FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2018056487101

TO: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)

RE: Joseph Gunnar & Co. LLC (Respondent)
Member Firm
CRD No. 24795

Pursuant to FINRA Rule 9216, Respondent Joseph Gunnar & Co. LLC submits this Letter of Acceptance, Waiver, and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described in this AWC.

I.

ACCEPTANCE AND CONSENT

A. Respondent hereby accepts and consents, without admitting or denying the findings and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Joseph Gunnar has been a FINRA member firm since March 1990. The Firm employs 56 registered representatives in four branch offices. Its principal place of business is New York, New York. Gunnar engages in a general securities business.

Respondent does not have any relevant disciplinary history.

OVERVIEW

From May 10, 2017 through June 1, 2018, the firm failed to establish and implement an anti-money laundering (AML) program reasonably designed to detect and cause the reporting of potentially suspicious activity relating to transactions involving low-priced securities. As a result, the firm violated FINRA Rules 3310(a) and 2010.

During the relevant period, the firm also failed to establish a due diligence program including policies, procedures, and controls reasonably designed to detect and report, on an ongoing basis, any known or suspected money laundering activity conducted through or involving correspondent accounts for foreign financial institutions (FFIs). As a result, the firm violated FINRA Rules 3310(b) and 2010.

FACTS AND VIOLATIVE CONDUCT

1. The Firm Failed to Establish and Implement a Reasonable AML Program

FINRA Rule 3310 requires that each member's AML program must, among other things, establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious transactions required under 31 U.S.C. § 5318(g) and the implementing regulations thereunder. The implementing regulation issued by the U.S. Department of the Treasury, 31 C.F.R. § 1023.320, requires broker-dealers to file with the Financial Crimes Enforcement Network "a report of any suspicious transaction relevant to a possible violation of law or regulation."

NASD Notice to Members 02-21 (NTM 02-21), issued in April 2002, provided detailed guidance to the industry regarding the obligation of a broker-dealer to monitor for and report suspicious transactions. In NTM 02-21, the NASD advised each broker-dealer that when developing an AML program, it should tailor the program to fit its business, taking into consideration, among other factors, "the types of transactions in which its customers engage." NTM 02-21 further reminded broker-dealers of their duty to look for "red flags," *i.e.*, signs of suspicious activity that suggest money laundering or other violative activity, and provided broker-dealers with a non-exhaustive list of such red flags. That list of red flags includes when a "customer, for no apparent reason or in conjunction with other 'red flags,' engages in transactions involving certain types of securities, such as penny stocks . . . which although legitimate, have been used in connection with fraudulent schemes and money laundering activity. (Such transactions may warrant further due diligence to ensure the legitimacy of the customer's activity.)" Where such red flags are detected, the NASD cautioned broker-dealers to "perform additional due diligence before proceeding with the transaction."[1]

In September 2015 and October 2016, the firm expanded its business by hiring a group of registered representatives that serviced foreign and institutional accounts, many of which engaged in transactions involving low-priced securities (the New Customers). As a result of that expansion, the volume of low-priced securities transactions that firm customers executed significantly increased. In particular, during the relevant period, a total of 945 customer accounts executed transactions in 341 low-priced securities for a total principal amount of $114,575,931. The New Customers executed transactions that represented more than 50% of that total principal amount. During the relevant period, however, the firm did not tailor its AML program to reasonably monitor its low-priced securities business or to detect and cause the reporting of potentially suspicious activity.

[1] More recently, in FINRA Regulatory Notice 19-18 (RN 19-18), issued in May 2019, FINRA reminded broker-dealers of their obligations to develop and implement a written AML program reasonably designed to achieve and monitor the firm's compliance with the requirements of the BSA and its implementing regulations, and to establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under the BSA and its implementing regulations.

First, the firm's AML procedures failed to include reasonable procedures for the surveillance of potentially suspicious trading in low-priced securities. For example, the firm's AML procedures failed to list or describe some of the most relevant red flags relating to potentially suspicious transactions in low-priced securities, such as:

- A sudden spike in investor demand for, coupled with a rising price, in a low-priced security;
- Multiple customer accounts buying or selling thinly traded low-priced securities;
- The volume of low-priced securities transactions comprising a large volume of total market trading; and
- Customers engaging in a pattern of depositing low-priced securities, liquidating the securities, and withdrawing or wiring the proceeds from the account.

The firm's AML procedures failed to address the process for assessing potential red flags associated with transactions in low-priced securities. The AML procedures also did not provide reasonable guidance about how to utilize the reports and tools the firm had at its disposal to monitor for potentially suspicious trading in low-priced securities. For example, the AML procedures did not provide any guidance about how to utilize the firm's AML exception reports (*i.e.*, reports that identified accounts with large or frequent cash or security deposits followed by cash or security withdrawals and accounts with large amounts of cash movement relative to total account value), and the firm did not use those reports to detect and report potentially suspicious activity during the relevant period.

Second, the surveillance reports and tools the firm actually used were not reasonably designed to detect and cause the reporting of potentially suspicious activity relating to transactions involving low-priced securities. In particular, the firm relied on its branch managers and compliance personnel to conduct a manual review of daily and five-day trade blotters for potentially suspicious activity. These blotters, however, did not include sufficient information to reasonably identify potentially suspicious activity, either on a transaction-by-transaction basis or over time. For example, it would be virtually impossible to discern from the blotters whether customers were engaging in patterns of depositing securities, liquidating the securities, and withdrawing/wiring the proceeds; whether a single customer (or a combination of customers) executed transactions in low-priced securities that comprised a large volume of the total market trading in those securities, or whether customer trading coincided with significant price fluctuations.

During the relevant period, the firm also used automated exception reports to detect and cause the reporting of potentially suspicious activity, including three reports that identified customer purchases of, and account concentrations in, low-priced securities (the Exception Reports). The Exception Reports, however, were not reasonably designed and failed to flag purchases of millions of shares of low-priced securities that should have triggered one or more of the reports' parameters. Additionally, the Exception Reports did not flag deposits or sales of low-priced securities, or other red flags for potentially suspicious activity. The Exception Reports did not flag the liquidation of more than $35 million in low-priced securities during the relevant period.

Third, although Joseph Gunnar received alerts from its clearing firm relating to potentially suspicious activity in low-priced securities, the firm did not reasonably respond to these red flags. For example, the firm failed to create any written analyses or compile other records indicating that it investigated this potentially suspicious activity and did not take steps to determine why its own AML program had failed to detect the potentially suspicious transactions that the clearing firm flagged.

As a result of these failures, the firm did not detect and investigate red flags that suggested potentially suspicious activity in the accounts of the New Customers, including those that deposited low-priced securities, liquidated those shares, and withdrew the proceeds. For example:

- Customer A solely deposited low-priced securities, sold them, and then immediately wired funds out of the account. In July 2017, Customer A deposited 125,000 shares of a low-priced security, and the next day sold 50,000 shares, representing more than 27% of the security's daily trading volume. One month later, Customer A sold 19,863 shares of this low-priced security over the course of two days, which represented 99% of the security's trading volume during this two-day period. After liquidating most of its shares for approximately $245,000, Customer A wired $235,000 to a foreign bank. The customer did not engage in any other activity during the relevant period. Although its clearing firm alerted Joseph Gunnar about Customer A's trading activity, the firm did not perform any documented investigation into the trading activity.

- Several customers engaged in the deposit and simultaneous liquidation of the same low-priced security. For example, in August 2017, Customer B deposited 100,000 shares of a low-priced security. In December 2017, Customer B liquidated its shares for $283,647 over the course of three days. During that three-day period, the price of the low-priced security rose from $2.21 per share to $6.15 per share. Later that month, Customer B wired the proceeds from these sales out of the account. Although Joseph Gunnar's clearing firm notified the firm of the potentially suspicious nature of the account and its activity, there is no evidence that the firm performed any investigation related to Customer B.

  Customer C deposited 50,000 shares of the same low-priced security in November 2017, and through December 2017, liquidated its entire position for $211,970 and wired out the proceeds through three different wire transfers. Despite this pattern of potentially suspicious activity, there is no evidence that the Firm performed an investigation to determine why Customer B and C's accounts liquidated the same low-priced security during the same period of time.

- Over the course of 8 days in February 2018, transactions by Customer D in a low-priced security represented a large percentage of the security's trading volume.

Customer D purchased 191,151 shares during that 8-day period, which represented approximately 57% of the security's trading volume. On a single day during that 8-day period, for example, the customer's transactions represented 99% of the security's daily trade volume. The firm's Exception Reports did not flag Customer D's transactions in this low-priced security, and the firm did not otherwise identify this trading as potentially suspicious.

- From February 2018 through March 2018, Customers D, E, and F purchased a total of 610,000 shares of a low-priced security in quantities that represented a large portion of the security's trading volume. For example, over the course of a 3-day period in February 2018, combined trading by Customers D and E represented over 71% of the security's trading volume. The firm's Exception Reports did not flag this activity and the firm did not identify it as potentially suspicious. In April 2018, Joseph Gunnar's clearing firm alerted it to the transactions, and flagged that in 2012, the authorized signatory for Customer F was the CEO of an entity fined by a foreign regulator for market manipulation. The firm did not independently identify, or then respond to, this negative news. The firm also did not investigate why its own AML program did not identify the potentially suspicious transactions.

Therefore, Respondent violated FINRA Rules 3310(a) and 2010.

2. The Firm Failed to Establish and Implement Due Diligence Policies, Procedures, and Controls for FFIs

FINRA Rule 3310(b) requires each member to establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act (BSA) and the implementing regulations thereunder, including 31 C.F.R. § 1010.610. Section 1010.610(a) requires financial institutions (including broker-dealers) to establish a due diligence program that includes appropriate, specific, risk-based, and, where necessary, enhanced policies, procedures, and controls that are reasonably designed to assess the money laundering risk posed by FFI correspondent accounts based upon a consideration of all relevant factors, which shall include, as appropriate: (i) the nature of the FFI's business and the markets it serves; (ii) the type, purpose and anticipated activity of such correspondent account; (iii) the nature and duration of the covered financial institution's relationship with the FFI; (iv) the AML and supervisory regime of the jurisdiction that issued the charter or license to the FFI; and (v) information known or reasonably available to the covered financial institution about the FFI's AML record. The regulation also requires covered financial institutions to "appl[y] risk-based procedures and controls to each such correspondent account reasonably designed to detect and report known or suspected money-laundering activity, including a periodic review of the correspondent account activity sufficient to determine consistency with information obtained about the type, purpose, and anticipated activity of the account."

Although 33 of the firm's customer accounts were correspondent accounts for FFIs during the relevant period, the firm failed to establish or implement policies and procedures related to the due diligence or review of correspondent accounts for FFIs.

The Firm failed to identify all of its FFI accounts because it had no system or processes in place to do so. In particular, the firm failed to identify that 15 of the 33 customer accounts were registered as FFIs in the IRS's public Foreign Account Tax Compliance Act FFI Registration System, and that the majority of the customers identified themselves as "Non-Regulation Foreign Financial" in account opening documents. Moreover, during the relevant period the firm had no system or procedure for performing risk-based reviews of FFIs and, as a result, did not review those customers' trading activity against any defined risk assessment or to determine if the trading was consistent with the customer's expected account activity. Although Joseph Gunnar's policies and procedures required it to conduct annual reviews of foreign accounts, the firm did not conduct any annual or periodic reviews of correspondent accounts for FFIs during the relevant period.

Therefore, Respondent violated FINRA Rules 3310(b) and 2010.

B. Respondent also consents to the imposition of the following sanctions:

- a censure;
- a $55,000 fine; and
- an undertaking to provide a certification. Within 60 days of Notice of Acceptance of this AWC, Respondent shall certify to FINRA in a submission signed by an officer and registered principal of Respondent that, as of the date of the certification, Respondent has established and implemented policies, procedures, and internal controls reasonably designed to achieve compliance with FINRA Rule 3310. The certification shall be addressed to Michael Dorfman-Gonzalez, Counsel, FINRA Department of Enforcement, 200 Liberty Street, New York, NY 10281 and shall be sent either by letter that identifies Joseph Gunnar and Matter No. 20180564871 or by email from a work-related email account of a registered principal of Respondent to EnforcementNotice@finra.org with a copy to michael.dorfman-gonzalez@finra.org. Upon written request showing good cause, FINRA staff may extend the procedural date set forth above.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a complaint issued specifying the allegations against it;

B. To be notified of the complaint and have the opportunity to answer the allegations in writing;

C. 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; and

D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and

C. If accepted:

1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;

2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;

3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and

4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this statement. This statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

11/25/20
Date

Joseph Gunnar & Co. LLC
Respondent

Print Name: Joseph Alagna

Title: CEO

Reviewed by:

Stephen H. Cohen, Esq.
Counsel for Respondent
Loeb & Loeb LLP
345 Park Avenue
New York, NY 10154

Accepted by FINRA:

12-4-2020
Date

Signed on behalf of the
Director of ODA, by delegated authority

Michael Dorfman-Gonzalez /sb

Michael Dorfman-Gonzalez
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