

NYSE ARCA, INC.

DEPARTMENT OF MARKET REGULATION,

Complainant,

v.

WEDBUSH SECURITIES, INC.,

Respondent.

Proceeding No. 20110263118-03

Hearing Officer – AHP

December 1, 2015

Respondent failed to establish, maintain, and enforce supervisory systems and procedures related to its direct market access and sponsored access business, in violation of NYSE Arca Equities Rules 6.18(a)–(c), 6.1(b), 6.2, 7.30(b), 9.2(a), 9.2(b)(4), and 2010.

Respondent failed to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the risks associated with its direct market access and sponsored access business. Respondent thereby violated Section 15(c)(3) of the Securities Exchange Act of 1934, Exchange Act Rule 15c3-5, and NYSE Arca Equities Rules 6.1(b), 6.2, and 2010.

Respondent failed to observe high standards of commercial honor and just and equitable principles of trade by (i) creating incentives that compensated its compliance personnel based on the firm’s direct market access and sponsored access trading volume and (ii) failing to monitor and detect potentially manipulative trading by customers, despite repeated red flags. Respondent thereby violated NYSE Arca Equities Rules 6.1(b) and 2010.

Respondent failed to take reasonable steps to avoid submission of direct market access and sponsored access orders that resulted in locked and crossed markets, and Respondent failed to reasonably supervise activity with respect to locked and crossed markets and order protection rules by customers with direct market access and sponsored access. Respondent thereby violated Regulation NMS Rule 611(c) and NYSE Arca Equities Rules 6.1(b), 6.18, 6.2, 7.30(b), 7.37(e)(2), 9.2(a) and (b), and 2010.

Consent to a censure and a \$566,666 fine.

Appearances

FINRA Market Regulation:

John Warshawsky, Esq.
Elyse D. Kovar, Esq.
Eric S. Brown, Esq.
James J. Nixon, Esq.
David E. Rosenstein, Esq.
Robert A. Marchman, Esq.

Wedbush Securities, Inc.:

John L. Erikson, Jr., Esq.
Charles B. LaChaussée, Esq.

A Hearing Officer at the Financial Industry Regulatory Authority (“FINRA”) considered an Offer of Settlement and Consent entered into between FINRA’s Department of Market Regulation on behalf of NYSE Regulation, Inc.¹ and Wedbush Securities, Inc. (“Wedbush” or the “Firm”).

The Offer of Settlement and Consent (“Offer”) was submitted for the purpose of settling this disciplinary proceeding without adjudication of any issues of law or fact and without admitting or denying any allegations or findings referenced in the Offer. The Offer was submitted in conjunction with the settlements of three other disciplinary actions FINRA brought against Wedbush on behalf of FINRA and two other self-regulatory organizations, which disciplinary actions include substantially the same allegations and charges as those in the Complaint in this action.²

The Hearing Officer accepts the Offer and issues this Decision in accordance with NYSE Arca Equities Rules.³

FINDINGS OF FACTS AND VIOLATIONS

Background and Jurisdiction

1. Wedbush (known as Wedbush Morgan Securities Inc. until April 2010) is headquartered in Los Angeles, California. Wedbush has been registered as an Equities Trading Permit (“ETP”) Holder with NYSE Arca, Inc. (“NYSE Arca Equities” or the “Exchange”) since

¹ FINRA is handling this matter on behalf of NYSE Regulation, Inc. and NYSE Arca, Inc. pursuant to a Regulatory Services Agreement among NYSE Group, Inc., New York Stock Exchange LLC, NYSE Arca, Inc., NYSE Amex (now NYSE MKT LLC), NYSE Regulation, Inc. and FINRA, which became effective June 14, 2010.

² The other disciplinary actions are: (1) Disciplinary Proceeding No. 20090206344-01, which was filed August 18, 2014, on behalf of FINRA; (2) Disciplinary Proceeding No. 20090206344-02, which was filed April 10, 2015, on behalf of The NASDAQ Stock Market, LLC; and (3) Disciplinary Proceeding No. 20090206344-04, which was filed October 1, 2015, on behalf of BATS Exchange, Inc.

³ The facts, allegations, and conclusions contained in this Decision are taken from the executed Offer of Settlement and Consent submitted on November 23, 2015.

October 29, 2004, and continues to be subject to NYSE Arca jurisdiction. Wedbush also is registered with FINRA and multiple equity and option exchanges.

2. FINRA's Department of Market Regulation, on behalf of NYSE Regulation, conducted an investigation into Wedbush's business of providing direct market access and sponsored access (together, "Market Access") to the NYSE Arca Marketplace between January 1, 2008, and August 26, 2013 (the "Relevant Period").
3. In letters dated January 13, 2010, March 28, 2011, July 21, 2012, November 13, 2012, and September 11, 2013, which Wedbush received, the Legal Section of FINRA Market Regulation on behalf of NYSE Arca Equities notified Wedbush that it was investigating suspicious and potential manipulative trading activity by its market access customers on the NYSE Arca Marketplace, and Wedbush's supervision thereof, during the Relevant Period.

SUMMARY

4. This matter involves supervisory violations committed by Wedbush during the Relevant Period in its business of providing Market Access to broker-dealers and non-registered market participants ("Market Access Customers") to multiple market centers, including the NYSE Arca Marketplace.
5. During the Relevant Period, Wedbush was one of the largest-volume Market Access providers. Without dedicating sufficient resources to ensure appropriate regulatory risk management controls and supervisory systems and procedures, Wedbush, through employees and management of its Correspondent Services Division, enabled its Market Access Customers to flood the exchanges with thousands of potentially manipulative wash trades and other potentially manipulative trading activity, such as layering⁴ and spoofing.⁵ Wedbush reaped millions of dollars from its Market Access business, but failed to devote sufficient resources, including qualified and adequately trained compliance personnel, surveillance systems and controls, to detect and prevent potential manipulative activity by its Market Access Customers.

⁴ "Layering" can involve a trading pattern in which multiple, non-bona fide limit orders are entered on one side of the market at various price levels away from the National Best Bid or Offer ("NBBO") in order to create the appearance of a change in the levels of supply and demand, thereby artificially moving the price of the security, then an order is executed on the opposite side of the market at the artificially created price, and the non-bona fide orders are immediately cancelled.

⁵ "Spoofing" can involve a trading pattern in which multiple, non-bona fide limit orders are entered generally inside the existing NBBO, with the intention of briefly triggering some type of market movement and/or response from another market participant, followed by cancellation of the non-bona fide orders, and the entry of an order on the opposite side of the market.

6. Wedbush permitted its Market Access Customers to use third-party Market Access systems to electronically route orders directly to the NYSE Arca Marketplace using a Wedbush-registered market participant identifier (“MPID”). As executing broker, Wedbush was responsible for monitoring and reviewing its Market Access Customers’ order flow to detect and report suspicious and potentially manipulative trades, and to ensure that order flow entered via a Firm MPID complied with applicable federal securities laws and regulations and NYSE Arca Equities rules. Despite its obligations, Wedbush largely relied on its Market Access Customers to self-monitor and self-report their own suspicious trades to Wedbush without sufficient oversight and controls.
7. Multiple industry-wide notices and disciplinary decisions published during the Relevant Period put Wedbush on notice that its Market Access business posed particular regulatory and compliance risks. *See, e.g., FINRA’s 2010 Annual Regulatory and Examination Priorities Letter* (“Priorities Letter”) (Mar. 1, 2010) (Market Access providers must ensure that their customers’ activities comply with all applicable securities rules and regulations, and that their orders represent bona fide trading interest and are free of errors; Market Access providers must have appropriate processes for conducting due diligence with respect to approval of Market Access customers, and must establish controls that systematically limit financial exposure arising from the trading activity of sponsored participants, limit the use of the system to authorized persons, establish checks for validation of order accuracy, and monitor for duplication or retransmission of orders)); *see also FINRA’s 2011 Priorities Letter* (Feb. 8, 2011); *FINRA’s 2012 Priorities Letter* (Jan. 31, 2012); *FINRA’s 2013 Priorities Letter* (Jan. 11, 2013).⁶
8. Moreover, during the Relevant Period, NYSE Arca Equities prohibited manipulative and abusive trading practices, such as fictitious transactions, wash trades and pre-arranged trades. *See, e.g., NYSE Arca Equities Rules 6.5, 6.15 and 2020* (as of June 30, 2011) (which prohibit, among other things, efforts to effect or induce securities transactions for the purpose of creating or inducing a false, misleading or artificial appearance of trading

⁶ *See FINRA’s 2011 Priorities Letter* (Feb. 8, 2011) (firms that generate orders by use of high-frequency models or trading algorithms have written policies and procedures reasonably designed to ensure that such trading complies with applicable laws, rules and regulations, including anti-manipulation provisions); *FINRA’s 2012 Priorities Letter* (Jan. 31, 2012) (Rule 15c3-5 compliance; market access providers must have post-trade surveillance procedures reasonably designed to identify potential trading violations such as wash sales, marking, spoofing, layering, quote stuffing and manipulation related to the open and close of trading; also surveillance of abusive high-frequency trading strategies, including activity initiated from outside of the United States involving momentum ignition strategies, where a market participant attempts to induce others to trade at artificially high or low prices; also concern with spoofing strategies 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); *FINRA’s 2013 Priorities Letter* (Jan. 11, 2013) (focus on high-frequency and algorithmic trading abuses intended to bait other market participants to trade at artificially higher or lower prices, and FINRA’s focus on activity originating from outside of the United States); *FINRA’s 2008 Priorities Letter* (Mar. 24, 2008) (focus areas included supervision); and *FINRA’s 2009 Priorities Letter* (Mar. 9, 2009) (focus areas included order-entry controls, and internal controls, procedures and surveillance practices, including for marking-the-close, to ensure that potential misconduct is timely identified and reviewed).

activity and directly or indirectly participating in, having an interest in the profits of a manipulative trading operation).

9. In addition, multiple self-regulatory organization (“SRO”) examinations beginning in 2007 identified concerns to the Firm relating to its onboarding of new Market Access Customers, identification of authorized traders, inadequate monitoring of activity for potential manipulation, and deficiencies in its written supervisory procedures (“WSPs”) with respect to the Firm’s Market Access business. The Firm was informed that multiple SRO investigations involved Wedbush Market Access Customer activity. Those investigations highlighted specific shortcomings in the Firm’s Market Access oversight and WSPs, including with respect to reviews for potential wash trades, pre-arranged trades, and potentially violative odd lot trades.
10. During the Relevant Period, Wedbush’s system of regulatory risk management controls and supervisory procedures were not reasonably designed to manage the risk associated with its Market Access business. Wedbush failed to dedicate sufficient resources, and had an inadequate number of competent and trained staff, to reasonably monitor the significant order flow by its Market Access Customers to ensure compliance with federal securities laws and exchange rules. Wedbush’s internal reviews were inadequate, and its written description of its risk management controls was insufficient. Moreover, Wedbush’s supervisory systems and procedures were not reasonably designed to achieve compliance with federal securities laws and regulations and NYSE Arca Equities rules addressing potentially manipulative and suspicious trading by the Firm’s Market Access customers, such as layering, spoofing, wash trading, suspicious patterns of order cancellations and odd-lot manipulation.
11. By failing to establish, maintain, and enforce supervisory systems and procedures that were reasonably designed to achieve compliance with securities laws, rules, and regulations, including NYSE Arca Equities rules addressing the monitoring, detection, and prevention of suspicious and potentially manipulative trading, Wedbush violated NYSE Arca Equities Rules 6.18(a)-(c) (concerning, among other things, ETP Holders’ supervisory responsibilities); 6.1(b) (concerning, among other things, adherence to principles of good business practice); and 2010 (as of June 30, 2011) (concerning, among other things, conduct inconsistent with just and equitable principles of trade).
12. In addition, by failing to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the regulatory and other risks of having and providing Market Access, Wedbush willfully violated Section 15(c)(3) of the Securities Exchange Act of 1934 (“Exchange Act”) (concerning, among other things, broker-dealers’ compliance with Securities and Exchange Commission (“SEC”) rules regarding safeguards, financial responsibility, and related practices of broker-dealers), and Rule 15c3-5 thereunder (beginning on July 14, 2011) (the “Market Access Rule,” requiring, among other things, that broker-dealers appropriately control

risks associated with Market Access); and the Firm also violated NYSE Arca Equities Rules 6.1(b), 6.2(b) (permitting, among other things, the imposition of penalties for conduct inconsistent with just and equitable principles of trade), and 2010.

13. By creating incentives that rewarded compliance personnel with monthly compensation based on Market Access Customers' trading volume, for which they had responsibility to oversee, and by failing to monitor and detect thousands of instances of potentially manipulative trading by recidivist customers, despite repeated red flags, Wedbush failed to observe high standards of commercial honor and just and equitable principles of trade, in violation of NYSE Arca Equities Rules 6.1(b) and 2010 (as of June 30, 2011).
14. By failing to have reasonable procedures to ensure that all authorized traders of its Market Access Customers comply with all NYSE Arca Equities rules, Wedbush violated NYSE Arca Equities Rules 7.30(b) (concerning, among other things, ETP Holders' procedures to ensure authorized traders' compliance with certain rules and procedures), 6.1(b), and 2010 (as of June 30, 2011).
15. By failing to use due diligence to learn essential facts relative to Market Access Customer accounts, Wedbush violated NYSE Arca Equities Rules 9.2(a) (concerning, among other things, ETP Holders' due diligence to learn essential facts relative to every customer and every order), 6.1(b), and 2010 (as of June 30, 2011).
16. By failing to periodically review Market Access Customer accounts for irregularities, Wedbush violated NYSE Arca Equities Rules 9.2(b)(4) (concerning, among other things, ETP Holders' review of customer accounts for irregularities or abuses), 6.1(b), and 2010 (as of June 30, 2011).
17. By failing to take reasonable steps to avoid submission by its Market Access Customers of orders that resulted in locked and crossed markets, Wedbush willfully violated NYSE Arca Equities Rules 7.37(e)(2) (concerning, among other things, the display of locking or crossing quotations) and Regulation NMS Rule 611(c) (concerning, among other things, the routing of intermarket sweep orders); and the Firm also violated NYSE Arca Equities Rules 6.1(b), 6.2, and 2010 (as of June 30, 2011).
18. By failing to reasonably supervise activity by its Market Access Customers with respect to locked and crossed markets, order protection rules, and compliance with NYSE Arca Equities Rule 7.37(e)(2) and Regulation NMS Rule 611(c), Wedbush violated NYSE Arca Equities Rules 6.18, 7.30(b), 9.2(a) and (b), 6.1(b), and 2010 (as of June 30, 2011).

Regulatory Framework

Member organizations are required to implement and maintain written procedures for controlling electronic order flow. During the Relevant Period, NYSE Arca Equities Rule 6.18(a)

required, among other things, that every ETP Holder supervise persons associated with it as to assure compliance with federal securities laws and the Constitution or Rules of NYSE Arca. NYSE Arca Equities Rule 6.18(b) required each ETP Holder to “establish and maintain a system to supervise the activities of its associated persons and the operation of its business.” Pursuant to NYSE Arca Equities Rule 6.18(b), “[s]uch system must be reasonably designed to ensure compliance with applicable federal securities laws and regulations and NYSE Arca Equities Rules.” Moreover, NYSE Arca Equities Rule 6.18(c) required each ETP Holder to “establish, maintain, and enforce written procedures to supervise the business in which it engages and to supervise the activities of its associated persons that are reasonably designed to achieve compliance with applicable federal securities laws and regulations, and with the NYSE Arca Equities Rules.”

19. Thus, any ETP Holder that enters customer orders onto the NYSE Arca Marketplace retains the responsibility and disciplinary liability for ensuring that such orders comply with all NYSE Arca Equities Rules and other applicable laws and regulations. Exchange Regulatory Information Bulletin RBE-07-01, *ETP Holders’ Supervisory Obligations of Order Flow* (Jan. 29, 2007), made clear that ETP Holders must have a supervisory system in place, including WSPs, designed to review all trading activity submitted to the NYSE Arca Marketplace by such ETP Holders, and to alert for potentially manipulative or otherwise improper trading patterns or practices. The Bulletin further noted that an ETP Holder’s failure to have in place an “automated surveillance system” to review customer accounts for abusive trading activity has been held to constitute a violation of NYSE Arca Equities Rule 6.18.
20. Exchange Regulatory Information Bulletin RBE-02-02, *Supervision Obligations of ETP Holders* (Apr. 25, 2002), identified specific types of manipulative trading practices required to be monitored by ETP Holders, including marking-the-close, prearranged trading, phantom orders, influencing the open, and wash sales. The Bulletin defined each of these prohibited practices, and noted that phantom orders (orders entered with the sole intention of artificially influencing the market) are usually canceled prior to execution. NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders’ Supervisory Obligations of Order Flow* (Jan. 29, 2007).
21. NYSE Arca Equities Rule 7.30(b) required ETP Holders to have reasonable procedures to ensure that all authorized traders comply with the trading rules and procedures related to the NYSE Arca Marketplace.
22. Pursuant to NYSE Arca Equities Rule 6.2(b), the willful violation of any provision of the federal securities laws, the regulations of the SEC, and NYSE Arca bylaws and rules shall be considered conduct or proceedings inconsistent with just and equitable principles of trade.

23. Pursuant to NYSE Arca Equities Rule 9.2(a), an ETP Holder must use due diligence to learn essential facts relative to customer accounts and orders.
24. Pursuant to Rule 9.2(b)(4), an ETP Holder must periodically review customer accounts for irregularities or abuses.
25. Pursuant to NYSE Arca Equities Rule 6.1(b), an ETP Holder must adhere to the principles of good business practice in the conduct of its business affairs.
26. Pursuant to NYSE Arca Equities Rule 2010 (as of June 30, 2011), an ETP Holder, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.
27. Section 15(c)(3) of the Exchange Act requires broker-dealers to comply with SEC rules regarding safeguards, financial responsibility, and related practices of broker-dealers . The SEC adopted Rule 15c3-5 of the Exchange Act⁷, or the Market Access Rule, in November 2010 to require that brokers or dealers, as gatekeepers to the financial markets, “appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system.”⁸
28. Subsection (b) of the Market Access Rule requires a broker-dealer with Market Access that provides a customer or any other person with access to an exchange through the use of its MPID or otherwise to “establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks” of its Market Access business.
29. Subsection (c) of the Market Access Rule identifies specific required elements of a broker-dealer’s system of risk management controls and supervisory procedures related to Market Access. Subsection (c)(1) addresses financial controls and procedures and subsection (c)(2) addresses regulatory controls and procedures. Under subsection (c)(2), a broker-dealer must have controls and procedures that are reasonably designed to ensure compliance with all regulatory requirements, including controls to prevent the entry of orders that do not comply with all regulatory requirements that must be satisfied on a pre-order entry basis and controls to restrict access to trading systems and technology that provide Market Access to persons and accounts pre-approved and authorized by the broker-dealer with Market Access.

⁷ 17 C.F.R. § 240.15c3-5. The initial compliance date for Rule 15c3-5 was July 14, 2011. On June 30, 2011, the SEC extended the compliance date for certain requirements of Rule 15c3-5 until November 30, 2011.

⁸ *Risk Management Controls for Brokers or Dealers with Market Access*, 75 Fed. Reg. 69792 at 69792 (Nov. 15, 2010) (final rule release).

30. Subsection (d) of the Market Access Rule makes clear that a broker-dealer that provides Market Access may not rely on its customers for regulatory compliance, must have “direct and exclusive control” over the regulatory risk management controls and supervisory procedures, and may not use systems created by or affiliated with its customers. This requirement is designed to eliminate the practice whereby the broker-dealer providing Market Access relies on its customer, a third party service provider, or others, to establish and maintain the applicable risk controls. If a Market Access provider uses a system developed by a third party, the system must still be in the direct and exclusive control of the Market Access provider; the third party service provider cannot have access to, or be responsible for, the regulatory controls implemented by the Market Access provider. Moreover, if a broker-dealer that provides Market Access reasonably allocates control over specific regulatory risk management controls and supervisory procedures, by written contract after a thorough due diligence review in accordance with the requirements set forth in the rule, to a customer that is a registered broker-dealer, the Market Access provider is not relieved from any obligation, including the overall responsibility to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of Market Access. The Market Access provider is expected to review the performance of the registered broker-dealer to whom it has allocated certain regulatory responsibilities.
31. Subsection (e) of the Market Access Rule requires a broker-dealer with Market Access to establish, document and maintain a system for regularly reviewing the effectiveness of its risk management controls and supervisory procedures. Reasonably designed WSPs are an important component of the system required by the rule, because they help to ensure that Market Access provider fulfills its obligations to conduct a review of the overall effectiveness of its risk management controls and supervisory procedures.
32. Wedbush was aware of the requirements set forth in Rule 15c3-5 when the Rule became effective. Wedbush submitted a comment letter to the SEC on March 31, 2010, during the public comment period for the then-proposed Rule 15c3-5.
33. NYSE Arca Regulatory Information Bulletin RBE-11-63, *New SEC Rule Governing Supervision of Market Access* (May 13, 2011), reminded ETP Holders that failure to establish and enforce the risk management controls and supervisory procedures required by Market Access Rule 15c3-5 may also violate NYSE Arca Equities rules, including the supervisory requirements of NYSE Arca Equities Rule 6.18. Among other things, the Bulletin made clear that where a broker-dealer that provides Market Access allocates control over specific regulatory risk management controls and supervisory procedures to another registered broker-dealer, as provided under Market Access Rule 15c3-5, such allocation does not relieve the broker-dealer with Market Access from any obligation under the Rule, including the overall responsibility to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed

to manage the financial, regulatory, and other risks of Market Access. The Bulletin further reminded ETP Holders of their obligation under NYSE Arca Equities Rule 6.18 to update their written compliance and supervisory policies and procedures to reasonably ensure compliance with the requirements of Market Access Rule 15c3-5, and that failure to have appropriate policies and procedures in place may result in disciplinary action under NYSE Arca rules.

34. In addition, at all relevant times, NYSE Arca Equities Rule 7.37(e)(2) provided that members shall reasonably avoid displaying, and shall not engage in a pattern or practice of displaying, any quotations that lock or cross a protected quotation pursuant to an effective national market system plan.
35. In addition, pursuant to the terms and conditions of the Sponsored Participant Agreements that Wedbush entered into with the Exchange and Wedbush's Market Access Customers to which it provided sponsored access to trade directly on the NYSE Arca Marketplace, Wedbush expressly acknowledged and agreed that: (i) any orders entered into the Exchange by or on behalf of Wedbush as the Sponsoring ETP Holder, and any execution occurring as a result of such orders, are binding in all respects on Wedbush; and (ii) Wedbush is responsible for all related contractual and regulatory obligations. Wedbush further represented and certified that it: (i) shall provide the Exchange with a list of the Sponsored Participant's proposed authorized traders, pursuant to NYSE Arca Equities Rule 7.30(a); (ii) shall supervise the orders of the Sponsored Participant and shall maintain adequate and appropriate WSPs related to the supervision of the Sponsored Participant's orders, pursuant to NYSE Arca Equities Rules 7.29 and 7.30; and (iii) has or will have upon commencement of trading by the Sponsored Participant real or near real time electronic records (i.e., Echo or Echo Equivalent) of the Sponsored Participant's order activity, pursuant to NYSE Arca Equities Rule 7.29(b).

Wedbush's Market Access Business

36. During the Relevant Period, Wedbush was one of the largest independent brokerage firms, providing a broad range of brokerage and advisory services to institutional and private clients. Wedbush was also one of the largest providers of liquidity as a result of its Market Access arrangements with a large number of broker-dealers and other market participants. For example, Wedbush Market Access Customers executed on the NYSE Arca Marketplace more than 330 million shares daily in 2008 and 2009, and more than 380 million shares daily in 2010. Wedbush collected tens of millions of dollars in revenue from trading activity by its Market Access Customers, who traded through Wedbush more than a billion shares daily on multiple exchanges.
37. Despite Wedbush's significant presence in the markets, it assigned an inadequate number of employees, and failed to provide adequate training and resources, to

- establish, implement, and enforce regulatory risk management controls and supervisory systems for its Market Access business. As a result of Wedbush's supervisory deficiencies, these employees lacked a fundamental understanding of multiple forms of manipulative trading, and failed to take effective steps to understand the Firm's Market Access Customers' trading activity and to implement necessary systems and controls to detect, prevent, and report suspicious activity. The Firm's Co-Chief Compliance Officer also lacked an adequate understanding of certain forms of market manipulation.
38. Wedbush delegated oversight for substantially all supervisory and compliance-related functions related to its Market Access business, including investigating and responding to regulatory inquiries, and developing and overseeing post-trade manipulation reviews, to its Senior Vice President of Correspondent Services, who was the Firm's Market Access compliance supervisor, but he was inadequately trained and grossly understaffed to handle all required compliance tasks delegated to her supervision. The Firm's Market Access compliance supervisor, in turn, delegated virtually all reviews of post-trade activity for potentially manipulative wash trades by Market Access Customers to one poorly-trained, unlicensed employee who, in turn, was charged with training another compliance analyst. Both the Market Access compliance supervisor and her subordinate viewed the designated task of reviewing post-trade reports for potential violative wash trades as largely administrative.
39. In addition to the lack of training and inadequate staffing and resources by Wedbush to achieve compliance with anti-manipulation rules and regulations, Wedbush had in place an incentive compensation system that was rife with potential conflicts of interest. During the Relevant Period, Wedbush compensated certain employees charged with monitoring trading activity by Market Access Customers for regulatory compliance based, in substantial part, on trading revenue generated by such accounts. This presented a potential conflict of interest because a significant portion of those employees' compensation was based upon the revenue generated by trading volume in accounts they were responsible for monitoring. This conflict of interest was most significantly highlighted with respect to the Senior Vice President of Correspondent Services, who for certain years during the Relevant Period, earned more in monthly incentive compensation payments than annual base salary payments.
40. From early in the Relevant Period, among dozens of Market Access Customers, Wedbush repeatedly identified three particular Market Access Customers as responsible for most of the activity referenced in the regulatory inquiries and daily exchange-generated wash reports, namely: (i) an unregistered foreign-based customer account, its predecessors, affiliates and successor ("Customer A"); (ii) Genesis Securities LLC, a former NYSE Arca registered broker-dealer that was expelled by FINRA in 2012, after having previously terminated its NYSE Arca membership, in connection with its failure to monitor manipulative trading activity by overseas day traders, operation of unregistered broker-dealers through master and subaccount arrangements, and

inadequate AML and supervisory procedures; and (iii) Hold Brothers On-Line Investment Services L.L.C., a former NYSE Arca and FINRA broker-dealer that was fined and expelled by FINRA in 2012 in connection with manipulative trading activity, including spoofing, layering, wash trades and pre-arranged trades, committed by overseas day traders via unregistered, non-broker-dealer entities owned and funded by the principals of Hold Brothers, and failing to supervise the foregoing.⁹ The traders at Customer A, as well as at the unregistered entities via Genesis Securities, Hold Brothers and other Market Access Customers that engaged in the suspicious trading, were typically foreign, high-volume and algorithmic day traders over which NYSE Arca lacks jurisdiction.

41. Although numerous red flags brought to the Firm's attention by regulators, as well as daily NYSE Arca-generated wash trade reports, should have alerted Wedbush to potentially manipulative wash trading, pre-arranged trading, layering, spoofing, excessive quoting, and other forms of manipulation by these particular Market Access Customers, Wedbush failed to take reasonable steps to monitor such accounts for such types of trading. Wedbush did not track the activity identified in regulatory inquiries, and it also did not attempt to identify whether any accounts or types of activity were the focus of multiple reviews. Moreover, Wedbush did not adequately review its Market Access Customers' trading outside of responding to regulatory inquiries, even when the same accounts appeared on multiple regulatory inquiries. In addition, Wedbush did not attempt to determine whether the trading that resulted in regulatory inquiries violated NYSE Arca Equities rules or the securities laws, and its supervisory systems and procedures lacked fundamental reviews to capture potentially manipulative activity.

Wedbush's Failure to Monitor for Layering, Spoofing, and Other Forms of Manipulation

42. During the Relevant Period, Wedbush had no systems or WSPs designed to detect and prevent various forms of market manipulation, such as layering, spoofing, and auto-execution manipulation, which is yet another form of manipulation involving the entry of orders with no intention of execution; they are entered simply to entice other buyers and sellers into trading at unfavorable prices. Such conduct continued despite Wedbush's receipt of numerous regulatory inquiries that identified such conduct as potentially violative by the same Market Access Customers of the Firm. Furthermore, prior to and during the Relevant Period, regulators issued guidance and releases discussing layering, spoofing, auto-execution, and other manipulative activity involving patterns of order cancellations, and the obligations of firms that provide Market Access to monitor for such activity.
43. On multiple occasions during the Relevant Period, regulators questioned Wedbush about conduct by traders in the same customer accounts that had appeared to be engaged in

⁹ The firm's NYSE Arca membership was suspended in 2012, and terminated in 2013.

potential layering. Although Wedbush identified the responsible customers in response to regulatory inquiries, Wedbush did not warn the customers' principals that their accounts would be disabled if the trading activity continued.

44. During the Relevant Period, Wedbush lacked surveillances to identify various forms of market manipulation, as required by NYSE Arca Equities Rules.¹⁰ For example, Wedbush did not have any surveillance to monitor trading volume per client against the total daily consolidated trading volume per symbol. Wedbush did not have surveillance to detect trades that were executed by Market Access Customers at prices away from the prevailing market price.
45. Five years after the start of the Relevant Period, Wedbush continued to enable Customer A, through the use of a Wedbush MPID, to trade directly on NYSE Arca and other exchanges despite numerous red flags that had specifically identified Customer A as having engaged in potential manipulative trading.
46. On May 1, 2013, Wedbush implemented some surveillance reviews via NASDAQ's SMARTS surveillance system for activity that had passed through certain third-party systems to monitor for activities such as layering, spoofing, market dominance on the open or close of trading, wash trades, and marking-the-open/close. However, the Firm assigned only one individual to review these surveillances for potential manipulative activity, and continued to keep the same employee discussed above responsible for wash trade surveillance. Given Wedbush's status as a leading liquidity provider,¹¹ it was not reasonable to assign just one person to this task. Moreover, during the period between May 2013 and August 2013, the Firm failed to evidence that it had reviewed numerous instances of potential manipulative activity by Wedbush Market Access Customers, and failed to ensure that all order and trade activity by its Market Access Customers was subject to its control and/or processed through its surveillances.

Wedbush's Failure to Reasonably Monitor Order Cancellations

47. Firms that submit orders to the marketplace are required to have in place written policies and procedures that are reasonably designed to ensure that such trading complies with applicable NYSE Arca rules and federal securities laws and regulations, including anti-manipulation provisions.¹²

¹⁰ See NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007) (ETP Holders are responsible to review all trading activity submitted to ArcaEx by the ETP Holder for manipulative or improper trading practices).

¹¹ For example, in May 2013, Wedbush was ranked among the top ten NASDAQ liquidity providers in NASDAQ, NYSE and NYSE Arca securities

¹² See *FINRA's 2012 Priorities Letter* (Jan. 31, 2012) (market access providers must have post-trade surveillance procedures reasonably designed to identify various potential trading violations such as wash sales, marking, spoofing, layering, quote stuffing and manipulation related to the open and close of trading).

48. The entry and cancellation of numerous orders with few or no executions by customers are red flags that warrant further review for potential erroneous orders and potential manipulative trading. During the Relevant Period, Wedbush's high-volume and algorithmic Market Access Customers engaged in excessive message activity on numerous trade dates whereby order and cancellation messages flooded the market in a short period of time, with few executions. Despite this activity, Wedbush conducted no reviews to monitor for patterns of order cancellations by its customers.

Wedbush's Failure to Reasonably Monitor for Wash Trade Manipulation

49. During the Relevant Period, Wedbush failed to effectively monitor for potentially violative wash trades (trades with no change in beneficial ownership). Violative wash trades feed false information into the market and can be used to manipulate prices. Intentionally taking both sides of a trade can minimize financial risk for the trading firm while potentially creating a false impression of higher volume in the market. Even wash transactions not undertaken with fraudulent or manipulative intent can create a misimpression of the level of legitimate trading interest and activity in a security. NYSE Arca members have an obligation to have policies and procedures in place to review trading activity to prevent wash sale transactions.
50. Wedbush's WSPs relating to sponsored access during the Relevant Period stated that wash trades are prohibited. The procedures required the Firm to distribute potential wash sale reports to sponsored participants, and review potential wash sale reports to determine potential violations. If potential wash trades were detected, the Firm was required to obtain representations from the sponsored participants regarding internal wash trade reviews and systems, and maintain records of correspondence. The procedures failed to specify how to review the wash sale reports to determine whether the transactions may have been executed with the intent to manipulate the market, or when Market Access should be terminated.
51. Wedbush did not conduct regular reviews of wash trades by Market Access Customers during the period between January 2008 and April 2009. The Firm commenced some reviews of wash trades when it began receiving wash sale reports in or about May 2009 from NYSE Arca and other exchanges; however, Wedbush did not review significant portions of the exchange-generated wash reports. For example, although the Customer A account was beneficially owned by two principals, it was traded by more than one thousand overseas unregistered traders. Wedbush did not review potential violative wash trades between Customer A traders with multiple trader identifiers ("IDs") who may have been trading with themselves, orders placed by the same trader ID on different exchanges, and orders matched between different traders of Customer A who may have been working in concert, even though these trades resulted in no change in beneficial ownership.

52. With respect to the subset of potential wash trades that Wedbush had determined were worthy of some review, however superficial, Wedbush's reviews were merely administrative, and lacked any meaningful substantive scrutiny for potential manipulation. Typically, Wedbush would e-mail the exchange-generated wash report to its Market Access Customers and ask them to report back on whether any of the transactions were wash trades and, if so, to explain the activity. Although Wedbush was responsible to monitor its customers' trading activity to ensure compliance with securities laws and applicable exchange rules, Wedbush relied on its customers to monitor their own activity and self-report to Wedbush.
53. Moreover, Wedbush generally accepted at face value its customers' explanations with respect to potential wash trades, without conducting its own investigation of the potential problematic trades. For example, when Customer A responded to wash trade reports sent by Wedbush by reporting that no wash trades had been detected, Wedbush would simply archive the response, without conducting any additional review or requesting supporting documentation. When Customer A acknowledged suspicious activity, rather than insisting that Customer A halt the activity if it did not want its access terminated, Wedbush simply accepted Customer A's response that it had suspended the responsible trader.¹³ Wedbush did not track Customer A trader suspensions or disabling of trader IDs. In many instances, Customer A responded within minutes of receiving the wash report from Wedbush, stating that none of the trades on the report were problematic, even if it had contained over a hundred potential wash trades conducted by multiple different traders, thus evidencing that Customer A did not reasonably review the activity on the report to determine whether it had involved manipulative trading. Further, Wedbush received responses to only about half of the wash trade inquiries it had sent to Customer A, and Wedbush failed to follow up with Customer A concerning those unanswered inquiries. Wedbush also did not conduct any analysis to identify the market impact of the potential wash trades that appeared on the daily wash trade reports, or whether they may have been manipulative.
54. Further, although Wedbush could have enabled wash trade prevention software to prevent wash trades by its Market Access Customers at the MPID level, it did not take reasonable steps to ensure that such controls had been enabled and functioning for all such customers, including Customer A. Wedbush's review of potential wash sales by Customer A only at the trader ID level were insufficient and not reasonably designed to detect and prevent violative wash trades, and Wedbush did not conduct any reviews to determine whether trades between different trader IDs at Customer A were improper pre-arranged trades.

¹³ See NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007) (making clear that ETP Holders must investigate any potentially abusive or improper client trading patterns or practices of customer activity, and ETP Holders who discover a pattern of improper client activity cannot continue to provide access to such client and should report such activity to NYSE Arca regulatory staff).

55. The Firm's deficient supervision in the monitoring of wash trading enabled its Market Access Customers to execute more than 100,000 potentially violative wash trades in hundreds of securities across multiple exchanges, including NYSE Arca, during the Relevant Period.
56. NYSE Arca Regulatory Information Bulletin RBE-08-05, *Preventing Clearly Erroneous Executions* (Nov. 11, 2008), reminded ETP Holders that they are ultimately responsible for all orders entered on the Exchange, whether entered by the ETP Holder, sponsored participant, or customer, even if such entity is using the services of a vendor to facilitate order entries. The Bulletin further made clear that when establishing and maintaining supervisory systems and procedures, trading systems should include controls that limit their use to authorized persons, check for order accuracy, including cross-checking price and volume instructions with current price and depth of book in the market, prevent orders that exceed preset credit and order-size parameters from being transmitted to the Exchange, and prevent the unwanted generation, cancellation, repricing, resizing, duplication, or re-transmission of orders. Moreover, RBE 08-05 stated that before permitting sponsored participant or customer access to an ETP Holder's trading system, a firm must have a supervisory system and WSPs in place and use due diligence to learn the essential facts relative to every customer, every order, and every account accepted or carried to ensure that such orders are not entered in error or in a manner inconsistent with NYSE Arca rules.

Wedbush's Failure to Monitor for Pre-arranged Trading

57. Although Wedbush's WSPs prohibited pre-arranged trades, Wedbush conducted no reviews for pre-arranged trades even though Wedbush effected hundreds of instances of apparent pre-arranged trades for its Market Access Customers in numerous different securities across multiple market centers, and even where there were patterns of trades between Customer A traders at the same location (i.e., wash trades which Wedbush had excluded from review). Wedbush should have reviewed such multiple instances of apparent pre-arranged trades between traders from the same customer account.

Wedbush's Failure to Monitor Authorized Trader IDs

58. Although certain Market Access customer accounts traded via numerous overseas, unregistered traders, Wedbush failed to take sufficient steps to ensure that each authorized trader to whom it had provided access to trade directly on NYSE Arca via a firm MPID was only issued one trader ID, or to terminate inactive trader IDs. On some occasions, a single trader had multiple trader IDs. Wedbush often did not implement controls or filters to prevent two different traders from trading with each other in a single customer firm's account or to prevent traders from self-trading by using different

trader IDs. Moreover, Wedbush failed to restrict trading to only those persons who were pre-approved and authorized by Wedbush.

59. For customer firms with hundreds or thousands of traders, Wedbush usually relied on the customer firms to maintain a list of authorized traders and their trader IDs. Wedbush neither spoke with any of the authorized traders nor took any steps to verify trader names or identities. Some of these customer firms were not registered broker-dealers.
60. Wedbush provided Market Access to customer firms with hundreds or thousands of traders, but Wedbush did not have controls and procedures to restrict access to trading systems and technology that provide Market Access to individual traders who had been pre-approved and authorized by Wedbush. When Wedbush opened a sponsored access account, Wedbush employees obtained identifying information and generally performed background checks only on the principals of the entity opening the account and not on other individuals that the entity authorized to trade through the account. Wedbush did not have any written policies or procedures for pre-approving or authorizing new traders for existing sponsored access accounts.
61. Wedbush did not have any controls or procedures requiring customers to obtain approval from Wedbush before authorizing new traders. Wedbush relied exclusively on its customer firms, some of which were not registered broker-dealers, to confirm trader identities and oversee their trading strategies. Wedbush had no controls or procedures for preventing traders who had been disabled by a customer or correspondent broker-dealer from obtaining a new trader ID through the same or a different Wedbush customer account.
62. Wedbush failed to establish and implement effective controls relating to the deactivation and sharing of trader IDs, the assignment of multiple trader IDs to a single trader and trading suspensions of disciplined traders. Wedbush's failure to adequately monitor its Market Access Customers' authorized trader IDs, including its inadequate control over both the issuance of trader IDs and the deactivation of inactive trader IDs, enabled its Market Access Customers to potentially use multiple trader IDs to circumvent surveillance monitoring conducted at the trader ID level, and to potentially have access to higher trading limits through the use of multiple IDs. It also allowed Market Access Customers to have the same person potentially continue trading under a different trader ID after that person's original trader ID had been terminated. Moreover, Wedbush failed to ensure that it had restricted trading to only those persons who had been approved and authorized by Wedbush.

63. Although Wedbush was required to ensure that it had reasonable procedures and controls to prevent erroneous order transmissions,¹⁴ Wedbush failed to restrict trading to only those persons who were pre-approved and authorized by Wedbush. For example, on January 10, 2012, an inactive Customer A trader ID was utilized to conduct unauthorized trading on the NYSE Arca Marketplace.

Wedbush's Failure to Monitor for Marking-the-Close

64. Marking-the-close involves the practice of executing transactions in a stock at or near the end of the trading day in order to affect the stock's closing price. Such activity sends false signals to the market about the value of the security. It has long been recognized that firms are required to maintain adequate systems to detect potential instances of marking-the-close.¹⁵ Despite Wedbush's WSPs and regulatory notices, which made clear that marking-the-close is prohibited, Wedbush had no surveillance in place until May 2013 to monitor Market Access Customers' trading based on the time of execution, including for potential instances of marking-the-close.

Potential Conflict of Interest with Employee Incentive Compensation

65. During most of the Relevant Period, until early 2013, Wedbush had in place a monthly incentive compensation system that was rife with potential conflicts of interest, whereby the Firm compensated employees charged with monitoring trading activity by Market Access Customers for compliance with applicable federal securities laws and regulations and NYSE Arca rules based, in substantial part, on trading revenue generated by such accounts. As a result, for several years during the Relevant Period, the Market Access compliance supervisor earned more in monthly incentive compensation payments than in annual base salary payments.
66. Since approximately half of the Market Access compliance supervisor's compensation was based upon the revenue generated by the trading volume of accounts that her staff was responsible to monitor, such arrangement presented a serious conflict of interest,

¹⁴ See NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007) (ETP Holders who accept electronic orders from clients must have real-time system checks to ensure that each order is submitted by an authorized person); NYSE Arca Regulatory Information Bulletin RBE-08-05, *Preventing Clearly Erroneous Executions* (Nov. 11, 2008) (trading systems should include controls that limit their use to authorized persons).

¹⁵ See NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007) (discussing requirements to review all trading activity submitted to the NYSE Arca Marketplace for manipulative or improper trading practices); *FINRA's 2012 Priorities Letter* (Jan. 31, 2012) (market access providers must have post-trade surveillance procedures reasonably designed to identify various potential trading violations, including marking and manipulation related to the open and close of trading); NYSE Information Memo 09-29, *Entering and Effecting Orders at or Near the Close* (June 19, 2009) (discussing that orders entered at or near the close can artificially distort prices); NYSE Information Memo 08-10 (Mar. 18, 2008) (discussing compliance procedures related to trading at or near the close).

which could have discouraged rigorous review of the potential manipulative trading activity identified in the dozens of regulatory inquiries received by the Firm throughout the Relevant Period. Wedbush not only failed to adequately train and staff its Market Access compliance supervisor; it rewarded the compliance supervisor with monthly incentive compensation for continuous high-volume trading by Market Access Customers.

Wedbush's Failure to Review for Abuse of Mid-Point Passive Liquidity Orders

67. Wedbush executed for its Market Access Customers multiple wash trades using mid-point passive liquidity (“MPL”) orders. MPL orders are undisplayed limit orders priced at the midpoint of the Protected Best Bid/Offer (“PBBO”).¹⁶ At times during the Relevant Period, firms that supplied liquidity using MPL orders received a rebate of \$0.20 per 100 shares, but were not charged a fee for taking liquidity; this inverted pricing was intended to incentivize market participants to use the MPL order type as another way to post hidden liquidity on the NYSE Arca Marketplace. During the period between March 1, 2010 and April 30, 2010, Customer A entered thousands of apparent wash and pre-arranged trades in the MPL order type in multiple securities in an apparent attempt to collect liquidity rebates from NYSE Arca. At times, Customer A’s trades comprised over 50% of the total daily consolidated volumes of multiple securities. Although Wedbush was required to review its Market Access Customers’ activity for manipulative or improper trading practices,¹⁷ Wedbush did not conduct any reviews to detect potential abuse of the MPL order type, including through the use of wash or pre-arranged trades.

Wedbush's Failure to Monitor for Potential Odd Lot Manipulation

68. During the Relevant Period before June 2011, odd lot orders on the NYSE Arca Marketplace received guaranteed execution at the NBBO, and were not reported to the Consolidated Tape. In June 2011, NYSE Arca Equities amended its rules to eliminate the concept of an “Odd Lot Dealer,” and deleted NYSE Arca Equities Rule 7.38(c), which prohibited the unbundling of round lots for the purpose of entering odd lot limit orders in comparable amounts, and required the aggregation of odd lot orders into round lots when such orders were for the same account. NYSE Arca Equities Regulatory Information Bulletin RBE 11-04, *Elimination of “Odd Lot Dealer” Concept from NYSE Arca Equities Rules ...* (June 10, 2011), which announced the rule changes, also made clear that notwithstanding the rule changes, “any activity involving odd-lot sized orders that violates NYSE Arca Rules and/or the federal securities laws including, but not limited to, manipulative activity, will remain subject to disciplinary action.”

¹⁶ The term “PBBO” refers to the Best Protected Bid and the Best Protected Offer on NYSE Arca (see NYSE Arca Equities Rule 1.1[eee]).

¹⁷ See NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007).

69. Until approximately August 2010, Wedbush did not conduct regular automated surveillance to detect and prevent potential manipulative odd lot executions. During the early part of the Relevant Period, Wedbush executed for its Market Access Customers multiple instances of potential odd lot manipulation on the NYSE Arca Marketplace. For example, on September 24, 2009, a Market Access Customer entered a series of odd lot orders which targeted NYSE Arca odd lot dealers who were obligated at the time to take the contra-side of odd lot orders at the NBBO. By entering round lot orders on other markets that set the NBBO, the customers achieved favorable executions against the NYSE Arca odd lot dealers who were obligated to execute the customer's odd lot orders at the new NBBO. The customer then repeated the process on the other side of the market. Although required to reasonably monitor for improper odd lot trading,¹⁸ Wedbush did not detect this activity.

Wedbush's Failure to Monitor Intermarket Sweep Orders ("ISOs")

70. Pursuant to NYSE Arca Equities Rule 7.37(e)(2), members shall reasonably avoid displaying, and shall not engage in a pattern or practice of displaying, any quotations that lock or cross¹⁹ a protected quotation pursuant to an effective national market system plan, except in certain defined circumstances. Similarly, Rule 611(c) of Regulation NMS requires firms to take reasonable steps to ensure that to ensure that ISOs sweep the market.
71. Wedbush's WSPs stated that ISOs are not permitted unless the market is swept to ensure that all better priced protected quotes are satisfied prior to sending the ISO; however, the WSPs did not indicate a supervisory review process with respect to locked or crossed markets, how such reviews would be documented, and the frequency of such reviews.
72. During the period between July 2009 and August 2009, a Wedbush Market Access Customer submitted ISOs in two securities, of which thousands locked or crossed the market. Specifically, on July 16, 2009, Wedbush entered approximately 39,899 buy-side ISOs, of which approximately 3,953 locked the market and approximately 270 crossed the market (10.58% of the buy ISO orders entered). Also, on August 3, 2009, Wedbush entered approximately 64,000 sell-side ISOs, of which approximately 3,850 locked the market and approximately 344 crossed the market (6.55% of the sell ISO orders entered). Wedbush did not detect the activity, and did not perform any supervisory

¹⁸ See NYSE Arca Regulatory Information Bulletin RBE-07-01, *ETP Holders' Supervisory Obligations of Order Flow* (Jan. 29, 2007) (citing an NYSE Arca disciplinary action involving a firm's failure to diligently supervise its market access customer insofar as it failed to have in place an "automated surveillance system" to periodically review customer accounts for abuse of NYSE Arca restrictions on odd lot trading).

¹⁹ A locked market is one where the bid and offer are equal in price; a crossed market is one where a bid is entered that is higher than the offer or, one where an offer is entered that is lower than the bid. Locked and crossed markets may create apparent market inefficiency and confusion for investors.

reviews of locked and crossed markets caused by ISOs entered by Market Access Customers. Moreover, Wedbush failed to establish, as required by its WSPs, that a market sweep had been conducted prior to its submission of the ISOs that locked and crossed the market.

73. Furthermore, during the Relevant Period of the subject ISOs, Wedbush did not conduct regular reviews, and had no WSPs, to detect locked or crossed markets resulting from ISOs submitted by its Market Access Customers. Thus, Wedbush did not take reasonable steps to ensure that Market Access Customers that submitted ISOs had actually swept the market

Wedbush's Inadequate WSPs

74. Wedbush's WSPs for its Market Access business did not require review of Market Access Customers' orders for potentially manipulative activity, and Wedbush did not implement any such reviews until May 2013. Wedbush's Market Access WSPs contained no procedures to monitor for various types of price manipulation, including layering, spoofing, pre-arranged trading, auto-execution, excessive order entry and cancellations, and marking-the-close.
75. Wedbush's WSPs also contained fundamental flaws with respect to established reviews, such as for wash trades. The WSPs identified the individual responsible for conducting daily reviews for wash or pre-arranged trades, and required that the designated person review potential wash sale reports and distribute the reports to sponsored participants; however, the procedures failed to indicate the steps for reviewing the wash sale reports and made no mention of how to reasonably monitor for potential pre-arranged trading activity. According to the WSPs, if potential wash transactions were detected, the designated reviewer was required to obtain representation from sponsored participants regarding internal wash trade reviews and systems. The procedures did not indicate what, if any, subsequent review or action was required. No reviews were conducted by Wedbush to detect potential pre-arranged trades.
76. Wedbush updated its WSPs as of July 14, 2011, to coincide with the effective date of Rule 15c3-5; however, the updated WSPs failed—consistent with the Market Access Rule—to specify reviews to ensure that Wedbush would: (1) prevent the entry of orders that exceeded appropriate pre-set credit or capital thresholds or that appeared to be erroneous; (2) prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis; (3) prevent the entry of orders that the customer was restricted from trading; (4) restrict Market Access technology and systems to authorized persons; and (5) make sure appropriate surveillance personnel receive immediate post-trade execution reports, and make sure appropriate reviews would be conducted to ensure compliance with the foregoing. The updated WSPs continued to lack procedures to monitor for various types of price

manipulation, including layering, spoofing, pre-arranged trading, auto-execution, excessive order entry and cancellations, and marking-the-close.

77. Wedbush also did not have an adequate written description of its risk management controls as part of its books and records. Wedbush's WSPs lacked procedures regarding how regulatory risk controls were to be utilized or the identity of the responsible individuals to monitor such controls. Moreover, despite Rule 15c3-5's requirement that the Firm's Market Access systems be under the Firm's exclusive control at all times, Wedbush failed to have adequate WSPs and controls to ensure that it had direct and exclusive control over regulatory risk management systems and financial controls with respect to order management systems used by its Market Access Customers. Wedbush's WSPs also failed to set forth the steps by which due diligence reviews would be conducted prior to approving new Market Access Customers.
78. Wedbush also did not adequately review its business activity in connection with its Market Access to assure the overall effectiveness of its risk management controls and supervisory procedures, including with respect to any allocated regulatory responsibilities to broker-dealer clients.
79. In sum, the Firm's Market Access procedures were not tailored to its Market Access business and could not reasonably have been expected to detect, prevent, and cause the reporting of suspicious activity. The Firm's Market Access procedures did not address how to monitor overseas day traders for suspicious activity, and the Firm inadequately monitored the activity by its Market Access Customers, which represented millions of shares traded daily on various exchanges, including NYSE Arca, using a Firm MPID. Wedbush failed to establish procedures to perform effective monitoring in light of the location of the traders and heightened risk. The Firm also failed to perform heightened monitoring of the activity in those accounts. The Firm ignored extensive red flags suggesting that its Market Access Customers' accounts had engaged in manipulative or otherwise unlawful activity. The Firm did not attempt to determine whether the trading activity that resulted in regulatory inquiries had violated NYSE Arca Equities rules or the securities laws.
80. Despite receiving numerous regulatory inquiries, and the fact that the same accounts were repeatedly identified in response to those inquiries, Wedbush did not place any of the accounts under heightened supervision. The Firm also did not track the activity identified in regulatory inquiries to determine if any accounts or types of activity were the focus of multiple reviews. The Firm failed to establish and implement policies and procedures that could have been reasonably expected to detect, prevent and cause the reporting of suspicious activity, or otherwise were reasonably designed to achieve compliance with securities laws and exchange rules prohibiting manipulative trading practices.

81. Wedbush updated relevant sections of its WSPs as of May 1, 2013, to coincide with its implementation of various Nasdaq SMARTS anti-manipulation surveillances; but the May 2013 WSPs lacked any references to such surveillances. After the Relevant Period, the Firm updated its WSPs as of October 11, 2013, and referenced its use of Nasdaq SMARTS to monitor for various activities including layering, spoofing, market dominance on open/close, ramping, wash trades, and marking-the-open/close; but the October 2013 WSPs still failed to identify the specific reports implemented, the parameters of such reports, the frequency of reviews, how such reviews should be conducted and documented, or what actions may or should be taken by the Firm.

DECISION

Supervisory Violations—Charge I

82. By failing to establish, maintain, and enforce supervisory systems and procedures that were reasonably designed to achieve compliance with applicable securities laws, rules and regulations and Exchange rules, Wedbush violated NYSE Arca Equities Rules 6.18(a)–(c), 6.1(b), and 2010 (as of June 30, 2011).
83. By failing to have reasonable procedures to ensure that all Authorized Traders of its Market Access Customers comply with the trading rules and procedures related to the NYSE Arca Marketplace, Wedbush violated NYSE Arca Equities Rules 7.30(b), 6.1(b), and 2010 (as of June 30, 2011).
84. By failing to use due diligence to learn essential facts relative to Market Access Customer accounts and orders, Wedbush violated NYSE Arca Equities Rules 9.2(a), 6.1(b), and 2010 (as of June 30, 2011).
85. By failing to periodically review Market Access Customer accounts for irregularities, Wedbush violated NYSE Arca Equities Rules 9.2(b)(4), 6.1(b), and 2010 (as of June 30, 2011).

Market Access Violations—Charge II

86. By failing to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the regulatory and other risks of having Market Access, including regulatory risk management controls and supervisory procedures reasonably designed to ensure compliance with all regulatory requirements, Wedbush willfully violated Section 15(c)(3) of the Exchange Act and Market Access Rule 15c3-5, and also violated NYSE Arca Equities Rules 6.1(b), 6.2, and 2010 (as of June 30, 2011).

Violations of Just and Equitable Principles of Trade—Charge III

88. By creating incentives that rewarded compliance personnel with monthly compensation based on Market Access Customers' trading volume, for which they had responsibility to oversee, and by failing to monitor and detect thousands of instances of potentially manipulative trading by recidivist customers, despite repeated red flags, Wedbush failed to observe high standards of commercial honor and just and equitable principles of trade, in violation of NYSE Arca Equities Rules 6.1(b) and 2010 (as of June 30, 2011).

Failure to Reasonably Avoid Displaying Locked and Crossed Markets—Charge IV

89. By failing to take reasonable steps to avoid submission by its Market Access Customers of orders that resulted in locked and crossed markets, Wedbush willfully violated Regulation NMS Rule 611(c), and also violated NYSE Arca Equities Rules 7.37(e)(2), 6.1(b), 6.2, and 2010 (as of June 30, 2011).
90. By failing to reasonably supervise activity by its Market Access Customers with respect to locked and crossed markets, order protection rules, and compliance with NYSE Arca Equities Rule 7.37(e)(2) and Regulation NMS Rule 611(c), Wedbush violated NYSE Arca Equities Rules 6.18, 7.30(b), 9.2(a) and (b), 6.1(b), and 2010 (as of June 30, 2011).

SANCTIONS

Wedbush Securities, Inc. is censured and fined \$566,666.²⁰ The sanctions shall take effect immediately.



Andrew H. Perkins
Chief Hearing Officer

²⁰ Wedbush settled the Related FINRA and Exchange Complaints for a total fine of \$1,800,000, which is allocated as follows: \$566,666 each to NYSE Arca, BATS Exchange, Inc., and NASDAQ, and \$100,002 to FINRA. In setting the fine amount, the parties took into consideration that Wedbush paid \$2.44 million to the Securities and Exchange Commission and agreed to hire an independent consultant in settlement of similar claims. *See Wedbush Sec., Inc.*, Exchange Act Release No. 73652 (Nov. 20, 2014).