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BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

In the Matter of the Application of

Lek Securities Corporation

For Review of

FINRA Disciplinary Action

File No. 3-17677

FINRA's BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW

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I. INTRODUCTION

From January 2008 through October 31, 2010, Lek Securities Corporation ("LSC"), a clearing firm, recklessly failed to establish or implement adequate anti-money laundering ("AML") procedures. LSC's AML program was not appropriate given that its primary business involved executing and clearing voluminous amounts of high-speed, electronic trades for institutional customers. LSC executed roughly 174,000 trades per day for hundreds of customer accounts. Despite this volume, LSC failed to utilize a computer monitoring system or automated exception reports to detect suspicious or manipulative trading activity. Instead, LSC relied on its employees to *manually* review trades in real time and just alert LSC's president if they spotted anything of concern. Even when LSC relented to regulatory pressure by adding three automated exception reports to monitor for potentially manipulative trading, those reports were not reasonably designed or implemented. A wash trade report was essentially useless on its own,

and LSC over-relied on introducing-brokers to investigate hits on exception reports, abdicating its independent AML responsibilities as a clearing firm.

LSC's written AML procedures also were deficient. Broker-dealers must establish written procedures that can be reasonably expected to detect suspicious activities and cause the reporting of them on a suspicious activity report ("SAR"). Suspicious activities include *trading activities*, such as market manipulation, prearranged or other non-competitive trading, and wash or other fictitious trading. Despite this and LSC's responsibilities as a clearing firm, LSC's AML procedures focused only on money-movement issues. They did not describe specific steps to monitor or detect manipulative trading—such as who should monitor for it or how—describe how to document investigations of trading activities, or describe when the detection of suspicious trading should result in the filing of a SAR.

FINRA's National Adjudicatory Council ("NAC") correctly found that LSC violated FINRA's AML rules and did so egregiously. LSC maintained an inadequate AML system for years, despite the volume of high-speed trading activity at the firm, inquiries from regulators about potentially manipulative trading involving its customers, evidence of attempted manipulative activity by one of its customers, and clear regulatory guidance. Moreover, the record reflects that LSC never fully embraced the need to develop a coherent, compliant AML program to investigate and report suspicious trading activity. Samuel Lek ("Lek"), LSC's president and AML officer, consistently disputed the need to monitor for some of the trading activities about which regulators were inquiring. And the only changes LSC made to its AML program in response to regulatory pressure were minor ones that inadequately addressed a small fraction of the deficiencies.

Given the severity of AML violations, numerous aggravating factors, and the absence of any mitigation, the $100,000 fine and censure that the NAC imposed are meaningful, remedial sanctions that will deter LSC from engaging in similar violations in the future and improve overall business standards in the securities industry.

II. FACTUAL BACKGROUND

A. LSC

LSC primarily provides electronic order execution and clearing services to introducing broker-dealers and institutional clients. RP 69, 2004-2005, 2226, 3205, 3332-3333, 3885-3886.[1] LSC offers direct access to securities markets and instant routing to all exchanges, multilateral trading facilities, electronic communication networks, and market makers. RP 2004-2005, 2227, 2229, 2230. LSC described its services as "filtered" access to markets because LSC has automated screens or filters that block trades exceeding size or credit limits set by LSC. RP 2227, 2406-2407, 3338.

LSC has customers all over the world who are primarily institutional and professional traders. RP 2237, 3205. LSC catered to high-speed, high-volume traders who wanted trades executed as quickly as possible. To them, split seconds—even "nanoseconds"—were important. RP 2227-2228, 2230. LSC's clientele was not limited, however, to high-speed traders. It also included institutional trading desks, market makers, exchange specialists, arbitrageurs, money managers, hedge funds, and pension funds. RP 2230, 3885.

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[1] References to the certified record are cited as "RP _____." References to LSC's opening brief are cited as "Br. ___."

During the review period, LSC executed millions of transactions and processed approximately 174,000 trades a day. RP 2050, 2468-2470, 4185, 4437. On average, as many as 500 trades per minute passed through LSC's automated systems. RP 3196.

B. Samuel Lek and Caitlin Farrell-Starbuck

Lek is LSC's founder, majority owner, chief executive officer, chief compliance officer, and AML officer. RP 69, 1996, 2226, 2237-2238. Lek was primarily responsible for LSC's AML program.

Caitlin Farrell-Starbuck ("Farrell-Starbuck") was a compliance officer at LSC. RP 1994-1996. LSC was Farrell-Starbuck's first employer in the industry.[2] RP 2141-2142. She was registered as a general securities representative, general securities principal, and compliance official. RP 2138. As a compliance officer, she handled and managed account opening procedures, handled LSC's customer identification program, responded to self-regulatory organizations' inquiries, reviewed exception reports, and managed trading inquiries. RP 1995-1996, 2133, 2141. She also fielded compliance questions that Lek thought she could handle. RP 2213-2214. She did not, however, do "real-time surveillance of trading activity." RP 1995. As explained more below, at some point Lek delegated some AML tasks to Farrell-Starbuck.

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[2] Prior to working as a compliance officer, Farrell-Starbuck was a trading assistant and an account opening manager. She left LSC in September 2010. RP 1994-1996.

C. LSC's AML Procedures

During the relevant period, LSC had at least three versions of its written AML Policies and Procedures (the "AML manual").[3] All three versions indicated that Lek was LSC's AML officer. RP 3896, 3928, 3956. The first and second versions provided that Lek "will delegate certain assignments to members of the firm with supervisory titles" but did not actually name any delegates. RP 3928, 3956. The third version provided that Lek "has delegated . . . Farrell-Starbuck, Compliance Officer, as the designated supervisor to monitor and carry out several of the duties outlined in the [AML manual]" and that "[a]s necessary, . . . Farrell-Starbuck will request Mr. Lek's approval, input and assistance." RP 3897. The discrete AML and compliance duties delegated to Farrell-Starbuck, however, were never specifically defined or memorialized. RP 2001, 2003-2004, 2212-2213, 2240-2241.

LSC purchased the AML manual from a vendor. RP 2238. Lek testified that LSC revised the purchased version to incorporate material from FINRA's AML Template for Small Firms and recommendations of LSC's AML auditor, Frank Calimano ("Calimano").[4] RP 2238-2239, 3310-3311. Lek approved any changes. RP 2214-2215, 2238-2239. Even taking into account the revisions LSC made to the off-the-shelf version, LSC's AML manual contained boilerplate language and was not tailored to LSC's high-speed, high-volume business or the specific types of manipulative or fictitious trading issues that could arise in LSC's trading business and might require a SAR.

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[3] One version was effective after July 2009, one was effective on December 14, 2009, and one was effective some point thereafter. RP 3893-3981.

[4] *See AML Template for Small Firms*, http://www.finra.org/industry/anti-money-laundering-template-small-firms.

Instead, LSC's AML manual focused on money-movement issues, such as money laundering. RP 3311, 3319-3320, 3440-3441, 3893-3981. For example, the AML manual listed 45 red flags that could occur during the account opening stage or the relationship with the customer and that might be "indicative of intent to use the account for money laundering" or be "examples of suspicious activities." Only two of these red flags, however, related to securities transactions in any way, and neither one described manipulative trading.[5] RP 2242, 3440-3441, 3908-3912, 3937-3941, 3966-3970.

In a key concession, Lek admitted that the AML manual's focus on money-movement activities was purposeful. RP 2242-2243, 3440-3441. Lek opined, defiantly, that if the AML manual included information concerning potentially manipulative trading, it would have been "less clear" and "muck[ed] up," and would have made LSC employees "less likely to focus on very specific anti-money laundering issues." RP 2242-2243, 3318-3320, 3440-3441.

D. LSC's Written Supervisory Procedures

Separate from LSC's AML manual were LSC's written supervisory procedures ("WSPs"). RP 4921-5782. The WSPs exceeded 400 pages. LSC purchased them from a vendor, and Lek testified that LSC did not edit them significantly. RP 3493. The WSPs, like the AML manual, contained a substantial amount of boilerplate.

Three pages of the WSPs described certain "prohibited transactions," including prearranged trading, wash trading, cross transactions, churning, parking securities, orders at the

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[5] One of those two red flags was "[t]he customer wishes to engage in transactions that lack business sense or apparent investment strategy, or are inconsistent with the customer's stated business strategy." RP 3908, 3938, 3966. The second was that "[t]he customer, for no apparent reason or in conjunction with other 'red flags,' engages in transactions involving certain types of securities, such as penny stocks, . . . Reg S_ stocks, and bearer bonds." RP 3910, 3933, 3968.

open or close for purposes of influencing the price of a security, and other activities. RP 5121-5124, 5556-5559. This "prohibited transactions" section contained nothing describing LSC's high-speed trading environment or any connection between the detection of prohibited transactions and the process for filing a SAR. Moreover, during most of the review period, the "prohibited transactions" section gave little guidance concerning who would monitor for prohibited transactions, how to do so, what to do if prohibited transactions were identified, or who would take such action. Rather, the WSPs identified and described types of prohibited transactions that could warrant escalation, stated that an unnamed "designated supervisor" had responsibility for monitoring, and recommended generally that "Compliance" be consulted. RP 2052, 3446-3451, 5121-5122, 5556. Exemplifying the WSPs' lack of tailoring, the "prohibited transactions" section provided that a record of the review of prohibited transactions should be made by initialing a branch manager's log, a document that did not exist at LSC. RP 3443, 5122, 5556. Prior to July 2010, the section made no references to any exception reports that staff should use to monitor for prohibited transactions. RP 5121-5124. Instead, it referred only to order records, customer monthly statements, and something called a "Daily Transaction Report." RP 5122.

In July 2010—months after FINRA began investigating LSC's AML program—LSC added a paragraph to the "wash transactions" portion of the "prohibited transactions" section.[6] RP 3317, 5557. It provided that "Compliance" was responsible for reviewing potential wash trades "using an exception report," investigating potential wash sales, taking "corrective action

[6] Wash sales are fictitious trades where a trader sells securities contemporaneous with a purchase of the same securities, thus resulting in no change of beneficial ownership. *Cohen v. Stevanovich*, 722 F. Supp. 2d 416, 426 (S.D.N.Y. 2010). Such trades may be effected for manipulative purposes.

with the customer directly" (if Compliance determined that transactions were potentially wash sales), and documenting any actions. RP 5557. LSC added another new paragraph to the "prohibited transactions" section describing "[m]arking the [c]lose" as among the prohibited transactions.[7] RP 5558. Despite these few revisions, the WSPs still did not address who specifically would monitor for prohibited transactions (wash sales being the sole exception), how responsible persons should review for manipulative trading, or any connection between the identification of prohibited transactions and the filing of a SAR. RP 5556-5559.

Approximately 100 pages before the "prohibited transactions" section was a separate, 16-page section concerning LSC's AML program. RP 5016-5031, 5446-5461. This AML section—just like the AML manual—contained nothing addressing LSC's high-speed trading environment or the need to monitor and report suspicious manipulative trading. Instead, it explained only that LSC was required to file SARs "for transactions that may be indicative of money laundering activity" and referred readers only to a separate "[m]oney [l]aundering" section in the WSPs for "[e]xamples of risk indicators." RP 4955-4959, 5024, 5383-5387, 5454. Neither the SARs section nor the "money laundering" section, however, referred to the "prohibited transactions" section or described any connection between identifying prohibited transactions and filing a SAR. *Id.*

Conceding that the WSPs provided little practical guidance, Lek testified that the WSPs "are not a description of exactly what in a 20-man firm everybody should do other than call Sam.

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[7] "'Marking the close' is the practice of attempting to influence the closing price of a stock by executing purchase or sale orders at or near the close of the market," and constitutes a manipulative practice. *Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *32 (May 16, 2014), *aff'd in relevant part*, 793 F.3d 147 (D.C. Cir. 2015).

That's . . . the general thing, let Sam know." RP 3446-3447. Lek added recalcitrantly that more instructions were "unnecessary." RP 3449.

E. LSC's AML Practices and Trade Monitoring Prior to Summer 2009

In practice, LSC's AML program also operated separately from its trade monitoring. Regarding who had AML responsibilities, Lek and Farrell-Starbuck testified that "every employee had AML responsibility." RP 2132, 2241. Lek and Farrell-Starbuck, however, had more specific AML responsibilities. Lek was the AML Officer, with overall responsibility for AML compliance. RP 1996, 2151, 2238. And at some point, Lek delegated some AML tasks—but not overall AML responsibility—to Farrell-Starbuck. RP 1996, 2000-2001, 2003-2004, 2150-2151, 3897. Farrell-Starbuck testified that her primary AML tasks were making sure new account documentation was in order and conducting "know your customer" tasks and "OFAC" (Office of Financial Assets Control of the U.S. Department of the Treasury) checks. RP 1995-1997, 2067-2068, 2133, 2151-2154. Farrell-Starbuck also was primarily responsible for reviewing trading activity from an AML perspective and dealing with customers on any follow-up. RP 2132-2133.

Farrell-Starbuck acknowledged that wash trades, fictitious trades, pre-arranged trading, and other non-competitive trading were things that LSC was supposed to be looking for as part of its AML responsibilities. RP 2056-2057, 4389. Lek also acknowledged that wash trades were something that LSC should look for. RP 2333-2334. Farrell-Starbuck conceded, however, that LSC staff looked for suspicious trading activity only as part of LSC's overall compliance program without a specific focus on AML issues, and that neither she nor anyone else was monitoring trading activity for AML purposes. RP 2052-2053. In Farrell-Starbuck's mind, AML "equaled KYC [know your customer obligations]." RP 2067-2068.

LSC's method for detecting suspicious trading activity was an on-the-fly, manual process, even though LSC executed hundreds of thousands of trades a day. Prior to summer 2009, LSC had *no* specific automated exception reports to monitor for potentially manipulative trading. RP 2051-2053, 2058-2059, 2101-2102, 2110, 3512. Rather, LSC relied on its employees to monitor trades in real time and "look at the screen" and on Farrell-Starbuck's manual review of trade blotters. RP 2052, 2143-2146, 2181, 3367-3368, 3404-3405, 3489-3490. Lek testified that the "entire staff" was to "be vigilant" for anything unusual, and that he would "give [his staff] lectures" or "just yell at everybody 'watch out for this.'" RP 2242, 2407-2408. Lek claimed that "as far as market manipulation, our staff is on top of it." RP 2410. Despite those boasts, Lek conceded some of the underlying flaws with LSC's manual monitoring process. Lek acknowledged that it was possible to miss problems when trades were paced more than 500 a minute and that LSC would not "catch everything." RP 3405, 3488-3489. And he realized that LSC needed a new wash trade surveillance system when "the high frequency trading started" and LSC started observing "many trades within a single second."[8] RP 3347-3348, 3374.

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[8] Lek tried to minimize the dangers with LSC's manual reviews but pointed to nothing that did so. Lek testified that LSC "may do periodic reviews of customers and look specifically at what they're doing," but there was no evidence of an established system for conducting such reviews or documentation showing that such reviews actually occurred. RP 3490. Lek also testified that LSC had controls that would "stop the typical violations that are determinable from the single order itself." RP 3488-3489. But LSC's controls and filters were not designed to flag potential manipulation; rather, the controls rejected orders that were outside authorized parameters, such as credit and size limits or prohibitions against odd lots. RP 3361-3366. To whatever extent the controls and filters could have been used to analyze for potential manipulation, there was no written guidance establishing procedures for doing so or documentation memorializing that any such procedures actually occurred. RP 3475-3477.

In the event that LSC staff happened to detect any suspicious activities—either compliance-related or AML-related—the expectation was that they should alert Lek. RP 2143, 2242, 2407-2408, 3310, 3311, 3465-66. Because of the size and layout of LSC's offices—LSC's 20 employees, including Lek, were seated close together in a single room—LSC employees usually just called out to Lek to draw his attention to concerning activity. RP 2213, 3309-3310, 3341-3342, 3447, 3466. Lek also bragged that "my eyes and ears are open" and "I hear what [LSC staff are] talking about." RP 3309-3310, 3465-3466.

When alerted to suspicious activities, Lek testified that he "made no distinction" whether they involved "a potential [AML] violation or a potential manipulative activity, they're both investigated" and that he determined whether to file a SAR. RP 3321-3322, 3467. If Lek personally conducted any reviews of potentially suspicious activity, however, he failed to document them in any useful way. RP 3481-3483. And when asked how he detected potential patterns without having documented his reviews, Lek said he relied on his *memory* to look for "the same thing twice from the same guy." RP 3482. Farrell-Starbuck testified that LSC would reach out to LSC's customers, such as its introducing brokers, to investigate suspicious activities. RP 2143-2144.

F. Dimension Securities LLC and Dimension Trading International LP

Dimension Securities LLC ("Dimension"), a New-York based introducing broker-dealer, cleared its trades through LSC and was a substantial source of LSC's transaction business.[9] RP 2245-2246, 2249-2250, 3001-3002, 3043-3044, 4437. Dimension accounted for nearly half of LSC's trades during the relevant period and over 56% of LSC's trades in 2009. RP 2007-2008,

[9] Dimension is now out of business.

2468-2478, 4437. Dimension introduced accounts on a "fully disclosed" basis. RP 3211. The clearing agreement between Dimension and LSC allocated different functions between them and delegated "know-your-customer" obligations to Dimension. RP 3210-3211, 3220-3224, 6059-6081.

One of Dimension's customers was Dimension Trading International LP ("DTI"). RP 2257, 3003, 3071. DTI constituted over 90 percent of Dimension's business. RP 3071. DTI was a British Virgin Islands limited partnership with a general partner and ten limited partners. RP 2253, 3018, 4725, 6023-6025, 7219-7232. Dimension introduced DTI to LSC, and LSC extended DTI margin. RP 2009, 2253, 2254, 3225-3233, 4387, 5955-6053. On LSC's books, DTI was organized as a master ("parent") account with nearly 4,000 subaccounts ("child" accounts). RP 2009-2010, 2021, 2253-2254, 3277, 3997-4068, 4727. Lek testified that, on average, DTI had 550 active subaccounts. RP 3277.

DTI employed a large number of traders, located around the world, who used different strategies to trade the DTI subaccounts. RP 2026-2027, 2201-2202, 2282-2283, 2296-2297, 2395, 3003-3004, 3030-3032, 3053-3054, 3064-3065. Lek estimated that DTI employed as many as 891 employees. RP 2395. DTI traders' typical trading strategy was a high-frequency one that generated small profits—$100 to $200 a day—on numerous small orders. RP 3053-3055. These strategies required patience, which caused significant turnover in DTI personnel. RP 2395, 3031. Farrell-Starbuck and Lek both described DTI's activities as "day trading" (RP 2033, 2344), but the DTI subaccounts did not always end the day flat. RP 2290, 3122-3123, 3454, 3455.

DTI's capital varied between $1.5 million and $11.5 million, which came from DTI's general partner and, possibly, DTI's limited partners. RP 2296, 2299, 2392, 3006, 3085, 3147-

3149. In general, each DTI limited partner was associated with several subaccounts in various locations.[10] RP 3064-3065, 3119-3120, 4725. DTI's limited partners were entitled to profit-sharing on profits they developed, and they managed the traders of DTI's subaccounts. RP 3065, 3119, 3120.

On LSC's books, each of the thousands of DTI subaccounts had an account title that Dimension supplied, and the same account titles were sometimes used for groups of DTI subaccounts. RP 2014-2018, 2021, 2260-2262, 2267, 2269, 3997-4068. Each DTI subaccount also had a unique acronym. RP 2010, 2013, 2017, 2260. LSC maintained DTI's accounts in this way at DTI's request, which allowed DTI to track trading information in each subaccount, including profits, losses, and capital gains. RP 2014, 2044-2045, 2047-2050, 2260, 2267-2268, 2287-2291, 3458, 4421-4428.

LSC gathered information about DTI's limited partners for "Customer Identification Program" purposes. RP 2254. LSC also had some information about the DTI subaccount traders, although how much is unclear.[11] Regardless, both Farrell-Starbuck and Lek claimed to know very little about the DTI subaccount traders. Farrell-Starbuck did not know traders' identities, their relationship to DTI or the subaccount names, their locations, their specific trading strategies, or the extent to which they worked with other DTI traders. RP 2025-2029, 2124, 2127, 2130-2131. She also did not know the relationship between subaccount names and DTI.

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[10] For example, one limited partner, Carese Trade & Invest Ltd., located in the British Virgin Islands, was associated with 484 DTI subaccounts. RP 4725.

[11] According to Farrell-Starbuck, LSC was not gathering information about entities or individuals named on particular DTI subaccounts, and LSC had that information only if Dimension provided it. RP 2024-2025. In contrast, Lek testified that LSC gathered some information about individual DTI subaccount traders, including passport information and drivers licenses, and used it to run OFAC checks but not to monitor trading activity. RP 2285-2286.

RP 2131. Lek likewise testified that he did not know the DTI traders' locations or whether traders in subaccount groupings were located together or worked together.[12] RP 2282-2284. Lek assumed, however, that traders associated with a DTI limited partner were "working for that limited partner."[13] RP 3420.

G. Regulatory Inquiries in Spring and Summer 2009

In spring and summer 2009, regulators began asking LSC about potentially manipulative trading. These inquiries started in April 2009, when LSC received inquiries from NYSE Arca about potential marking-the-close trades. RP 2119-2120, 2586. Then in spring and summer 2009, LSC received inquiries from NYSE Arca about possible wash trades in one of LSC's accounts. RP 2036-2037, 2057-2058, 2147-2148, 2584-2586.

LSC also began receiving a series of inquiries concerning pre-market cancellations, many involving Dimension and DTI. The first inquiry came in June 2009, when NYSE Regulation contacted LSC about the entry on various dates in June 2009 of large orders (above 10,000 shares) in three securities (including Goldman Sachs Group, Inc.) and their cancelation just prior to the market open. RP 2088, 2089, 2564-2565, 2574, 4187. In a letter that Lek and she prepared, Farrell-Starbuck responded that there were two customers involved, one of which was DTI. RP 2090, 4189. Farrell-Starbuck further shared LSC's "guess" about why the customers cancelled their orders (to "stop another market participant from front running or the specialist from leaning on the orders") and concluded "that there is no real violation." RP 4189. Farrell-

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[12] Dimension, on the other hand, gathered information about the DTI limited partners and traders within the limited partners' "group[s]." RP 3023-3024.

[13] Dimension and DTI ceased doing business with LSC in 2011. RP 2398.

Starbuck wrote that "this trading behavior" is "practiced by the vast majority of market participants"—an assertion NYSE investigators disagreed with—and "is not a clear violation." RP 2090-2091, 2575, 4189-4190. Nevertheless, Farrell-Starbuck wrote that LSC had informed its customers that pre-market cancellations were "attracting scrutiny." RP 4190.

The next inquiry was on August 19, 2009, when NYSE Regulation asked LSC for the identities of accounts and traders that entered and subsequently cancelled large orders in Goldman Sachs Group, Inc. stock before the market opened on August 12, 2009, and for explanations. RP 4191. Lek responded that DTI members were responsible and that LSC had asked Dimension for an explanation. RP 4193. Without knowing more details, Lek minimized NYSE's entire inquiry by writing that entering and quickly canceling orders was commonplace. RP 4193.

As it turned out, the August 12, 2009 pre-market cancellations were an attempted manipulation. Prior to market opening, a DTI trader placed an order for Goldman Sachs stock, canceled it, replaced it with a larger order, and then did this repeatedly. RP 2320-2324, 3075-3079, 3097-3098, 4213. Eventually, the DTI trader was able to place and cancel an order for 100,000 shares of Goldman Sachs stock for $16 million. RP 4213. NYSE Regulation asked Dimension about it on August 27, 2009, and Dimension responded that the trader "exploited an unknown bug" in Dimension's risk management system, evaded Dimension's size limit for DTI's orders, admitted he had attempted to manipulate the opening price of Goldman Sachs stock, and had been terminated. RP 3097-3098, 4213-4214. Dimension informed NYSE Regulation that the incident "prompted an immediate software change" to prevent the problem from recurring. RP 4213. Dimension also communicated with LSC about the Goldman Sachs

trading.[14] RP 3078-3079. LSC had not detected the trading as problematic because it did not exceed LSC's credit or size limits for DTI. RP 3362.

In late August 2009 or early September 2009, LSC's trading desk "flagged" several large pre-market cancellations in a DTI trading account. RP 2102-2103, 2179-2180, 4203. LSC relied on Dimension to investigate the trading, which was LSC's standard practice. RP 2096, 2100-2105, 2114, 4203. Dimension informed LSC that the cancellations were "not appropriate" and that Dimension had instructed the responsible individuals to stop. RP 2103, 4203. That information was vague at best, yet Farrell-Starbuck did not recall doing any further investigation. RP 2108.

In October and November 2009, NYSE Regulation twice contacted LSC about pre-market cancellations in June, August, and September 2009 that NYSE Regulation indicated "may have artificially impacted the price of several securities prior to the market's opening." RP 4195-4200, 4205, 4206. In response, LSC reported that the activities involved Dimension and DTI, and that LSC was working with Dimension to determine whether the customer's intention was to manipulate. RP 4201, 4203.

On October 14, 2009, Dimension responded to an NYSE inquiry about pre-market cancellations of orders for two stocks (Allied Irish Banks, ConocoPhillips) on September 2 and 4, 2009, among other cancellations. Dimension wrote that these involved "some of the same

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[14] Philip Potter, co-founder and managing member of Dimension, testified that he was "pretty sure I had a conversation with somebody [at LSC]" about the activity and that, while he did not recall "specifically," "it would not be unreasonable" to conclude that he told LSC "exactly what [he] had found in [his] investigation." RP 3078-3079. Lek admitted that Dimension told him about the event but denied that Dimension informed him it was an attempted manipulation. RP 2321-2325. As noted below, the Hearing Panel generally found Lek's testimony not credible.

people from previous inquiries" and were "an apparent effort to influence the opening print." RP 2584, 3081-3082, 3099-3102, 4229, 4231, 4240. Contrary to its previous suggestion to regulators, Dimension implied that everyone involved had *not* been previously fired, writing that some had only been "strenuously reminded" in "early September" of "the prohibition against such order [sic]" and had "apparently headed [sic] the proscription since then." RP 4240. Potter testified that the attempted manipulations on September 2 and 4, 2009, occurred before Dimension discovered how its software was being exploited and fixed it. RP 3099-3101. Potter testified that he was "sure" he shared information with LSC about these attempted manipulations. RP 3082.

In December 2009, NYSE Arca contacted LSC with another inquiry about potential marking the close and wash sales. RP 2586.

H. LSC's AML Practices from Summer 2009 Forward

In response to the numerous regulatory inquiries described above, LSC developed three new exception reports to monitor for potential wash sales, pre-market cancelations, and marking the close. Farrell-Starbuck testified that she was primarily responsible for reviewing the exception reports and trading activity from an AML perspective and dealing with the introducing brokers on any follow-up. RP 1995-1996, 2132-2133, 2141. As explained below, however, Farrell-Starbuck did very little other than rely on introducing brokers to investigate.

1. Wash Trades

The first new exception report, implemented in August 2009, monitored for wash trades. RP 2058-2061, 4265, 6090-6091. Lek developed it.[15] RP 2310-2311. Given its design and that DTI was one of LSC's primary customers, the wash trade report had limited utility by itself. At first, LSC designed it to look for potential wash trades by "customer." Because LSC considered DTI to be its "customer" and because DTI had hundreds of active subaccounts, the report flagged hundreds of potential wash trades occurring daily at DTI. RP 2068-2072, 4269-4292. LSC ran that version of the report for more than one year. Concluding that many hits were false positives, LSC changed the report's parameters in October 2010 to monitor only for potential wash trades by individual subaccounts. RP 2070, 2080-2085, 2335-2336, 3407-3412. As a result, the revised report no longer reflected any potential wash sales between different DTI subaccounts and resulted in substantially fewer hits. RP 2341, 3411-3412. Neither version focused on potential wash sales between subaccounts grouped under the same account name. RP 3411-3412, 3420. Inexplicably, Lek dismissed the potential usefulness of that information, despite his assumption that the numerous traders associated with a DTI limited partner were "working for that limited partner" and his acknowledgment that it may be important to know if groups of subaccount traders are working together. RP 2339-2440, 3411, 3420.

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[15] Citing Lek's testimony, LSC implies that Lek developed the wash trade report on his own initiative, when the "speed of customer trading quickened" and LSC began seeing customer trades on opposite sides of the market within one second. Br. 14-15, 23-24. In reality, Lek developed the report only after NYSE Arca inquired with LSC about potential wash trades. RP 2036-2037, 2057-2059, 2584-2586. There is no evidence that the speed of customer trading was materially different when LSC finally adopted the wash trades report compared to the beginning of the relevant period.

LSC ran the wash trade report after the market close, and Farrell-Starbuck tried to review it daily.[16] RP 2060-2061, 6090. When the reports displayed trades through Dimension, Farrell-Starbuck sent the reports to Dimension and "request[ed] further explanation" (such as "whether . . . there was potential coordination across subaccounts") but left it to Dimension to investigate its customers' activity. RP 2060-2062, 2071-2077, 4293-4329, 6090-6091. Lek testified that when LSC began to generate the wash sale report at the "subaccount level," it sent only that narrower report to Dimension. RP 3408. At that point, LSC was no longer even asking Dimension about the substantial volume of potential wash trades that could be occurring between any of the thousands of DTI subaccounts.

If Dimension represented to LSC that none of the flagged trades were wash trades, Farrell-Starbuck accepted Dimension's conclusion. As she explained, Dimension "had a better understanding of what [DTI's] structure was and whether there was actual knowledge and intent associated with the trading activity" and "I trusted them." RP 2074, 2076, 2077, 2156. Farrell-Starbuck did not believe she ever asked Dimension for a list or indication of what DTI subaccounts Dimension thought were associated. RP 2076. Farrell-Starbuck kept no records of any follow-up communications with Dimension about any particular trades and did not document whether Dimension responded to her inquiries on each possible wash trade.[17] RP 2060-2061, 2074, 2079.

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[16] Lek testified that he reviewed the wash sales report "periodically" (RP 2328) and "daily" (RP 3370) and would try to detect patterns of repetitive wash sales between the same traders in the same stocks. RP 3370. There is, however, no documentation of him having done so.

[17] Farrell-Starbuck testified that "as time went on" she became "more formal" in her documentation of her reviews. RP 2061. But she did not state that she documented anything other than the fact that she sent Dimension requests for information. RP 2060-2061, 2063.

No LSC employee reviewed the wash sales report based on which DTI subaccounts were associated with the same account name. RP 2285, 3420. One of Lek's excuses was that LSC lacked the ability to run the wash sale report at the limited partner level—a dubious assertion considering that LSC maintained data concerning the DTI subaccount "names."[18] RP 3502-3503. Lek's other excuse was that only Dimension knew whether parties on either side of a trade were related or working together. RP 2283-2285, 2339-2342. Lek admitted, however, that he had conversations with Dimension's principal and learned "as a general rule" what traders were working together. RP 2284-2285. Lek offered no explanation why, if he was able to obtain that information, he did not incorporate it into LSC's wash sales report or obtain more specific information about DTI's subaccount traders.

At some point, Dimension began creating its own wash sale report, which both Lek and Farrell-Starbuck viewed as superior to LSC's report. RP 2341-2342, 3039, 6371. Farrell-Starbuck believed that Dimension's report identified potential associated subaccounts, and she recalled asking Dimension for more information about it with the hope of improving LSC's wash sales report. RP 2080-2085. There is no evidence, however, that Farrell-Starbuck ever obtained that information. RP 2082-2085, 4331, 4385. LSC never contacted DTI or its principals directly to investigate any trading. RP 2074.

2. Pre-Market Canceled Orders

The second exception report that LSC developed monitored pre-market cancelations. Lek developed it on October 20, 2009, in response to the numerous regulatory inquiries. RP

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[18] Indeed, FINRA Enforcement staff and Dimension were each able to review data at the limited partner level. RP 2608, 2610, 3140-3142.

2087, 2100-2102, 2109-2110, 2311, 4202, 4207. The report showed the cumulative amount of orders and cancellations but not individual orders and cancellations or the time and price of any orders. RP 2373-2375.

Farrell-Starbuck handled the pre-market cancelations report the same way she handled the wash sales report: she relied on Dimension to investigate exceptions.[19] RP 2116-2117. In February 2010, several months after the report was created, Farrell-Starbuck began to log her related communications with Dimension. RP 2175, 7101. At first, she tracked the stocks and customers involved and logged brief descriptions. After just three weeks, however, she abandoned tracking even that minimal amount of detail and switched to logging only the dates of the exception reports and even shorter descriptions, which in nearly all cases was simply "reviewed and fine." RP 7101. Raising doubts about how seriously she reviewed the report, Farrell-Starbuck opined that pre-open cancellations posed no risk of manipulation and implied that LSC created the report not to implement an adequate review system but just to make the activity go away. RP 2159, 2164-2165.

Lek's testimony raised similar questions. On the one hand, Lek claimed—with no corroborating documentation—that he analyzed activity on LSC's pre-market cancelations report to determine whether it looked like normal business or something that required investigation.[20]

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[19] Farrell-Starbuck testified that when she detected "AML risk indicators," or if she thought that something required further analysis after hearing from Dimension, she would generally "escalate to Sam." RP 2141-2142, 2151-2152. But Farrell-Starbuck conceded that "to some degree I depended on Dimension to escalate things." RP 2028.

[20] Lek claimed to have looked at general volume, how much the trader traded, if the trader eventually bought the stock, other potentially relevant trades, market circumstances, and, periodically, prices and times of individual orders. RP 2375, 3387-3389. Lek claimed to have learned that only 55% of DTI's pre-market orders were cancelled before market open, which he

[Footnote continued on next page]

RP 3387. On the other hand, Lek vociferously denied any need to monitor pre-market cancelations and even proclaimed LSC's exception report as not "particularly useful." RP 2405-2406, 2382-2383, 3349. Lek clung to that opinion despite also acknowledging that DTI had engaged in concerning trades. RP 3449.

Separately, LSC pressed Dimension to stop pre-market cancellations larger than 1000 shares. RP 2110-2118, 3393-3394, 4241, 4243-4262, 4263, 4731. But that activity persisted and Farrell-Starbuck repeatedly asked Dimension for months why the activity continued and what Dimension was doing to stop it. RP 2106-2107, 2111-2113, 2117-2118, 2158, 2159, 2165-2166, 2168-2174, 4201-4204, 4241-4263, 4731, 7001-7099.

3. Marking the Close

LSC's third exception report monitored potential marking-the-close activities. LSC developed it in March 2010, waiting nearly a year after receiving a regulatory inquiry about such activities. RP 2120-2121, 3512. The report identified orders placed late in the day that moved the market in the direction of the order. RP 3396-3397. Lek claimed—again with no supporting documentation—that he reviewed the report daily and looked for whether traders had any position in stocks appearing on the report. RP 3397-3398. Lek was just as dismissive of the

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indicated was smaller than Dimension's overall cancellation ratio and "much smaller" than the cancellation ratio of LSC's customers combined. RP 3388.

need for the marking-the-close report as he was with the pre-market cancellations report.[21] RP 3398.

III. PROCEDURAL HISTORY

FINRA began investigating LSC in December 2009. RP 2416-2418. On February 25, 2013, Enforcement filed the complaint that commenced this proceeding. Cause one alleged that LSC violated FINRA's AML rules and its rule requiring just and equitable principles of trade and high standards of commercial honor.[22] RP 1-21.

A FINRA Hearing Panel found that Enforcement proved the allegations in cause one. The Hearing Panel found that Lek's testimony generally lacked credibility, and it credited just three discrete aspects of his testimony.[23] It also found that, as alleged, LSC failed to implement policies, procedures, and internal controls that could be reasonably expected to detect and cause the reporting of suspicious transactions and that were reasonably designed to achieve compliance

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[21] On February 6, 2015, the NYSE Regulation Board of Directors affirmed the findings of a NYSE Hearing Board that LSC, among other violations, failed to reasonably supervise and implement adequate controls concerning, in relevant part, wash trading and marking-the-close activities. The Board reduced the sanctions. *LSC*, Proceeding No. 20110270056 (NYSE Reg. Bd. of Dirs. Feb. 6, 2015), *aff'g in part and modifying in part Dep't of Mkt. Regulation v. LSC* (NYSE Hearing Bd. Nov. 14, 2013) (RP 4797-4893). LSC's appeal is pending. *LSC*, SEC Admin. Proceeding File No. 3-16424 (appeal filed Mar. 6, 2015).

[22] The complaint contained a second cause of action that was dismissed by the Hearing Panel and is not at issue.

[23] The Hearing Panel found that certain aspects of Lek's testimony were "on their face . . . not credible" and "damaged his credibility generally." RP 7493. At the same time, the Hearing Panel accepted Lek's testimony regarding "what he and his staff did in setting up the DTI account, monitoring the trading, and establishing and modifying the exception reports." RP 7493.

with the Bank Secrecy Act, in violation of NASD Rules 3011(a) and 2110 and FINRA Rules 3310(a) and 2010. RP 7459-7506. The Hearing Panel imposed a censure and a $100,000 fine.

The NAC affirmed. RP 7913-7932. It found LSC's violation to be "egregious" and "reckless," and that its AML procedures "fell far below the minimum standard." RP 7929-7930. It found that LSC failed to establish an AML program tailored to its high-volume trading environment and the suspicious trading activities that could occur "[d]espite regulators' warnings" and "evidence of attempted manipulation." RP 7929. It found that LSC's AML procedures provided no guidance as to the process for determining timely whether to report suspect trading on a SAR. RP 7930. And it found that Lek's testimony and LSC's numerous AML shortcomings evidenced LSC's disregard of AML rules. RP 7929. This appeal followed.

IV. ARGUMENT

LSC did not take its AML responsibilities seriously. It failed to develop or implement an AML program that was reasonably designed to achieve compliance with its AML responsibilities and the applicable SAR reporting requirements. It did not tailor its AML program to its high-speed, high-frequency trading environment, develop any AML procedures concerning potentially manipulative trading, or develop any procedures concerning when to report any suspicious trading on a SAR. Despite processing hundreds of thousands of trades daily, LSC stuck for years with a manual system for monitoring potentially manipulative activity and failed to document any investigations. LSC reluctantly made minor adjustments to its AML program only after regulators inquired about potentially manipulative trades, and it inappropriately continued to outsource its independent investigative responsibilities to introducing brokers. The NAC correctly concluded that LSC egregiously violated FINRA's AML rules and that a censure and $100,000 fine were warranted.

A. LSC Failed to Develop and Implement Compliant AML Policies and Procedures.

1. Relevant AML Standards

NASD Rule 3011 and its successor, FINRA Rule 3310, set forth the minimum standards required for each FINRA member firm's AML compliance program.[24] One primary standard requires that member firms "[e]stablish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder." NASD Rule 3011(a), FINRA Rule 3310(a). A second primary standard requires firms to "[e]stablish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act" and its implementing regulations. NASD Rule 3011(b); FINRA Rule 3310(b).

The implementing regulations under 31 U.S.C. § 5318(g) concern the filings of SARs. They require that broker-dealers file with the Financial Crimes Enforcement Network ("FinCEN") a report of any suspicious transaction relevant to a possible violation of law or regulation. 31 C.F.R. § 103.19(a)(1) (2010).[25] The SAR for the securities industry identifies 20 types of suspicious activities that broker-dealers are required to report. RP 4389. They are not

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[24] NASD Rule 3011 was effective until December 31, 2009; FINRA Rule 3310 was effective on January 1, 2010. *FINRA Regulatory Notice 09-60*, 2009 FINRA LEXIS 171, at *1 (Oct. 2009).

[25] The implementing regulations further require broker-dealers to report to FinCEN any transaction, alone or in the aggregate, that is conducted or attempted by, at, or through a broker dealer, involves $5,000 in funds or assets and the broker-dealer knows, suspects, or has reason to suspect that the transaction: (1) involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity; (2) is designed to evade the requirements of the Bank Secrecy Act; (3) has no business or apparent lawful purpose or is not the sort in which a particular customer would normally engage; or (4) involves the use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 103.19(a)(2) (2010).

limited to money-movement activities, but include suspicious trading activities, including market manipulation, money laundering/structuring, prearranged or other non-competitive trading, securities fraud, and wash or other fictitious trading. RP 4389.

Concurrent with the adoption of NASD Rule 3011, FINRA issued *NASD Notice to Members 02-21*, which "provide[d] guidance to assist members in developing AML compliance programs that fit their business models and needs." 2002 NASD LEXIS 24, at *2-3 (Apr. 2002); *Order Approving Proposed Rule Change*, 67 Fed. Reg. 20854 (Apr. 26, 2002). The notice's key message was that a broker-dealer's AML program must be tailored to the firm. AML procedures "must reflect the firm's business model and customer base." *NASD Notice to Members 02-21*, 2002 NASD LEXIS 24, at *17. Firms developing AML programs must consider its "business activities, the types of accounts it maintains, and the types of transactions in which its customers engage." *Id.* at *20.

The notice also emphasized that a firm's written procedures should name a person responsible for procedures, set a frequency, and require documentation of reviews. "As with any supervisory procedure, the firm must establish and implement controls and written procedures that explain the procedures that must be followed, the person responsible for carrying out such procedures, how frequently such procedures must be performed, and how compliance with the procedures should be documented and tested." *Id.* at *21. Because an "awareness of . . . 'red flags' will help ensure that broker/dealer personnel can identify circumstances warranting further due diligence," appropriate red flags "should be described in the written policies and AML compliance procedures." *Id.* at *42.

The notice also emphasized that compliance procedures relating to the detection and reporting of suspicious activities on SARs should be an AML program's "focus," and it

conveyed FINRA's preference for automated, computerized detection procedures. *Id.* at *36, 43. It explained that "[f]irms should implement systems, *preferably automated ones*, that would allow firms to monitor trading . . . and other account activity to allow firms to determine when suspicious activity is occurring." *Id.* at *43 (emphasis added). It expressed an even stronger preference for automated surveillance at online firms and clearing firms, such as LSC. "Online firms should . . . consider conducting computerized surveillance of account activity to detect suspicious transactions and activity" and "clearing firms *should establish* . . . automated systems." *Id.* at *28, 54 (emphasis added). It assumed that AML programs would use "exception reports" to monitor transaction activities, instructed firms to "develop procedures for following-up on transactions that have been identified as suspicious or high risk," and advised firms to develop procedures that "address the process for filing SARs." *Id.* at *43-44.

Finally, the notice emphasized the important AML role that clearing firms shoulder. Compared to introducing brokers, clearing firms "may be in a better position to monitor customer transaction activity, including but not limited to, . . . trading." *Id.* at *54. While "it is imperative that introducing and clearing brokers work together" to detect suspicious activity, "[b]oth introducing brokers and clearing brokers must establish and implement . . . appropriate AML procedures." *Id.* at *53.

2. LSC's AML Program Had Numerous Deficiencies.

LSC's AML program—both its written procedures and actual practices—was not reasonably designed to achieve compliance with the Bank Secrecy Act, the implementing regulations promulgated thereunder, and the SAR reporting requirement. The AML program suffered from an abundance of flaws.

First, LSC's AML program did not have surveillance tools or follow-up procedures appropriate for its high-frequency trading environment. Prior to summer 2009—seven years after FINRA advised clearing firms to use automated surveillance—LSC continued to use an improvised, *manual* review to monitor for suspicious trading activities. This system relied on LSC's employees to be "vigilant" and on Lek to recall patterns of trades by memory. If any LSC staff happened to detect something suspicious, they were expected to turn their head and say, "Sam, look at this, this is what I'm seeing." RP 3341-3342. Lek would also occasionally shout to his employees to look out for certain trading activity. In short, LSC relied on an unorganized, haphazard, and antiquated system that relied on staff to perform surveillance tasks that were not humanly possible. With LSC processing roughly 500 trades per minute and hundreds of thousands of trades per day, identifying patterns of potential market manipulation would have been difficult at best, if not humanly attainable. *Cf. Dep't of Enforcement v. Brown Bros. Harriman & Co.*, Case No. 2013035821401, at 7 (FINRA AWC Feb. 4, 2014), http://disciplinaryactions.finra.org/Search/ViewDocument/35225 ("*Brown Bros. AWC*") (finding that manual review of 7,000 daily trades was inadequate); *Dep't of Enforcement v. Hold Bros. On-Line Invest. Servs. LLC*, Case No. 2010023771001, at 11 (FINRA AWC Sept. 25, 2012), http://disciplinaryactions.finra.org/Search/ViewDocument/32397 ("*Hold Bros. AWC*") (finding that a manual review of hundreds of thousands of daily trades was unreasonable for AML purposes).[26] In fact, LSC's manual reviews did not detect DTI traders' attempted manipulation in August 2009 of the opening price of Goldman Sachs securities.[27]

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26 "AWC" refers to Letters of Acceptance, Waiver, and Consent.

27 Attempting to smooth over this critical deficiency, LSC says it conducted "technology-assisted manual review" with "filtering tools" and "trade queries" to "perform more focused

[Footnote continued on next page]

LSC's eventual, reluctant addition of three automated exception reports did not materially improve things. Apart from creating the reports, LSC developed no written procedures concerning who was responsible for using them, how to use them, or how frequently any such procedures should occur. *Cf. NASD Notice to Members 99-45*, 1999 NASD LEXIS 20, at *4 (June 1999) (explaining that supervisory procedures should instruct supervisors on which automated exception reports to review, how often to review them, what steps to take if suspicious activity is discovered, and how to document oversight); *Brown Bros. AWC, supra*, at 7 (finding that firm failed to develop procedures instructing AML staff on how to use a low-priced equities report). In addition, LSC developed two versions of a wash trade report that were of limited utility. The first version was run at the "customer" level and, thus, generated pages of

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analysis." Br. 17. There is no documentary evidence corroborating LSC's alleged use of filtering tools and trade queries, and the Hearing Panel found Lek's testimony not credible on all but a few points. In any event, any such filtering tools or trade queries prior to summer 2009, such as structured query language queries, were initiated manually (sometimes while "looking at the screen" as orders "are coming in"), not driven by automated exception reports that monitored for manipulative trading. RP 2029, 2140, 3367-3368.

In a related argument, LSC contends that *Dep't of Enforcement v. Sterne, Agee & Leach, Inc.*, Complaint No. E052005007501, 2010 FINRA Discip. LEXIS 18, at *43 (FINRA OHO Mar. 5, 2010), shows that its system of monitoring cannot be found deficient absent evidence that it missed suspicious transactions that an automated review would have caught. Br. 16-18. *Sterne*, however, provides little guidance here. *Sterne* related to an earlier period of time when AML requirements were in their infancy. *Sterne* found that automated software systems at that time were "expensive" and "burdensome" and not "proven" or "reliable." *Sterne, Agee*, 2010 FINRA Discip LEXIS 18, at *43-44. Furthermore, compared to LSC, Sterne Agee used far more manpower and formality to monitor far fewer transactions. Sterne Agee, a 400-employee firm, made specific assignments to numerous departments to monitor only 75,000 transactions a month. *Id.* at *5, 15, 45. In contrast, LSC, a 20-person firm, had a single 2-person compliance department and processed hundreds of thousands of transactions a day, during a period when monitoring software was commonly available. RP 2797. Moreover, the record shows at least one attempted manipulation, if not more, that LSC failed to detect.

"bad hits" from trades between DTI's hundreds of active subaccounts. The second version was run only at the "subaccount" level and, thus, omitted any trades between DTI's hundreds of active subaccounts.[28] LSC also chose to send only the less useful, narrower version to Dimension, the introducing broker on which Farrell-Starbuck primarily relied to investigate hits. As a result, LSC ensured that Dimension would review only a fraction of potentially problematic wash trades.

Another critical deficiency was that LSC's AML program did not require documentation of investigations of potential manipulative trading. For example, when questions arose concerning DTI's trading, Farrell-Starbuck just referred those questions to Dimension, without documenting the substance of any investigation. Even when Farrell-Starbuck began keeping a log of pre-market cancellations, it was nearly devoid of any useful information. Likewise, although Lek claims to have conducted his own reviews into trading activities and hits on exception reports, he kept no records of any such investigations. RP 3412-3415; *cf. Hold Bros. AWC, supra*, at 10 (finding that firm's AML program did not contain procedures requiring documentation of reviews of suspicious activities).

LSC argues that the exception reports themselves and e-mails reflecting instances in which LSC followed up with Dimension were sufficient documentation. Br. 19. But the exception reports were just lists of trades and only a potential starting point, not documentation of what investigations LSC actually performed. Likewise, the three e-mails to which LSC refers are only examples of Farrell-Starbuck passing along exception reports to Dimension and posing

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[28] *Cf. Dep't of Enforcement v. Credit Suisse Sec. (USA) LLC*, Case No. 2013038726101, at 5 (FINRA AWC Dec. 5, 2016) ("*Credit Suisse AWC*"), http://www.finra.org/sites/default/files/CreditSuisse_AWC_120516.pdf (finding firm set thresholds on automated surveillance systems too high, reducing the number of hits).

general questions about them. Those e-mails did not document any specific investigations, responses, or follow-up. RP 4243, 4263, 4293. Moreover, neither the e-mails nor the exception reports allowed LSC to better search for patterns of suspicious activity over time. Indeed, Lek conceded that what little documentation LSC had was essentially useless. He testified that LSC may have had "some e-mails going back and forth" and "some notes going to the file" but admitted that "[t]he problem is, when somebody goes and asks us for them, I don't know where to find them, and—I'm not a good filer." RP 3481-3482. LSC's argument also overlooks that instead of owning up to this obvious flaw, Lek obstinately dismissed the need to document investigations, asserting that if "I did that, I would never get through my day." RP 3415.

Another deficiency was that LSC did not tailor its AML manual to its high-frequency trading business. LSC purchased an AML manual from a vendor and slightly modified it to include parts of FINRA's AML Template for Small Firms and suggestions from LSC's AML auditor. To comply with FINRA's rules, however, a FINRA member must tailor its AML program to its business. *See, e.g., Dep't of Enforcement v. Domestic Sec., Inc.*, Complaint No. 2005001819101, 2008 FINRA Discip. LEXIS 44, at *14, 16 (FINRA NAC Oct. 2, 2008). Boilerplate and "one-size-fits-all" AML compliance procedures do not suffice. *Id.* at *17. Neither does including parts of the FINRA's AML Template for Small Firms into the AML manual. *Dep't of Enforcement v. N. Woodward Fin. Corp.*, Complaint No. 2011028502101, 2016 FINRA Discip. LEXIS 35, at *29-30 (FINRA NAC July 19, 2016); *see also Domestic Sec.*, 2008 FINRA Discip. LEXIS 44, at *17-18 (explaining how the template warns that "following this template does not guarantee compliance with . . . [AML] requirements); *AML Template for Small Firms, supra* ("The language in this template is provided only as a helpful starting point . . . .").

The changes LSC made to the off-the-shelf AML manual did not tailor it to LSC's specific businesses or customers. Although LSC processed more than 500 trades per minute, its AML manual contained no reference to high-frequency trading. And while one of LSC's primary customers was DTI, its AML manual contained nothing related to tackling the challenge of monitoring the trading activity of a customer with thousands of subaccounts.[29]

Yet another basic problem was that LSC's AML procedures failed to cover the detection and reporting of manipulative trading practices. Lek conceded that, by design, LSC's AML manual focused on money-movement issues and excluded manipulative trading issues. But the NAC has held that compliant AML procedures must cover the detection and reporting of a broad range of a manipulative trading practices associated with the firm's business. *Domestic Sec.*, 2008 FINRA Discip. LEXIS 44, at *16; *cf. Dep't of Enforcement v. Firsttrade Sec., Inc.*, Case No. 2010021211901, at 6-7, http://disciplinaryactions.finra.org/Search/ViewDocument/33515 (FINRA AWC May 7, 2013) (finding that firm lacked AML procedures addressing how to review, detect, and escalate potentially suspicious activity and manipulative trading); *Hold Bros. AWC, supra*, at 10-11 (AMLCO did not perform reviews related to suspicious trading activity).

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[29] LSC contends that it is legal to purchase manuals, that there was tailoring "in the initial construction of the . . . manual," and that LSC's incorporation of FINRA's AML Template for Small Firms shows its "thought and analysis" when developing its AML manual. Br. 13-14. As explained above, however, LSC's modifications still left the AML manual as boilerplate and generic. LSC also argues that it is a "red herring" to fault its AML policies for a lack of tailoring to its trading business, opining that "[p]otentially manipulative trading" is "not a function of trade speed." Br. 14-15. When trades are being processed at a rate of 500 per minute, however, it certainly affects what steps need to be taken to detect potentially manipulative trading. Indeed, Lek conceded the need to add a wash trades exception report in light of the high-frequency trades. Moreover, the problems with LSC's AML manual were not just its failure to account for high-frequency trading but also for manipulative trading that can flourish in a high-speed trading environment.

LSC's AML manual also lacked any guidance connecting the detection of potential manipulative trading with the filing of a SAR.[30]

LSC's AML program was deficient not just in form but in practice. LSC delegated too much of AML compliance responsibilities to its introducing broker-dealer clients. Introducing and clearing brokers that choose to work together in complying with AML regulations still retain independent compliance responsibilities. *NASD Notice to Members 02-21*, 2002 NASD LEXIS 24, at *15, 53-55. LSC's unreasonable reliance on its introducing broker-dealers was exemplified in how LSC handled questions that arose from DTI's trading activity.

When potential wash trades appeared on LSC's new wash trades exception report, Farrell-Starbuck sent the report to Dimension and relied on Dimension to investigate. Farrell-Starbuck did nothing but accept Dimension's evaluation of those trades and kept no records of any follow-up communications with Dimension, despite the fact that Dimension would sometimes not get back to Farrell-Starbuck and that she had to follow up. RP 2078; *cf. Wedbush*

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30 Again citing *Sterne, Agee*, LSC argues that language in its AML manual that "Compliance will gather relevant information to enable it to evaluate potentially suspicious activity" was sufficient guidance on how to review trading activity, especially "where Enforcement has not proven . . . that employees 'had any difficulty understanding what would constitute a red flag that should be brought to the attention of supervisors or the AML compliance officer.'" Br. 11. *Sterne, Agee* is distinguishable. The written procedures in *Sterne Agee* adequately described how to identify and review indicia of possible money-laundering activity, including descriptions of 25 red flags were "sufficiently specific to enable . . . personnel to identify account activity that raised red flags" and to know how to escalate red flags. *Sterne, Agee*, 2010 FINRA Discip LEXIS 18, at *16. Moreover, Sterne Agee assigned tasks to specific staff that were "sufficiently well defined and within their specific areas of responsibility that they could be expected to spot suspicious activity." *Id.* at *45. In contrast, LSC used an AML manual that contained no red flags of potentially manipulative trading activity, that failed to assign specific responsibility to any staff to review for potentially manipulative trading activity, and did not address escalating red flags of potentially manipulative trading activity. *Sterne Agee* also did not concern a firm's AML obligations to investigate potential manipulative trading that needs to be reported on a SAR.

Sec., Inc., Exchange Act Release No. 73652, 2014 SEC LEXIS 4463, at *32-33, 45-46 (Order Making Findings and Imposing Remedial Sanctions, Nov. 20, 2014) (describing how associated person of broker-dealer that offered market access generally did not follow up when customer firms represented that potential wash trades were not wash trades or were errors). In addition, although Dimension possessed information about DTI that made Dimension's wash sales report superior to LSC's report, LSC did not insist that Dimension share that information with LSC. Instead, Farrell-Starbuck claimed to have never even wondered why some of the DTI subaccounts were grouped a certain way (RP 2033), and Lek argued that such information would not have been useful.

Likewise, LSC over-relied on Dimension to investigate hits on LSC's pre-market cancellation exception report, even in the face of concerning circumstances warranting more independent scrutiny. These circumstances included that Dimension detected what it called the "inappropriate" pre-market cancelations only when contacted by LSC about them; that Farrell-Starbuck had to plead with Dimension for months to halt pre-market cancelations; and that regulators had made numerous inquiries concerning trading activities initiated by Dimension's primary customer.

LSC disputes that it over-relied on Dimension, contending that Lek performed his own reviews of activity and did not find a basis to disagree with Dimension's explanations. Br. 20-22. Because Lek did not document whatever investigations he made, however, there is no documentary evidence corroborating Lek's reviews, let alone their frequency or scope. Moreover, the record shows that it was Farrell-Starbuck who was primarily responsible for

reviewing the exception reports and reviewing the trading activity.[31] LSC's argument also flies in the face of Lek's admission that he was content to just pass the buck to Dimension. Specifically, Lek testified that it was "[o]ur job . . . to flag a potential problem and investigate as best we could, and then forward it on for further investigation by someone who apparently was in a better position to do the investigation than we were." RP 2313, 2389.

The substantial breadth and scope of the deficiencies dispels LSC's attempt to minimize this case as being only about LSC's failure to detect DTI's traders' attempted manipulation using pre-market cancelations. Br. 27-28. Indeed, the overwhelming evidence is a broad indictment of the deficiencies of LSC's AML program, both in design and function, and of LSC's failure to treat potentially manipulative trading as anything more than an afterthought to its AML program. LSC's AML program was not reasonably designed to comply with the Bank Secrecy Act.

3. Expert Testimony Supports the Finding that LSC Established and Implemented a Deficient AML Program.

That LSC's AML program had numerous flaws is strongly bolstered by the testimony of Aaron Fox ("Fox"), a highly qualified AML expert. RP 2782-2786. Fox testified that a technologically advanced firm like LSC should have used an automated surveillance system, that surveillance software was commonly used by 2008, and that LSC's lack of automated exception reports before summer 2009 constituted a "complete failure." RP 2792, 2796-2798, 2814. She found fault with the exception reports that LSC finally adopted, testifying that the first version of

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[31] Farrell-Starbuck testified to that fact. RP 2132-2133. E-mails corroborate it. *See, e.g.*, RP 4243, 4263, 4293. So did Potter, who testified that Farrell-Starbuck talked to Dimension staff "daily" and "usually" handled follow-up communications. RP 3050-3051. Potter also testified that he would talk with Lek about issues related to DTI only "[t]o the extent that [issues] would rise to Sam and I's level." RP 3049.

the wash sale report captured too many trades to be useful and that the second version was "worthless." RP 2817-2819. Fox further criticized LSC for failing to develop procedures addressing who was responsible for reviewing the exception reports, when any such reviews had to be performed, how to evidence those reviews, or how the reports were to be used to effect the AML program.[32] RP 2815, 2817, 2882, 2884.

Fox also criticized LSC's failure to adopt or implement procedures requiring documentation of investigations of suspicious trading activities. RP 2793-2794, 2815-2817, 2832. Explaining the import of documentation, Fox testified that "if you don't create records and . . . processes that drive people to look at information when the same account or collections of accounts come up, you miss seeing a pattern."[33] RP 2794. Fox continued that documentation of investigations is "especially" important with an AML program like LSC's, where "everyone is responsible for AML and no one is responsible for AML" and where "there is no evidence that anybody is actually monitoring what's happening related to this program." RP 2793-2794, 2796. *Cf. Credit Suisse AWC, supra*, at 4 (finding that firm sometimes failed to document reviews of alerts generated and the results of investigations).

Fox also faulted LSC for: (1) failing to tailor its AML procedures to its business (RP 2788-2789, 2809); (2) failing to address suspicious trading in its AML procedures, including

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32 LSC points selectively to Fox's opinion that the AML manual did not have to specially list the exception reports. Br. 16. Fox's full testimony, however, was that "I would have expected desktop procedures, something that explained how [the exception reports] were used." RP 2862.

33 Adequate documentation is also critical for determining when a review of unusual activity should be initiated and when suspicious activity requiring the filing of a SAR has been detected. FinCEN, *The SAR Activity Review—Trends, Tips & Issues*, Issue 10 (May 2006), at 44-46, https://www.ffiec.gov/bsa_aml_infobase/documents/new_8_2006/Combined/SAR_Act_Rev_10.pdf (addressing when the 30-day period for filing a SAR begins).

describing how to review for suspicious trading (RP 2790, 2800, 2811-2812); (3) not linking the detection of suspicious trading activities to SAR reporting procedures (RP 2794); and (4) relying on Dimension to investigate transactions. Fox found LSC's reliance on Dimension to be especially troubling, considering that Dimension's clients were regularly showing up on the exception reports, that DTI had admitted to attempted manipulation, that regulators were making multiple inquiries about trading activities conducted through Dimension, and that Dimension was failing to halt pre-market cancellation activity despite LSC's repeated demands.[34] RP 2820, 2821, 2827-2830. Fox's expert testimony fully supports that LSC violated NASD and FINRA rules.

4. LSC's WSPs Did Not Salvage Its Deficient AML Procedures.

LSC again argues that its AML manual and its WSPs, in combination, added up to a compliant AML program. Br. 5-7. It did not. A firm's AML procedures relating to monitoring and reporting manipulative trading practices must be specifically presented in the AML context to be considered as a component of a firm's AML program. *Domestic Sec.*, 2008 FINRA Discip.

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[34] LSC dismisses Fox's expert opinion on grounds that she did not review numerous "exception reports" that LSC used prior to summer 2009. Br. 15. As explained below, however, those other exception reports were not designed to monitor for manipulative trading in an AML context. LSC also argues, in a gross mischaracterization of a snippet of Fox's testimony, that Fox opined that the sole problem was that LSC's AML manual did not cross-reference the prohibited transactions section of the WSPs. Br. 14. In fact, that testimony consisted only of Fox's answer to a question about why LSC's various pre-summer 2009 exception reports could not be considered as part of its AML program. Moreover, Fox's response faulted not just the lack of a closer relationship between the exception reports, the WSPs, and the AML procedures, but also the inadequate red flags, the absence of policies defining a requirement to use the exception reports to identify suspicious activities or connecting appropriate red flags to the exception reports, and the lack of documentation showing the connection between actions taken as a result of the exception reports and filing a SAR. RP 2890-2891.

LEXIS 44, at *16-17 (holding that firm's AML manual did not sufficiently incorporate its "Capital Markets Manual" because "there was no expectation that . . . employees, when faced with a potentially suspicious activity, would also reference the [AML] manual for direction and guidance"). Neither LSC's AML manual nor the SARs chapter in LSC's WSPs referred to any discussion of manipulative trading practices or when detecting such practices should result in the filing of a SAR. Although LSC's WSPs contained a separate "prohibited transactions" section describing various kinds of potentially manipulative trading, it did not direct the reader to consult either the AML manual or the AML chapter appearing 100 pages earlier in the WSPs. *Id.*

LSC argues that the lack of cross-references between the "prohibited transactions" section of the WSPs and the AML manual was immaterial because its WSPs directed employees to contact "Compliance" if they suspected prohibited securities transactions and its two-person compliance department was responsible for AML compliance. Br. 8. LSC's argument not only ignores *Domestic*, it misses the larger point and overlooks the key deficiencies with its AML program. Its procedures did not identify who should investigate for suspicious trading activities, how they should do so, how investigations should be documented, or how the detection of suspicious trading activities related to the SAR filing process. Indeed, despite LSC's claim that its compliance department was "fully aware of the need to review trades for SAR reporting purposes," Farrell-Starbuck had no such understanding. Instead, she understood that her AML responsibilities equated to "know your customer" obligations and testified that no one was monitoring trading activities "specific to AML." RP 2052, 2067-2068; *cf. Credit Suisse AWC*, *supra*, at 3 (finding that systems and procedures to monitor trading for other purposes were not designed to detect potentially suspicious activity from an AML perspective).

LSC also contends that both its AML manual and WSPs had language making it clear that "securities trading can have AML implications." Br. 7. In support, LSC points to passages in the AML manual stating that "trading" should be monitored and that suspicious activities include "a transaction that has no business or apparent lawful purpose, or . . . where the [f]irm has no reasonable explanation for the transaction," and a similar passage in the WSPs' money laundering section. Br. 6-7. But neither the AML manual nor the WSPs gave further context or descriptions as to what this language might refer to or any suggestion that it related to manipulative trading activity.

5. LSC's Other Exception Reports Were Not Part of LSC's Program.

LSC argues that its various exception reports that were operational before summer 2009 "would stop the typical violations that are determinable from the single order itself." Br. 18, 23. The NAC correctly found, however, that there was no evidence these other exception reports were part of LSC's AML program. Lek admitted that none of these other exception reports, controls, or filters were designed to detect potentially suspicious trading activity or manipulations. RP 3345. Instead, they simply rejected orders that fell outside LSC's authorized parameters, such as credit and size limits or prohibitions against odd lots. RP 3361-3366. Whatever potential existed to use these controls and filters to analyze for potential manipulation in an AML context, LSC had no written guidance establishing such a procedure or any written documentation memorializing any such reviews. RP 3475-3477. Indeed, although LSC's WSPs directed employees to review customer account statements and order documents to monitor for prohibited transactions, the WSPs did not refer to any of these exception reports, filters, or controls. As Fox opined, LSC's various exception reports were not evidence of a reasonable

AML program given that LSC lacked procedures identifying which exception reports were used for AML surveillance reasons or how they were to be used. RP 2862, 2881-2882, 2884, 2890.

6. Pre-Market Cancelations and Marking-the-Close Activities Are Relevant to AML Programs.

LSC argues that pre-market cancelations cannot be manipulative and that there was no reason for LSC to monitor them. Br. 24-26. The SEC, however, has prosecuted at least one case premised on the notion that pre-market cancelations can be manipulative. *See Briargate Trading, LLC*, Exchange Act Release No. 76104, 2015 SEC LEXIS 4170 (Order Instituting Cease-and-Desist Proceedings, Oct. 8, 2015) (finding that respondent placed and canceled multiple, large, non-bona fide, pre-market orders that impacted the market's perception of demand for the stocks and often the prices).[35] Moreover, it is undisputed that soon after regulators alerted LSC in June 2009 about some pre-market cancelations: (1) a DTI trader in August 2009 attempted to manipulate the market in Goldman Sachs stock through the use of pre-market cancelations; (2) LSC's trading desk flagged some pre-market cancelations in late August and early September 2009 that Dimension called "inappropriate"; and (3) in September 2009, a group of DTI traders—including some of the traders involved in prior incidents—attempted to influence the opening price of two stocks using pre-market cancelations. Attempted manipulation can be illegal solely because of the actor's purpose to manipulate, and regardless of whether the attempt succeeds. *See, e.g., Koch v. SEC*, 793 F.3d 147, 153-54 (D.C. Cir. 2015) (citing *Markowski v. SEC*, 274 F.3d 525, 529 (D.C. Cir. 2001)).

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[35] LSC attempts to distinguish *Briargate Trading* by asserting that there were no executions occurring in other markets by LSC's customers, and that the SEC's enforcement action occurred after the relevant period. Br. 26. But these arguments have nothing to do with whether, as a general matter, pre-market cancelations can be manipulative.

As the NAC found, to accept LSC's argument that pre-market cancelations could *never* affect the market would mean that the entire process of pre-market bids and offers was meaningless and that market participants engage in it for no reason. *See also* FINRA, 2012 Regulatory and Examination Priorities Letter, at 13, https://www.finra.org/sites/default/files/Industry/p125492.pdf (discussing "problematic [high frequency trading] or algorithmic activity . . . related to the open or close of regular market hours that involve distorting disseminated market imbalance indicators through the entry of non-bona fide orders and/or aggressive trading activity near the open or close").[36]

LSC similarly argues there was no need to monitor for marking-the-close activities because such activities raise questions only when holding overnight positions, and DTI was a day-trading customer that did not hold overnight positions. Br. 30-31. DTI, however, did not always end flat at the end of the day. LSC's argument also ignores that it had other institutional customers besides DTI that were not day traders.

7. An AML Program Can Be Deficient Even in the Absence of Evidence that Customers Actually Manipulated the Market.

Finally, LSC defends itself on grounds that there is no evidence it failed to detect any trades that were actually manipulative. Br. 3, 5. A determination that a respondent has violated FINRA's supervisory rules is not dependent, however, on a finding of an underlying violation. *Cf. Robert J. Prager*, 58 S.E.C. 634, 662 (2005) (stating that a violation of NASD Rule 3010 can

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[36] LSC relies on the opinion of expert witness Stewart Mayhew that pre-market cancelations could not lead to market manipulation. Br. 24-25. At the hearing, however, Mayhew backed away from his absolutist position and admitted it was "possible" that pre-market cancellations could be manipulative. RP 3625. Moreover, *Briargate Trading* shows the SEC's view that pre-market cancelations can be manipulative. Regardless, it is undisputed that DTI traders were attempting to use pre-market cancelations to influence the market price of various stocks.

occur in the absence of an underlying rule violation); *NASD Notice to Members 98-96*, 1998 NASD LEXIS 121, at *5 (Dec. 1998) (same). This case is not about whether any trades cleared by LSC were manipulative. Rather, it is about LSC's failure to design and implement a reasonable AML program to monitor for potentially manipulative trading and to report anything suspicious.

B. A $100,000 Fine and Censure for LSC's Egregious AML Violations Are Meaningful Sanctions That Will Deter LSC from Future Violations.

The $100,000 fine and censure that the NAC imposed for LSC's AML violations are fully warranted sanctions. Violations of AML rules are unquestionably severe offenses. FINRA's requirement to maintain AML programs is a direct result of the PATRIOT Act, which imposed obligations on broker-dealers "to make it easier to prevent, detect, and prosecute money laundering and the financing of terrorism." *NASD Notice to Members 03-34*, 2003 NASD LEXIS 41, at *2-3 (June 2003). "[B]roker-dealers play a vital front line role in assisting regulators and law enforcement in identifying and addressing suspicious activities to prevent our financial systems from being used for criminal purposes," and SAR reporting "contributes directly to [the SEC's] work . . . to protect investors and ensure that our markets operate fairly." Kevin W. Goodman, National Associate Director, SEC, Anti-Money Laundering: An Often-Overlooked Cornerstone of Effective Compliance, Speech at SIFMA Conference (June 18, 2015), https://www.sec.gov/news/speech/anti-money-laundering-an-often-overlooked-cornerstone.html. AML is "a national security concern." Susan F. Axelrod, Executive Vice President, FINRA, Remarks at SIFMA AML and Financial Crimes Conference (Feb. 9, 2017), http://www.finra.org/newsroom/speeches/020917-remarks-sifma-anti-money-laundering-and-financial-crimes-conference.

LSC's violation was accompanied by numerous aggravating factors, all of which were considered by the NAC. LSC failed to develop or implement a reasonable AML program for an extended period of time—nearly three years.[37] It stuck with its deficient AML program despite regulators' numerous inquiries about potentially manipulative trading,[38] evidence of attempted manipulation occurring through its systems (of which LSC was either actually aware or recklessly unaware), specific AML guidance both old (like *Notice to Members 02-21*) and new (like *Domestic*), the availability of affordable monitoring software, and Lek's awareness that manually looking for manipulation in an avalanche of trading activity would permit some suspicious activities to go undetected. And LSC continued to rely on Dimension to investigate exception reports, notwithstanding that Dimension—one of LSC's most significant customers—was not halting large pre-market cancelations as LSC requested, was sometimes not responsive to Farrell-Starbuck's inquiries, and was the subject (along with its customer) of repeated regulatory inquiries.

When LSC eventually made changes to its AML program in the wake of regulators' numerous inquiries, it made only minor tweaks that added little or no benefit. LSC continued to use an inadequate AML manual that did not discuss how LSC should detect and investigate suspicious trading, that provided no guidance about the process for timely determining whether to report suspect trading on a SAR, and that required no documentation of trading activities.

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37 *FINRA Sanction Guidelines*, at 6 (2015) [hereinafter Guidelines] (Principal Considerations in Determining Sanctions, Nos. 8, 9).

38 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 15).

LSC's demonstrated disregard for its AML responsibilities shows that LSC was reckless, if not defiant.[39]

LSC makes numerous arguments that there are mitigating factors—including several arguments that it never made to the NAC—but each claim is flawed. LSC argues that it has reformed its procedures and continues to enhance its surveillance controls, but the NAC correctly rejected this argument. Br. 34-35; RP 7930. The Guidelines indicate that a firm's employment of subsequent corrective measures is mitigating only when it is done "voluntarily" and "prior to detection or intervention . . . by a regulator," and LSC did not relent to make even the few minor changes to its AML program until after regulators began making inquiries.[40] Moreover, LSC proffered little evidence of any new procedures or controls other than Lek's testimony, which was outside the few discrete areas that the Hearing Panel found credible. RP 3477, 3481, 7493.

The NAC also properly rejected LSC's argument that the fine imposed in *Domestic Securities* supports a lower fine here. Br. 32. The SEC has "repeatedly rejected attempts by respondents to compare the sanctions imposed against them to the sanctions imposed against others." *Dep't of Enforcement v. Nicolas*, Complaint No. CAF040052, 2008 FINRA Discip. LEXIS 9, at *80 (FINRA NAC Mar. 12, 2008). If anything, *Domestic Securities* supports a higher sanction because it provided LSC with specific, on-point AML guidance, immediately prior to the relevant period, that LSC ignored.

LSC wrongly claims it deserves mitigation as a small firm. Br. 32. While a firm's size can be considered when assessing sanctions, the Guidelines counsel that relevant factors include

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39 *Id.* (Principal Considerations in Determining Sanctions, No. 13).

40 *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 3).

not just the number of individuals associated with the firm, but also the firm's financial resources, the nature of the firm's business, the level of trading activity at the firm, and any other relevant factors.[41] Those factors do not support any mitigation here. Although LSC had only 20 employees, LSC proffered no evidence of its financial resources, and the record shows that it executed substantial amounts of trades as a clearing firm. LSC chose to clear for high-frequency trading firms and cannot now claim mitigation because it hired a small number of employees to meet its responsibilities.

LSC contends that a lower sanction is also warranted because, citing the Guidelines' Principal Consideration 7, it reasonably relied on Calimano's annual assessment that LSC's AML program had no material deficiencies.[42] Br. 35; RP 3173, 3178-3182, 6163-6209. This argument also fails. Calimano is not a certified AML specialist or a qualified expert, nearly all of his industry experience preceded the PATRIOT Act, and he never served as an AML compliance officer. RP 3190-3191. In addition, the three audits that Calimano delivered to LSC during the relevant period showed that his overall assessments were unreliable. The lists of persons Calimano interviewed to prepare his audit reports did not even include Lek. RP 3169, 3193, 3199. Calimano's reports consisted largely of repeated boilerplate without addressing LSC's high-volume, high-frequency trading environment.[43] RP 6163-6209. Although each annual audit included "suggested enhancements," Calimano did not address in later reports

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41 *Id.* at 2 (General Principles Applicable to All Sanction Determinations, No. 1).

42 *Id.* at 6.

43 Of the three reports delivered during the relevant period, only Calimano's June 2008 report even mentioned that LSC executed 200,000 trades per day. The other reports omitted such information. RP 6167, 6181, 6197.

whether LSC adopted his earlier suggestions, and Calimano had to repeat in the July 2009 report a recommendation made the year before to include an anti-retaliation policy. RP 3197-3204, 6174, 6187-6190, 6204-6208. Calimano also did not cite as a material deficiency LSC's failure to document its reviews for suspicious activities and made almost no suggestions about documentation, despite his opinion that "everything you review should be noted somehow, whether it's on the document itself or whether you keep a log, a daily log." RP 3171, 3174-3179. Indeed, each of Calimano's reports stated that a "more comprehensive" examination of LSC's AML program might uncover deficiencies. RP 3184-3185, 6165, 6179, 6195.

LSC's argument that its AML training provides mitigation also lacks merit. Br. 9, 35. There is no evidence that LSC's AML training programs addressed the key deficiencies with LSC's AML program regarding monitoring for manipulative trading. LSC relies on a single line in the AML manual stating the AML Officer will conduct training seminars on "how to identify suspicious activities." Br. 9 (citing RP 3916, 3946). That single line does not demonstrate whether or how LSC trained employees to monitor for suspicious manipulative trading that might need to be reported on a SAR. In fact, none of LSC's training materials addressed who would monitor for manipulative trading in an AML context (or otherwise), how they should do so, or any connection between identifying suspicious manipulative trading activity and the filing of a SAR. *See generally* RP 6497-6763.

Citing Principal Consideration 18, LSC also contends that the "number, size and character of the transactions at issue" is mitigating because there is no allegation that any manipulative trades occurred through LSC or that LSC failed to file any necessary SARs.[44] Br.

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[44] *Guidelines*, at 7.

34. Principal Consideration 18, however, is inapposite: LSC's violation does not involve any "transactions," but rather a deficient AML program.

Sanctions should protect the investing public, support and improve overall business standards in the securities industry, and be meaningful enough to deter the respondent from engaging in future misconduct and others from engaging in similar misconduct.[45] Considering the general severity of AML violations, the aggravating factors that accompany LSC's conduct, and the lack of mitigation, a stringent sanction is warranted that is more than just "a cost of doing business."[46] This is all the more so considering how obstinate and intransigent LSC remained, in the face of regulatory inquiries and long-standing guidance regarding AML compliance. Lek was dismissive of the need to investigate wash sales, despite conceding that he now detects daily about four wash sales that "deserve some further investigation and attention." RP 2338-2339, 3421. He disputed that he should be concerned with attempted manipulations. RP 2326. He claimed, absurdly, that the DTI account titles were "unimportant" and "irrelevant," even though he admitted that DTI subaccount traders might be working with specific DTI limited partners. RP 2266-2271, 3420. He refused to accept that pre-market cancelations could be manipulative, despite regulators' repeated inquiries and DTI traders' repeated attempts to manipulate the market with such tactics. He opined that adding more instructions to the WSPs was "unnecessary." RP 3449. And he complained that having to document investigations would prevent him from getting other things done.

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45 *Id.* at 2 (General Principles Applicable to All Sanction Determinations, No. 1).

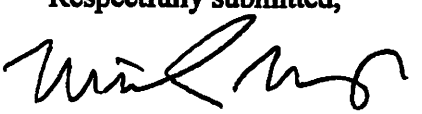
46 *Id.*

The NAC calibrated the sanctions based on the presence of numerous aggravating factors and the lack of mitigating factors. The $100,000 fine and censure are meaningful sanctions that will remedy LSC's violations, serve the public interest, and deter LSC and others from recklessly disregarding their responsibilities to develop and implement compliant AML programs.

V. CONCLUSION

The NAC correctly found that LSC egregiously failed to establish and implement a compliant AML program, in violation of FINRA's AML rules and its just-and-equitable principles-of-trade rule. Considering the importance of AML compliance, the aggravating factors, the lack of any mitigation, and LSC's clear disregard for its obligations, a $100,000 fine and censure is fully warranted to remedy LSC's misconduct. The SEC should affirm the NAC's decision in all respects.

Respectfully submitted,



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Dated: March 13, 2017

CERTIFICATE OF COMPLIANCE

I, Michael Garawski, certify that the foregoing FINRA's Brief in Opposition to Application for Review (File No. 3-17677) complies with the length limitation set forth in SEC Rule of Practice 450(c). I have relied on the word count feature of Microsoft Word in verifying that this brief contains 13,875 words.

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CERTIFICATE OF SERVICE

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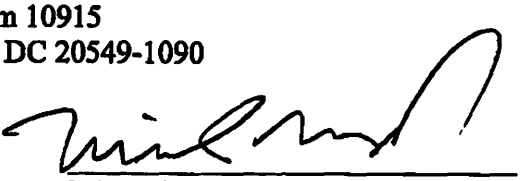

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