supervise, the Division must show that: (1) Yancey was a registered person; (2) Yancey failed to reasonably supervise Johnson/Delaney with a view toward preventing violations of the securities laws; (3) Johnson/Delaney were registered persons; (4) Johnson/Delaney were subject to Yancey's supervision; and (5) Johnson/Delaney committed violations of the securities laws. *See* 15 U.S.C. § 78o(b)(6), *see also id.* § 78o(b)(4)(E). Neither scienter nor willfulness is an element of a failure to supervise charge. *Michael Bresner*, Rel. No. 517, 2013 WL 5960690 at * 117 (Nov. 8, 2013) (*citing Clarence Z. Wurts*, Rel. No. 34-43842, 2001 WL 32844 at * 8 (2001)).

A. Yancey Was Responsible for Supervising Johnson, but Failed to Do So.

Many of the facts relevant to Yancey's failure to supervise Johnson are undisputed or indisputable. Both Yancey and Johnson were registered persons associated with PFSI throughout the relevant time period. (Stip. FoF 102 (Johnson); Stip. FoF 2 (Yancey)). And as discussed above, Johnson aided and abetted PFSI's violations of Rule 204. As explained below, the facts also show that Johnson was subject to Yancey's supervision, and that Yancey failed to reasonably supervise him – indeed, to supervise him at all.

i. PFSI's Written Supervisory Procedures Designate Yancey as Johnson's Supervisor.

Regulated entities like PFSI are subject to strict rules regarding supervision. NASD Rule 3010(a)(5) requires firms to "assign[ ] ... each registered person to an appropriately registered representative(s) and/or principal(s) who *shall be responsible for supervising* that person's activities." (Emphasis added). (*See also* Stip. FoF 98). As Yancey's expert conceded, this is an important rule for the protection of investors. (Div. FoF 266).

PFSI made its supervisory designations in its Written Supervisory Procedures ("WSPs"). (Div. FoF 258). The WSPs were an important document, a source of information for PFSI's regulators, and a document Yancey expected to be accurate. (Div. FoF 256-257). In its designation of supervisors, the WSPs incorporated PFSI's supervisory matrix. (Div. FoF 258, 260).[1] The matrix listed employees under various PFSI executives. (Div. FoF 261). It also contained two columns: a "Regulatory Supervisor" column and a "Pi Org Chart Supervisor" column. (Div. FoF 264). The "Regulatory Supervisor" was PFSI's assignment of supervisors for purposes of NASD Rule 3010(a)(5). (Div. FoF 265; *see also* Div. FoF 267).

PFSI's matrix – and thus PFSI's WSPs – consistently designated Yancey as Johnson's supervisor. Johnson was always listed under Yancey, rather than Pendergraft. (Div. FoF 262-263). And critically, Yancey was always listed as Johnson' s "Regulatory Supervisor" in the matrix. (Stip. FoF 37; Div. FoF 269). In short, PFSI's WSPs make clear that Yancey was assigned "responsib[ility] for supervising [Johnson's] activities" throughout the relevant time period. NASD Rule 3010(a)(5).

[1] Notably, the WSPs do not incorporate any organizational chart for purposes of designating supervisors. (Div. FoF 261).

In addition to the matrix's incorporation into PFSI's WSPs, PFSI's regulators typically requested, and were frequently provided, copies of the matrix that represented that Yancey was Johnson's supervisor. (*See* Div. FoF 294). For example, in September 2010, PFSI received a FINRA inquiry requesting, among other things, a "description of Penson's supervisory chain identifying each supervisor's direct reports as well as the individual(s) to which each supervisor reports." (Div. FoF 296). In response, PFSI sent a copy of the supervisory matrix. *Id.* That document listed Johnson under Yancey, and designated Yancey as both Johnson's Regulatory Supervisor and Pi Org Chart Supervisor. *Id.* As numerous witnesses confirmed, by looking at this document FINRA would have concluded that Yancey was Johnson's supervisor. (Div. FoF 298). This is important: Yancey himself stressed the need for communications with regulators to be accurate and complete. (Div. FoF 194, 293; *see also* Div. FoF 297 (Delaney would expect communications with FINRA to be accurate, complete, and up to date)). And this is not the only example. PFSI sent numerous similar communications to regulators, each of which contained matrixes that listed Johnson under Yancey and designated Yancey as both Johnson's Regulatory Supervisor and Pi Org Chart Supervisor. (Div. FoF 299-303). In short, PFSI consistently represented to its regulators that Yancey was responsible for supervising Johnson.

In the face of this overwhelming evidence that PFSI's WSPs gave Yancey supervisory responsibility for Johnson, and that PFSI's regulators were regularly told the same, the only argument Yancey can muster is that the matrix was wrong and should not have listed him as Johnson's supervisor. This argument is both factually and legally flawed. Factually, the matrix was regularly reviewed and updated, and changes and corrections were made if needed. (Div. FoF 271). As Kim Miller, the compliance

department employee charged with maintaining the matrix, explained, she attempted to make the matrix as accurate as possible, relied on executives to inform her of errors, and made corrections when they were brought to her attention. (Div. FoF 272-274). Further, Miller directly sent Yancey the matrix on more than one occasion, and specifically asked if any changes needed to be made. (Div. FoF 278-279, 285-286). Yancey had a chance to read and review these matrices. *Id.* But although these matrices listed Yancey as Johnson's supervisor, Yancey never asked Miller to make any corrections.[2] (Div. FoF 282-284, 289). In short, Yancey had repeated chances to correct what he now contends was an error in a critical document, but failed to do so.

As a result, legally, Yancey's argument that the matrix was erroneous cannot save him. Yancey's argument is essentially that even though he reviewed the matrix, and even though the matrix was incorporated into the WSPs that Yancey himself admits are important, and even though the matrix designated supervisors pursuant to a specific regulatory rule (NASD Rule 3010(a)(5), and even though the matrix was repeatedly sent to regulators and indisputably informed them that Yancey was Johnson's supervisor, he should not be held responsible because the document was simply wrong. Such an argument only highlights his lack of diligence, and should not allow him to escape liability. *Cf. Angelica Aguilera*, Admin. Proc. File No. 3-14999, 2013 WL 3936214, *23 (July 31, 2013) ("Aguilera argues that the WSPs did not accurately reflect job responsibilities .... Instead of helping Aguilera, this argument hurts her. The fact that the

[2] While Miller did testify that she perceived that Pendergraft was Johnson's boss, which was inconsistent with the matrix, she also testified that at some point she was explicitly instructed to move Johnson from underneath Pendergraft in the matrix to underneath Yancey, and to add Yancey as Johnson's Regulatory Supervisor – a change she presumed Yancey was aware of. (Div. FoF 275-276).

firm's WSPs were inaccurate, and Aguilera, the firm's President, knew that they were inaccurate, reflects that her dereliction of duty was egregious.").

PFSI's WSPs expressly state, and PFSI's regulators were repeatedly told, that Yancey was Johnson's supervisor. On this basis alone, Yancey should be found to have supervisory responsibility for Johnson.

ii. Yancey is Johnson's Presumptive Supervisor.

In addition to the express designation in the WSPs, the basic presumption is that Yancey had supervisory responsibility over Johnson. Again, the president and CEO of a broker-dealer has supervisory responsibility for all registered persons unless and until he effectively delegates that responsibility. (Div. FoF 221-223). It is undisputed that Yancey was PFSI's president and CEO. (Stip. FoF 2). Thus, unless Yancey can put forward "reliable evidence" that he clearly delegated full supervision of Johnson, he remains liable. *See SEC v. Yu*, 231 F. Supp. 2d 16, 201 (D.D.C. 2002).

iii. Yancey Did Not Delegate Supervision of Johnson.

Yancey argues that he fully delegated supervision of Johnson to Phil Pendergraft in August 2008. Any delegation must be clear to be 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). Said another way, as Yancey's expert witness conceded, if there is confusion concerning delegation, that delegation is by definition not clear, reasonable, or effective, and the CEO retains supervisory responsibility for the registered person. (Div. FoF 224). *See also Koch Capital, Inc.*, Rel. No. 34-31652, 1992 WL 394580 at *5 (December 23, 1992). Here, the evidence shows that Yancey did not delegate the responsibility for supervising Johnson as to regulatory and compliance issues – such as the Rule 204

compliance issues relevant to this case – or, at the very least, did not delegate it clearly. Either way, Johnson remained subject to Yancey's supervision throughout the relevant time period.

It is undisputed that, when Johnson was initially hired to run PFSI's Stock Loan department, Yancey was his supervisor. (Stip. FoF 118; *see also* Div. FoF 212). Yancey contends that he fully delegated all supervisory responsibility for Johnson to Phil Pendergraft, CEO of PFSI's parent company, at the time Johnson was promoted to Senior Vice President for Global Stock Lending, which happened sometime prior to the implementation of Rule 204T. (*See* Stip. FoF 9, 117). The evidence does not bear out his claim.

As a threshold matter, Johnson played a key role at PFSI both before and after his promotion to head of Global Stock Lending. PFSI's Stock Loan department was a core function of the broker-dealer: it lent shares owned by PFSI's customers, provided locates for PFSI customers, and borrowed shares on behalf of PFSI's customers. (Div. FoF 199-204; Stip. FoF 116). These activities generated significant profits for PFSI. (Div. FoF 205-206). Moreover, Stock Loan financed PFSI by using stock as collateral for loans, which provided real advantages over financing through a bank. (Div. FoF 207-208). In short, Stock Loan was a key part of PFSI's business model. (Div. FoF 209). The firm could not exist without a stock lending function. *Id.*

Not only was Stock Loan a core function of PFSI, but Johnson was heavily involved in the department. Johnson was personally involved in stock lending activities before and after his promotion. (Div. FoF 213, 214, 218). He retained significant responsibility and authority over PFSI's Stock Loan department, even after his promotion. (Stip. FoF 41, 55). And notably, his interactions with PFSI's Stock Loan

department did not materially change after his promotion; and he remained a highly involved, hands-on manager. (Div. FoF 217). In short, Johnson remained closely associated with PFSI, even after he became head of Global Stock Lending. Given Johnson's position in a core function of PFSI, as Delaney explained, it "would have been my expectation from a compliance standpoint that a core function of the broker-dealer would report in to [the CEO] from a supervisory standpoint." (*See* Div. FoF 211).

Despite Johnson's integral role in a core function of PFSI, Yancey claims he fully and completely delegated to Pendergraft, the CEO of PWI, *all* responsibility for Johnson, including responsibility for all PFSI-related issues. More specifically, Yancey claims that, at a closed-door meeting in August 2008 in which Pendergraft announced his "vision" for creating a global stock lending product line with Johnson in charge, Yancey fully and completely delegated supervisory responsibility for both Johnson and PFSI's Stock Loan department to Pendergraft. (*See* Div. FoF 231a). Yancey's story, however, is directly contradicted by Pendergraft – the only other person in the purported August meeting. (Div. FoF 232). As Pendergraft explained, while he (or another PWI executive) directed Johnson with respect to his global responsibilities, Yancey did *not* delegate supervisory responsibility for Johnson as to regulatory or compliance issues – responsibility for those issues remained with PFSI. (Div. FoF 226-227). For a number of reasons, Pendergraft's testimony should be credited over Yancey's self-serving claims.

First, Yancey himself vouched for Pendergraft's credibility, urging the Division to take his testimony during the investigation in order to properly understand the supervisory structure over Johnson. (Div. FoF 23). Yancey's attempt to disavow the testimony he personally encouraged should be rejected.

Second, Pendergraft's testimony is consistent with other evidence. Rudy DeLaSierra, Stock Loan's vice president, did not observe interactions between Pendergraft and Johnson on regulatory or compliance issues. (*See* Div. FoF 312). And the supervisory matrix consistently designated Yancey as Johnson's "Regulatory Supervisor" – the individual responsible for supervision from a compliance standpoint. (Div. FoF 269).

Third, Yancey's story is inconsistent with other evidence. For example, while Yancey contends he delegated supervisory responsibility for both Johnson *and PFSI Stock Loan* to Pendergraft, both Brian Gover and Johnson himself testified that Stock Loan always reported directly to Yancey. (Div. FoF 199, 231c). Pendergraft also testified that he did not recall the August 2008 conversation, and that he believes the global stock lending position was created in 2007, not 2008. (Div. FoF 234). And notably, there is no document evidencing that Yancey delegated full supervisory responsibility to Pendergraft. (Div. FoF 237-238). There is, however, documentary evidence that Yancey retained supervisory authority for Johnson. In addition to the supervisory matrix, PFSI's 2011 CEO certification, which Yancey personally signed and ensured was accurate, lists Johnson as part of PFSI's "Senior Directors Team" that met weekly to report to Yancey. (Div. FoF 252-255).

Fourth, Pendergraft's testimony is logical. PWI did not have regulatory compliance obligations, such as obligations under Rule 204 – those obligations rested with PFSI, the broker-dealer. (Stip. FoF 111). It makes sense that the CEO of the parent company would not supervise regulatory and compliance issues that were not the responsibility of the parent company. (*See* Div. FoF 211 (Delaney was not surprised that, from a compliance standpoint, a core function of the broker-dealer would report to

the CEO of the broker-dealer)). Moreover, as Yancey's own witnesses confirmed, it would not be inappropriate to divide supervisory responsibilities, and indeed there were employees other than Johnson – including Bart McCain, PFSI's chief administrative officer – who were supervised by Pendergraft for certain matters related to the parent company and Yancey with respect to their responsibilities at PFSI. (Div. FoF 228-229).

Finally, the arguments Yancey advanced at trial to support his version of events were largely discredited. For example, Yancey relied heavily on PFSI's organizational charts, which he and his witnesses claimed *clearly* showed Johnson supervised by Pendergraft. (Div. FoF 239). In fact, the organizational charts plainly state that Johnson reported to another executive, Dan Son. (Div. FoF 240-241). Yancey also insisted that, out of the hundreds of e-mails Johnson received each day, a handful of e-mail communications between Johnson and Pendergraft established that Pendergraft had exclusive supervisory authority over Johnson. (*See* Stip. FoF 119). But, of course, none of these e-mails directly discuss or reference any delegation of supervision from Yancey to Pendergraft. And, in fact, the evidence showed both Pendergraft and Johnson had similar email communications with others with whom they were decidedly not in a supervisory relationship. (Div. FoF 247-251).

For all of these reasons, Pendergraft's testimony should be credited over Yancey's. Because Yancey did not, in fact, delegate regulatory and compliance supervisory responsibilities to Pendergraft, those responsibilities remained with Yancey.

But even if the Court does not find Yancey incredible, at best the evidence shows confusion about Johnson's supervision. (*See* Div. FoF 231). Yancey claims he fully delegated all supervisory responsibility for Johnson and PFSI Stock Loan to Pendergraft. (Div. FoF 231a). Pendergraft, by contrast, understood that Johnson

reported to him (or another PWI executive) with respect to his global responsibilities, but that supervision for regulatory and compliance issues remained with PFSI. (Div. FoF 231b). In yet another version of events, Johnson testified that he, personally, reported to Pendergraft, but that the PFSI Stock Loan department reported to Yancey. (Div. FoF 231c). And Rudy DeLaSierra, PFSI Stock Loan's vice president, testified that he thought Johnson reported to Dan Son. (Div. FoF 231d). Thus, even if the Court chooses not to make credibility determinations, the evidence shows significant confusion over the supervisory scheme. As a result, and as Yancey's own expert has conceded, supervisory responsibility for Johnson remained with Yancey. (Div. FoF 224); *see also Koch Capital*, 1992 WL 394580 at *5.

In sum, whether the Court credits Pendergraft's testimony, or simply considers all of the evidence proffered, there was no clear and effective delegation. Johnson is subject to Yancey's supervision for regulatory and compliance purposes.

iv. Yancey Did Not Discharge His Supervisory Obligations As To Johnson.

Finally, the evidence shows that Yancey did not supervise Johnson with respect to regulatory and compliance issues – indeed, no one did. Within Stock Loan, Johnson had the primary responsibility for compliance with Rule 204. (Stip. FoF 38). Yancey concedes that, after August 2008, he did not exercise any supervision over Johnson or PFSI's Stock Loan department. (Div. FoF 304). Yancey expressly asked Johnson to stop attending Yancey's weekly meetings with his direct reports. (Div. FoF 305). Yancey was so removed from PFSI Stock Loan issues that he was not aware of the Rule 204 violations for months after PFSI had disclosed those violations to its regulators. (Div. FoF 307-308; *see also* Stip. FoF 43). As Johnson himself explained, he was largely kept out of the loop on Penson matters, and received only one review in his twelve years at

the firm. (Div. FoF 310-311). At bottom, no one supervised Johnson or PFSI Stock Loan with respect to regulatory or compliance issues. (Div. FoF 312-313). Rather, in the words of Mike Johnson, he and Stock Loan had to "run on the fly and make it." (Div. FoF 314). In light of Yancey's complete absence of supervision, Yancey plainly "failed to reasonably supervise [Johnson] with a view toward preventing violations" of Rule 204. *See* 15 U.S.C. § 78o(b)(4).[3]

v. Whether Pendergraft Could *Also* be Liable for Failing to Supervise is Irrelevant.

The Division expects Yancey will argue, as he did at trial, that the "facts and circumstances" show that Pendergraft was Yancey's supervisor. The "facts and circumstances" analysis stems from a Commission settlement in *John H. Gutfreund*, 51 S.E.C. 93 (1992). However, that analysis is not relevant here for two reasons.

First, the analysis does not apply where, as here, the supervisor in question is the CEO of a broker dealer. *See Aguilera*, 2013 WL 3936214, at *24 (noting that the *Gutfreund* test applies to the assessment of supervisory liability of personnel, like a chief legal officer, who "did not become a supervisor 'solely' because of his position, *as opposed to the president of the firm*, who … 'was responsible for compliance with all of the requirements imposed on his firm,' pending reasonable delegation.'") (emphasis added); *see also 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."). The appropriate analysis for a CEO is, simply, whether he or she has clearly, reasonably, and effectively delegated the

[3] Further, with no established procedures for supervising Johnson in place, the affirmative defense provided in Section 15(b)(4)(E) is unavailable to Yancey.

supervisory responsibility they are charged with in the first instance. *See Aguilera*, 2013 WL 3936214, at *24. For the reasons detailed above, Yancey did not do so here.

Second, the "facts and circumstances" analysis has never been used to prove delegation, or determine who, among multiple choices, is the exclusive supervisor. Rather the "facts and circumstances" test is used to expand supervisory liability to those outside the normal chain of chain in addition to those who are traditionally liable. *See John H. Gutfreund*, 51 S.E.C. 93 (1992).

B. Yancey Failed to Reasonably Supervise Delaney by Ignoring Red Flags.

As was the case with Johnson, many of the facts relevant to Yancey's failure to supervise Delaney are undisputed or indisputable. Both Yancey and Delaney were registered persons associated with PFSI. (Stip. FoF 2 (Yancey); Stip. FoF 102 (Delaney)). Yancey does not dispute that he was responsible for supervising Delaney. (Stip. FoF 42, 112). And, as discussed above, Delaney aided and abetted PFSI's violations of Rule 204. *See supra* at IIIC. Thus, the only issue the Court need decide is whether Yancey failed to reasonably supervise Delaney with a view toward preventing those violations.

Yancey's supervisory failures with respect to Delaney relate to his failure to vigorously follow up on red flags that Delaney may be concealing PFSI's Rule 204 compliance problems from regulators. "[T]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." *Dennis S. Kaminski*, Rel. No. 34-65347, 2011 WL 4336702, *8 (Sept. 16, 2011) (quotation omitted); *see also Banc of America Investment Services, Inc. and Virginia Holliday*, Release No. 34-60870, 2009 WL 3413048 (October 22, 2009) ("Red flags and suggestions of irregularities demand

inquiry as well as adequate follow up and review."); *George T. Kolar*, Rel. No. 34-46127, 2002 WL 1393652, at *4 (June 13, 2002) ("Decisive action is necessary whenever supervisors are made aware of suspicious circumstances."). The need for such vigorous inquiry and follow up is particularly important at large organizations like PFSI. *See Kaminski*, 2011 WL 4336702, at *8 ("In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention."). As Yancey himself conceded, if he saw a red flag that Delaney were not being honest with regulators, Yancey would have a duty to follow up on it. (Div. FoF 194-196).

Although Yancey was not aware of Stock Loan's Rule 204 violations, he did become aware of significant Rule 204 compliance problems in the Buy-ins department. As discussed above, in December 2009, as part of its FINRA Rule 3012 testing, the Compliance department tested Buy-ins' compliance with Rule 204, and found that 112 of the 113 securities transactions tested failed to comply with the rule – a failure rate of more than 99%. (Stip. FoF 15; Div. FoF 105, 107, 111). This was one of the most significant failure rates the Compliance department had ever seen. (Div. FoF 112; *see also* Div. FoF 114). Delaney himself characterized the failures as "massive," "profound," and "anomalous." (Stip. FoF 21; Div. FoF 113).

Yancey was repeatedly presented with the results of this testing. He received and reviewed the test results in December 2009. (Div. FoF 182). A few weeks later, in January 2010, Yancey met with members of the Compliance department for their quarterly Rule 3012 testing. (Div. FoF 183). Issues were raised at these quarterly meetings only if they were significant enough to warrant Yancey's attention. (Div. FoF 184). Compliance department personnel again explained the results of the test, and

specifically pointed out that 112 of the 113 items tested failed. (Div. FoF 185). Indeed, the Rule 204 test results were one of only two items discussed at this meeting. *Id.* The Rule 204 test results were discussed again at the next quarterly meeting, held in March. (Stip. FoF 21; Div. FoF 186).

Despite the "massive," "profound," and "anomalous" failures, the Rule 204 test results were omitted from PFSI's annual Rule 3012 Summary Report to regulators. The Report, which was a key document for regulators for which Delaney was ultimately responsible, was intended to discuss "key compliance problems" for the period from April 2009 through March 2010. (Stip. FoF 21, 45-46; Div. FoF 153, 155-157). It was also supposed to summarize the "extensive testing" that had been conducted. (Div. FoF 154). Despite these requirements, there was no mention of any Rule 204 compliance issue anywhere in the Report. (Stip. FoF 21, 46; Div. FoF 161-162). Even Delaney could not explain the omission. (Div. FoF 163).

Yancey was acutely aware of the Report. The Report was attached to the Annual CEO Certification, which Yancey personally signed. (Stip. FoF 46, 175; Div. FoF 152, 190). As part of Yancey's process for signing the Certification, he carefully reviewed the Report and met with Delaney to discuss it. (Stip. FoF 45; Div. FoF 188, 189). Further, Yancey knew the Report was an important document, and that it was going to be sent to regulators. (Div. FoF 190-191). But although the Report contained no reference to the Rule 204 test results that Yancey had repeatedly discussed with the Compliance department – indeed, had discussed on the same day that he signed the Annual CEO Certification – Yancey made no effort to follow up on why the test results were not included. He did not have discussions with anyone, including Delaney, about why the

results were omitted. (Div. FoF 193). Yancey simply does not know why the test results were not included in the Report. (Div. FoF 192).

The exclusion of the dismal results of the Rule 204 testing was a suspicious circumstance suggesting Delaney was not being forthcoming with regulators about PFSI's Rule 204 compliance problems – the very violation Delaney was committing. Such circumstances demand decisive action, vigorous investigation, and follow up and review. Instead, Yancey did nothing. This lack of follow up on a clear red flag constituted a failure to reasonably supervise Delaney.

V. THE REMEDIES SOUGHT BY THE DIVISION AGAINST RESPONDENTS:

Given Respondents' serious rule violations, significant sanctions are warranted.

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

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).

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.*

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.*

Delaney's violation was extremely serious. Indeed, the Commission has said that the conduct constituting part of Delaney's substantial assistance, the deliberate deception of regulatory authorities, justifies the severest of sanctions. *Gary M. Kornman*, Rel. No. 34-59403, 2009 WL 367635 (Feb. 13, 2009). Delaney's conduct was recurrent, lasting from late 2008 through early 2010. Delaney's acted with a high degree of scienter – despite admitted knowledge of Rule 204 violations, he failed to disclose the violations during discussions or communications regarding the very rule being violated. Moreover, Delaney has been continuously untruthful and evasive during this proceeding. Delaney has not recognized the wrongful nature of his conduct nor made any assurances against future violations. Finally, because Delaney is currently a compliance officer, he has the opportunity to commit future violations.

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

Section 15(b)(b) of the Exchange Act permits the Commission to 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). 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 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)); *Ralph W. LeBlanc*, Rel. No. 34-48254, 2003 WL 21755845 at * 6 (July 30, 2003); *Peter Siris*, Rel. No. 34-71068, 2013 WL 6528874 at n.72 (Dec. 12, 2013). 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 David Henry Disraeli*, Rel. No. 34-57027, 2007 WL 4481515 at * 15 (Dec. 21, 2007)).

i. Delaney

It is in the public interest to bar Delaney from association in the securities industry. Most importantly, 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. (Div. FoF 322). Delaney's violations were egregious. As noted above, the Commission has said that conduct like Delaney's justifies the severest of sanctions. *Kornman,* Rel. No. 34-59403. Delaney's conduct was recurrent. As discussed above, Delaney's acted with a high degree of scienter – both in his violations and during this proceeding. Delaney has not recognized the wrongful nature of his conduct nor made any assurances against future violations. Finally, because Delaney is currently a compliance officer, unless he is barred from the securities industry, he has the opportunity to commit future violations.

ii. Yancey

Barring Yancey for his failures to supervise is also in the public interest. Yancey violated a "touchstone" requirement of broker-dealers – proper supervision. *Kaminski*, 2011 WL 4336702. Indeed, as to Johnson, his complete abdication of his supervisory responsibilities – leaving Johnson and Stock loan to, in Johnson's words, "run on the fly and make it" – was egregious, and created an environment where Stock Loan violated an SEC rule every day for three years. And despite purporting to promote a "culture of compliance" at PFSI, he failed to follow up on clear red flags that Delaney, PFSI's chief compliance officer, was not being candid with regulators.

Moreover, Yancey has not recognized the wrongfulness of his conduct or given any assurances against future violations. Instead, he continues to make excuses. Despite the indisputable fact that the WSPs designate him as Johnson's supervisor, and

the regulators were repeatedly told the same, he refuses to accept the consequences of these representations, arguing that the document (that he was repeatedly asked to review) was simply a mistake. Similarly, despite begging the Division to take Pendergraft's testimony to explain Johnson's supervisory scheme, Yancey made an about-face and disavowed this testimony at the hearing, going so far as to accuse Pendergraft of perjury. (*See* Tr. 1466:5-9). Put simply, despite clear evidence from documents Yancey reviewed, and testimony Yancey encouraged, that he was Johnson's supervisor for the issues relevant to this case, he continues to refuse to take any responsibility for his actions.

In addition, Yancey currently works in the broker-dealer industry, and continues to supervise staff. (Stip. FoF 2; Div. FoF 316). This occupation certainly gives him an opportunity to commit future violations. For all of these reasons, a bar is appropriate and in the public interest.

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

i. Delaney

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). Further, if the Court finds that Delaney caused PFSI's violations of Rule 204, the Court may order a penalty against him.

Section 21B(a)(1) of the Exchange Act 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). 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).

Delaney's violations involved the deliberate or reckless disregard of a regulatory requirement. Moreover, Delaney's actions as a Chief Compliance Officer who was not truthful with regulators during examinations, not truthful with Commission staff during the investigation in this matter, not truthful with the Commission in his Wells submission, and not truthful with the Court in this proceeding, are egregious. Justice and the need to deter Delaney and others who would behave in such a manner demonstrate that a substantial penalty is in the public interest.

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). Because Delaney's conduct involved a deliberate or reckless disregard of a regulatory requirement, a third tier penalty is appropriate.

ii. Yancey

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). Even where the failure to supervise does not involve fraud or deceit or create a significant risk of substantial losses, a first-tier penalty is appropriate. *Id.* § 78u-2(b)(1). Further, a penalty is appropriate for each discrete violation. *See id.* ("The maximum amount of penalty for each act or omission described in subsection (a) ...") The maximum first-tier penalty amount is $7,500 per violation. 17 C.F.R. § 201.1004; *id.*, Part 201, Subpart E, Table IV.

As discussed above, sanctions against Yancey are in the public interest. His failure to supervise Johnson was egregious, and created an environment where Stock Loan violated an SEC rule every day for three years. Similarly, he failed to follow up on clear red flags that Delaney, PFSI's chief compliance officer, was not being candid with regulators. And notably, Yancey fails to take any responsibility for his actions. A first-tier civil penalty is appropriate for each of Yancey's failures to supervise.

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

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).

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). "Because disgorgement is an equitable remedy, '[t]he district court has broad discretion not only in determining whether or not to order disgorgement but also in calculating the amount to be disgorged.'" *SEC v. Wyly*, --- F. Supp. 3d. ---, 2014 WL 4792229, *1 (S.D.N.Y. 2014) (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474–75 (2d Cir.1996)). "[D]isgorgement need only be a reasonable approximation of the profits causally connected to the violation." *Zacharias v. SEC*, 569 F.3d 458, 472-73 (D.C. Cir. 2009). "[T]he well-established principle is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that uncertainty." *Id.*

Disgorgement of a portion of Respondents bonuses during the relevant time period is a reasonable approximation of their ill-gotten gains. Bonuses had three components: Penson Worldwide's performance; PFSI's performance; and Yancey's personal goals. (Div. FoF 319). From 2008 through 2010, Yancey earned bonuses of between $300,000 and $1.2 million. (Div. FoF 320). From 2008 through 2010, Delaney earned bonuses of approximately $40,000. (Div. FoF 321)

Respondents should be ordered to disgorge the portion of their bonuses tied to PFSI's performance. Stock Loan violated Rule 204 and delayed its buy-ins in response to significant push-back from its counterparties, who were eager to avoid being bought in. (Stip. FoF 10; Div. FoF 51, 55). Maintaining relationships with these counterparties was extremely important to PFSI's business model. (Div. FoF 56). Indeed, without those relationships, PFSI would likely have gone out of business. (Div. FoF 56). Since Stock Loan's violations secured relationships that were critical to PFSI's very existence,

Respondents should be ordered to disgorge the 1/3 of their bonuses tied to PFSI's performance. *Cf. SEC v. Church Extension of the Church of God*, 429 F. Supp. 2d 1045-1050 (S.D. Ind. 2005) (ordering disgorgement of one-half of defendants' salaries for last year of entity's operations where entity would have collapsed earlier but for securities violations).

VI. CONCLUSION[4]

The Respondents in this action were PFSI executives – licensed professionals responsible for PFSI's compliance with the regulations put in place by the Securities and Exchange Commission for the protection of investors. Each of them completely failed in his responsibilities: Delaney by failing to disclose to Yancey and regulators Rule 204 violations by PFSI's Stock Loan department despite his knowledge of their violations and situations in which disclosure was called for, and Yancey by failing to adequately supervise Delaney or to provide any supervision to the head of Stock Loan, who put the violative policies in place. As a result, for nearly three years, PFSI's Stock Loan department violated Rule 204 each and every day. Respondents should be held liable for their conduct and remedies imposed against them.

[4] Pursuant to the Court's Prehearing Order attached hereto is a timeline of significant events.

DATED: December 19, 2014.

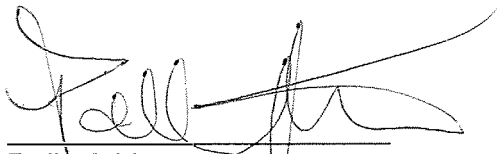

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Exhibit A- Division's Timeline of Events

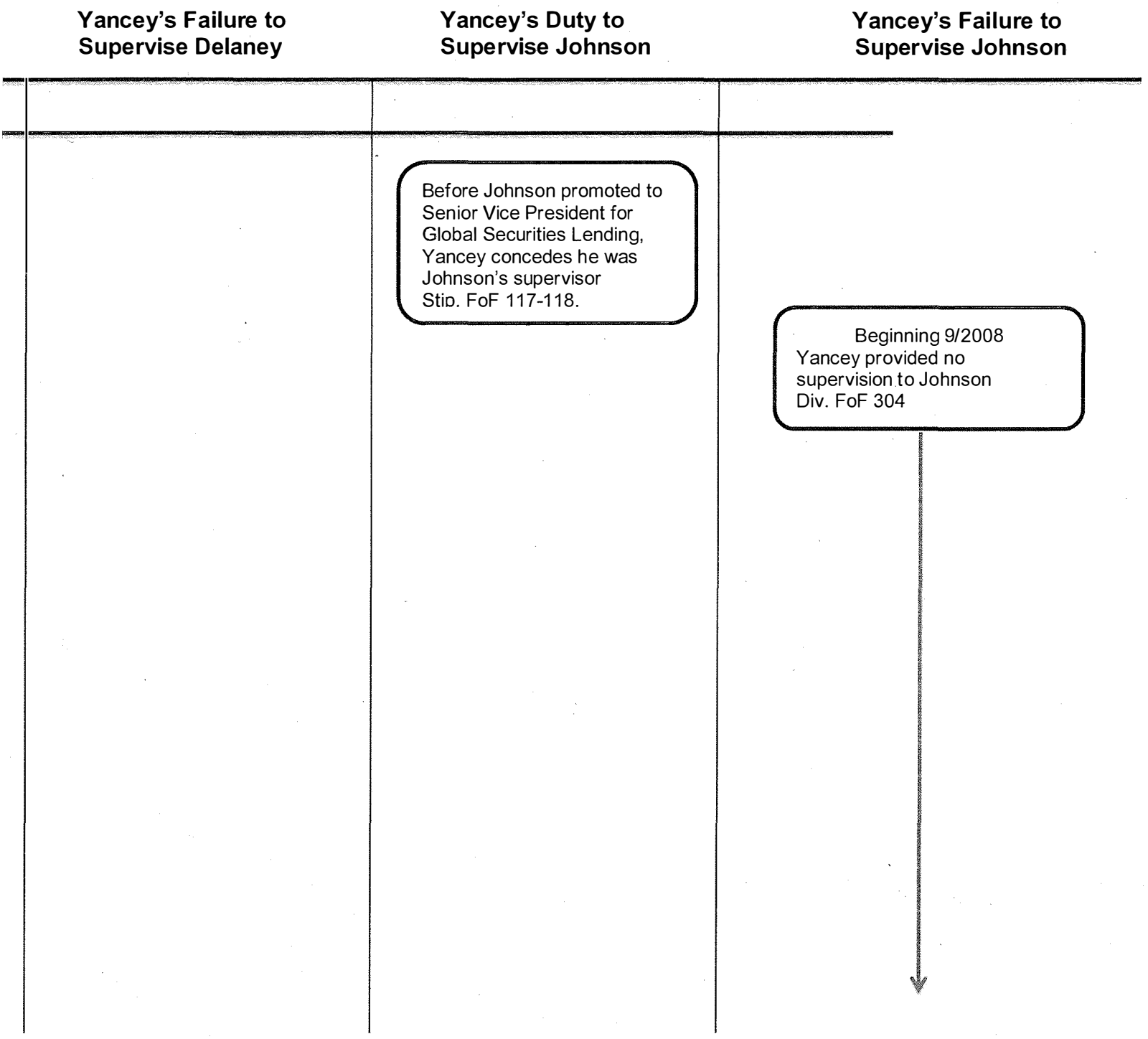

Exhibit A- Division's Timeline of Events

Yancey's Failure to Supervise Delaney	Yancey's Duty to Supervise Johnson	Yancey's Failure to Supervise Johnson
		

Exhibit A- Division's Timeline of Events

Yancey's Failure to Supervise Delaney	Yancey's Duty to Supervise Johnson	Yancey's Failure to Supervise Johnson

Exhibit A- Division's Timeline of Events

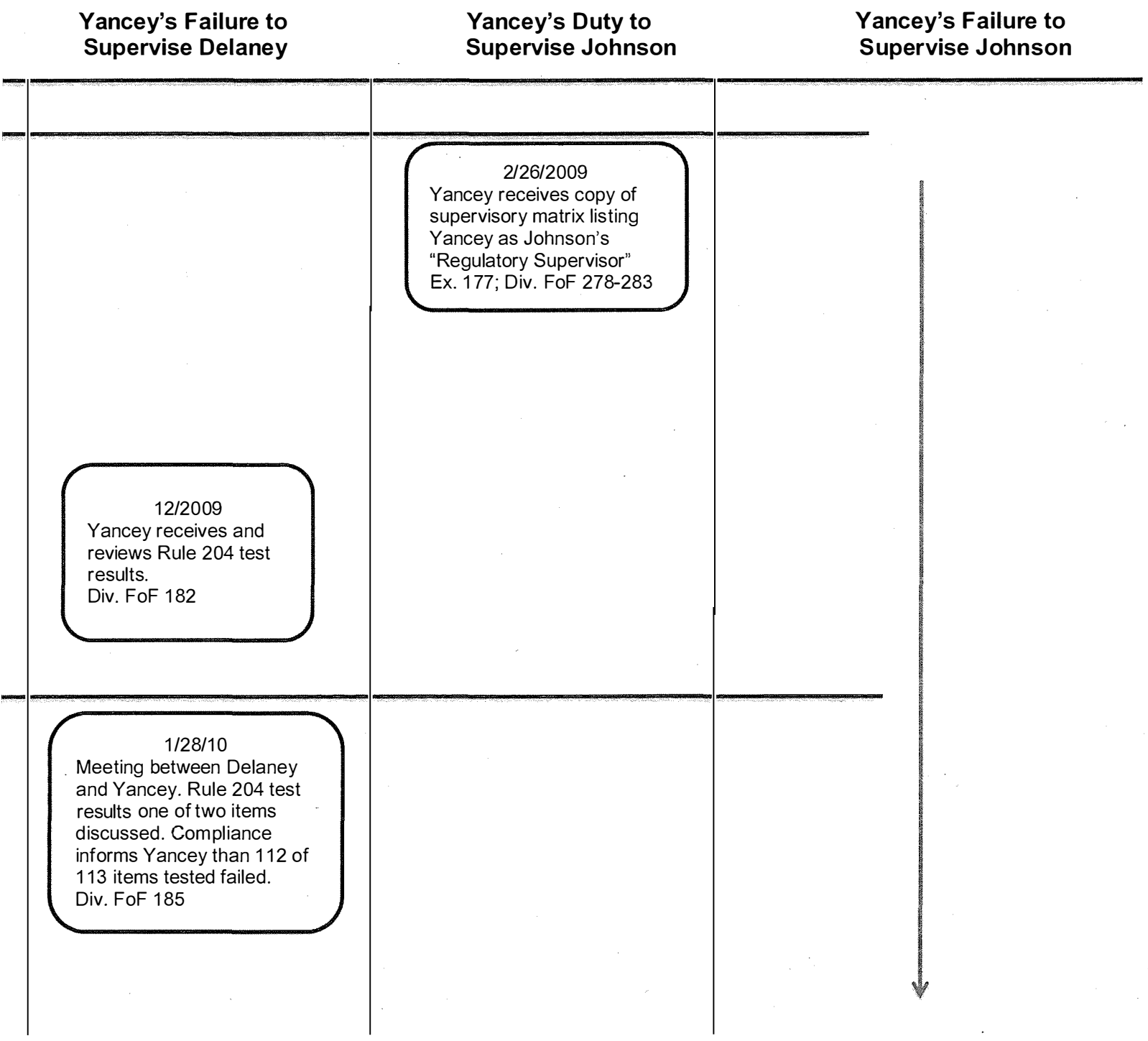

Exhibit A- Division's Timeline of Events

Yancey's Failure to Supervise Delaney	Yancey's Duty to Supervise Johnson	Yancey's Failure to Supervise Johnson
3/31/2010 Meeting between Delaney and Yancey. Rule 204 test results discussed again. Stip. FoF 21; Div. FoF 186		
3/31/2010 Delaney's annual compliance report for the CEO certification did not mention Rule 204 test results or issues. Yancey reviews report before signing certification. Ex. 135; Div. FoF 161-162, 188-189; Stip. FoF 21, 46		
	5/26/2010 Yancey receives an updated version of the supervisory matrix listing Yancey as Johnson's "Regulatory Supervisor" Ex. 96; Div. FoF 285-288	

Exhibit A- Division's Timeline of Events

Yancey's Failure to Supervise Delaney	Yancey's Duty to Supervise Johnson	Yancey's Failure to Supervise Johnson
	9/3/2010 Kim Miller sends supervisory matrix to the National Stock Exchange listing Yancey as Johnson's supervisor. Ex. 200; Div. FoF 299	
	9/8/2010 Kim Miller sends supervisory matrix to FINRA listing Yancey as Johnson's supervisor. Ex. 201; Div. FoF 296	

Exhibit A- Division's Timeline of Events

Yancey's Failure to Supervise Delaney	Yancey's Duty to Supervise Johnson	Yancey's Fails to Supervise Johnson
	10/11/2010 Kim Miller sends supervisory matrix to FINRA listing Yancey as Johnson's supervisor. Ex. 202; Div. FoF 300	
	11/1/2010 Holly Hasty sends supervisory matrix to the Chicago Board of Options Exchange listing Yancey as Johnson's supervisor. Ex. 205; Div. FoF 301	

Exhibit A- Division's Timeline of Events