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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

RESPONDENT CHARLES W. YANCEY'S RESPONSIVE POST-HEARING BRIEF

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INTRODUCTION

The Division's post-hearing brief confirms that this case never should have been filed and that the claims against Bill Yancey should be dismissed. Nothing in the Division's brief establishes any basis for the unparalleled extension of well-established supervisory standards that the Division seeks. In the face of overwhelming evidence that Bill Yancey did not fail reasonably to supervise *anyone*, and after abandoning the vast majority of its case, the Division nevertheless asks the Court to impose sanctions on Yancey—creating a precedent on every CEO in the United States' securities industry to blindly second guess the judgment of their Compliance team and Senior Officers.

With respect to the claim that Yancey failed to supervise Michael Johnson, the Division asks the Court to disregard the testimony of nearly a dozen witnesses, dozens and dozens of contemporaneous documents, the testimony of its own expert witness, and even *Pendergraft's own admission that he supervised Johnson*. Instead, the Division clutches to the erroneous supervisory matrix. But a wrong document—even a wrong document sent to regulators—cannot change the fact that Yancey properly delegated all supervisory responsibility over Johnson to Pendergraft, and Pendergraft supervised Johnson in every aspect of his job.

With respect to the claim that Yancey failed to supervise Delaney, the Division has now abandoned nearly all of its theories. The Division instituted this case conceding that Yancey did not know about the Rule 204(a) violations and that they were *actively concealed* from him, but argued instead that four "red flags" should have together alerted him to the violations. The Division has now abandoned all but one of those "red flags"—the absence of an explicit reference to the December 2009 Audit results in the March 31, 2010 3012 Summary Report. But the Division concedes that the December 2009 Audit *had nothing to do with the transactions at*

issue in this case—long sales of loaned securities. And in any event, neither Delaney nor Alaniz—both experienced compliance professionals with unblemished records—believed that the December 2009 Audit results warranted inclusion in the report because substantial remediation efforts were already underway, none of the 20 other 3012 tests conducted for that year were explicitly referenced in the report, and all of the testing materials were made available to FINRA. The law is well-settled that Yancey was entitled to rely on their professional judgment. To hold Yancey liable on these facts would destroy long-standing and well-settled concepts of supervision. The claims against Yancey should be dismissed.

ARGUMENTS AND AUTHORITIES

I. The Division Failed to Prove that Bill Yancey Failed to Reasonably Supervise Michael Johnson.

A. Yancey properly delegated all supervision of Johnson to Phil Pendergraft.

The Division does not dispute that the president of a broker-dealer can delegate supervisory responsibility to other individuals at the firm.[1] The Commission has "long recognized" that individuals with overarching supervisory responsibilities over many employees, such as presidents and CEOs, "*must* be able to delegate supervisory responsibility."[2] Here, there is overwhelming evidence that Yancey delegated all supervisory responsibility over Johnson to Pendergraft. Faced with this evidence, the Division urges the Court to put blinders on and rely solely on the erroneous supervisory matrix and select and skewed pieces of Phil Pendergraft's testimony. Neither of these arguments can outweigh the evidence Yancey adduced at trial.

1. The Division asks the Court to ignore the bulk of the evidence.

The Division asks the Court to ignore the overwhelming evidence that Yancey delegated

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[1] Stip. COL 9.

[2] *See In the Matter of Patricia Ann Bellows*, SEC Admin. Proc. File 3-8951, Initial Decision Release No. 128, 1998 WL 409445, at *8 (July 23, 1998) (emphasis added).

all supervision of Johnson to Pendergraft. The Division asks the Court to ignore the testimony of Johnson, Yancey, Gardner, Delaney, and McCain, all of whom confirmed that in August 2008 Yancey clearly and unequivocally delegated all supervision of Johnson to Pendergraft.[3] The Division asks the Court to ignore that in August 2008 Pendergraft explicitly directed Dawn Gardner to move Johnson out of Yancey's organization and into Pendergraft's organization.[4] And the Division asks the Court to ignore Pendergraft's testimony that: (1) Johnson became one of his direct reports; (2) he and Yancey spoke multiple times about this transition; and (3) after the move, he controlled Johnson's activities, including his PFSI activities.[5]

The Division also asks the Court to ignore the testimony of Johnson, Yancey, Gardner, Delaney, DeLaSierra, Hasty, McCain, and Miller—each of whom testified unequivocally that Pendergraft was Johnson's supervisor.[6] The Division asks the Court to ignore the statement of Brian Hall (a Stock Loan V.P. under a cooperation agreement who the Division elected not to call) who told the Division that Pendergraft was Johnson's supervisor. The Division asks the Court to ignore Pendergraft's own admission that he supervised Johnson.[7]

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[3] Yancey Test. at 951:6-8 ("Q: And then -- and then your position . . . is that in approximately August of 2008, that's when you delegated to Phil Pendergraft? A: Fully delegated, fully accepted."); Gardner Test. at 1149:3-16 ("Q: Was Mike Johnson moved into the PWI organization at some time? A: Yes, he was. . . . Q: Who was Mike Johnson's supervisor during the time period August 2008 through November of 2011? A: Phil Pendergraft."); Delaney Test. at 1332:3-7 ("Q: Did you understand that with that transition, that Mr. Yancey and Mr. Pendergraft had agreed that Mr. Pendergraft would be the supervisor for Mr. Johnson? A: Yes."); McCain Test. at 2182:5-16 ("Q: How did Mike Johnson come to be assigned to or report to Mr. Pendergraft, to your knowledge? A: . . . my recollection is that Phil and Bill discussed who would manage Stock Loan and who was the best suited to manage Stock Loan, and Phil was -- was chosen to be that person.") (Prop. FOF 6).

[4] Exs. 608, 698.

[5] Pendergraft Test. at 1512:16-21 ("**whenever I picked up Mr. Johnson as direct report, I'm highly confident that I talked with Mr. Yancey about it**. . . .") (emphasis added) (Prop. FOF 20); 1529:6-1534:1 (agreeing that he performed various activities with respect to Johnson) (Prop. FOF 9); 1537:5-10 (agreeing that Yancey routinely checked in regarding the activities performed and acted reasonably in ensuring that Johnson and the Stock Lending group were conducting business in accordance with securities laws) (Prop. FOF 11); 1521:5-11 ("Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question? A: **Then I would say that I provided supervision to Mr. Johnson.**") (Prop. FOF 14).

[6] *See* Prop. FOF 18, 22 (Gardner, Delaney, DeLaSierra, Hasty, McCain, and Miller testimony); Prop. FOF 6, 21 (Yancey testimony); Prop. FOF 28 (Johnson testimony); Prop. FOF 51 (Hall statement).

[7] *See* Prop. FOF 14 (Pendergraft Test. at 1521:5-11).

The Division also asks the Court to ignore the testimony of its own expert witness, David Paulukaitis, who agreed that the delegation of supervisory responsibility is reasonable where, as here, the delegatee is qualified to perform those functions in a satisfactory manner, and the delegator takes reasonable steps to follow up on that delegation.[8] The Division also asks the Court to ignore Pendergraft's admission that Yancey consistently followed up with him regarding his supervision of Johnson. And that Yancey routinely checked in with him regarding his evaluation and review of Johnson's performance; his disciplining of Johnson; his approvals of Johnson's budget and compensation; his advice to Johnson on customer relations issues, and business development plans; his instructions to Johnson regarding PFSI financing and lending balances; and his approvals of Johnson's travel expenses.[9] The Division does not address any of this evidence either.

All of this evidence—the testimony, documents, and stipulated facts—is *precisely* the type of "reliable evidence of supervisory control by another individual" that unequivocally establishes that Yancey fully delegated supervisory responsibility over Johnson to Pendergraft.[10]

2. The Division's evidence does not meet its burden.

a. The supervisory matrix is wrong.

In the face of all of this evidence, the Division clings to the fact that the supervisory matrix erroneously listed Yancey as Johnson's regulatory supervisor.[11] The Division argues that

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[8] *See* Stip. COL 9; Stip. FOF 82, 88.

[9] *See* Prop. FOF 11, 21 (Yancey followed up on Pendergraft's supervision); Prop. FOF 20 (Pendergraft consulted Yancey regarding taking on Johnson as a direct report).

[10] *See SEC v. Yu*, 231 F. Supp. 2d 16, 22 (D.D.C. 2002); *In the Matter of Swartwood Hesse, Inc.*, Exchange Act Release No. 34-31212, 1992 WL 252184 at *6 (Sept. 22, 1992) (where all parties testified about the delegation, Commission concluded president successfully delegated supervisory authority to another, even if no formal delegation and even where a trader testified that he had "no idea" whether president delegated his "compliance responsibility"); *In the Matter of Thomas F. White*, Exchange Act Release No. 34-34398, 1994 WL 389903 at *2-3 (July 19, 1994) (finding president delegated where president "assigned" supervisory authority to delegatee and supervisee discussed all matters previously discussed with former supervisor with delegatee) (Prop. COL. 12).

[11] *See* Division of Enforcement's Post Hearing Brief in Support of Its Findings of Fact and Conclusions of Law ("Div. Post-hearing Br.") at 29-32.

Kim Miller—the person responsible for authoring, maintaining, and updating the matrix—"regularly reviewed and updated" the document and that, therefore, the supervisory matrix was accurate and reliable.[12]

But the Division inexplicably omits the fact that the supervisory matrix was, in fact, *wrong*. Miller herself confirmed this fact. As did several others.[13] Miller testified that: (1) the matrix was wrong; (2) it was wrong for Yancey to be listed as Johnson's Pi Org Chart supervisor; (3) it was wrong for Yancey to be listed as Johnson's regulatory supervisor; and (4) Johnson should have been listed under Pendergraft because Pendergraft was his supervisor.[14] Miller emphasized that she was "very clear" about the matrix being wrong:[15]

> Q: But just to be clear, you knew that Bill Yancey was not the regulatory supervisor?
> A: I know that Bill Yancey was not Mike Johnson's regulatory supervisor. I don't know that I gave it any thought with regard to this document. It just wasn't a big part of my job. I didn't look at it that often.[16]

Remarkably, the Division asks the Court to credit all of Miller's testimony other than her testimony that the matrix was wrong. The Division cannot have it both ways. There is no reason to reject Miller's testimony that the matrix was wrong; Miller was an objectively neutral witness. Indeed, the Division took investigative testimony from Miller on two separate occasions and chose not to ask her *a single question* about the matrix.[17] The Division also listed Miller on its "may call" trial witness list but elected not to call her. Tellingly, if the Division had asked Miller who supervised Johnson once in its over three-year investigation, she would have told the

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[12] *See* Div. Post-hearing Br. at 30-31.
[13] *See* Hasty Test. at 1794:12-1795:8 (identifying as an error that Yancey was listed as Johnson's supervisor); McCain Test. at 2190:6-2191:24 (identifying errors in the supervisory matrix) (Prop. FOF 16).
[14] *See* Miller Test. at 2601:25-2602:11 ("Q: Let me ask it this way. **Do you think that the document is wrong when it lists Bill Yancey as the Pi org chart and the regulatory supervisor for Michael Johnson? A: In both columns, yes.**"); 2603:1-6; 2623:14-19; 2594:13-21; 2595:19-25 (Prop. FOF 16).
[15] Miller Test. at 2595:19-25 (Q: But how clear are you, in your mind, that it's not correct? A: **Very clear.**)
[16] Miller Test. at 2597:12-18.
[17] Miller Test. at 2585:6-12.

Division that "***[h]e reported to Phil Pendergraft.***"[18]

The Division's argument that Yancey had supervisory responsibility over Johnson because the supervisory matrix was sent to regulators similarly fails.[19] At most, this evidence shows that a wrong document was sent to regulators. But that does not make Yancey Johnson's supervisor, nor make him liable for failing to supervise Johnson. As Judy Poppalardo testified, sending an inaccurate document to a regulator does not magically make the document accurate.[20]

Nor does it alter the fact that Pendergraft was supervising Johnson. The Division asks the Court to ignore the fact that during the entire relevant period, Pendergraft was evaluating and reviewing Johnson's performance;[21] disciplining Johnson;[22] approving Johnson's budget and compensation;[23] overruling and overriding Johnson's decisions;[24] advising Johnson on customer relations issues, business development plans, and customer relation plans and budgets;[25] instructing Johnson regarding PFSI firm financing and lending balances;[26] approving Johnson's travel budget and expenses;[27] reprimanding Johnson regarding internal policies and regulatory considerations;[28] directing Johnson to report to him regarding meetings with regulators;[29]

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[18] Miller Test. at 2585:6-12 (emphasis added).
[19] *See* Div. Post-hearing Br. at 30.
[20] *See* Poppalardo Test. at 2041:2-14 ("Q: If a supervisory matrix is given to FINRA . . .what does that say about who has day-to-day responsibility for supervision? A: It doesn't say anything. . . Q: And is that matrix . . . determinative of who is a supervisor for day-to-day purposes? A: No. . . it would depend on a lot of other things.").
[21] Ex. 565 (email discussing Johnson's performance); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[22] Ex. 668 (email discussing breach of internal policies); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[23] Exs. 521, 627, 684, 791, 796, 797, 809, 506, 527, 590, 636, 664 (emails approving Johnson's compensation budget and requesting report on revenue and expenses of PFSI stock loan); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[24] Exs. 783 (Johnson seeking Pendergraft's approval); 788 (Pendergraft directing Johnson to implement charges); 790 (directing Johnson to obtain financing); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[25] Exs. 793, 794, 795, 801, 707, 741, 502, 591 (emails from Pendergraft advising Johnson regarding client relations and approving business development plans); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[26] Exs. 780, 790, 803, 804, 806, 515, 607 (emails from Pendergraft instructing Johnson regarding financing and lending balances); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[27] Ex. 517 (email from Pendergraft approving Johnson's travel expenses); 550 (email from Pendergraft requesting information from Johnson on recent expense report); *see also* Pendergraft Test. at 1529:6-1534:1 (Prop. FOF 9).
[28] Ex. 668 (email from Pendergraft to Johnson discussing breach of internal policies).
[29] Exs. 563, 638 (emails from Johnson to Pendergraft reporting on FINRA reviews).

consulting with Johnson about Rule 204 issues;[30] providing guidance to Johnson about Reg SHO;[31] and even revising and editing communications to PFSI's correspondents regarding Rule 204.[32] And Pendergraft was performing all of these activities—including regulatory and compliance—within the context of Johnson's responsibilities for *PFSI's* Stock Lending department.[33] That a wrong document was sent to regulators cannot negate the reality that Pendergraft was actively and comprehensively supervising Johnson.

The Division argues that because the erroneous supervisory matrix listed Yancey as Johnson's regulatory supervisor, and because that document was sent to regulators, "*[o]n this basis alone*, Yancey should be found to have supervisory responsibility for Johnson."[34] But even the Division's own expert rejected this argument. Paulukaitis testified that determining if a particular person is a supervisor depends on whether, under the *facts and circumstances* of a particular case, that person has the requisite degree of authority to affect the conduct of the employee whose behavior is at issue.[35] Paulukaitis made clear that the supervisory matrix was just *one fact and circumstance* that needed to be balanced against all of the other evidence.[36]

The Division relies on the *Aguilera* and *Pasztor* cases for the unremarkable proposition that the facts and circumstances test cannot be used to absolve the president of a broker-dealer of his or her overarching supervisory responsibility *absent a delegation.*[37] Fair enough. But that is not what is at issue here. The relevant issue here is *delegation*—whether Yancey reasonably delegated supervisory responsibility over Johnson to Pendergraft. Contrary to the Division's

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[30] Ex. 730 (email from Johnson to Pendergraft regarding easy to borrow lists and regulatory criteria).
[31] Johnson Test. at 541:25-542:2 ("Q: Did you talk with Mr. Pendergraft about Reg SHO? A: Yes.") (Prop. FOF 10).
[32] Ex. 813 (Pendergraft providing revisions on a Special Compliance Memorandum regarding Rule 204).
[33] Pendergraft Test. at 1536:21-1537:4; 1528:5-1534:9 (agreeing he performed the specific activities) (Prop. FOF 9).
[34] *See* Div. Post-hearing Br. at 32 (emphasis added).
[35] Paulukaitis Test. at 486:10-18; 487:18-21; Ex. 238, at 5-7 (Paulukaitis Report).
[36] Paulukaitis Test. at 486:23-487:8.
[37] *See In the Matter of Angelica Aguilera*, 2013 WL 3936214, at *23 (July 31, 2013); *In the Matter of James J. Pasztor*, Rel. No. 34-42008, 1999 WL 820621, at *5 n. 27 (Oct. 14, 1999).

assertion,[38] courts often apply the facts and circumstances test to determine whether supervisory responsibility *has been delegated*.[39] For example, in *Midas Securities*, the court applied the factors from *Gutfreund* to analyze whether the president of a broker dealer delegated supervisory authority to a subordinate.[40] Similarly, in *S.E.C. v. Yu*—a case relied on by the Division—the Commission sought to enjoin Yu, the president of a broker dealer, on the grounds that he violated an order barring him from associating in a supervisory capacity.[41] Yu argued that he had delegated all supervisory responsibilities to a senior officer.[42] The court applied the facts and circumstances test to analyze whether Yu had indeed delegated supervisory authority.[43]

Balanced against the overwhelming evidence that Yancey delegated supervisory authority over Johnson to Pendergraft, and that Pendergraft actively supervised Johnson in every aspect of Johnson's job, the erroneous supervisory matrix cannot form the basis for liability against Yancey.

b. Pendergraft's self-serving testimony does not outweigh the evidence that Yancey adduced at trial.

The Division argues that Yancey did not delegate responsibility for supervising Johnson "*as to regulatory and compliance issues.*"[44] In support, the Division asserts that "Pendergraft's testimony should be credited over Yancey's self-serving claims."[45] As is evident from their ever-changing theory, the Division cannot point to evidence sufficient to meet its burden.

i. The Division's constantly-evolving theory is not based on *fact*.

This is now the third time the Division has changed its theory regarding Johnson's

[38] *See* Div. Post-hearing Br. at 39.
[39] *See* Yancey Prop. COL 16 (and cases cited therein).
[40] *See In the Matter of the Application of Midas Securities, LLC*, 2012 WL 169138, at *13 (Jan. 20, 2012).
[41] *S.E.C. v. Yu*, 231 F. Supp. 2d 16, 20 (D.D.C. 2002).
[42] *Id.* at 20-21.
[43] *Id.* at 20-21; *see also* Yancey Prop. COL 16 (and cases cited therein).
[44] *See* Div. Post-hearing Br. at 32.
[45] *See* Div. Post-hearing Br. at 34.

supervision. After conducting a three-year investigation, the Division filed an OIP alleging that Yancey was Johnson's sole supervisor.[46] Prior to trial, the Division abandoned this theory and pivoted to a new theory. In its pre-hearing brief, the Division argued that there was split supervision between PWI and PFSI, with Yancey supervising Johnson at the PFSI level and Pendergraft supervising Johnson at the PWI level.[47] The Division argued that "Yancey could have delegated responsibility to supervise Johnson, but there is no evidence that he did so."[48]

At trial, not one witness or document supported the Division's split supervision theory. Even Pendergraft rejected the Division's theory. Now, the Division runs to yet another new theory. The Division now concedes that Yancey did, in fact, properly and reasonably delegate supervision of Johnson to Pendergraft as to every single aspect of Johnson's job at the PFSI level *other than* regulatory and compliance—the one aspect that is at issue in this case. Indeed, the Division concedes that Yancey properly delegated supervisory responsibility to Pendergraft as to Johnson's performance, discipline, budget and compensation, customer relationships, business development plans, travel budget, expenses, and management of firm financing and lending balances responsibilities.[49] The Division's ever-changing story highlights the flaws in its argument.

ii. Nearly every other witness contradicted Pendergraft's testimony.

The Division's argument that Pendergraft's testimony "should be credited over Yancey's self-serving claims" is fatally flawed for at least three reasons.[50] First, the Division is not asking the Court to credit Pendergraft's testimony over only Yancey's testimony; rather, the Division is

[46] *See* OIP at 14, ¶¶ 9, 70.
[47] *See* Division's Pre-hearing Brief at 22.
[48] *Id.*
[49] Pendergraft admitted he performed these activities with respect to Johnson, and the Division does not dispute this.
[50] *See* Div. Post-hearing Br. at 34.

asking the Court to credit Pendergraft's testimony over the testimony of Yancey, Johnson, Gardner, Delaney, Wetzig, DeLaSierra, Hasty, McCain, Miller, and Hall, as well as over 50 contemporaneous emails and documents that clearly reflect Pendergraft supervising Johnson.

Next, the Division asks the Court to reject all of the evidence that Pendergraft did, in fact, supervise Johnson with respect to regulatory and compliance issues. Indeed, Pendergraft reprimanded Johnson regarding internal policies and regulatory considerations,[51] directed Johnson to report to him regarding meetings with regulators,[52] consulted with Johnson about Rule 204 issues,[53] provided guidance to Johnson about Reg SHO,[54] and even revised and edited communications to PFSI's correspondents regarding Rule 204.[55]

Finally, none of the Division's five arguments why the Court should credit Pendergraft's testimony over all of the other evidence holds water. First, the Division makes the nonsensical argument that "Yancey himself vouched for Pendergraft's credibility" by "urging the Division to take his testimony during the investigation to properly understand the supervisory structure over Johnson."[56] But Yancey did not vouch for Pendergraft's credibility—he urged the Division to take Pendergraft's testimony in hope that Pendergraft would admit what nearly every other witness in this case has confirmed—that he was Johnson's supervisor. Indeed, had the Division not taken Pendergraft's testimony ***after*** Yancey had already received a Wells notice, ***after*** Pendergraft was aware of the potential charges that he could face with an admission of his role, ***after*** he had the opportunity to review the transcripts of other witnesses, and ***after*** his counsel advised him on the risks of admitting his supervision, Pendergraft would have been far more

[51] Ex. 668 (email from Pendergraft to Johnson discussing breach of internal policies).
[52] Exs. 563, 638 (emails from Johnson to Pendergraft reporting on FINRA reviews).
[53] Ex. 730 (email from Johnson to Pendergraft regarding easy to borrow lists and regulatory criteria).
[54] Johnson Test. at 541:25-542:2 ("Q: Did you talk with Mr. Pendergraft about Reg SHO? A: Yes.") (Prop. FOF 10).
[55] Ex. 813 (Pendergraft providing revisions on a Special Compliance Memorandum regarding Rule 204).
[56] *See* Div. Post-hearing Br. at 34.

likely to tell the truth.

Second, the Division argues that Pendergraft's testimony is "consistent with other evidence." But as demonstrated above, the evidence overwhelmingly demonstrates that Yancey delegated supervisory responsibility over Johnson to Pendergraft. The only contrary evidence that the Division can muster is a cherry-picked snippet of DeLaSierra's testimony and the erroneous supervisory matrix.[57] DeLaSierra testified that, given his personal observations, Pendergraft was supervising Johnson, including with respect to issues related to Reg SHO.[58]

Third, the Division's argument that Yancey's story is inconsistent with other evidence is meritless.[59] As demonstrated above, there is a mountain of evidence reflecting Yancey's delegation of supervisory responsibility over Johnson to Pendergraft, including the testimony of Yancey, Gardner, Delaney, and Hasty, all of whom confirmed that in August 2008 Yancey delegated supervision of Johnson to Pendergraft, and Pendergraft accepted this delegation unconditionally.[60] The Division argues that Gover and Johnson testified that Stock Loan reported up to Yancey, but this argument is misplaced. The trial record confirms that Mike Johnson supervised the Stock Loan department, and Yancey delegated supervisory responsibility over Johnson to Pendergraft. Regardless, the issue in this case is not who supervised Stock Loan, *it is who supervised Mike Johnson*. Ignoring the testimony of countless witnesses, the Division argues that there "is no document evidencing that Yancey delegated full supervisory responsibility to Pendergraft."[61] Even if this were true, it would be irrelevant because the law does not require that the act of delegation be written.[62] But the delegation is documented in

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[57] *See* Div. Post-hearing Br. at 35.
[58] *See* DeLaSierra Test. at 302:22-304:4.
[59] *See* Div. Post-hearing Br. at 35.
[60] *Supra* notes 3-7; 21-33.
[61] *See* Div. Post-hearing Br. at 35.
[62] *Swartwood Hesse, Inc.*, 1992 WL 252184 at *6 (where all parties testified about the delegation, Commission concluded president successfully delegated supervisory authority, even if no formal delegation and even where

Pendergraft's unconditional direction to Dawn Gardner to move Johnson out of Yancey's organization and into Pendergraft's organization.[63] As Gardner testified, from this point forward, Pendergraft was Johnson's supervisor in every aspect.[64]

Fourth, the Division argues that Pendergraft's testimony "is logical" because "PWI did not have regulatory compliance obligations, such as obligations under Rule 204."[65] But this argument ignores the stipulated fact that at all relevant times Pendergraft was an Executive Vice President at PFSI.[66] Moreover, as Ms. Poppalardo testified, the Division's argument is illogical.[67] Under the Division's logic, supervisors could easily avoid liability simply by delegating "regulatory and compliance supervision" to others who may be far removed from the day-to-day activities of those they supervise. This would turn well-established supervision standards on their head and remove supervisory responsibility from those closest to—and most able to prevent and detect—potential misconduct.

Fifth, the Division claims that Yancey's arguments have been "largely discredited."[68] But the Division cites to Penson's organization charts, which clearly reflect that after 2008 Johnson no longer reported to Yancey. Nor do the organization charts reflect that Johnson had dotted line reporting to Yancey.[69] That Dan Son assisted Pendergraft's supervisory undertaking

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trader testified that he had "no idea" whether president delegated his "compliance responsibility"); *id.* at *5 ("the fact that there was no written documentation to support this division of authority is not dispositive of the issue"); *In the Matter of Raymond James*, SEC Admin. Proc. File 3-11692, 2005 WL 2237628 at * 47 (Sept. 15, 2005) ("[T]hat [broker dealer's] CEO did not formally delegate to [delegatee] responsibility for . . . supervisory procedures does not change the fact that [delegatee] was responsible for supervising [supervisee]. [Delegatee] controlled [supervisee's] activities," and was responsible for hiring and firing supervisee) (Prop. COL 12).

[63] Ex. 608.

[64] Gardner Test. at 1150:3-6 ("Q: And who was Mike Johnson's supervisor during this entire -- during that entire period, August 2008 through November 2011? A: Phil Pendergraft."); 1153:13-21 (testifying that Pendergraft engaged in performance management, compensation management, and business strategy with respect to Johnson).

[65] *See* Div. Post-hearing Br. at 35.

[66] Stip. FOF 75.

[67] Poppalardo Test. at 1999:8-24 ("A: . . . I feel really strongly that—that you just can't parse the business activities from the regulatory requirements. . . . A: I've never seen it.").

[68] *See* Div. Post-hearing Br. at 36.

[69] *See, e.g.*, Ex. 571 (organizational chart).

in no way minimizes the delegation. The Division also misleadingly asserts that Yancey relied on a "handful of email communications between Johnson and Pendergraft." In fact, the Court admitted over 50 contemporaneous documents reflecting Pendergraft's supervision of Johnson.

c. There was no confusion about Penson's supervisory structure.

In a last-ditch attempt to salvage its claim, the Division argues that "at best the evidence shows confusion about Johnson's supervision." There is no merit to this argument either. The trial record clearly demonstrates that there was no confusion within Penson about who supervised Mike Johnson.[70] Nearly a dozen witnesses testified unequivocally that Johnson reported to Pendergraft.[71]

The Division's reliance on *Koch Capital* is unavailing.[72] In *Koch*, the Commission concluded that the president of a broker dealer had not properly delegated supervisory authority because, among other things: (1) the president made no effort to discharge his supervisory authority; (2) the president could not testify to whom he had delegated supervisory authority; (3) the president knew that one of the people he attempted to delegate supervisory authority to was inexperienced; and (4) the president attempted to transfer supervisory authority from one delegatee to another, but there was no effective transfer, creating a time where "no one assumed responsibility for compliance."[73] *Koch* does not stand for the proposition that contradictory evidence as to delegation necessarily shows confusion in the supervisory structure sufficient to negate the delegation; rather, *Koch* stands for the unremarkable proposition that the president of

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[70] Gardner Test. at 1153:24-1154:2 ("Q: Ms. Gardner, are you aware of anyone in the company that was confused about who supervised Mike Johnson? A: No."); McCain Test. at 2194:9-16 ("Q: In your mind, was there any confusion about who Mike Johnson reported to? A: Absolutely not."); Hasty Test. at 1745:13-16 ("Q: Are you aware of anyone at the Penson organization who was confused about who Mike Johnson was supervised by? A: No."); Delaney Test. at 1336:10-13 ("Q: To your knowledge, Mr. Delaney, was there anyone in the Penson organization who was confused about who Mr. Johnson's supervisor was? A: No.") (Prop. FOF 18).

[71] *See* Respondent Yancey's Post-hearing Brief ("Yancey Post-hearing Br.") at 9-10 (table of testimony).

[72] *See In the Matter of Koch Capital, Inc.*, Rel. No. 34-31652, 1992 WL 394580 at *5 (Dec. 23, 1992).

[73] *Koch Capital, Inc.*, 1992 WL 394580 at *5.

a firm will continue to be responsible for compliance with all regulations unless and until he properly delegates that supervisory authority.

Here, in contrast, Yancey effectively and unambiguously delegated supervisory responsibility over Johnson to Pendergraft. Nearly a dozen witnesses testified that Pendergraft supervised Johnson. Pendergraft comprehensively supervised Johnson as to every aspect of his job. Pendergraft was qualified to supervise Johnson, and Yancey reasonably followed up on that delegation.

B. Johnson was reasonably supervised.

The Division next argues that Yancey "did not discharge his supervisory obligations as to Johnson" and that "no one" supervised Johnson with respect to regulatory and compliance issues.[74] But Johnson himself testified that he went to Pendergraft for issues related to Reg SHO and Rule 204.[75] And the Division overlooks the contemporaneous documentary evidence demonstrating that Pendergraft reprimanded Johnson regarding internal policies and regulatory issues, directed Johnson to meet with regulators, consulted with Johnson about Rule 204 issues, and provided guidance to Johnson about Reg SHO.[76]

In any event, Yancey's consistent and robust follow-up of Pendergraft's supervision provided reasonable supervision of Johnson. Yancey met regularly with Pendergraft and discussed Johnson's performance in those meetings. Yancey monitored Pendergraft's supervision of Johnson's activities. Yancey "routinely checked in" with Pendergraft regarding: his evaluation and review of Johnson's performance; his disciplining of Johnson; his approvals of Johnson's budget and compensation; his advice to Johnson on customer relations issues,

[74] *See* Div. Post-hearing Br. at 37.
[75] Johnson Test. at 541:25-542:5 ("Q: Did you talk with Mr. Pendergraft about Reg SHO? A: Yes."); 542-543; 561:5-562:9; *see also* Exs. 94, 551, 563, 638, 710, 730, 810, 813, 814.
[76] Ex. 668 (Pendergraft disciplining Johnson); Exs. 94, 551, 563, 638, 710, 730, 810, 813, 814 (Pendergraft involved in PFSI's regulatory issues, and directing Johnson with respect to same); Johnson Test. at 541:25-542:5 (Johnson discussed Reg SHO with Pendergraft); 543:9-16 (Johnson went to Pendergraft regarding Rule 204).

business development plans, and customer relation plans and budgets; his instructions to Johnson regarding PFSI firm financing and lending balances; and his approvals of Johnson's travel budget and expenses. Yancey also attended weekly meetings with Pendergraft and Johnson, which allowed Yancey to receive updates regarding Johnson.[77] Pendergraft himself admitted that Yancey acted reasonably in ensuring that Johnson and Stock Loan were properly conducting business in accordance with the securities laws.[78] Thus, Johnson did not go unsupervised—Yancey reasonably supervised Johnson by virtue of his consistent follow-up.[79]

II. Yancey Reasonably Supervised Tom Delaney.

A. The Division's claim fails as a matter of law.

1. The Division failed to prove Delaney "aided and abetted" violations of Rule 204(a) regarding long sales of loaned securities.

A failure to supervise claim fails as a matter of law if there is no underlying securities violation by another person.[80] Here, the Division failed to prove that Delaney aided and abetted a "policy and practice of intentionally and consistently" violating Rule 204(a) with respect to long sales of loaned securities.[81] The Division's claim against Yancey, therefore, fails as a matter of law.[82]

2. If the Court finds that Delaney "caused" violations of Rule 204(a), the failure to supervise claim against Yancey fails as a matter of law.

Undoubtedly recognizing the flaws in its "aiding and abetting" claim against Delaney, the

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[77] *See* Yancey Test. at 948:23-950:23.
[78] Pendergraft Test. at 1537:5-10.
[79] *Cf. In the Matter of Theodore W. Urban*, SEC Admin. Proc. File 3-13655, Initial Decision Release No. 402 at 52-55 (Sept. 8, 2010) (finding no delegation but finding no failure to supervise because respondent reasonably supervised individual whose conduct was at issue).
[80] To prevail on a failure to supervise claim brought under Section 15(b)(4)(E), the Division must prove 4 elements, including "an underlying securities law violation by another person." *See In the Matter of Dean Witter Reynolds, Inc.*, SEC Admin. Proc. File 3-9686, 2001 WL 47244 at *38 (Jan. 22, 2001) (Prop. COL. 2).
[81] *See* Post-hearing Brief of Respondent Thomas R. Delaney II.
[82] *See In the Matter of Michael Bresner*, Exchange Act Release No. 34-68464, 2012 WL 6608195, at *2 (Dec. 18, 2012) (denying as inefficient a request to sever action against supervisor and representative because, "as in all failure-to-supervise cases, the underlying violation must be proven as the first step in substantiating a charge of supervisory failure against [the supervisor]") (Prop. COL 4); (Prop. COL 2).

Division argues instead that Delaney "caused" violations of Rule 204(a).[83] For a failure to supervise claim, Section 15(b)(4)(E) requires the subordinate to have "***willfully*** aided, abetted, counseled, commanded, induced, or procured" the underlying violation.[84] To establish a "willful" violation, the subordinate must have acted with willfulness or scienter, which is shown where a person intends to commit an act that constitutes a violation.[85] A "causing" violation, on the other hand, may be satisfied by negligence.[86] Because 15(b)(4)(E) requires proof of "willfulness," proof of a "causing" violation is insufficient to establish the predicate element in a failure to supervise case.[87] Therefore, if the Court determines that Delaney "caused" violations of Rule 204(a), the Division's failure to supervise claim against Yancey fails as a matter of law.

B. The Division has not proven that Yancey failed reasonably to supervise Delaney.

1. Yancey had no knowledge of the Rule 204(a) violations at issue.

It is well-established that lack of scienter "may be considered in evaluating the reasonableness of supervision."[88] Here, the Division has stipulated that Yancey did not know about Rule 204(a) violations regarding long sales of loaned securities.[89] This is undisputed.[90] Not only does this weigh heavily in favor of a finding that Yancey reasonably supervised

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[83] OIP at ¶ 85.
[84] 15 U.S.C. § 78o(b)(4)(E) (emphasis added); *see also* Div. Prop. COL 3.
[85] *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) ("[A] finding of willfulness [requires] . . . intent to commit the act which constitutes the violation.").
[86] *See KPMG Peat Marwick LLP*, 74 SEC Docket 384, 421 (Jan. 19, 2001) (holding that negligence is sufficient to establish liability for causing a primary violation that does not require scienter); *see also* Div. Prop. COL 8.
[87] *In the Matter of H.J. Meyers & Co.*, SEC Admin. Proc. File 3-10140, 2002 SEC LEXIS 2075 at *93 (Aug. 9, 2002) ("[I]f the primary violation requires a showing of scienter, there can be no liability for causing that violation without a finding of scienter.").
[88] *See Aguilera*, 2013 WL 3936214 at *21; *In the Matter of Clarence Z. Wurts*, 54 S.E.C. 1121, 1132 (Jan. 16, 2001); (Prop. COL 3).
[89] Stip. FOF 43.
[90] The Division misleadingly states that Delaney "raise[d] the issue of the violations with Yancey." This contradicts a stipulated fact (Stip. FOF 43) and contradicts the Division's own theory that Delaney concealed the violations from Yancey. *Compare* Div. Post-Hearing Br. at 12 *with* Div. Post-Hearing Br. at 21 and OIP at ¶¶ 60, 64, 68.

Delaney,[91] it makes the Division's case against Yancey an extreme outlier.[92]

2. No evidence supports the Division's theory that "red flags" should have alerted Yancey to Stock Loan's violations of Rule 204(a).

The Division has abandoned 75% of its "red flag" allegations against Yancey. In the OIP, the Division alleged that four "red flags" should have alerted Yancey to "Delaney's misconduct relating to his aiding and abetting" violations of Rule 204(a): (1) a purported nexus between the Stock Loan and Buy Ins departments that, based on the December 2009 Audit, should have led Yancey to knowledge of Stock Loan violations; (2) Mike Johnson's absence from a March 31, 2010 meeting; (3) the absence of a specific reference in the March 31, 2010 Summary Report of the Buy Ins department's 204(a) issues; and (4) the absence of a specific reference to the Buy Ins department's 204(a) issues in a November 2010 OCIE response.[93] The Division has now abandoned purported red flags (1), (2), and (4).[94] In its post-hearing brief, the Division does not address these allegations at all.[95] The only issue briefed relates to the March 31, 2010 3012 Summary Report and whether the absence of a specific reference to the Buy Ins department's Rule 204(a) issues was a "red flag" such that Yancey should have been alerted to intentional violations of Rule 204(a) in the Stock Loan department—keeping in mind that the

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[91] *See In the Matter of Charles F. Kirby*, SEC Admin. Proc. File No. 3-9602, Initial Decision No. 177, 2000 WL 1787908, at *20-23 (Dec. 7, 2000) (CEO had no notice of violations and given subordinate's covert activities had no evidence of suspicious or irregular events; thus, no failure to supervise.); *Dean Witter Reynolds*, 2001 WL 47244 at *53 (no failure to supervise when the supervisor had no indications of irregularity and reasonably relied on subordinate's representations because he had no reason to discredit it); *Swartwood Hesse,* 1992 WL 252184 at *6 (in part because CEO was not aware of any irregularity he did not fail reasonably to supervise).

[92] The vast majority of failure to supervise findings are supported by actual knowledge of the supervisor. *See, e.g., Michael Bresner*, 2013 WL 5960890 (failure to supervise found against supervisor who admitted the violation was a known problem); *In the Matter of John A. Carley,* 92 S.E.C. 1316, 2008 WL 268598 (Jan. 31, 2008) (failure to supervise found against President who knew of actual violations by subordinates); *In the Matter of Stephen J. Horning*, Exchange Act Release No. 56886, 2007 SEC LEXIS 2796 (Dec. 3, 2007) (failure to supervise found against President who was aware of trading violations by subordinate).

[93] *See* OIP at ¶¶ 74-83.

[94] *Compare* OIP at ¶¶ 74-83 *to* Div. Post-hearing Br. at 39-42.

[95] As demonstrated in Yancey's Post-hearing brief, these four purported "red flags" were not "red flags" at all. *See* Yancey's Post-hearing Br. at 28-42.

Division alleges that Delaney *actively concealed* those violations from Yancey.[96]

a. The March 31, 2010 CEO Certification 3012 Summary Report was not a "red flag."

The absence of an explicit reference to the December 2009 Audit results in the Summary Report, appended to Yancey's March 31, 2010 CEO Certification, was not a "red flag" that Delaney was concealing Stock Loan's Rule 204(a) violations. As the trial record demonstrates, the Summary Report was compiled through a deliberate and thorough process on which Yancey was reasonably entitled to rely.[97]

First, Penson's Compliance department was responsible for preparing and reviewing the Summary Report.[98] As the compliance experts with the most familiarity with Penson's 3012 testing, Delaney and Alaniz were in the best position to compile the report.[99] In particular, Delaney, as CCO, employed his business judgment and expertise to determine whether an issue should be included in the Summary Report.[100]

Neither Delaney[101] nor Alaniz[102] considered the December 2009 Audit results worthy of inclusion in the report. Ms. Poppalardo agreed with that decision.[103] Indeed, Alaniz and Delaney testified that *none* of the approximately twenty Rule 3012 tests conducted that year warranted explicit reference in the Summary Report.[104] Instead, all 3012 testing materials,

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[96] *See* OIP at ¶¶ 60, 64, 68.
[97] Delaney Test. at 1361:10-24, 679:10-17; Alaniz Test. at 719:9-12 (Prop. FOF 78).
[98] *See* Alaniz Test. at 856:22-24; 719:9-12; Delaney Test. 1361:10-24 (Prop. FOF 33, 78).
[99] Delaney Test. at 1361:22-1363:1; *see also* Yancey Test. at 1886:22–1887:4.
[100] *See* Poppalardo Test. at 1959:24-1960:7 ("A: But we don't see. . . every exception that's been identified in . . . internal testing, because there's just too many. . . There's got to be some judgment, and you have to—and it's really the Chief Compliance Officer who determines what it material enough to—to be in the report."); Delaney Test. at 673:18-20; 679:10-13; Alaniz Test. at 719:13-15 (Prop. FOF 79).
[101] Delaney Test. at 1362:5-10 ("Q: Why was it not specifically identified? A: The testing results from Eric that had come, that had been reported out, had already been substantially starting to be remediated at that point, and it was inclusive in the material that was there with the report.") (Prop. FOF 25, 40).
[102] Alaniz Test. at 857:22-858:23; 858:7-23 (Prop. FOF 25, 77).
[103] *See* Ex. 828 at 18 (Poppalardo Report) ("I do not believe there was an omission in the 3012 Summary Report regarding the results of the December 2009 Rule 3012 audit. . . .") (Prop. FOF 40).
[104] Alaniz Test. at 857:19-21; Delaney Test. at 1303:8-18 (Prop. FOF 87).

including the December 2009 Audit, were made separately available to regulators for review.[105]

Second, as CEO, Yancey was entitled to rely on the determination that the December 2009 Audit did not rise to the level of a "key compliance issue."[106] The Division's suggestion that Yancey "made no effort to follow up" on the contents of the Summary Report is belied by the evidence.[107] Yancey had a thorough discussion with Delaney and Alaniz prior to signing the Summary Report.[108] Moreover, the absence of a specific reference in the Summary Report was not at all "suspicious" given that: (1) no other 3012 test result was included[109] and (2) Yancey had been repeatedly assured that the issues revealed in the December 2009 Audit were the focus of prompt remediation.[110] Indeed, Delaney himself testified there was no reason Yancey should have overruled the judgment of the Compliance department.[111]

b. Yancey reasonably supervised Delaney.

There was overwhelming evidence at trial that Yancey reasonably supervised Delaney. Delaney, himself, testified that Yancey was "a great supervisor," "a friend of the Compliance department," a "mentor," and someone Delaney is "proud to know."[112] Yancey's supervision of Delaney—and all his direct reports—was consistent,[113] robust,[114] progressive,[115] and reasonable.

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[105] Alaniz Test. at 804:12-805:3; Delaney Test. at 1304:10-24; Ex. 135 (3012 testing documentation was "available in the Compliance Department") (Prop. FOF 26).
[106] *See* Ex. 829 at 23 (Paz Report); Ex. 828 at 18 (Poppalardo Report); Poppalardo Test. at 1998:3-12.
[107] Div. Post-hearing Br. at 41.
[108] *See* Yancey Test. at 1885:14-1886:2 ("Did you ask any questions or have any discussions with people prior to signing it? A: Yes, ma'am. . . I ask a lot of questions about a lot of things, but the big question that I always ask is: Does anybody know of any reason that I wouldn't sign this or that Tom wouldn't sign this? Is there anything at all that we should know, that we should do? Is there anything about it we could do before I sign this document? Q: Who did you ask that of? A: I certainly asked it of Tom Delaney, Eric Alaniz. . . ."); 1887:22-1888:13 ("Q: Did you have any reason to disagree with Mr. Delaney's inclusion or exclusion of material on his Summary Report? A: No ma'am. . . ."); *see also* Yancey Test. at 882:23-883:11.
[109] Alaniz Test. at 857:19-21; Delaney Test. at 1303:8-18 (Prop. FOF 87).
[110] *See* Stip. FOF 77; *see* Alaniz Test. at 795:17-21; 845:4-19; 851:20-852:16; *see also* Yancey Test. at 1879:7-15; Delaney Test. at 1354:6-12; Exs. 134, 669 (Prop. FOF 64).
[111] Delaney Test. at 1362:22-1363:1 (Prop. FOF 39).
[112] Delaney Test. at 1338:24-1339:19; 1328:13-17 (Prop. FOF 62).
[113] Stip. FOF 95; *see also* Delaney Test. at 1338:24-1339:19; 1339:23-1340:1; Yancey Test. at 1840:9-14 ("A: I set up a one-on-one with them, and then I held a regular Tuesday morning at 9:00 a.m. staff meeting for my direct

III. Penson had Established Procedures to Prevent and Detect Violations, and Yancey Reasonably Satisfied his Supervisory Duties.

The Division's supervisory claims against Yancey also fail because: (i) Penson had established procedures, and a system for applying such procedures, to prevent and detect violations, and (ii) Yancey reasonably satisfied his duties and obligations without reasonable cause to believe that the procedures and system were not being followed.[116]

A. Penson had reasonably designed procedures and systems.

Penson's supervisory system was robust. It consisted of policies, procedures, and controls that designated qualified supervisors and provided guidance for complying with the securities laws, as well as a robust testing process to prevent and detect violations.[117] Ms. Poppalardo thoroughly analyzed and reviewed Penson's systems and processes and found them to be "reasonable"[118]—meaning "a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to [Penson's] business."[119] To suggest there were "no established procedures, or a system for applying those procedures"[120] ignores the weight of the documents and testimony.[121] Just as in the *IFG* case, Penson and Yancey "implemented procedures that were addressed specifically" to address Rule 204, including

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reports every week."); 1918:25-1919:11; McCain Test. at 2178:5-7, 14-25; Hasty Test. at 1701:25-1702:8; Wetzig Test. at 423:16-424:3 (Prop. FOF 23, 30).

[114] *See* Stip. FOF 95; Prop. FOF 35 (and evidence cited therein).

[115] Delaney Test. at 1369:7-14 (Prop. FOF 62).

[116] *See* Prop. COL 33, 34.

[117] *See* Ex. 828 at 7-13 (Poppalardo Report).

[118] *See* Ex. 828 at 7-13 (Poppalardo Report).

[119] *See* NASD Notice to Members 99-45 (June 1999) (NASD Provides Guidance on Supervisory Responsibilities); *see also In the Matter of IFG Network Sec., Inc.*, Exchange Act Release No. 34-54127, 2006 WL 1976001 (July 11, 2006) (Commission did not find the broker-dealer President failed to reasonably supervise and rejected Division's arguments that a different system would have been "more reasonably designed" to prevent the violations).

[120] *See* Div. Prop. COL 17.

[121] *See* Prop. FOF 34 (discussing FINRA training programs), 35 (quarterly 3012 testing regime and meetings), 50 (Penson's rule implementation process), 52 (compliance training on Reg SHO and Rule 204), 53 (WSP updates), 66 (approximately 20 Rule 3012 audits per year), 68 (robust 3012 testing), 69 (Rule 204 audit), 93 (checklists and desk procedures), 94 (compliance memos and alerts), 95 (technology updates), 96 (3012 testing practice).

"written compliance materials,"[122] as well as "annual audits" via its 3012 testing program[123] that "could reasonably have been expected to prevent" the violations.[124]

B. Yancey reasonably discharged his duties.

Nearly every witness touted Yancey as an engaged, accessible, ethical, and honest CEO.[125] Yancey had a strong supervisory routine, including meeting with each direct report and his superiors twice a week—in both group and one-on-one settings.[126] This allowed Yancey to exercise effective supervision over all of his direct reports, including Penson's CCO Tom Delaney, and follow up on the delegation of supervisory responsibilities with Phil Pendergraft.[127] As discussed above, no red flags were raised to Yancey that would have given him reasonable cause to believe the reasonably-designed systems and procedures were not being complied with.

IV. The Remedies Sought by the Division are Unsupported and Excessive.

If the Court finds Yancey liable, none of the *Steadman* factors supports imposing sanctions beyond a censure.

A. A supervisory bar is unwarranted.

In seeking a bar, the Division mischaracterizes Yancey's alleged supervisory conduct and ignores other relevant and necessary considerations,[128] such as: (a) the degree of scienter, (b) the harm to investors and the marketplace resulting from the violation, and (c) the standards of conduct in the securities industry.[129] When analyzed under the proper framework, Yancey's conduct is

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[122] *See, e.g.*, Ex. 540 at 383-399; Ex. 746 at 325-341; *see also* Ex. 828 at 10-12 (Poppalardo Report) (Prop. FOF 92); Exs. 519, 582; Hasty Test. at 1713:17-1714:16; Wetzig Test. at 393:16-23 (Prop FOF 93).

[123] *See* Alaniz Test. at 714:10-12; 739:13-19; Poppalardo Test. at 1995:8-10 ("A: I thought they had a very good – a very robust Series [30]12 testing process. It was better than a lot that we've seen."); Ex. 828 at 12-13 (Poppalardo Report); Exs. 70, 84 (Rule 204 audits) (Prop FOF 68, 96).

[124] *See IFG Network*, 2006 WL 1976001 (Commission detailed the firm's reasonable policies and procedures finding the Division did not prove that IFG or broker-dealer President, Ledbetter, failed to exercise reasonable supervision).

[125] Prop. FOF 30 (and evidence cited therein); *see also* Prop. FOF 85 (and evidence cited therein).

[126] Delaney Test. at 1339:1-19; McCain Test. at 2178:14-25; Yancey Test. at 1840:9-25 (Prop. FOF 23).

[127] Delaney Test. at 1339:1-19; Yancey Test. at 948:18; Pendergraft Test. at 1537:5-10 (Prop. FOF 11).

[128] *See* Yancey's Post-Trial Br. at 48-49.

[129] *See In re Prime Capital Services, Inc., et al.*, 2010 WL 2546835, at *48 (June 25, 2010) (Prop. COL 42).

wholly distinguishable from the type of conduct for which courts reserve such a severe and debilitating sanction. Indeed, as the following cases demonstrate, courts overwhelmingly reserve associational bars and civil penalties for individuals with far more culpability than Yancey, namely those who had ***actual awareness*** of misconduct:

- Senior manager ***knew of his employee's prior disciplinary record*** regarding misrepresentations made to regulators and ***knew*** that his employees were not completing the required documentation at issue. *In the Matter of Ronald S. Bloomfield,* SEC Admin. Proc. File No. 3-13871, Release No. 9553 (Feb. 27, 2014).

- Supervisor ***knew*** of employee's past disciplinary history and current violations. *In the Matter of Eric J. Brown*, Securities Exchange Act Release No. 6646 (Feb. 28, 2012).

- CEO ***knew*** of employee's previous similar violations, the employee's efforts to conceal those violations, and was ***aware*** of suspicious activities related to the violations at issue. *In the Matter of John A Carley*, 92 S.E.C. 1316, 2008 WL 268598 (Jan. 31, 2008).

- Manager of a registered broker-dealer ***knew*** of detailed allegations against employee, ***knew*** they came from a credible source, and performed no follow-up investigation resulting in a ***10-12 million dollar*** loss to the investing public. *In the Matter of George J. Kolar,* 2002 SEC LEXIS 3420 (June 26, 2002).

- Vice President and Director of a broker-dealer ***knew about*** employee's past bad conduct, customer complaints, inexperience, and conflicts of interest. *In the Matter of Steven Muth,* Securities Exchange Act Rel. No. 8622 (Oct. 3, 2005).

- CEO of a broker-dealer ***actively concealed information*** – he heard misrepresentations made to investors, ***knew they were false***, and failed to correct them. The business realized over a million dollars in benefits from the ***fraudulent scheme***. *In the Matter of Johnny Clifton*, Exchange Act Rel. No. Release No. 9417 (July 12, 2013).

The Division's case against Yancey is vastly different than the above-cases. Here:

- It is undisputed that Yancey was not aware of the violations at issue;[130]
- Any violations were actively concealed from Yancey;
- Yancey reasonably relied on the assurances of Tom Delaney;[131]
- Delaney had an unblemished record after more than 15 years in the industry;[132]
- Yancey was told the regulatory issues were the focus of prompt remediation;[133]
- Yancey delegated supervisory responsibility of Johnson to Pendergraft, an

[130] Stip. FOF 43 (Yancey was not aware that Penson's Stock Loan Department was violating Rule 204).
[131] *See* Ex. 828 p. 18 (Poppalardo Report) ("Mr. Yancey, like most CEOs in the industry, relied on the report prepared by his CCO, and I believe his reliance was reasonable . . .") (Prop. FOF 39).
[132] Ex. 241 (Delaney's CRD) (Prop. FOF 88).
[133] *See* Stip. FOF 77 (Yancey was frequently told the 204 testing results were the subject of prompt remediation).

experienced and qualified individual;[134]

- Johnson had an unblemished record after more than 15 years in the industry;[135]
- Pendergraft consistently and comprehensively supervised Johnson;[136] and
- Yancey followed up with Pendergraft regarding his supervision.[137]

Finally, the ***only quantifiable benefit*** Penson gained from not timely closing out was approximately .08% of Stock Loan's total revenue, or **$59,000.**[138] Under these circumstances, Yancey's supervision, even if imperfect, was not unreasonable, much less egregious.[139]

The risk of future violations by Yancey is minimal. Testimony regarding Yancey's honest and ethical qualities and his dedication to compliance provides assurance against future violations.[140] Also, the Division fails to recognize the stark differences in Yancey's current position versus his position at Penson – Yancey now supervises ***only two*** individuals in the sales department. Yancey's unblemished record speaks for itself, and the repercussions and stigma of these allegations are more than a sufficient deterrent. The sanctions the Division asks this Court to impose emulates punishment rather than deterrence and thus, should not be awarded.[141]

B. A civil penalty and/or disgorgement is not in the public interest.

Section 21B(a)(1) of the Exchange Act authorizes the Commission to impose a civil penalty only if it finds that such penalty is in the public interest. But any civil penalty must be *proportionate* and *reasonable* in light of the *Steadman* factors and the "public interest" factors

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[134] Yancey Test. at 951:6-8 ("Q:. . .[I]n approximately August of 2008, that's when you delegated to Phil Pendergraft? A: Fully delegated, fully accepted.") (Prop. FOF 6); Stip. FOF 82.
[135] Ex. 242 (Johnson's CRD) (Prop. FOF 89).
[136] Pendergraft Test. at 1521:5-11 ("Q: If supervise means give guidance on how to properly run the Stock Loan Department of PFSI in Dallas, how would you answer the question? A: Then I would say that I provided supervision to Mr. Johnson."), 1513:5-7 (". . . in this time frame that Mr. Johnson reported to me, he would have largely taken his direction from me."); *see also* Prop. FOF 9 (Pendergraft supervised Johnson regarding numerous activities).
[137] Prop. FOF 11 (Pendergraft testified Yancey followed-up regarding his supervisory activities).
[138] *See* Stip. FOF 53, 80.
[139] *See In re Bellows,* 1998 WL 409445, at *9 (concluding there was "reasonable supervision under the attendant circumstances" even though the supervision was not perfect and a more thorough investigation might have revealed supervisee's misconduct).
[140] Stip. FOF 72, 90; Prop. FOF 30, 35, 36, 62, 85 (testimony that Yancey is honest, ethical, and full of integrity).
[141] The purpose of imposing sanctions is *not* to punish the Respondent. *See Horning*, 2007 SEC LEXIS 2796, at *24 (Prop. COL 39).

annunciated in Section 21B,[142] including: (1) whether the act or omission 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 the act or omission; (3) the extent to which any person was ***unjustly enriched***; (4) whether the ***respondent previously*** had been found by the Commission or another regulatory agency to have ***violated*** the securities laws, or the rules of a self-regulatory organization; and (5) the ***need to deter*** the respondent and other persons from committing the acts or omissions.[143]

The Division failed to present any evidence that Yancey acted fraudulently or even with reckless disregard, which requires "an extreme departure from the standards of ordinary care."[144] Instead, it is undisputed that ***Yancey was unaware of the violations at issue***.[145] The Division also failed to present evidence showing the public was harmed in any way or the extent to which Yancey received a benefit based on his alleged failure to supervise Delaney or Johnson, if any. For these reasons, the Court should reject the Division's request for civil penalties.

Disgorgement is also an inappropriate and unjust remedy given the facts and circumstances of this case. As the Division admits, "disgorgement need only be a reasonable approximation of the profits ***causally connected*** to the violation."[146] At best, the causal connection is tenuous if not completely immeasurable.

The Division's rationale for and calculation of disgorgement bears the mark of the same gravity of error found in the expert report of Larry Harris. The Division seeks 1/3 of Yancey's cumulative bonuses over the relevant time period – that is, the ***entire portion*** of Yancey's bonus that the Division claims represents PFSI's performance.

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[142] *See generally In the Matter of Raymond J. Lucia*, Initial Decision Release No. 540 (Dec. 6, 2013).
[143] *See* 15 U.S.C. § 78u-2(c).
[144] *Aguilera*, 2013 WL 3936214 at *25.
[145] Stip. FOF 43.
[146] Div. Post-Hearing Br. at 49; *see also Ronald S. Bloomfield,* 2014 WL 768828, at *20.

It is undisputed that the only causally connected and quantifiable benefit Penson gained during the relevant time period is $59,000 or .08% of Stock Loan's total revenue.[147] Additionally, Stock Loan revenue only accounted for approximately 10% of PFSI's revenue, [148] and Yancey was one of many individuals who received bonuses based on PFSI's performance. Thus, Yancey's derivative benefit (i.e. a portion of 1/3 of his bonus attributable to PFSI's performance) is ***far less*** than the inconsequential .08% of revenue gained as a result of the violations. The Division's attempt to justify disgorgement of 1/3 of Yancey's cumulative bonus during the relevant time period lacks a basis in logic, mathematics, and the law. Accordingly, the Court should reject the Division's unsupported claim for disgorgement.

CONCLUSION

Nothing in the Division's post-hearing brief establishes any basis for holding Bill Yancey liable for failing to supervise Mike Johnson or Tom Delaney. The Division's claim as to Johnson's supervision fails because Yancey reasonably delegated all supervisory responsibility over Johnson to Pendergraft. Nearly every witness confirmed this fact. The Division's claim as to Delaney's supervision also fails because the absence of an explicit reference to the December 2009 Audit results in the March 2010 3012 Summary Report was not a "red flag"; rather, it was a collaborative decision made by Penson's Compliance Department. Yancey, like any CEO, was entitled to rely on the judgment and expertise of these qualified licensed individuals. To find a failure to supervise on these facts would substantially undermine long-standing concepts of reasonable supervision. The claims against Yancey should be dismissed.

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[147] *See* Stip. FOF 53, 80. Cases in which the court has imposed civil penalties have involved a substantial loss or benefit. *See, e.g., George J. Kolar,* 2002 SEC LEXIS 3420 (investing public lost *10-12 million dollars* because of the violations); *Johnny Clifton,* Exchange Act Rel. No. Release No. 9417 (the business realized *over a million dollars* in benefits from the fraudulent scheme).

[148] McCain Test. at 2164:19-24.

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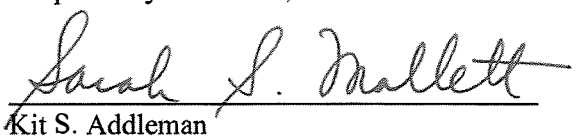
Respectfully Submitted,



Kit S. Addleman
kit.addleman@haynesboone.com
Ronald W. Breaux
ron.breaux@haynesboone.com
Scott M. Ewing
scott.ewing@haynesboone.com
Sarah S. Mallett
sarah.mallett@haynesboone.com
HAYNES AND BOONE, LLP
2323 Victory Ave, Suite 700
Dallas, Texas 75219
214.651.5000 (Telephone)
214.651.5940 (Facsimile)

ATTORNEYS FOR RESPONDENT CHARLES W. YANCEY