

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 89404 / July 27, 2020

ADMINISTRATIVE PROCEEDING

File No. 3-19893

In the Matter of

**Celadon Financial Group
LLC**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 15(b) AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Celadon Financial Group LLC (“Celadon” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. From at least July 2016 through December 2017 (the "Relevant Period"), Celadon, a registered broker-dealer, facilitated order flow from other broker-dealers engaged in the sale of large volumes of shares in low-priced and often thinly-traded over-the-counter ("OTC") microcap stocks. Celadon derived, on average, 32% of its revenue during this period from the trading profits it generated by facilitating the sale of such shares. While doing so, Celadon repeatedly violated the federal securities laws in two different ways.

2. First, Celadon violated Rule 203(b)(1) of Regulation SHO promulgated under the Exchange Act. During the Relevant Period, Celadon would receive from certain broker-dealers "not held" orders to sell low-priced microcap securities, which Celadon would execute in a series of principal short sales throughout the day. Celadon did not, however, "locate" shares to cover its short sales prior to execution as required by Rule 203(b)(1) of Regulation SHO.

3. Second, although Celadon was engaged in facilitating high volume liquidations of low-priced and often thinly-traded OTC stocks, Celadon did not adequately implement its anti-money laundering ("AML") policies and procedures so as to reasonably address the risks associated with this aspect of its business. As detailed below, due to the deficiencies in Celadon's implementation of its AML policies and procedures ("AML Policies"), Celadon failed to file Suspicious Activity Reports ("SARs") for numerous transactions that it had reason to suspect involved possible fraudulent activity or had no business or apparent lawful purpose. As a result, Celadon violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

Respondent

4. During the Relevant Period, Celadon was a registered broker-dealer headquartered in Chatham, New Jersey. Historically, the firm's primary revenue source had been securities commissions on self-directed transactions from its customer base and proprietary trading in fixed income securities. During the Relevant Period, Celadon began facilitating the sale of large volumes of low-priced and often thinly-traded OTC stocks into the market for other broker-dealers. In the third and fourth quarters of 2016, nearly half of Celadon's revenue was derived from such sales.

Other Relevant Entities

5. During the Relevant Period, Broker-Dealer A was a registered broker-dealer headquartered in Salt Lake City, Utah. Broker-Dealer A's primary business activities focused on executing its customers' trades in low-priced OTC stocks. Broker-Dealer A has an extensive disciplinary history.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

6. During the Relevant Period, Broker-Dealer B was a registered broker-dealer headquartered in Salt Lake City, Utah. Broker-Dealer B's business activities included executing its customers' trades in low-priced, OTC stocks. Broker-Dealer B has an extensive disciplinary history.

7. During the Relevant Period, Broker-Dealer C was a registered broker-dealer headquartered in New York, New York. Broker-Dealer C's business activities included executing its customers' trades in low-priced, OTC stocks. Broker-Dealer C has an extensive disciplinary history.

Background

A. Regulation SHO Violations

8. Rule 203(b)(1) of Regulation SHO prohibits a broker or dealer from accepting a short sale order from another person or effecting a short sale in an equity security for its own account unless the broker or dealer has borrowed the security, entered into a bona-fide arrangement to borrow the security or has reasonable grounds to believe that the security can be borrowed so that it can be delivered on the delivery date (the "locate requirement"). Rule 203(b)(1) also requires the broker or dealer to document its compliance with the locate requirement.

9. When Celadon received long sale orders for the sale of stock from its broker-dealer customers, including Broker-Dealers A, B, and C, Celadon typically facilitated the execution of these orders in the following manner. The broker-dealer customer gave Celadon a "not held" long sale order for an OTC stock, giving Celadon time and price discretion in working the order, which Celadon then executed in a series of short sales throughout the day in a principal capacity, building a short position over the course of the day. Celadon covered its short position at the end of the day by buying the same number of shares from the broker-dealer customer at a lower price, also on a principal basis. Celadon's trading gains were equal to the difference between the average price of its short sales to the market and the lower price at which it bought the shares from the broker-dealer customer.

10. During the Relevant Period, there were thousands of transactions where Celadon failed to comply with the locate requirement of Regulation SHO while engaging in short sales to facilitate long sale orders from broker-dealer customers without borrowing the securities, arranging to borrow the securities, or having reasonable grounds to believe that the securities could be borrowed in time for delivery on the date delivery was due. Although Regulation SHO includes certain exceptions to the locate requirement, none of those exceptions applied to these transactions. Celadon's transactions in OTC securities resulted in more than 10,000 short sales without locates in violation of Rule 203(b)(1) of Regulation SHO during the relevant period.

B. AML Violations

11. The Bank Secrecy Act ("BSA") and implementing regulations promulgated by the Financial Crimes Enforcement Network ("FinCEN") require that broker-dealers file SARs

with FinCEN to report a transaction (or pattern of transactions of which the transaction is a part) conducted or attempted by, at or through the broker-dealer involving or aggregating to at least \$5,000, that the broker-dealer knows, suspects, or has reason to suspect: (1) involves funds derived from illegal activity or is conducted to disguise funds derived from illegal activities; (2) is designed to evade any requirement of the BSA; (3) has no business or apparent lawful purpose and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity. 31 C.F.R. § 1023(a)(2) (“SAR Rule”).

12. Exchange Act Rule 17a-8 requires broker-dealers registered with the Commission to comply with the reporting, recordkeeping and record retention requirements of the BSA. The failure to file a SAR as required by the SAR Rule is a violation of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

13. During the Relevant Period, Celadon had Written Supervisory Procedures (“WSPs”) that, among other things, described its AML Policies. Those WSPs recognized that the firm was required to file SARs for transactions that may be indicative of money laundering activity and described the circumstances that might indicate potential money-laundering activity. During the Relevant Period, however, Celadon’s implementation of its written AML Policies was deficient and, as a result, Celadon failed to file SARs or conduct a review of numerous transactions and patterns of activity that raised red flags under its AML Policies. These red flags concerned the issuers, price movements, and volume of the trades by Celadon’s broker-dealer customers and the customers of the broker-dealers on whose behalf the trades were being made.

14. Celadon’s WSPs that were in effect during the Relevant Period identified order flow from other broker-dealers involving the liquidation of large volumes of low-priced or microcap securities as a potential AML red flag. The WSPs specifically stated that accounts engaged in such transactions “should be the subject of reasonable inquiry to determine the source of the securities and to identify potential money laundering and registration issues” and that such transactions “may involve suspicious activity subject to the filing of a Suspicious Activity Report under the Bank Secrecy Act.”

15. Celadon’s WSPs identified the following additional AML red flags: issuers with nominal assets and low operating revenue; atypical trading patterns in an issuer’s securities, such as sudden spikes in price and trading volume; notification from a clearing firm that the clearing firm had identified potentially suspicious activity in the securities of certain issuers or certain customer accounts; customer transactions that include a pattern of receiving stock in physical form; and a customer (or a person publicly associated with the customer) who has a questionable background or is the subject of news reports indicating possible criminal, civil, or regulatory violations. During the Relevant Period, Celadon failed to identify or identified and ignored each of these red flags.

16. Although Celadon’s AML Policies indicated an awareness that facilitating high volume liquidations of low-priced OTC securities presented significant AML risks, Celadon failed to adequately review transactions involving low-priced securities to address the risks posed by that part of its business. Moreover, even when the firm’s monitoring did identify red flags, Celadon did not take the steps required by its WSPs. For example, when Celadon identified

numerous instances of the firm's daily trading in a particular stock constituting a substantial portion of the market volume in that security, as well as large price fluctuations in the security, Celadon did not conduct adequate further inquiry into those transactions. Throughout the Relevant Period, Celadon failed to file a single SAR.

17. As illustrated by the examples described below, Celadon was, or should have been, aware of red flags indicating suspicious activity associated with the orders from its broker-dealer customers. However, as a result of the deficiencies in its implementation of its AML Policies, Celadon repeatedly failed to report suspicious transactions or conduct adequate inquiries concerning those transactions. Accordingly, Celadon did not comply with the requirements of the BSA and violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

(a) *Suspicious Trading in Issuer A*

18. Issuer A was a development stage company in the marijuana industry. Issuer A underwent a name and symbol change in early 2016 and had been the subject of at least one promotional campaign in February 2016. It was a low-priced stock trading at sub-penny levels in the OTC market.

19. From July 1, 2016 through November 29, 2016, Celadon facilitated the liquidation of over two billion shares of Issuer A, representing 31% of Issuer A's total outstanding shares, 91% of which came from one broker-dealer customer, Broker-Dealer A. On 12 dates, Celadon facilitated trading that constituted between 30% and 47% of the total daily trading volume in Issuer A. There were also significant spikes in market volume during Relevant Period. For example, on three dates in late October 2016, Issuer A's daily market volume was between 355% and 481% of the previous 90-day average daily volume. During this period, Issuer A's price was volatile, fluctuating between \$0.0001 and \$0.0022 as trading volume spiked. Celadon's internal surveillance reports identified excessive intraday price volatility in 15 instances, with one-day fluctuations sometimes as high as 100%.

20. Celadon did not conduct any follow-up inquiry concerning these red flags and failed to file SARs concerning its customer's trading in Issuer A.

(b) *Suspicious Trading in Issuer B*

21. Issuer B provided services for companies in the marijuana industry. Its stock was low-priced and traded in the OTC market, often at sub-penny levels. On October 17, 2016, two days before Celadon began trading the stock of Issuer B, it underwent a one-for-20 reverse stock split. This was followed by the rapid issuance of additional shares through convertible promissory notes.

22. As of November 18, 2016, Issuer B had just over 37.5 million shares outstanding, a figure that rose to approximately 150 million as of the date Celadon ceased facilitating trading in the shares of Issuer B on November 30, 2016. Between October 19, 2016 and November 30, 2016, Celadon facilitated the liquidation of 37.7 million shares of Issuer B, constituting approximately 50% of the average shares outstanding during that period. Eighty-

four percent of the shares liquidated by Celadon were attributable solely to orders from Broker-Dealer C.

23. During the same period, Celadon facilitated trading, which constituted more than 30% of total market volume in Issuer B on three days and more than 42% of total market volume on one day. On ten days during this period, Celadon facilitated daily trading in Issuer B ranging from 78% to 199% of the previous 30-day average daily trading volume. As of November 4, 2016, the 30-day average daily trading volume for Issuer B was 1.2 million shares and increased to 11.7 million shares as of November 30, 2016. While trading volume increased dramatically, the price of Issuer B's stock fell precipitously. The closing price of Issuer B's stock fell from \$0.15 on October 19, 2016 to \$0.003 on November 30, 2016. Celadon's internal surveillance reports flagged extreme one-day price declines ranging from 53% to 99% on 3 dates associated with this trading.

24. Had Celadon reviewed the unusual activity as required by its WSPs, it would have revealed that the stock had been the subject of several promotions in 2016, its SEC filings were often late, and that it experienced extreme dilution of its stock. Celadon did not conduct any follow-up inquiry concerning these red flags and failed to file SARs concerning its customers' trading in Issuer B.

(c) *Suspicious Trading in Issuer C*

25. Issuer C was an SEC reporting company with a history of delinquent public filings. From December 18, 2013 to September 9, 2016 Issuer C was delinquent in filing periodic reports on nine occasions. Issuer C's stock was low-priced and traded in the OTC market.

26. In its annual report on Form 10-K for the year 2015, Issuer C reported no revenues. Despite its weak financials, Issuer C's market capitalization was \$1.8 million as of December 31, 2016 and it had been the subject of multiple promotions since 2013, including approximately eleven during 2016.

27. On 21 days between July 21, 2016 and October 12, 2016, Celadon facilitated the liquidation of approximately 4.1 million shares of Issuer C. Of those transactions, 84% of the sell orders came from Broker-Dealer B and 15% from Broker-Dealer C. On six days during this period, Celadon facilitated trading in Issuer C, which represented 30% of the total market volume and over 40% on two of those days. During the period that Celadon facilitated trading in Issuer C, the price was highly volatile, ranging from an intraday high of \$0.0591 on July 20, 2016 to an intraday low of \$0.01 on October 7, 2016, representing an 83% decline. On October 7, 2016, Celadon's internal surveillance reports captured a single-day price decrease of 68.75%. At the time Celadon began facilitating trading in the stock of Issuer C, it had a history of dramatic spikes in trading volume. On October 30, 2015, the 120-day average daily trading volume of Issuer C was 80,453 shares. On July 19, 2016, the 120-day average daily trading volume had increased 1,589% to almost 1.4 million shares.

28. Celadon did not conduct any follow-up inquiry into these red flags as required by its WSPs and failed to file SARs concerning its customers' trading in Issuer C.

(d) Concerns Raised by Celadon's Clearing Firm

29. During the Relevant Period, one of Celadon's clearing firms told Celadon that it had general regulatory concerns about Celadon's low-priced security business, including the delivery of physical stock certificates, two of the AML red flags identified in Celadon's WSPs. Specifically, the clearing firm told Celadon that it had "way too many regulatory concerns with this low priced security business"; it had "great concern that the regulators will be inquiring about this business and in some cases have already"; that these issues were "at the top of the house here" and it told Celadon it would no longer clear these types of transactions.

30. Rather than responding to the clearing firm's concerns with an inquiry into the risks identified by the clearing firm, which may have led to the filing of one or more SARs, Celadon ignored the regulatory issues raised by its clearing firm and simply attempted to get additional time to find another clearing firm that would allow it to continue to execute the transactions that its clearing firm identified as raising regulatory concerns.

(e) Suspicious Trading by a Person with a History of Securities Violations

31. During the Relevant Period, Celadon executed orders it received from various broker-dealers for the sale of nearly six billion shares of low-priced securities that were made on behalf of entities controlled by Individual A, a person who had twice been charged by the Commission with the illegal sale of unregistered securities in violation of the Securities Act of 1933.

32. Individual A's association with these sales was an AML red flag under Celadon's WSPs, which identified transactions with individuals who were the subject of civil or regulatory violations. But, because Celadon did not conduct the type of inquiry that these high volume microcap sales should have triggered, it failed to identify Individual A's association with the transactions and failed to file any SARs reporting his connection to these transactions.

33. As a result of the conduct described in Section III.A above, Celadon willfully² violated Rule 203(b)(1) of Regulation SHO promulgated under the Exchange Act.

34. As a result of the conduct described in Section III.B above, Celadon willfully violated Section 17(a) of the Exchange Act and Rule 17a-8 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in the Offer.

Accordingly, pursuant to Sections 15(b) and 21(C) of the Exchange Act, it is hereby

² "Willfully," for purposes of imposing relief under Section 15(b) of the Exchange Act "means no more than that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Rule 203(b)(1) of Regulation SHO promulgated under the Exchange Act, and Section 17(a) of the Exchange Act and Rule 17a-8 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall, within twenty-one (21) days of the entry of this Order pay a civil monetary penalty in the amount of \$125,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch HQ
Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Celadon as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa Countryman
Secretary