

BATS EXCHANGE, INC.

Department of Market Regulation, on behalf
of BATS Exchange, Inc.,

Complainant,

v.

Wedbush Securities Inc. (CRD No. 877),

Respondent.

Disciplinary Proceeding
No. 20110263118-04

Hearing Officer: MAD

**DECISION ACCEPTING OFFER
OF SETTLEMENT**

Date: December 1, 2015

INTRODUCTION

Disciplinary Proceeding No. 20110263118-04 was filed on October 1, 2015, by the Department of Market Regulation, on behalf of BATS Exchange, Inc. (BZX) (Complainant). Respondent Wedbush Securities Inc. (CRD No. 877) (Respondent or Wedbush) submitted an Offer of Settlement (Offer) to Complainant dated November 18, 2015. Pursuant to BZX Rule 8.8(a), BZX's Chief Regulatory Officer (CRO) has accepted the Offer. Accordingly, this Decision now is issued pursuant to BZX Rule 8.8(a). The Findings and Conclusions and Sanctions set forth in this Decision are those consented in the Offer as accepted by the Complainants and approved by CRO.

Under the terms of the Offer, Respondent has consented, without admitting or denying the allegations of the Statement of Charges (as amended by the Offer), and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of BZX or to which BZX is a party, to the entry of Findings and Conclusions and violations consistent with the allegations of the Statement of Charges (as amended by the Offer), and to the imposition of the Sanctions set forth below, and fully understands that this Decision will become part of

Respondent's permanent disciplinary record and may be considered in any future actions brought by BZX against the firm.

Further, under the terms of the Offer, Respondent specifically and voluntarily waived the following rights granted under BZX Rules:

1. To defend against the allegations in a disciplinary hearing before a Hearing Panel, to have a written record of the hearing made and to have a written decision issued;
2. To appeal any such decision to the Appeals Committee of the BZX's Board of Directors and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals;
3. Any right to claim bias or prejudgment of the CRO in connection with his or her participation in discussions regarding the terms and conditions of this Offer, or other consideration of this Offer, including acceptance or rejection of this Offer; and
4. Any right to claim that a person violated the ex parte prohibitions of BZX Rule 8.16, in connection with such person's or body's participation in discussions regarding the terms and conditions of this Offer, or other consideration of this Offer, including its acceptance or rejection.

By accepting the Offer, BZX agrees that it shall not institute or entertain, at any time, any further proceeding as to Respondent based upon the allegations of the Statement of Charges.

BACKGROUND

Wedbush is a California-based broker-dealer that has been registered with BZX since August 18, 2008, and is currently registered with multiple equity and option exchanges. During the relevant period, it employed over 400 registered representatives in approximately 100 branch offices. It was one of the largest independent brokerage firms, providing a broad range of

brokerage and advisory services to institutional and private clients.

Wedbush has the following relevant disciplinary history involving supervisory violations:

- Acceptance, Waiver and Consent (“AWC”) in FINRA Matter No. 2013035824401 (Sep. 22, 2015) (\$20,000 fine and supervisory undertaking)
- AWC in BATS Exchange Matter No. 2010024913201 (Aug. 21, 2015) (\$20,000 fine and supervisory undertaking)
- AWC in FINRA Matter No. 2011026107603 (Dec. 9, 2014) (\$67,500 fine and supervisory undertaking)
- AWC in NYSE Matter No. 2012032742901 (Dec. 19, 2013) (\$95,000 fine and supervisory undertaking)
- AWC in FINRA Matter No. 2009018146101 (Oct. 16, 2013) (\$95,000 fine)
- AWC in FINRA Matter No. 2009016641301 (Sept. 27, 2013) (\$87,500 fine and supervisory undertaking)
- Order Accepting Offer of Settlement in FINRA Matter No. 20070077690 (June 25, 2013) (\$750,000 fine and supervisory undertaking)
- AWC in FINRA Matter No. 2009017002603 (June 25, 2013) (\$72,500 fine and supervisory undertaking)
- Order Accepting Offer of Settlement in FINRA Matter No. 2009020701901 (April 9, 2013) (\$75,000 fine)
- AWC in NASDAQ Matter No. 2009017002602 (Apr. 2, 2013) (\$12,500 fine and supervisory undertaking)
- AWC in BATS Exchange Matter Nos. 2009017002601 and 20100216049 (March 4, 2013) (\$12,500 fine and supervisory undertaking)

- NYSE Hearing Board Decision in FINRA Proc. No. 20110275603 (Jan. 2, 2013) (\$25,000 fine)
- Order Accepting Settlement in FINRA Matter No. 2008012738002 (Sept. 10, 2012) (\$375,000 fine)
- AWC in BATS Exchange Matter No. 20110709 (May 21, 2012) (\$75,000 fine and supervisory undertaking)
- AWC in NASDAQ Matter No. 2008015287001 (June 28, 2010) (\$10,000 fine and supervisory undertaking)

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:

Summary

1. This matter involves supervisory violations committed by Wedbush Securities Inc. (“Wedbush” or the “Firm”) during the period between August 18, 2008 and August 26, 2013 (the “relevant period”) in its business of providing direct market access and sponsored access (together “market access”) to broker-dealers and non-registered market participants (“market access customers”) to multiple market centers, including BZX.

2. 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 layering¹ and spoofing.² 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.

3. Wedbush permitted its market access customers to use third-party market access systems to electronically route orders directly to BZX 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 the rules of BZX. 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.

4. 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.,* BATS Regulatory Circular 09-003, *Notice Regarding Current BATS Exchange Obligations Applicable to Sponsored Access and Sponsored Access Risk Management Tools Available from the Exchange* (Mar. 30, 2009) (Sponsoring Member is responsible for all orders entered by its Sponsored Participants, and any executions occurring as a result of such orders are binding in all respects on the Sponsoring Member); *FINRA’s 2010*

¹ “Layering” is a form of market manipulation in which multiple, non-bona fide limit orders are entered on one side of the market at various price levels in order to create the appearance of a change in the levels of supply and demand, thereby artificially moving the price of the security. An order is then executed on the opposite side of the market at the artificially created price, and the non-bona fide orders are cancelled.

² “Spoofing” is a form of market manipulation that involves the market manipulator placing non-bona fide orders that are intended to trigger some type of market movement and/or response from other market participants, from which the market manipulator might benefit by trading bona fide orders.

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).³

5. Moreover, during the relevant period, BZX rules prohibited manipulative and abusive trading practices, such as fictitious transactions, wash trades and pre-arranged trades. *See, e.g.*, BZX Rules 12.1 and 12.2 (which prohibit, among other things, entering orders or effecting securities transactions for the purpose of creating or inducing a false, misleading or artificial appearance of trading activity).

³ *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).

6. 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 and pre-arranged trades.

7. 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 BZX rules addressing potentially manipulative and suspicious trading by the Firm’s market access customers, such as layering, spoofing, wash trading and suspicious patterns of order cancellations.

8. 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 BZX rules addressing the monitoring, detection, and prevention of suspicious and potentially manipulative trading, Wedbush violated BZX Rules 5.1 (concerning, among other

things, Members' supervisory responsibilities), 5.4 (concerning, among other things, Members' responsibility to conduct periodic examination of customer accounts to detect and prevent irregularities or abuses), and 3.1 (concerning, among other things, adherence to commercial honor and just and equitable principles of trade).

9. 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 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 also violated BZX Rule 3.1.

10. 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 BZX Rule 3.1.

Respondent and Jurisdiction

11. Wedbush Securities Inc. (known as Wedbush Morgan Securities Inc. until April 2010) is headquartered in Los Angeles, California. Wedbush has been a member of BZX since August 18, 2008, and it remains subject to BZX jurisdiction. During the relevant period, the Firm employed over 400 registered representatives in approximately 100 branch offices. Wedbush is also registered with multiple equity and option exchanges.

Statement of Facts

12. 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. 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 all of the self-regulatory organizations of which it was a member.

13. Despite Wedbush's significant presence in the markets, the Firm 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.

14. 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 was inadequately trained and grossly understaffed to handle all required compliance tasks delegated to her supervision. This individual, 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.

15. 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 rife with potential conflicts of interest. During the relevant period, the Firm 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.

16. 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 BZX broker-dealer that was expelled by the Exchange in 2012 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 BZX and FINRA broker-dealer that was terminated by BZX in 2013 after being fined and then 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. 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 BZX lacks jurisdiction.

17. Although numerous red flags brought to the Firm’s attention by regulators, as well as daily BATS-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.

18. For example, Wedbush did not track the activity identified in regulatory inquiries and 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 BZX 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

19. 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.

20. On multiple occasions during the relevant period, regulators informed Wedbush that traders in the same customer account had appeared to be engaged in potential layering. Wedbush did not warn the customer's principals that the account would be disabled if the trading activity continued.

21. During the relevant period, Wedbush lacked surveillances to identify various forms of market manipulation, as required by BZX Rules.⁴ During the relevant period, 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 by market access customers that were executed at prices away from the prevailing market price.

22. Over four 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 BZX and other exchanges despite numerous red flags that had specifically identified Customer A as having engaged potential manipulative trading.

23. On May 1, 2013, the Firm 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 the volume of trading, 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 had 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.

⁴ See BATS Regulatory Circular 09-003, *Notice Regarding Current BATS Exchange Obligations Applicable to Sponsored Access and Sponsored Access Risk Management Tools Available from the Exchange* (March 30, 2009) (A Sponsoring Member is responsible for all orders entered by its Sponsored Participants and any executions occurring as a result of such orders are binding in all respects on the Sponsoring Member).

Wedbush's Failure to Reasonably Monitor Order Cancellations

24. Firms submitting 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 BZX rules and federal securities laws and regulations, including anti-manipulation provisions.

25. 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 conducted no reviews to monitor for patterns of order cancellations by such customers. 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.

Wedbush's Failure to Reasonably Monitor for Wash Trade Manipulation

26. 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. BZX members have an obligation to have policies and procedures in place to review trading activity to prevent wash sale transactions.

27. 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.

28. Wedbush did not conduct regular reviews of wash trades by market access customers during the period between August 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 BZX 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 utilized for trading by more than a 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.

29. 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.

30. 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 were 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. 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 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 and did not take seriously its obligation to prevent 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. In addition, Wedbush 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.

31. 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 was 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.

32. 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 BATS, during the relevant period.

Wedbush's Failure to Monitor for Pre-arranged Trading

33. 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

34. 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 BZX 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.

35. 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.

36. 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.

37. 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.

38. 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.

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

39. 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. Although Wedbush's WSPs prohibited orders entered at the open or close of the market for the purposes of influencing the price of a security, 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

40. During most of the relevant period, until early 2013, Wedbush had in place a monthly incentive compensation system 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 BZX 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.

41. 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, 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 its market access compliance supervisor and hire and train an adequate number of staff to monitor the market access business; it rewarded the compliance supervisor and others with monthly incentive compensation for continuous high-volume trading by market access customers.

Wedbush's Inadequate WSPs

42. 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.

43. 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.

44. 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) ensure appropriate surveillance personnel receive immediate post-trade execution reports, and ensure 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.

45. In addition, Wedbush 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.

46. Moreover, Wedbush 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.

47. 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 BZX, using a Firm MPID. The Firm 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 BZX rules or the securities laws.

48. Despite receiving numerous regulatory inquiries, and the fact that the same accounts were repeatedly identified in response to those inquiries, the Firm 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.

49. The Firm updated relevant sections of its WSPs as of May 1, 2013, to coincide with its implementation of various Nasdaq SMARTS anti-manipulation surveillances; however, 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; however, 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. Moreover, between May 2013 and August 2013, substantially all of the alerts that had been generated for review for potential manipulative activity had not been reviewed by the Firm's one designated reviewer.

**First Cause of Action
Supervisory Deficiencies
BZX Rules 5.1, 5.4 and 3.1**

50. Market Regulation re-alleges and incorporates by reference each preceding paragraph.

51. As described above, Wedbush's supervisory systems and procedures governing market access were deficient in numerous ways, including the following: (i) the Firm did not conduct adequate reviews for potentially manipulative trading activity; (ii) the Firm did not subject to appropriate review accounts that posed heightened risk, including when an account's trading was the subject of multiple regulatory inquiries; (iii) the Firm allocated insufficient

resources and unqualified personnel to monitor its market access business and ensure compliance with applicable securities laws, rules and regulations; and (iv) the Firm delegated compliance reviews to personnel to monitor transactions for accounts when their compensation was directly tied to the level of trading activity in the accounts.

52. During the relevant period, and despite numerous red flags that should have alerted Wedbush to the types of potential manipulation by its market access customers, Wedbush's WSPs continued to lack reasonable or any procedures and reviews for various types of price manipulation, including layering, spoofing, pre-arranged trading, auto-execution, excessive order entry and marking-the-close, and contained fundamental flaws with respect to established reviews.

53. Wedbush failed to establish, maintain and enforce WSPs reasonably designed to supervise the types of business in which it was engaged and to supervise the activities of registered representatives, registered principals and other associated persons that were reasonably designed to achieve compliance with applicable securities laws, regulations and BZX Rules, including Rule 15c3-5.

54. As a result of the foregoing conduct, Wedbush violated BZX Rules 5.1 and 5.4 by failing to have a supervisory system reasonably designed to achieve compliance with the securities laws and BZX rules, and by failing to establish, maintain and enforce written procedures to supervise the types of business in which it engaged. By virtue of these violations, Wedbush also violated BZX Rule 3.1.

Second Cause of Action
Market Access Violations
Section 15c(3) of the Exchange Act, Rule 15c3-5 Thereunder,
and BZX Rule 3.1

55. Market Regulation re-alleges and incorporates by reference each preceding paragraph.

56. Wedbush failed to appropriately control the risks associated with providing its customers with market access so as not to jeopardize the Firm's and other market participants' financial condition and the integrity of the trading on the securities markets, as required by SEC Rule 15c3-5.

57. In its capacity as a provider of "market access," as the term is defined in Rule 15c3-5, Wedbush failed 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 providing market access, as required by Rule 15c3-5(b).

58. Wedbush failed to ensure, as required by Rule 15c3-5(c), that it had in place appropriate regulatory risk management controls and supervisory procedures so as to: (i) prevent the entry of orders unless there was compliance with all regulatory requirements; (ii) prevent the entry of orders if the customer or trader is restricted from trading; (iii) restrict access to trading systems and technology to persons pre-approved and authorized by Wedbush; and (iv) make sure appropriate surveillance personnel receive immediate post-trade execution reports that result from market access.

59. Wedbush failed to ensure that it had adequate risk management controls to prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time. The Firm's price and size parameters did not take into account the current market price, NBBO or trading volume of a

security. For example, in January 2012, for one of the Firm's market access customers, the price and size parameters did not prevent the entry of orders at prices less than \$999, with sizes less than 100,000 shares, and a notional order value less than \$1,000,000.

60. Wedbush failed to ensure that its regulatory risk management controls and supervisory procedures were under its direct and exclusive control, as required by Rule 15c3-5(d). Wedbush failed to reasonably allocate, by written contract, after a thorough due diligence review, control over specific regulatory risk management controls and supervisory procedures to a broker-dealer customer. Wedbush was not relieved of any of its obligations 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 Firm failed to adequately review the performance of broker-dealers to whom it has allocated certain regulatory responsibilities.

61. Wedbush failed to establish, document and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures as required by Rule 15c3-5(e).

62. As detailed above, by failing to establish, document and maintain a system of risk management controls and supervisory procedures reasonably designed to systematically manage the regulatory and other risks of providing market access, Wedbush willfully violated Section 15(c)(3) of the Exchange Act, and Rule 15c3-5 thereunder (for misconduct beginning July 14, 2011), and violated BZX Rule 3.1.

67. By virtue of the foregoing, in the conduct of its business, Wedbush failed to observe high standards of commercial honor and just and equitable principles of trade, in violation of BZX Rule 3.1.

Based upon the foregoing, Respondent violated BZX Rules 3.1, 5.1, and 5.4, and willfully violated Section 15(c)(3) of the Exchange Act, and Rule 15c3-5 thereunder.

Based upon these considerations, the sanctions hereby imposed by the acceptance of the Offer are in the public interest, are sufficiently remedial to deter Respondent from any future misconduct, and represent a proper discharge by BZX, of its regulatory responsibility under the Securities Exchange Act of 1934.

SANCTIONS

It is ordered that Respondent be censured and fined a total of \$1,800,000 in connection with this proceeding and the concurrent settlements of Disciplinary Proceeding No. 20090206344-01 (FINRA); Disciplinary Proceeding No. 20110263118-03 (NYSE Regulation, Inc.); and Disciplinary Proceeding No. 20110263118-02 (Nasdaq). The fine has been allocated \$566,666 each to the separately executed settlements in this proceeding; the NYSE Regulation, Inc. proceeding; and the Nasdaq proceeding; with the remainder of the fine, \$100,002, allocated to the FINRA proceeding.⁵

Respondent is ordered to pay the monetary sanction of \$566,666.00 on or before the 20th business day from the entry of this Decision accepting the Offer. Respondent has executed an

⁵ BZX took into consideration, for sanctions purposes, that that Respondent paid \$2.44 million to the Securities and Exchange Commission, and agreed to hire an independent consultant, to resolve similar claims. On November 20, 2014, Respondent entered a settlement with the SEC reflected in Order Making Findings and Imposing Remedial Sanctions and a Cease and Desist Order . . . as to Wedbush Securities, Inc., *In re Wedbush Securities, Inc., et al.*, Exchange Act. Rel. No. 73652 (Nov. 20, 2014). The SEC also sanctioned two Wedbush officers. Order Making Findings and Imposing Remedial Sanctions and a Cease and Desist Order . . . as to Jeffrey Bell, *In re Wedbush Securities, Inc., et al.*, Exchange Act. Rel. No. 73653 (Nov. 20, 2014); Order Making Findings and Imposing Remedial Sanctions and a Cease and Desist Order . . . as to Christina Fillhart, *In re Wedbush Securities, Inc., et al.*, Exchange Act. Rel. No. 73654 (Nov. 20, 2014).

Installment Payment Plan Sanctions Addendum to the Offer which will govern the terms of Respondent's payment of the monetary sanction.

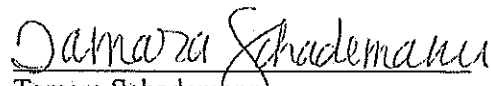
This Decision expressly includes a finding that Respondent willfully violated Section 15(c)(3) of the Securities Exchange Act of 1934. Respondent consented to the willful finding. In the Offer; Respondent confirmed it understands that, under BZX Rule 1.5(z), the willful finding makes Respondent subject to a statutory disqualification with respect to membership.

The sanctions imposed herein shall be effective 20 business days from the entry of this Decision pursuant to BZX Rule 8.8(a). Respondent may not seek review of this Decision after it becomes final pursuant to BZX Rule 8.8(a).

SO ORDERED.

BATS EXCHANGE, INC.

By


Tamara Schademann
Chief Regulatory Officer