BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Silver Leaf Partners, LLC New York, NY, Respondent.	Decision Complaint No. 2014042606902 Dated: June 29, 2020

Member firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws, regulations, and FINRA rules, and paid transaction-based compensation to nonmember brokers. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Perry C. Hubbard, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Jeffrey A. Sexton, Esq., Salah Borghei-Razavi, Esq.

Decision

Silver Leaf Partners, LLC, appeals a January 29, 2019 Extended Hearing Panel decision. The Hearing Panel found Silver Leaf failed to establish and maintain a supervisory system reasonably designed to supervise its "stock loan and block trade introduction business."[1] The Hearing Panel also found that Silver Leaf paid transaction-based compensation to nonmember brokers, and failed to establish and maintain a supervisory system reasonably designed to prevent those payments. For this misconduct, the Hearing Panel fined Silver Leaf a total of $100,000,

[1] As used in this decision, the term "stock loan" refers to stock-based loan programs that allow investors to pledge fully-paid stock as collateral for "non-recourse" loans from third-party lenders who are generally unregistered and unregulated. It does not refer to loans of stock to cover short sales or margin loans. *See FINRA Investor Alert: Stock-Based Loan Programs: What Investors Need to Know* (May 17, 2016), https://www.finra.org/investors/alerts/stock-based-loan-programs-what-investors-need-know (last visited June 26, 2020).

barred it from facilitating "stock loan or block trading transactions," and ordered it to retain an independent consultant to conduct a comprehensive review of its policies, systems, and procedures. After reviewing the record, we affirm the Hearing Panel's findings of violation, but we modify the sanctions it imposed.

I. Background

A. Origin of the Investigation

This matter arose from a multi-million dollar FINRA arbitration claim filed in 2014 by BTIG, LLC, against Silver Leaf; BHP, LLC; and Floyd Associates, Inc. BTIG sought damages for losses incurred while executing a block trade.[2]

The transaction originated in October 2013, when BHP asked Silver Leaf to find a buyer for a large block of stock in Gading Development Tbk ("GAMA"), an Indonesian company whose shares traded on the Indonesia Stock Exchange. Silver Leaf brought the transaction to Floyd, and facilitated discussions between Floyd and BHP.[3] Floyd and BHP agreed that Floyd would buy 426 million GAMA shares from BHP on the exchange, and, a few days later, BHP would deliver to Floyd an additional 107 million shares for free. BHP and Floyd chose BTIG to execute the transaction. On Floyd's order, BTIG bought the shares from BHP for $18 million. After that, the share price began declining. Before settlement, Floyd told BTIG it was cancelling the trade due to a material breach by BHP. BTIG was not able to cancel the trade and took the shares into its own account. BTIG eventually sold the shares at a $16 million loss. BTIG filed an arbitration claim against Silver Leaf, BHP, and Floyd alleging fraud, misrepresentation and manipulation, conspiracy to defraud, aiding and abetting fraud, and negligent misrepresentation.

FINRA's Member Regulation Department notified the Department of Enforcement ("Enforcement") about the arbitration. In 2015, Enforcement opened the investigation that led to this proceeding.

In 2016, an arbitration panel held that Silver Leaf, BHP, and Floyd "were negligent in their failure to disclose material facts and in making other misrepresentations and omissions which led to BTIG's damages." The arbitration panel found them jointly and severally liable for $16 million in damages, plus $4 million in interest, fees, and costs.

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[2] BTIG is a FINRA member; neither BHP nor Floyd is a FINRA member. BTIG also named several individuals as respondents. Their names are not relevant to this decision.

[3] Silver Leaf objects to the use of the word "facilitate" to describe its conduct because, it contends, "facilitate" has a meaning in the securities industry that does not reflect the firm's role in the transactions at issue. Unless otherwise noted, we use the term "facilitate" as it ordinarily is used, i.e., "to make easier," or "help bring about." "Facilitate." Merriam-Webster Dictionary, https://www.merriam-webster.com/dictionary/facilitate (last visited June 26, 2020).

[Footnote continued on next page]

B. Disciplinary Proceedings

1. Complaint

In September 2017, Enforcement filed a two-cause complaint against Silver Leaf alleging violations of FINRA's supervisory rules, NASD Rule 3010 and FINRA Rule 3110, as well as its rule prohibiting the payment of transaction-based compensation to nonmember brokers or dealers, NASD Rule 2420.[4]

First, Enforcement alleged that Silver Leaf's supervisory system "completely failed to address its stock loan and block trade introduction business," i.e., the business line involved in the GAMA trade. Enforcement alleged that Silver Leaf failed to respond to "red flags" that should have alerted the firm to its supervisory deficiencies in this area. These red flags arose in two stock loans Silver Leaf facilitated for BHP just before the GAMA block trade. Both stock loans resulted in BHP's counterparty threatening litigation and regulatory action against BHP and Silver Leaf. Enforcement alleged the GAMA block trade also was a red flag because it was "structured in a manner that could hide the number of shares being transferred and the true price for the shares." Enforcement alleged that Silver Leaf failed to appreciate or protect itself against the risk it could become financially responsible for the GAMA block trade, and failed to implement a supervisory system reasonably designed to prevent the firm's customers from engaging in transactions that endangered the markets and other market participants.

Second, Enforcement alleged that Silver Leaf paid approximately $200,000 in transaction-based compensation to SH, an "unregistered finder" who referred potential transactions to the firm. Enforcement alleged these payments occurred in connection with BHP's two stock loan transactions and a block trade for another customer.

Third, Enforcement alleged that, between February 2013 and April 2015, Silver Leaf paid a total of $2.7 million in transaction-based compensation to nonmember entities affiliated with its registered persons (the "Nonmember Entities"), rather than paying the registered persons directly.

Finally, Enforcement alleged the payments to SH and the Nonmember Entities resulted from Silver Leaf's failure to supervise. Enforcement alleged that Silver Leaf "had no written procedures . . . nor did it implement appropriate supervisory procedures, prohibiting or otherwise addressing the payment of transaction-based compensation to finders or unregistered entities owned by Silver Leaf registered representatives."

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[4] We apply the rules in place at the time of the alleged violations. FINRA Rule 3110 replaced NASD Rule 3010 effective December 1, 2014. *FINRA Regulatory Notice 14-10*, 2014 FINRA LEXIS 17, at *1 (Mar. 2014). FINRA Rule 2040 replaced NASD Rule 2420 effective August 24, 2015. *Regulatory Notice 15-07*, 2015 FINRA LEXIS 5, at *1 (Mar. 2015).

2. Hearing

A six-day hearing was held in August 2018. During the hearing, for the first time, Silver Leaf argued that Enforcement failed to prove any violation of FINRA's rule prohibiting payment of transaction-based compensation to nonmembers. Silver Leaf asserted that, under the United States Supreme Court's holding in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), NASD Rule 2420 applied only to payments in connection with domestic securities transactions, and the firm claimed that Enforcement failed to establish that any transaction at issue was domestic.

After the hearing, in response to Silver Leaf's new *Morrison* argument, Enforcement withdrew some of its allegations relating to the payments to the unregistered finder. In its post-hearing brief, Enforcement stated that it no longer sought to hold Silver Leaf liable for payments to SH in connection with the two stock loan transactions for BHP.[5] Enforcement did not withdraw its allegations that the payment to SH in connection with the block trade for another customer violated NASD 2420 or that the payments to the Nonmember Entities violated NASD Rule 2420. Nor did Enforcement withdraw its allegation that the payments to SH were evidence of Silver Leaf's alleged supervisory failures.

3. Decision

The Hearing Panel issued a decision in January 2019 finding Silver Leaf liable for the violations alleged in the complaint, as amended by Enforcement's post-hearing brief. For Silver Leaf's supervisory violations, the Hearing Panel fined the firm $50,000, ordered it to engage an independent consultant to review its supervisory systems and procedures, and barred it "from directly or indirectly facilitating stock loan or block trading transactions." For Silver Leaf's payment of transaction-based compensation to nonmembers, the Hearing Panel fined the firm $50,000.

4. Silver Leaf's Appeal

Silver Leaf appealed the Hearing Panel's findings and the sanctions it imposed. Silver Leaf raises a number of procedural and substantive issues in its appeal. Primarily, however, it makes three arguments.

First, Silver Leaf argues that its supervision of its stock loan and block trading business was reasonable because the firm's involvement in these transactions was strictly limited to making introductions. Silver Leaf contends it acted only as an "introducer," and once it made an introduction, "the services of Silver Leaf were complete." Silver Leaf asserts that the Hearing Panel did not understand the limited role it played in the transactions at issue. According to Silver Leaf, the firm "was not lax in supervising its business. It was supervising the business it

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[5] Enforcement did not concede Silver Leaf's argument that *Morrison* limited the scope of NASD Rule 2420 or that the transactions involved were not domestic securities transactions. Enforcement stated it was withdrawing the allegations because it believed the Hearing Panel "should not reach th[e] unsettled question" of whether *Morrison* limits Section 15(a).

had. It did not, and could not, supervise the business that . . . the [Hearing] Panel imagined it to have."

Second, Silver Leaf argues that it did not approve any payments to SH, and that one of the firm's registered persons, Jay Chapler, made the payments without Silver Leaf's knowledge or approval. Silver Leaf contends "there is literally no evidence . . . that Silver Leaf paid [SH] any money," and that Chapler "duped Silver Leaf" by sharing his commission payments with SH.

Third, Silver Leaf argues that Enforcement failed to establish FINRA's jurisdiction over any of the alleged payments to non-FINRA members. Silver Leaf contends that, under *Morrison*, NASD Rule 2420 applies only to domestic securities transactions, and "[t]he cold evidence was that payments were made based on foreign transactions not subject to U.S. rules and regulations."

II. Facts

A. Silver Leaf

Silver Leaf was established in and has been a FINRA member since 2003. The firm has one office located in New York City. Between January 2012 and April 2015, Silver Leaf had between 65 and 75 registered persons.

During the relevant period, Silver Leaf engaged in three business lines, which it described as "Institutional Brokerage," "Fund Marketing," and "Corporate Advisory."[6] Through its Institutional Brokerage business, Silver Leaf provided "mini-prime brokerage" services to institutional money managers, including correspondent clearing, financing, and trading services.

Through its Fund Marketing business, Silver Leaf provided "introductory and marketing services" to private fund managers seeking introductions to institutional investors. Typically, Silver Leaf would enter into a contract with the fund manager under which it agreed to use its best efforts to identify prospective investors and introduce them to the manager.

Through its Corporate Advisory business, Silver Leaf found counterparties for its clients "seeking introductions to investor capital, debt, or other financial arrangements," including stock loans and block trades.

In both the Fund Marketing and Corporate Advisory businesses, if Silver Leaf's introduction led to a transaction, Silver Leaf received a fee based on the size of the transaction. Silver Leaf retained a percentage of the fee and passed the rest on to the registered person who made the introduction. If an introduction did not lead to a transaction, Silver Leaf was not paid.

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[6] The name of this business line was "Investment Banking and Corporate Advisory." Silver Leaf did not engage in activities traditionally associated with investment banking, such as underwriting securities offerings. For clarity's sake, we refer to this business as "Corporate Advisory."

Fyzul Khan and Kevin Meehan were Silver Leaf's co-owners and registered principals. Khan was the majority owner and served as the firm's chief executive officer, chief compliance officer, and managing member. He oversaw the firm's Fund Marketing and Corporate Advisory businesses, including introductions for stock loans and block trades. Meehan served as the firm's vice-chairman, president, chief financial officer, and financial operations principal. He oversaw the Institutional Brokerage business and was responsible for all finance and accounting functions.

Khan was responsible for Silver Leaf's general compliance supervision. Khan approved the firm's written supervisory procedures ("WSPs") and was tasked with reviewing and updating them. He also was responsible for supervising the firm's associated persons, reviewing and approving transactions, and reviewing and approving correspondence. As Khan put it, he supervised "the entire business."[7]

B. Silver Leaf's Corporate Advisory Business and Alleged Payment of Transaction-Based Compensation to the Unregistered Finder

1. Background

a. Jay Chapler Registers with Silver Leaf; Silver Leaf Formalizes Its Corporate Advisory Business

Silver Leaf's Corporate Advisory business began taking shape after Jay Chapler registered with the firm in 2010. Until then, Silver Leaf had focused on its Institutional Brokerage and Fund Marketing businesses. Although Silver Leaf engaged in some Corporate Advisory business before Chapler's arrival, Khan said it did so only in a "haphazard way without a formalized focus around it." Silver Leaf had passed on some opportunities in this area because Khan was not comfortable supervising introductions to these types of transactions. Indeed, Khan had never supervised a stock loan introduction before Chapler joined the firm. Khan said Chapler's hiring "was the actionable event that made [Khan] not look away from these other transactions but now say okay. I have somebody that has a business know-how." Khan gave Chapler the title of managing director and head of investment banking (i.e., Corporate Advisory).

Chapler had expertise in non-recourse stock loans, in particular. In these transactions, the borrower transfers stock to the lender, and the lender gives the borrower loan proceeds equal to a fraction of the stock's value. Once the borrower delivers the shares to the lender, the lender is free to sell them at any time. When the borrower pays back the loan, the lender must return the shares, or their present equivalent value, to the borrower. If the borrower fails to pay back the loan, the lender's only recourse is to sell the stock (assuming it has not already done so). There are risks for the borrower and the lender. The borrower bears the risk the lender will not perform, either by failing to deliver the loan proceeds after the borrower has delivered the shares, or by failing to return the shares once the loan is repaid. The lender bears the risk that, once it delivers the loan proceeds, the value of the shares will fall below the value of the loan, and the borrower will walk away.

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[7] Meehan supervised Khan.

Chapler specialized in stock loans and block trades in which larger firms were not interested. Chapler testified that the "big banks will make loans against stocks that are . . . very liquid and have a large market capitalization," but "other groups, private groups will make loans against stocks that are still liquid but less liquid [and] have a small capitalization." Similarly, according to Chapler, "big banks will do block trades with large market capitalization stocks, where some of these private groups will do it with smaller capitalizations and less liquidity." Chapler focused on the transactions the "big banks" did not want, which he described as "second-tier."

b. Chapler Introduces Khan to BHP

Chapler introduced Khan to BHP, a Bahamian entity with an office in Toronto, Canada. BHP engaged in "second tier" stock loans and block trades. Chapler described BHP as a "multi-family office." Chapler testified that he did "a certain level of due diligence" on BHP. He said he "tried to find out as much as [he] could" and asked around about BHP. He said that "a lot of times these are entities that are closed and they don't like to give out the balance sheets[.]"

Chapler represented to Khan that BHP's principals, SD and MW, were very wealthy. At the hearing, Chapler testified that he "d[idn't] know [MW's] personal balance sheet," but MW "had a really nice car" and "seemed to have helped out somebody who [Chapler] knew with a lot of money[.]" Chapler said he "ha[d] no real evidence [of MW's wealth] other than the fact that [MW] seemed to have nice things."

Khan did not verify what Chapler told him about SD's and MW's wealth. Khan testified that what he knew about their net worth "was all inferential from what Mr. Chapler told [him.]" Khan said that Chapler "went there and saw the size of their houses. [Chapler] used to work for [SD]. Based on the pay scale at [Chapler's and SD's former firm], [Chapler] was pretty comfortable that their representations and the bonus pool that [SD] was part of, that [SD] was likely worth . . . around $300 million."

Khan testified that he was not sure how BHP's business worked or where its capital came from. Khan explained, "[F]amily offices like BHP are very private and it is very difficult to understand when you deal with them if the capital that they are deploying is just their capital, if it is leveraged, if they are working with other family offices. . . . [T]hey are opaque in many ways and they are intended to be, that is what they do."

In April 2012, Silver Leaf and BHP entered into an "Agent Agreement" under which Silver Leaf would "introduce[] to BHP prospective borrowers suitable for BHP's collateralized stock loan and block purchase business as an independent agent[.]" In return, on "any stock loan or block purchase" referred by Silver Leaf, BHP would pay Silver Leaf "a reasonable commission based on the net loan or block purchase amount." BHP agreed to pay the commission "within five business days from the date that each loan tranche is funded."

The agreement did not fix Silver Leaf's fee. Chapler said that was because "every transaction is a little bit different," and the firm's fee would vary depending on the circumstances. When asked what services Silver Leaf was expected to perform to receive a fee,

Chapler replied, "Mostly the introduction and you know we would facilitate it as well." Chapler continued, "It is like any transaction, nothing is black and white. It is not like cookie cutter that every transaction is the same. So there is some back and forth . . . some structuring to some degree. . . . So we were the facilitator besides making the introduction. So we continued on throughout the transaction."

c. Chapler Introduces Khan to the Unregistered Finder

Chapler was particularly interested in procuring "second tier" stock loans and block trades for wealthy individuals and entities in Turkey and the Middle East. Chapler testified that markets there made it more difficult to obtain capital than in the west.

SH, the unregistered finder, did business in Turkey and had extensive contacts there. SH was a U.S. citizen who lived in Florida. He also was a physician and the chief executive officer of a Florida corporation. Chapler met SH in late 2011 or early 2012 and found him to be "a very good networker" with a "very charming and outgoing personality." Chapler thought SH could be "a good business developer" and a good source of "deal flow" for the firm.

Chapler introduced SH to Khan, and the three discussed how SH would help Chapler source Corporate Advisory transactions, particularly in Turkey and Middle Eastern markets. Khan was impressed; he viewed SH as a "jet-setting doctor turned banker" and a "potential new broker" for the firm.

d. Chapler Agrees to Split His Silver Leaf Commissions with the Unregistered Finder

In April 2012, Chapler agreed to share his commissions with SH because, as Chapler put it, "nobody works for free." Chapler and SH entered into a "Consulting Agreement" under which Chapler would share any commission he received from Silver Leaf on transactions referred by SH.[8] Chapler and SH exchanged copies of the agreement through Silver Leaf's email system, but Khan testified he did not see the contract during his email review.

e. Silver Leaf Increases Its Override on Stock Loans and Block Trades Due to Increased Risk

Khan and Meehan knew Chapler's business involved greater risks than the firm's other business lines and decided the firm should be paid extra for taking on that risk. In April 2012, Silver Leaf increased its override on Chapler's Corporate Advisory transactions from 10 to 25 percent. Khan directed Meehan to send an email to Chapler explaining the reason for the change. In his email, Meehan wrote that when Chapler was first introduced to the firm, Meehan "was under the impression that [Chapler was] a [] fund marketer," and that although he and Khan "very much like the opportunities that [Chapler's] business model presents[,] . . . it is different from what we had anticipated. It has the possibilities for greater success fees but also puts

[8] Chapler did business through his entity, DEMC Capital, LLC. The agreement was between DEMC Capital and SH.

[Silver Leaf] in the direct role of brokering a transaction; that's good but also risky." Meehan closed the email by telling Chapler, "We will split on a net basis so if you have third parties that need to get paid then their payment will come off the top before our splits."

2. The Domestic Co. Block Trade

In August 2012, SH referred a potential block trade transaction for a Turkish holding company ("Parent Co.").[9] Parent Co. wanted to sell a large block of stock in one of its subsidiaries ("Subsidiary Co."). Subsidiary Co. was a public company whose shares traded on the Istanbul Stock Exchange. Chapler brought the transaction to one of Silver Leaf's clients (Domestic Co.), a Delaware company based in Indianapolis, Indiana.

After introducing Parent Co. and Domestic Co., Chapler and SH helped them come to terms on a block trade. According to Chapler, he and SH went back and forth between the parties "like a real estate agent," and "in the end, [Chapler and SH] were just facilitating the transaction, getting feedback from the seller and getting feedback from the buyer and trying to make sure that everybody is in agreement."

Later that month, Parent Co. and Domestic Co. entered into an agreement under which Parent Co. would sell 21 million shares of Subsidiary Co. in several tranches. The purchase price for each tranche would be about 80 percent of the stock's fair market value, as reflected by the average closing price on the exchange. Silver Leaf would receive a total fee of four percent of the stock's market value on each tranche. Silver Leaf's fee comprised a three-and-a-half percent "origination fee," plus an additional one-half percent fee for acting as a principal in the trade.

The first tranche was completed on September 4, when Parent Co. sold 300,000 shares to Domestic Co. for $331,919 on the exchange. Two days later, Parent Co.'s agent in Turkey wired Silver Leaf's fee of $13,233.

Meehan calculated a three-way split of Silver Leaf's fee between Silver Leaf, Chapler, and SH. On September 7, Meehan sent an email to Chapler with the subject line, "Trade Date 9.4.12 payout." Attached to the email was a spreadsheet. Under the heading "Payout Calculation," the spreadsheet showed, "Wire Received 9/6/12 $13,233," and directly under that, showed "$5,954.85 45% to [SH]." Khan testified that he did not review Meehan's email.

Silver Leaf deposited SH's and Chapler's shares of the firm's fee, a total of $11,413, in Chapler's bank account.[10] Chapler then wired SH's share, $5,954, to SH's bank account in

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[9] Silver Leaf's alleged payment of transaction-based compensation to SH in violation of NASD Rule 2420 occurred in connection with this transaction. This transaction also is relevant to Silver Leaf's alleged supervisory failures.

[10] Silver Leaf directly deposited the payments to Chapler into a bank account belonging to Chapler's Nonmember Entity, DEMC Capital.

[Footnote continued on next page]

Florida.[11] The split of Silver Leaf's commission among Silver Leaf, Chapler, and SH was consistent with the compensation structure described in Meehan's April 30, 2012 email to Chapler. SH was a "third part[y] that need[ed] to get paid," so SH's fee came "off the top" of Silver Leaf's gross fee. Chapler and Silver Leaf shared the remainder.

The second tranche was completed the next day, September 11, when Parent Co. sold 2.2 million shares to Domestic Co. for a total of $2,485,876 on the exchange. Two days later, on September 13, Parent Co.'s agent in Turkey wired Silver Leaf's fee of $99,383. Silver Leaf deposited a total of $85,612 in Chapler's bank account, representing Chapler's and SH's fees for the second tranche. Chapler then wired SH's share, $44,722, to SH. As with the first tranche, the split of Silver Leaf's gross and net fees was consistent with the compensation structure described in Meehan's April 30, 2012 email.

3. The Three BHP Transactions

In 2013, Silver Leaf facilitated three transactions for BHP. These transaction are relevant to Silver Leaf's alleged supervisory failures only.[12]

a. The L-Co. Stock Loan

In May 2013, SH referred to Chapler a potential stock loan transaction for a Turkish company ("L-Co."). L-Co.'s shares traded on the Istanbul Stock Exchange. L-Co. was seeking to borrow $20 million against 30 million shares of its stock. Chapler brought the transaction to BHP.

In June 2013, BHP and the president of L-Co., LE, entered into an agreement under which LE would deliver up to 30 million shares of L-Co. stock in multiple tranches. The loan proceeds for each tranche would equal 65 percent of the shares' value, as determined by the closing price on the exchange. BHP would "release the funds in the amount of each such tranche . . . and [LE would] release the Pledged Securities . . . through a simultaneous exchange to occur on an agreed-upon date[.]" The agreement placed restrictions on what BHP could do with the shares it received from LE. BHP was allowed to sell the shares, but it was prohibited from shorting the stock or selling the shares at or below the stock's value at the time the tranche closed. When a tranche closed, BHP would pay Silver Leaf a fee of 1.95 percent of the gross loan amount.

When asked what involvement he had in shaping this agreement, Chapler responded that his role was "to find a group that needs cash and is willing to put up collateral . . . and then . . . also structure it. . . . [A] BHP boilerplate transaction does not fit everybody exactly. So . . . there

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[11] All payments to SH were sent to a bank account owned by SH's corporation. That fact is not relevant to this alleged violation, as neither SH nor SH's corporation was a FINRA member.

[12] Enforcement initially alleged that Silver Leaf paid transaction-based compensation to SH in connection with the first two BHP transactions in violation of NASD Rule 2420. Enforcement withdrew these allegations in its post-hearing brief.

is some negotiations back and forth. So our goal is to help facilitate the transaction[] by relaying back to BHP what the needs are of the client."

On June 24, LE began delivering shares to BHP. The first tranche was one million shares. LE initiated the second tranche on June 27, when he delivered three million shares.

By June 28, BHP still had not paid for the first tranche, and L-Co. began alleging misconduct and threatening legal action against BHP and Silver Leaf. In an email to SH, which SH forwarded to Chapler under the subject line "URGENT," SH's contact in Turkey wrote there was a "big dump today on [L-Co.'s] shares which comes from a foreign seller," believed to be BHP, and that LE had cancelled a planned third tranche of six million shares "because [BHP] does not stick to the agreement and [is] selling below [the price at the time the tranche closed.]." SH's contact wrote that, if Silver Leaf did not "fix the sells" by buying back the shares, LE was "going to take legal action against [Silver Leaf] and [BHP] after proving sells coming from [BHP]." SH's contact warned, "Don't trust [BHP] . . . they may play games behind [Silver Leaf's] back." Khan could not remember whether he saw this email during his email review.

Two days later, L-Co. accused BHP of improperly dumping its shares to fund the loan and manipulating the price of the stock. In an email to SH, which SH forwarded to Chapler, SH's contact wrote that BHP was "taking the shares dump[ing] them and t+2 they get the money . . . and that's why it takes so long . . . selling [LE's shares] and giving his money back to him." The email continued, "there is a bigger picture . . . they r [sic] down pushing the stock and trying to make the lowest floor[] price for the rest of the 20-25 million shares . . . and after getting all the shares they would buy back and make the price higher to secure a good floor[] price and reasonable target for 300% goal."

Chapler testified he did not specifically remember what he did after receiving this email, but "usually when that happens, [he] would go to BHP and say what is going on. Why is the stock going down. Why are you not delivering what you promised on. This is creating havoc with the client. Our job is to service the clients, not to create difficulty."

On July 2, L-Co. sent someone to Silver Leaf's office to inquire about the delayed payments. As Chapler explained at the hearing, "this guy from New Jersey who looked like a mountain, comes into my office, he was like 6' 6", and he sits there." Chapler said the man stayed at Silver Leaf's office "for a while." Later that day, Chapler sent an email to BHP: "Please contact me, I had no communication from BHP today. The borrowers had someone from their NJ office sit in my office most of the day, this is really degrading."

Three days later, on July 5, eleven days after LE delivered the first tranche of shares, BHP wired the money for the first tranche. Silver Leaf received a fee of $21,162, which included its 1.95 percent origination fee and an additional two percent "back-end" fee. Chapler said the "back-end" fee "was just something that, . . . [he] negotiated with [BHP] because of all of the headaches they gave us."[13]

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[13] The record does not indicate whether LE was aware of the additional fee BHP paid to Silver Leaf.

On July 8, Chapler sent an email to Khan and Meehan attaching a spreadsheet showing how Silver Leaf's fee should be split between Silver Leaf, Chapler, and SH. The spreadsheet showed Chapler and SH were entitled to a total of $18,349, of which Chapler would receive $7,969 and SH would receive $10,380.[14]

Meehan replied to Chapler's email, "Jay this seems straightforward to me."

A few days later, Chapler deposited $18,349 in his bank account, the total amount Chapler had calculated he and SH should receive from Silver Leaf. Chapler then wired $10,380 to SH's bank account.

In the meantime, Chapler and BHP continued exchanging emails regarding L-Co.'s complaints. Chapler wrote to BHP that "[s]itting tight and waiting for the other side to fold will make things difficult," and if L-Co. "put[s] in a claim to the Capital Markets Board [of Turkey], which they can do with a phone call, it will mess this up and all future transactions."[15]

BHP responded by suggesting that Chapler "find a way to solve this and get them to transfer the [additional] 6M shares back" from the tranche LE cancelled on June 28.

Chapler replied, "right now [L-Co.'s] attorney claims that BHP is in default under 2(e) [of the loan agreement], 'simultaneous exchange of cash for share[s].' What is my counter argument?"

When asked what he hoped to accomplish with this email exchange, Chapler said he was "trying to make everybody happy. Trying to make sure each side did not want to strangle the other. That is our job as facilitators to keep everybody's interest in mind and facilitate at the same time. This is typical, this happens, . . . our job is to try to make it work, even though there are problems. That is why we get paid, otherwise we would not get paid."

According to Khan, he did not come across these emails during any of his email reviews because, he explained, he was not looking for them. Khan testified, "Mr. Chapler discussed with me what was happening. It was not necessary for me to look at or search the emails because he kept me up to date." Khan said he "was fully aware of the issues with this transaction."

On July 18, almost three weeks after LE delivered the second tranche of shares, BHP wired Silver Leaf's fee. Although the parties initially contemplated a loan against a total of 30 million shares, there were no additional tranches.

The fee split for the second tranche occurred as it had for the first. Silver Leaf received a fee of $33,648. Chapler emailed Meehan a spreadsheet showing how the fee should be split among the firm, Chapler, and SH. This time, however, rather than using SH's name, Chapler

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[14] The fee calculation for SH included an extra $2,410.88 for the "Turkey broker's" fee.

[15] The Capital Markets Board of Turkey is the regulatory and supervisory authority in charge of the securities markets in Turkey.

[Footnote continued on next page]

referred to SH as "Jay 2." Chapler testified that he did not remember why he did that. Meehan said he did not recall asking Chapler about it. And Khan testified he did not see the email. Chapler's spreadsheet showed Chapler and "Jay 2," i.e., SH, were entitled to a total fee of $29,052, and SH's share of that amount was $16,434.[16] A few days later, Silver Leaf paid Chapler $29,052. Chapler then wired $16,434 to SH.

Following this transaction, Chapler went to Toronto to meet with BHP. Chapler said he wanted to "sort this out," tell BHP that it "can't conduct business this way," and "just [] scold them . . . on not conducting themselves as good as they should."

Chapler testified that BHP had a "handful of people" in its office, and that he met with MW and one of BHP's traders, Mark Valentine. Valentine had pleaded guilty to federal securities fraud in 2004, and the SEC had barred him from participating in penny stock offerings in 2006. Neither Silver Leaf nor Chapler was aware of Valentine's criminal or regulatory history. Chapler said he "just assumed that [Valentine] was part of BHP and BHP looked to me like a legitimate organization, so I just carried it over to him."

b. The Subsidiary Co. Stock Loan

A short time later, SH referred another potential transaction for Parent Co. This time, Parent Co. wanted to borrow against Subsidiary Co. shares.

Chapler brought the transaction to BHP and one of its affiliates, Carlton Family Office ("Carlton"). BHP and Carlton were essentially the same company. Chapler testified that BHP "set up" Carlton, that Carlton and BHP had the same owners, and that BHP and Carlton were interchangeable.

Hoping to avoid the problems that plagued BHP's prior stock loan, Silver Leaf agreed to serve as the escrow agent in this transaction. As Chapler explained, "The whole idea of the escrow agreement was to create the same thing as [delivery versus payment]. . . . [H]ave the shares come into the escrow agreement and then have the cash go into the escrow and then do a swap, which effectively would be a [delivery versus payment]. So that was some of the pain and frustration we experienced in the first [BHP] transaction, we did this in the second transaction, we tried to correct some of that."

Khan testified that he was not concerned with Silver Leaf serving as the escrow agent. Khan believed doing so would give the firm more control over the transaction, which he viewed as a good thing. Khan explained that, in a stock loan, "there is basically opportunity . . . for exploitation . . . on both sides because of the nature of the illiquidity of the positions." However, Khan explained, "when you have the escrow agreement . . . you control the situation. Both sides are now in your control and you can make sure both sides have proper delivery." Additionally, Khan said he saw this "as part of [the firm's] own learning about how much or how little of a role [it] wanted in these transactions."

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16 The fee calculation for SH included an extra $3,817 for "Expenses."

On August 7, Parent Co. and Carlton entered into a loan agreement. Parent Co. would deliver a total of 50 million Subsidiary Co. shares to escrow, and Carlton would deliver loan proceeds totaling approximately 100 million Turkish lira (about $50 million dollars at the time). The shares and loan proceeds would be distributed to Parent Co. and Carlton, respectively, in two tranches of 25 million shares, as specified in an escrow agreement. The loan agreement restricted what Carlton could do with the shares it received. Carlton was allowed to sell the shares but could not short the stock or sell at or below its value at the time the tranche closed. Silver Leaf would receive a fee of three percent of the loan amount for each tranche when the loan proceeds were disbursed.

The same day, Silver Leaf, Parent Co., and Carlton entered into an escrow agreement governing the transfer of the shares and the loan proceeds. The agreement identified Silver Leaf as the "escrow agent."[17] The first tranche was supposed to occur as follows: (1) Parent Co. would deliver all 50 million shares to the escrow account, and Carlton would deliver the loan proceeds for the first tranche to the escrow account; (2) Silver Leaf would release 25 million shares to Carlton; (3) four days later, Silver Leaf would release the loan proceeds for the first tranche to Parent Co. Silver Leaf would receive an "Escrow Agent fee" of one-quarter percent.

In addition to the fees described in the loan and escrow agreements, Silver Leaf negotiated an additional two percent "back end" fee with BHP, bringing its total fee to five and a quarter percent of the loan amount. This additional fee was not disclosed to Parent Co.

In mid-August, Khan and Chapler exchanged emails regarding Chapler's sharing of commissions with SH. Khan notified Chapler that the firm would be taking a larger override on the escrow fee because someone else at the firm came up with the idea of using an escrow agreement. Chapler responded that Khan was incorrect, and that he, SH, and Parent Co. had "crafted the [e]scrow concept for this transaction and its terms and conditions." Chapler wrote that if he told SH "that the split for the escrow agreement is changing because [Silver Leaf] came up with the idea, he will think I have lost my mind and worse, he will significantly reduce his opinion of our operations[.]"

Khan replied, "I have to talk to the 3 of you together [Chapler and two Silver Leaf employees]. You can have [SH] join too if you like."

Later that day, Khan sent another email to Chapler and Meehan discussing how fees would be split on transactions going forward. Khan wrote, "This is my decision: [Parent Co.] & other Jay/[SH] origination: 75/25," "BHP & Dave C. origination: 85/15," "Everything else: nothing to Jay/[SH]."

On August 28, almost immediately after the first tranche closed, Parent Co. notified Silver Leaf that Carlton was violating the loan agreement, and that Carlton's conduct had drawn attention from securities regulators in Turkey. In an email to Khan, Chapler, and SH, Parent Co.'s chief executive officer, RI, wrote that Carlton did not give Parent Co. a loan on all 25

[17] Chapler testified that Silver Leaf had an account at a bank in Turkey and held the cash and shares there.

million shares. Instead, he alleged, Carlton "returned" 15 million shares, and gave [Parent Co.] a loan for only half of the 10 million shares it retained, and even that disbursement was short. "In the meantime," RI continued, "the Turkish Capital Markets Board has noticed the movement of 50 [million] shares . . . due to [the] continuous drop in [U-Co.] share price because of nonstop selling of our shares by [Carlton]." He wrote that Parent Co. told the regulators it had transferred the shares to escrow as part of a stock loan transaction, but "this strange delay in loan disbursement puts us in a very awkward situation, making this look like a disguised sale instead of a proper loan." He closed his email by telling Silver Leaf that Carlton needed to deliver the loan proceeds for the other 5 million shares it had received.

About a month later, on October 1, RI emailed Khan and Chapler again, telling them he was still under investigation and needed Silver Leaf's help. RI wrote that Turkey's Capital Markets Board had "taken a decision to send me to the DA with a potential court case of 2-5 years of jail," and that his "future and the financial situation of [his] companies are at stake." He implored Khan that "coming over here to explain to the [Capital Markets Board] that this is a genuine loan is the least you can do."

Khan refused to help because, according to Khan, Silver Leaf did not know enough about Turkey's securities regulations or its client, Carlton. In an email to RI, Khan wrote that Silver Leaf was "knowledgeable and familiar with US [sic] rules and regulations," but was "not familiar with Turkish rules or regulations or the [Capital Markets Board]." Khan said Silver Leaf was "concerned that, notwithstanding our best intentions, we may say something that is not congruent with their expectations or that is not factually correct." Khan continued, "The transaction with [Carlton] is what interests/concerns the [Capital Markets Board] and we do not know, and therefore cannot speak to, [Carlton's] intentions, positions, actions, or intended actions."

The next day, October 2, Khan moved to protect Silver Leaf from any liability resulting from Carlton's and BHP's misconduct. Khan drafted an indemnification agreement between Carlton and its affiliates, including BHP, as indemnitor, and Silver Leaf and its "agents (such as Mr. [SH])," as indemnitee.[18] The agreement acknowledged that Carlton's and BHP's "stock lending programs" can "result in complications, misunderstandings, liabilities, disagreements and other such disputes that may . . . have the effect or result of bringing [Silver Leaf] into legal, regulatory or other conflict dispute actions related thereto[.]" Khan emailed the agreement to Chapler and SH. SH presented the agreement to Carlton and BHP, but neither Carlton nor BHP signed it.

A week later, RI once again threatened legal and regulatory repercussions for Carlton, BHP, and Silver Leaf. In an email to SH, which SH forwarded to Chapler's personal email account, RI wrote that if Carlton did not return the five million shares it still had not paid for, Parent Co. would "pursue complaints at all relevant Canadian authorities to make sure BHP does not do this kind of destructive activity in Turkish markets in the future." "As for Silver Leaf," he continued, "we are preparing complaints to the SEC and FINRA as well as legal action towards

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[18] When asked at the hearing why he referred to SH as Silver Leaf's "agent" in the indemnification agreement, Khan said it was predicated on SH registering with the firm.

all who have made us suffer immeasurably." When asked at the hearing whether he told Khan that Parent Co. was threatening to complain to FINRA and the SEC about Silver Leaf, Chapler responded, "I'm sure I must have. . . . Anything that affects Silver Leaf in general, I would always tell Fyzul [Khan][.]" Chapler said that he and Khan "were definitely trying to resolve [the dispute] in every way possible."

Silver Leaf earned a fee of approximately $260,000 from Carlton, and as with prior transactions, Chapler sent Meehan an email showing how the fee should be split between Silver Leaf, Chapler, and SH. This time, the spreadsheet identified Chapler as "Broker 1" and SH as "Broker 2." "Broker 2's" share of the fee was approximately $120,000. Meehan testified that he did not recall asking Chapler who Broker 2 was. Khan said he did not see the email during his email review. Chapler instructed Carlton to wire SH's share of Silver Leaf's fee directly to SH. Carlton complied with Chapler's request.

c. The GAMA Block Trade

In October 2013, BHP approached Silver Leaf about selling a large block of GAMA shares. GAMA was an Indonesian company whose shares traded on the Indonesia Stock Exchange. BHP told Silver Leaf it had hundreds of millions of GAMA shares, and that Silver Leaf could market the transaction as a large block trade at a 20 percent discount to market price. Valentine was Silver Leaf's point person at BHP for this transaction.

Silver Leaf brought the transaction to Floyd. Floyd was a private company based in California. It had a brokerage account at Silver Leaf and had expressed interest in buying discounted blocks of stock in the Asian markets. Jacques Tizabi was Silver Leaf's contact person at Floyd. Unknown to Silver Leaf, NASD had barred Tizabi from the securities industry in 2005.

BHP, Floyd, and Silver Leaf worked together to structure a transaction that would achieve the desired 20 percent discount. Chapler proposed a market transaction followed by a free delivery of additional shares. He also proposed a stock loan.

In an October 29 email to Chapler, another Silver Leaf registered person wrote, "Not sure what happened to your solution yesterday, a free delivery of additional shares after transacting at the market, but let's get the loan solution pinned down. One thing we really need to do is find out about it printing on the tape, cause [sic] I am hearing that it does and that could be a problem."

Chapler responded, "I have been on the phone with Fyzul [Khan] and [Silver Leaf's operations manager] for the last hour trying to work through this." Chapler testified that Silver Leaf was supposed to execute the transaction, and that he, Khan, and the firm's operations manager were trying "to see if there was a framework that we could execute this . . . . [W]e were obviously trying to stay within what we were allowed to do and see if it was possible to execute this. So the conversations . . . were centered around is there a solution or not."

BHP and Floyd settled on the free delivery transaction proposed by Chapler. BHP and Floyd agreed that, on October 31, Floyd would purchase 426 million shares from BHP on the exchange. A few days later, Floyd would receive a free delivery of an additional 107 million shares from BHP. The free delivery would provide the desired 20 percent discount to Floyd.

Silver Leaf was not able to execute the proposed transaction, apparently because its clearing firm balked at the free delivery component. Chapler testified that Silver Leaf "could not do the transaction[] in the format that they wanted to do it in." Chapler said Silver Leaf "checked up and down with [its clearing firm] and other people and we didn't see how [the free delivery] was possible. . . . [T]hat was a real problem." BHP and Floyd selected BTIG to execute the transaction instead.

On October 31, BHP and Floyd initiated the transaction on the exchange through BTIG. Floyd placed an order for 426 million shares. BTIG bought the shares from BHP for $18 million. After that, the stock price began declining.

In the meantime, Silver Leaf was working to facilitate the transfer of 107 million GAMA shares from BHP to Floyd through a stock loan. BHP provided a letter to Silver Leaf asking the firm to deliver 107 million shares to Floyd on November 6 "for the purpose of executing a Loan Agreement between both parties." Ultimately, Silver Leaf did not deliver the shares from BHP to Floyd.

On November 3, Floyd notified BTIG that it wanted to cancel the GAMA trade, alleging that BHP had materially breached the parties' agreement.

On November 4, BTIG contacted Silver Leaf and asked Khan what he knew about BHP and Floyd. Khan "advised [BTIG] that BHP and Floyd were both new relationships that were not yet well known to Silver Leaf, and advised BTIG to proceed with caution." Khan testified that he did not disclose any of the problems Silver Leaf had encountered during its previous transactions with BHP because, according to Khan, they were not relevant.

On November 6, BTIG settled the GAMA trade. BTIG eventually sold the shares for a loss of $16 million. Two weeks later, BHP wired Silver Leaf its fee of $179,677 for the GAMA transaction.[19]

C. Silver Leaf's Alleged Payment of Transaction-Based Compensation to the Nonmember Entities

Around 2005, Silver Leaf began paying transaction-based compensation to entities affiliated with its registered persons, rather than paying the registered persons directly. Khan

[19] Even after three problematic transactions, Silver Leaf continued working with BHP to find new counterparties for Corporate Advisory transactions.

testified that Silver Leaf began doing so at the request of its "fund marketers," i.e., registered persons working in its Fund Marketing business.

Paying the entities rather than the individuals benefitted the fund marketers and Silver Leaf. According to Khan, many fund marketers were independent contractors who were free to move from firm to firm. Doing business under the name of their own entity, either individually or as part of a team, allowed them to have "continuity in the market place." Meehan testified that the fund marketers received certain tax advantages from being compensated through the entities. From Silver Leaf's perspective, paying the entities made sense because, in addition to keeping the fund marketers happy, it allowed the firm to stay out of disputes between fund marketers working together under the same entity. As Khan put it, "if there is a dispute between partner-representatives as to who earned what portion of the money, then Silver Leaf can remain out of the fray. If [Silver Leaf] were forced to pay one individual as opposed to another, then we [would be] drawn into disputes between two or more business partners."

The SEC staff did not share Silver Leaf's enthusiasm for the practice. Following an examination in 2012, the SEC staff cited the firm's payments to the entities as one of the firm's "deficiencies and weaknesses." In a March 2012 letter to Khan, under the heading "Payments to Non-Registered Entities – NASD Conduct Rule 2420," the SEC staff wrote that Silver Leaf "had shared . . . compensation with 10 non-members of FINRA. The shared marketing fees . . . were paid to non-registered entities, which are affiliated with the firm's hedge fund marketers[.]" The staff identified payments to ten different entities, totaling $224,614.90, between April and September 2011. The SEC staff asked Silver Leaf to respond to the finding and explain how the firm intended to address it.

Khan initially disputed the findings, taking the position that paying the entities was permissible under NASD Rule 2420 because the entities were wholly owned by the firm's registered persons. In an April 2012 letter to the SEC's examination manager, Khan wrote that Silver Leaf did "not agree with the Staff's conclusion that our practice of paying our registered persons through entities they own violates [NASD] Rule 2420." Khan continued, "[i]n every case, the underlying owners of these [entities] are registered persons of Silver Leaf and payment is ultimately being made to a firm-registered broker." Khan offered to "have all of [Silver Leaf's] registered persons who conduct business in the name of any entity and receive payments through that entity [] make an annual representation that the only owners of such entity are Silver Leaf registered persons," and he asked the SEC staff "to reconsider their position in this regard."

The SEC staff was unmoved by Khan's argument. In August 2012, an SEC attorney responded to Khan by email, writing that she had received Khan's letter, but it "does not include the steps you have taken or intend to take with respect" to the staff's findings regarding the payments to the entities. The attorney asked Khan to provide that information within two weeks.

In September 2012, Khan relented and agreed to halt the practice of paying the entities pending receipt of "no-action" relief from the SEC staff. In a letter to the SEC attorney, Khan wrote that Silver Leaf "maintain[s] that paying single or joint registered representative-owned [entities] rather than paying our registered representatives directly does not raise any regulatory issues of any consequence," but he also acknowledged "that the 'no-action' letter process is the

only appropriate method to seek relief from the technical requirements of NASD Conduct Rule 2420." Kahn assured the attorney that "pending the no-action relief process, [Silver Leaf] will immediately begin to convert [its] payables to individual representatives rather than entities owned by them."

Just five months later, however, Silver Leaf resumed the practice without seeking no-action relief from the SEC staff. After hearing "grumblings" from some of the firm's registered persons who were not happy about being paid directly, Meehan asked the firm's payroll processor about reinstituting the payments to the entities. According to Meehan, the payroll processor said the firm could pay transaction-based compensation to an entity as long as the registered person who owned the entity completed an IRS Form W-9 identifying him- or herself as the beneficial recipient of any payments to the entity, and provided a letter stating that he or she was the entity's sole owner. Meehan relayed this information to Khan, and Khan directed Meehan to resume paying the entities.

Khan said he believed the firm could pay the Nonmember Entities as long as the registered person completed an IRS Form W-9 in his or her own name, because then Silver Leaf's books would reflect that it had paid the individual, even if Silver Leaf actually had deposited the money into the Nonmember Entity's bank account. Khan conceded, however, that he did not give the issue much thought. Between February 2013 and April 2015, Silver Leaf paid over $2.6 million in transaction-based compensation to seven Nonmember Entities, rather than paying the registered persons directly.

III. Discussion

A. Silver Leaf Paid Transaction-Based Compensation to Nonmembers, in Violation of NASD Rule 2420 and FINRA Rule 2010

The Hearing Panel found Silver Leaf violated NASD Rule 2420 and FINRA Rule 2010 by paying transaction-based compensation to SH and the Nonmember Entities.[20] We affirm the Hearing Panel's finding of violation.

NASD Rule 2420 prohibits any FINRA member from paying transaction-based compensation to any "nonmember broker or dealer." *Continuance in Membership Application of Firm A*, Application No. 20100226181, 2011 FINRA Discip. LEXIS 19, at *14 (FINRA NAC Apr. 15, 2011). A member may not evade the rule through indirect payments.[21]

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[20] A violation of NASD Rule 2420 also violates FINRA Rule 2010. *Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2011027666902, 2017 FINRA Discip. LEXIS 16, at *11 n.7 (FINRA NAC May 26, 2017), *aff'd in relevant part*, Exchange Act Release No. 86404, 2019 LEXIS 1771 (July 17, 2019) (holding a violation of any FINRA rule also is a violation of FINRA Rule 2010)

[21] *NASD Notice to Members 05-18*, 2005 NASD LEXIS 25, at *15 (Mar. 2005) ("A member also may not evade Rule 2420 through indirect payments").

1. Silver Leaf Violated NASD Rule 2420 by Paying Transaction-Based Compensation to SH

The Hearing Panel found Silver Leaf violated NASD Rule 2420 by paying transaction-based compensation to SH in connection with the block trade between Parent Co. and Domestic Co. Silver Leaf does not dispute that SH received more than $50,000 of the firm's fee from that transaction, but argues that (1) the firm's fee was an "introducer's fee," and therefore SH did not receive transaction-based compensation; and (2) Chapler, not Silver Leaf, shared the fee with SH, and Silver Leaf did not know about or approve the payments. The record belies both arguments.

Silver Leaf's fee for the block trade was transaction-based compensation. "Transaction-based compensation" is compensation that is based on the size or completion of a securities transaction.[22] In the block trade, Silver Leaf received an "origination fee" of three-and-a-half percent of the fair market value of the transaction, plus an additional one-half percent for acting as principal. Silver Leaf's fee was payable only when a tranche closed; if a tranche did not close, Silver Leaf was not paid. Because Silver's Leaf's fee was based on the size of the transaction, and contingent on each tranche's closing, the fee was "transaction-based compensation."

Silver Leaf knew about, approved, and facilitated the payments to SH. A few days before the first tranche closed, Meehan sent an email to Chapler detailing how the firm's fee would be shared among Silver Leaf, Chapler, and SH. When Silver Leaf received its fee, Meehan caused the firm to deposit an amount totaling Chapler's and SH's combined fee, as calculated by Meehan, into Chapler's bank account. Chapler then wired SH's fee to SH. That process was repeated with Silver Leaf's fee for the second tranche.

We attribute Meehan's conduct to Silver Leaf. "It is well established that a firm may be held accountable for the misconduct of its associated persons because it is through such persons that a firm acts." *Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *59 n. 80 (Dec. 10, 2009) (affirming disciplinary action against a firm for the manipulation of a security sold to public investors by the firm's co-chief executive and head trader); *see also A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977) (noting that a firm "can act only through its agents, and is accountable for the actions of its responsible officers"). At the time of the payments to SH, Meehan was Silver Leaf's co-owner, registered principal, vice-chairman, president, chief financial officer, and financial operations principal. Essentially, Meehan *was* Silver Leaf. We therefore find that Silver Leaf paid transaction-based compensation to SH.

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[22] *See, e.g., SEC v. Mowen*, No. 2:14-cv-01290-ODW, 2012 U.S. Dist. LEXIS 81301, at *11-12 n.3 (D. Utah June 11, 2012) ("Bartholomew received interest differentials that were tied to the principal amount of the securities he sold. Accordingly, the receipt of these interest differentials constitutes transaction-based compensation because the amount of compensation was directly correlated to Bartholomew's success in selling the securities."); *SEC v. Braslau*, No. 2:09-CV-00786-DB, 2014 U.S. Dist. LEXIS 161602, at *11-12 (C.D. Cal. Nov. 17, 2014) ("He received transaction-based compensation, earning 27% of the amount invested by any person he closed by himself and 10 to 15% of the amount invested by any person he closed with the assistance of others.").

Meehan claims that, at the time, he must have believed SH was registered with the firm. "At this point," Meehan testified, "I don't know why [SH's fee] would be on here except there was confusion about his registration at one point with me." We do not find this testimony credible. Had Meehan believed that SH was registered with Silver Leaf, the firm would have paid SH directly rather than sending the payment through Chapler. In any event, what Meehan believed about SH's registration is not relevant to Silver Leaf's liability, as a violation of NASD Rule 2420 does not require a finding of scienter.

SH was a "nonmember broker." A broker is any person "engaged in the business of effecting transactions in securities for the account of others." FINRA By-Laws, Art. I(e). NASD Rule 2420 defines "nonmember broker or dealer" to include any non-FINRA member who makes use of the means of interstate commerce to effect any transaction, or induce the purchase or sale, of any security, other than on a national securities exchange.[23] SH was not a FINRA member, nor was SH registered with any FINRA member during the Relevant Period.

To determine whether SH acted as a broker, we consider whether SH (1) actively solicited investors; (2) advised investors as to the merits of an investment; (3) acted with a "certain regularity of participation in securities transactions"; or (4) received commissions or transaction-based compensation. *See Continuance in Membership Application of Firm A*, 2011 FINRA Discip. LEXIS 19, at *14. Of these factors, "receipt of transaction-based compensation is the 'hallmark of broker-dealer activity.'" *Id.* at *15. SH was regularly involved in soliciting securities transactions for Silver Leaf for which he received transaction-based compensation. Between August 2012 and 2013 alone, SH facilitated three securities transactions and received compensation from those transactions totaling approximately $200,000. SH engaged in this business through means of interstate commerce, frequently using email to discuss transactions with Chapler and Khan. We therefore find that SH was a "nonmember broker," as defined under the rule.

For these reasons, we affirm the Hearing Panel's finding that Silver Leaf violated NASD Rule 2420 and FINRA Rule 2010 by paying approximately $50,000 in transaction-based compensation to SH.

2. Silver Leaf Paid $2.6 Million in Transaction-Based Compensation to the Nonmember Entities

Between February 2013 and April 2015, Silver Leaf directly deposited more than $2.6 million into bank accounts owned by the Nonmember Entities. Each of the Nonmember Entities was affiliated with a person registered with Silver Leaf. These payments represented transaction-based compensation earned by the registered persons on securities transactions for

[23] Under the Securities Exchange Act of 1934 (the "Exchange Act"), a "national securities exchange" is a securities exchange that has registered with the SEC under Section 6 of the Exchange Act. 15 U.S.C. § 78f (2020). None of the securities involved in this case were registered on a national securities exchange. Excepted from NASD Rule 2420 is any a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills. None of these exceptions applies here.

Silver Leaf. On these undisputed facts, we find that the Nonmember Entities were "nonmember brokers," as defined under NASD Rule 2420.

Silver Leaf argues that its payments to the Nonmember Entities did not violate NASD Rule 2420. Silver Leaf contends that the firm's books and records show the payments were made to the registered persons in their individual capacity, and that where the firm actually deposited the money does not matter. Additionally, Silver Leaf contends that the entities that received the payments were owned by a single person, and therefore the payments "did not result in anyone but the firm's broker's receiving payment[.]"

The SEC staff has rejected Silver Leaf's argument and made clear that members cannot pay transaction-based compensation to entities affiliated with their registered persons unless those entities are registered as broker-dealers under the Exchange Act. Specifically, the SEC Division of Trading & Markets has published guidance stating that "[t]he law . . . does not permit unregistered entities to receive commission income on behalf of registered representatives. For example, associated persons cannot set up a separate entity to receive commission checks. An unregistered entity that receives commission income . . . must register as a broker-dealer."[24] Indeed, the SEC staff has "consistently declined to grant no-action relief with respect to the practice of routing commissions or other transaction-related compensation directly from a broker-dealer to an unregistered entity established and controlled by the broker-dealer's registered representatives."[25] Regardless of what Silver Leaf's books and records reflect, Silver Leaf deposited money into bank accounts owned by the Nonmember Entities, and that is not allowed.

Moreover, at the time it made these payments, Silver Leaf knew the SEC staff's position on this issue. The SEC staff notified Silver Leaf in 2012 that the firm's practice of paying commissions to its registered persons' entities was among the firm's "deficiencies and weaknesses." Khan assured the staff that Silver Leaf would halt the payments pending receipt of no-action relief. Yet, just a few months later, based on Meehan's conversation with the firm's payroll processor, Khan gave Meehan permission to resume the payments.

Silver Leaf contends the payments to the Nonmember Entities during the Relevant Period were qualitatively different from prior payments to similar entities because the firm verified that all of the Nonmember Entities were single-member entities owned by one registered person. This argument fails for two reasons. First, Silver Leaf has not identified any exception for single-member entities in the SEC staff's guidance. Second, Silver Leaf did not establish that each Nonmember Entity was, in fact, a single-member entity. To the contrary, the evidence showed that one of the Nonmember Entities was not a single-member entity; the registered person's spouse was the entity's co-owner and its chief financial officer.

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[24] *Guide to Broker-Dealer Registration*, SEC Division of Trading & Markets at § II.D.1 (Apr. 2008) (modified Dec. 12, 2016), https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html.

[25] *BMH Inv. Grp., LLC*, 1998 SEC No-Act. LEXIS 866, at *1 (Aug. 17, 1998).

For these reasons, we affirm the Hearing Panel's finding that Silver Leaf violated NASD Rule 2420 and FINRA Rule 2010 by paying $2.6 million in transaction-based compensation to the Nonmember Entities.

3. Silver Leaf's *Morrison*-Based Argument Fails

Silver Leaf argues that FINRA lacks jurisdiction over the payments to SH and the Nonmember Entities because, it contends, the payments were "not subject to U.S. regulations and rules[.]" Silver Leaf relies on the Supreme Court's decision in *Morrison* and a federal district court's decision in *SEC v. Benger*, 934 F. Supp. 2d 1008 (N.D. Ill. 2013). In *Morrison*, the Court held that Exchange Act Section 10(b) does not provide a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on a foreign exchange. The Court held that a civil suit under Section 10(b) could not be sustained unless the transaction involved a security listed on a domestic securities exchange or a domestic purchase or sale of a security. In *Benger*, the magistrate judge extended *Morrison* to Exchange Act Section 15(a), holding that "[t]here is nothing in [Exchange Act Section 15(a)] which remotely suggests that the Act was concerned with or intended to require registration to regulate brokers involved in foreign transactions on foreign exchanges." *Benger*, 934 F. Supp. 2d at 1012.

Based on *Morrison* and *Benger*, Silver Leaf asserts that Enforcement failed to establish FINRA's jurisdiction over the payments at issue. Silver Leaf argues that, because the firm did business inside and outside the United States, Enforcement "bore the burden of proof to establish which payments were regulatorily subject [to U.S. securities laws and regulations]," and, "on this threshold matter, [Enforcement] provided no evidence whatsoever."

As an initial matter, Silver Leaf's argument raises an issue going to the merits of the violation alleged, not FINRA's jurisdiction. FINRA is a membership organization with jurisdiction over its members and their associated persons by virtue of its By-Laws and membership agreements.[26] FINRA has jurisdiction over all of Silver Leaf's business-related conduct. *See, e.g.*, *Daniel C. Adams*, 47 S.E.C. 919, 921 (1983) ("We have previously held that [FINRA's] disciplinary authority is broad enough to encompass business-related activity that contravenes [its] standards even if that activity does not involve a security."). Silver Leaf's

[26] FINRA's jurisdiction extends to business-related conduct inside and outside of the United States. *See, e.g.*, *Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to the Definition of the Term "Branch Office*," 53 Fed. Reg. 4254 (Feb. 12, 1988) ("The proposed amendment to Article I, Section (c) of the NASD By-Laws eliminates the restrictive language 'located in the United States,' contained in the definition of the term 'branch office,' making the definition applicable to all member branch offices, wherever located."); *Order Approving Proposed Rule Change*, Exchange Act Release No. 25428, 1988 SEC LEXIS 446, at *1 (Mar. 15, 1998) (approving proposed amendment).

[Footnote continued on next page]

payment of transaction-based compensation to SH and the Nonmember Entities is business-related conduct; FINRA therefore has jurisdiction over it.[27]

Moreover, Silver Leaf's argument is based on a misinterpretation of NASD Rule 2420. Silver Leaf's argument assumes that, to prove a violation of NASD Rule 2420, Enforcement must prove that SH and the Nonmember Entities were, *in fact*, required to register as broker-dealers under Section 15(a). To do that, Silver Leaf contends, Enforcement must show that the payments at issue occurred in connection with domestic securities transactions. Silver Leaf argues that Enforcement did not introduce evidence showing that these transactions were domestic transactions, and therefore failed to prove any violation of NASD Rule 2420.

Silver Leaf's argument misses the mark. To show a violation of NASD Rule 2420, Enforcement is not required to prove that SH and the Nonmember Entities were, in fact, violating Section 15(a). NASD Rule 2420 "compl[e]ments [the federal] regulatory framework by prohibiting FINRA members from paying any commissions or fees derived from securities transactions to any non-member that *may* be acting as an unregistered broker-dealer" in violation of the Exchange Act. *Continuance in Membership Application of Firm A*, 2011 FINRA Discip. LEXIS 19, at *16 (emphasis added). As explained above, to prove a member's violation of NASD Rule 2420, Enforcement must show only that the member (1) paid transaction-based compensation (2) to a "nonmember broker or dealer," as defined under the rule. That said, FINRA staff generally has taken the position, through interpretive letters and other guidance, that a member would not violate NASD Rule 2420 by paying transaction-based compensation to a person who, in the opinion of the SEC staff, was not, *in fact*, acting as an unregistered broker-

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[27] The record before us shows that Silver Leaf, an SEC-registered broker-dealer with one office in New York City, deposited $2.5 million of transaction-based compensation into accounts at American banks owned by the Nonmember Entities; that each of the Nonmember Entities was a domestic company; and that each of the Nonmember Entities was affiliated with a Silver Leaf registered person living in the United States. The record further shows that Silver Leaf paid transaction-based compensation to SH in connection with a block trade involving Domestic Co., a Delaware company based in Indiana, and that the transaction occurred within the United States. Although Silver Leaf is incorrect that Enforcement must prove that a FINRA member's conduct took place within the United States, this evidence strongly supports that it did.

[Footnote continued on next page]

dealer.[28] Silver Leaf cannot assert that defense, however, because it did not obtain no-action relief for its payments to SH or the Nonmember Entities.[29]

FINRA had jurisdiction over the payments to SH and the Nonmember Entities because they involved the firm's business-related conduct. Enforcement established that the payments violated NASD Rule 2420. Therefore, Silver Leaf's *Morrison*-based argument fails.

B. Silver Leaf Failed to Reasonably Supervise Its Business, In Violation of NASD Rule 3010 and FINRA Rules 3110 and 2010

The Hearing Panel found that Silver Leaf violated NASD Rule 3010 and FINRA Rules 3110 and 2010.[30] We affirm the Hearing Panel's finding of violation.

"Assuring proper supervision is a critical component of broker-dealer operations." *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007). Appropriately designed and implemented supervisory systems protect investors from fraudulent trading practices and help ensure that members are complying with rules designed to promote the transparency and integrity of the market.[31] Effective supervisory systems enhance investor confidence and, in turn, promote the fairness, liquidity, and efficiency of the market for all market participants.[32]

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[28] *See Order Approving Proposed Rule Change to FINRA Rules 0190 and 2040 in the Consolidated FINRA Rulebook, and Amend FINRA Rule 8311*, Exchange Act Release No. 73954, 2014 SEC LEXIS 5051, at *8 (Dec. 30, 2014) ("FINRA generally has interpreted [NASD Rule 2420] . . . to prohibit the payment of commissions or fees derived from a securities transaction to any non-member that may be acting as an unregistered broker-dealer. . . . FINRA has refrained from providing interpretive guidance on whether a person is acting as an unregistered broker-dealer, as the authority to interpret Section 15(a) of the Exchange Act rests with the SEC."); *see also, e.g.*, *Interpretive Letter to Trish Stone-Damen, Investors Retirement & Management Company, Inc.* (Jan. 29, 1999), https://www.finra.org/rules-guidance/guidance/interpretive-letters/trish-stone-damen-investors-retirement-management-company-inc (last visited May 19, 2020) ("[W]hether the Corporation is acting as an unregistered broker/dealer is a matter determined by the SEC. . . . In the past the NASD has determined that where an entity can furnish to the NASD a 'no-action' position from the SEC that it is not required to register as a broker/dealer as a result of engaging in certain activities, then it would be appropriate for the NASD to conclude that engaging in those activities would not violate Rule 2420.").

[29] To the contrary, the evidence shows the SEC staff believed Silver Leaf's payments to the entities affiliated with its registered persons violated NASD Rule 2420. Silver Leaf told the SEC staff it would seek no-action relief for its payments to those entities but never did.

[30] A violation of NASD Rule 3010 and FINRA Rule 3110 also violates FINRA Rule 2010. *See Merrimac Corp. Sec., Inc.*, 2017 FINRA Discip. LEXIS 16, at *11 n.7.

[31] *NASD Notice to Members 98-96*, 1998 NASD LEXIS 121, at *1 (Dec. 1998).

[32] *Id.* at *2.

NASD Rule 3010 and FINRA Rule 3110 require each member to establish and maintain a system to supervise the activities of its registered representatives, registered principals, and associated persons that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. An adequate supervisory system must include WSPs tailored to the firm's business lines. *Dep't of Enforcement v. Midas Sec., LLC*, Complaint No. 2005000075703, 2011 FINRA Discip. LEXIS 62, *20 (FINRA NAC Mar. 3, 2011), *aff'd*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199 (Jan. 20, 2012). The WSPs must describe mechanisms for ensuring compliance and detecting violations, not merely set out what is prohibited. *John A. Chepak*, 54 S.E.C. 502, 506 (2000). Whether a particular supervisory system or set of WSPs is "reasonably designed to achieve compliance" depends on the facts and circumstances of each case. *Kresge*, 2007 SEC LEXIS 1407, at *27.

When red flags arise suggesting that misconduct may be occurring, the duty of supervision includes an obligation to investigate "and to act upon the results of such investigation." *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008). Supervisors "must respond with the utmost vigilance when there is any indication of irregularity, and take decisive action when they are made aware of suspicious circumstances." *KCD Fin., Inc.*, Exchange Act. Release No. 80340, 2017 SEC LEXIS 986, at *34-35 (Mar. 29, 2017). When a supervisor discovers red flags suggesting irregularities, the supervisor cannot "discharge his or her supervisory obligations simply by relying on the unverified representations of employees." *Michael H. Hume*, 52 S.E.C. 243, 248 (1995).

1. Silver Leaf Failed to Supervise Its Corporate Advisory Business

Silver Leaf failed to supervise its Corporate Advisory business from the outset and failed to take corrective action even after completing two turbulent transactions for BHP that portended the disastrous GAMA trade. When Silver Leaf "formalized" its Corporate Advisory business, the firm knew the business involved greater risks than its other business lines. It also knew that Chapler's business was particularly risky because Chapler specialized in stock loans involving "less liquid" securities and large amounts of money. Moreover, Chapler was targeting transactions in Turkey and the Middle East, unfamiliar markets for Silver Leaf, and was working closely with the unregistered finder, SH.

To account for this added risk, Silver Leaf increased its override on Chapler's Corporate Advisory business from 10 to 25 percent. Khan explained, "When we do marketing for a fund, there is an offering document, there is a prospectus. There are attorneys associated with their audit statements. There are a lot of things you could rely on. But . . . we are not making a placement. We are not making representations to you or Mr. or Mrs. investor. You rely on the fund documents." By contrast, in a Corporate Advisory deal, Khan explained, "there is not that sort of . . . protective collateral that is present [in a Fund Marketing deal]." "[M]y decision," Khan said, "was to be paid for the greater risk."

Similarly, Meehan testified that Chapler's Corporate Advisory transactions were "bigger" than the firm's Fund Marketing transactions, "[a]nd with the bigger is more risk in terms of . . . mistakes being made, things going wrong, compliance oversight and things like that." He explained the "unknown risk of one of these block trades failing," saying that the larger the

dollar value, "the bigger they fail, [and] the larger a clawback would be on our fees. So it was a combination of things that Fyzul [Khan] and I thought would deem [sic] a higher override."

Despite recognizing the risks involved in the Corporate Advisory business, the firm did not implement any system at all to supervise that business. Silver Leaf had no WSPs for its Corporate Advisory business. Silver Leaf's WSPs consisted of a "Broker-Dealer Compliance Manual and Written Supervisory Procedures," (the "Compliance Manual") and what the firm called its "marketing procedures." Although Silver Leaf had no retail business, the firm derived its Compliance Manual from an off-the-shelf product for retail broker-dealers. Silver Leaf described the marketing procedures as "a mix of contracts, policies, standards, and procedures specifically applicable" to its Fund Marketing and Corporate Advisory businesses.[33]

Silver Leaf asserted that its WSPs for the corporate advisory business were contained in the marketing procedures. Silver Leaf introduced several of these documents at the hearing; they included emails between Khan and prospective registered persons regarding the firm's compensation structure and procedures for registering with the firm, forms of agreements between Silver Leaf and registered persons, and continuing education materials. The marketing procedures are not WSPs. Some of the documents comprising the marketing procedures explain some of Silver Leaf's general compliance policies (e.g., the process for registering with the firm and continuing education requirements), but none explains how the corporate advisory business is supervised, or describes mechanisms for ensuring compliance and detecting violations.

The absence of WSPs for the Corporate Advisory business is consistent with Khan's generally lax approach towards supervision. Khan testified that he did not supervise the firm's registered persons closely because he trusted them. "[T]hese are very, very smart and sophisticated people," Khan said, "They are not a compliance risk, if you ask me what my due diligence protection is, selecting the right people." Khan said he trusted Chapler and Meehan, in particular, and that they were "the most trusted people at the firm." Khan testified that his primary concern in supervising the Corporate Advisory business was making sure the firm was contacting "the right parties" (i.e., institutions rather than individuals), providing "correct and appropriate information to those parties," and "looking for an exit as quickly as possible."

Chapler testified that Khan gave him considerable latitude. Chapler said that he "went after deals without any day to day oversight . . ., when it got to an execution part, Mr. Khan would come in and . . . do his due diligence and also make sure the deal was appropriate for the firm." When asked what else Khan did to supervise, Chapler answered, "Like I said, . . . the door to his office was open generally. So everybody could walk in there and talk to him about anything."

Khan's review of the firm's email communications was inadequate. Silver Leaf's WSPs required Khan to review the firm's email correspondence at least once a month, and "create a

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[33] Silver Leaf did not produce the marketing materials during Enforcement's investigation when asked to produce "[a]ll written supervisory procedures in effect at any time during the relevant period." Khan testified he did not provide them because he "did not understand the full scope of what [Enforcement] was trying to review."

report of said review." Khan explained that Silver Leaf's email review system did not automatically flag emails containing key words or phrases. Instead, Khan could enter his own key words and phrases each time he reviewed emails. However, Khan testified that he did not usually use key words or terms to search emails; instead, he decided which emails to review based on hunches. Khan testified that he "look[ed] at the subject lines and . . . select[ed] different emails to review based on the status of different transactions and where they were and different people and where they were. What [Khan] thought were things or people that [he] should be focusing on more than others."

Khan's review of Meehan's and Chapler's emails, in particular, was deficient. Khan said he did not review *any* emails sent to or from Meehan, and that reviewing Chapler's emails was a "low priority." Khan testified that, at the time, the firm had about 65 associated persons, and if he "ranked the order of risk, on the bottom of that list were emails from Kevin Meehan and just above him on the second bottom [sic] was Mr. Jay Chapler." "If I saw Mr. Meehan's name in the to line or the from line," Khan said, "I skipped past it." Khan said he did not view Chapler's emails as a priority because, in addition to trusting him, Chapler's business was "a tiny sliver of the business of Silver Leaf." As a result of Khan's inadequate email review, he failed to identify several emails containing serious allegations of misconduct by BHP. Khan also failed to create any reports of his email reviews, as required by the WSPs.

Silver Leaf did not correct its supervisory deficiencies even after encountering glaring red flags in its dealings with BHP. Silver Leaf's first transaction with BHP, the L-Co. stock loan, was plagued with allegations of unethical and potentially illegal conduct by BHP. L-Co. accused BHP of failing to timely pay for the shares it received and attempting to manipulate the market for L-Co.'s stock. L-Co. threatened legal action against Silver Leaf and BHP, and explicitly warned Silver Leaf: "Don't trust [BHP] . . . they may play games behind [Silver Leaf's] back."

When SH referred the next transaction to Silver Leaf, the Parent Co. stock loan, Silver Leaf knew that SH and his contacts in Turkey had misgivings about BHP's behavior. Khan testified that they "were getting uncomfortable with these kinds of transactions because of the liquidity issues, the parties involved. . . . Both parties could equally harm one another and in this transaction, they wanted us to help make sure that was not the case." To assuage SH and Parent Co.'s concerns, Silver Leaf agreed to act as the escrow agent for this transaction, standing between Parent Co. and BHP. Khan testified that, by doing so, Silver Leaf could "make sure both sides have proper delivery" in the stock loan. Still, BHP violated the terms of its agreement with Parent Co. Shortly after the first tranche closed, Parent Co. notified Silver Leaf that BHP had not fully funded the loan and also failed to pay for all of the shares it received. As a result of BHP's failure to perform, securities regulators in Turkey were investigating Parent Co.'s chief executive officer.

By this time, Silver Leaf was so concerned about BHP's conduct that it sought indemnification for any liability arising from BHP's actions. In an email to Khan, Chapler wrote that SH was going to Toronto to meet with BHP and Carlton, "and we want to have BHP/[Carlton] sign something that protects us against past and future transactions." Khan drafted an indemnity agreement and emailed it to Chapler and SH. In his email, Khan wrote,

"[W]e three will need to talk some time next week about a better working together arrangement that is feasible for all."

Despite all of this, however, Silver Leaf did not implement any supervisory system for its Corporate Advisory business, nor did it increase its scrutiny of BHP. Silver Leaf continued "business as usual" with BHP, ultimately immersing itself in the GAMA block trade—a transaction involving a free-delivery component that raised even more red flags.

Silver Leaf contends that its supervision of the Corporate Advisory business was sufficient because, it claims, the business was limited to making introductions. Silver Leaf incredibly argues that the Hearing Panel's decision "reflects an *extraordinary* lack of understanding between the role of an introducer (i.e., the actual activities of Silver Leaf) as distinguished from the role of a facilitating agent (e.g., BTIG's role in handling the GAMA trade). . . . Once an introduction was made, the services of Silver Leaf were complete." There is no evidence that Silver Leaf's business was limited to making introductions. To the contrary, the record shows that Silver Leaf was deeply involved in Corporate Advisory transactions from beginning to end. Silver Leaf structured the deals, helped the parties carry out their agreements, and tried to resolve disputes that arose during and after the transactions.[34] Silver Leaf had a duty to reasonably supervise throughout that process. It did not do so.

2. Silver Leaf Failed to Supervise Its Payment of Transaction-Based Compensation to Nonmember Brokers

Silver Leaf's WSPs regarding its compensation practices were not tailored to the firm's business. The Compliance Manual addressed sharing of commissions by registered persons with non-registered persons in the context of retail securities transactions. But the WSPs did not address the firm's payment of transaction-based compensation to unregistered finders or nonmember entities affiliated with the firm's registered persons. Nor did the WSPs explain how the firm would ensure compliance with, or detect violations of, its own WSPs and NASD Rule 2420.

Khan knew the firm was paying transaction-based compensation to SH and took no action to stop it. Khan claimed at the hearing that when he met SH, he made it clear that Silver Leaf would not pay SH for any referrals unless SH registered with the firm, and that SH did not seem to care. According to Khan, SH said he "is going to Turkey and the Middle East and he does not need to be paid by [Silver Leaf]. He has his own arrangements and sometimes does not even have any arrangements to be paid." However, the Hearing Panel concluded, based on Chapler's credible testimony on this issue, that Khan was generally aware from the very beginning that Chapler was paying SH. We defer to the Hearing Panel's credibility findings, which are well supported by the record. *Daniel D. Manoff*, 55 S.E.C. 1155, 1161-62 & n.6 (2002) (explaining that a Hearing Panel's credibility determination is entitled to deference absent substantial evidence to the contrary).

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[34] Silver Leaf also acted as a principal in one of the block trades and served as an escrow agent in one of the stock loans.

Moreover, by July 2013, Khan knew for a fact that Silver Leaf was paying SH through Chapler. Early that month, Chapler sent Khan and Meehan an email showing a three-way split between Silver Leaf, Chapler, and SH of the firm's fee for the L-Co. stock loan. Khan testified that, shortly after receiving Chapler's email, he met with Meehan and Chapler and expressly told them that SH was not allowed to receive payments from Silver Leaf or Chapler. We do not find Khan's testimony on this issue credible. Khan did not mention this meeting during his on-the-record interview ("OTR") with Enforcement staff. Meehan testified at the hearing that he was "pretty certain" such a meeting occurred, but said he did not mention it during his OTR because he "felt pressured," and "it was very hard for [him] to put things in perspective" while being questioned. Chapler testified he did not recall anyone from Silver Leaf ever telling him he could not pay SH.

Indeed, just a few weeks later, in August 2013, Khan and Chapler exchanged emails further discussing the sharing of Silver Leaf's fees with SH. Silver Leaf argues the discussion related solely to the firm's fee for "escrow administration" in the Sub. Co. stock loan, which, it contends, was "a non-securities transaction." Khan admitted at the hearing, however, that the emails discuss the "breakdown [of fees] on a going forward basis." While Khan claimed that the sharing of fees discussed in his email was contingent on SH registering with the firm, the email makes no mention of SH's registration.

Khan also was aware that the firm was paying transaction-based compensation to the Nonmember Entities. Indeed, Khan directed Meehan to resume those payments even after assuring the SEC staff the firm had halted the practice. Khan's decision to reinstitute the payments reflects his generally lax approach to supervision. Khan testified that the decision was "not something I really thought about," and "[t]here was no deep thought put into it."

For these reasons, we affirm the Hearing Panel's finding that Silver Leaf violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

C. Silver Leaf's Other Arguments Fail

Silver Leaf raises several other arguments in support of its assertion that the hearing was unfair. None has merit.

1. Adequacy of Enforcement's Investigation

Silver Leaf argues that the hearing was unfair because Enforcement "failed to conduct an adequate investigation and inform Silver Leaf about the nature and scope of the investigation," so that Silver Leaf could "address important matters that would have impacted the scope of the [h]earing." Exchange Act Section 15A(b)(8) provides that FINRA disciplinary proceedings must be conducted in accordance with fair procedures. *See Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *51 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010). Section 15A(h)(1) of the Exchange Act requires FINRA to "bring specific charges, notify such member or person of and give him an opportunity to defend against, such charges, and keep a record." This proceeding was fair to Silver Leaf. The complaint provided Silver Leaf with sufficient notice of the allegations against it, and Silver Leaf was given a full and fair

opportunity to present relevant evidence in its defense. *See William C. Piontek*, 57 S.E.C. 79, 90-91 (2003) (finding that respondent who "'understood the issue[s]' and 'was afforded full opportunity' to litigate . . . had sufficient notice of the charges against him and opportunity to prepare and present his defense"); *Thomas E. Warren, III*, 51 S.E.C. 1015, 1020 (1994) (rejecting arguments that a hearing was unfair because FINRA conducted an inadequate investigation or did not conduct interviews that the respondent asserted could assist him in his defense), *aff'd*, 1995 U.S. App. LEXIS 30824 (10th Cir. Oct. 23, 1995). Therefore, this argument fails.

2. Hearing Panelists' Qualifications

Silver Leaf argues that the Office of Hearing Officers did not assign this matter to panelists who "had experience with broker dealers [sic] providing introductory services to institutional clients." Silver Leaf does not have a right to dictate the qualifications of the panelists. *Dist. Bus. Conduct Comm. v. Guevara*, Complaint No. C9A970018, 1999 NASD Discip. LEXIS 1, at *38 (NASD NAC Jan. 28, 1999), *aff'd*, 54 S.E.C. 655 (2000). Additionally, we see no evidence that the panelists did not understand Silver Leaf's business. To the contrary, the panelists were engaged throughout the hearing; they asked probative questions and demonstrated their understanding of the issues involved.

3. Hearing Officer Bias

Silver Leaf contends that, because the Hearing Officer is a former Enforcement employee, the firm's allegations about Enforcement's misconduct "could be expected to trigger bias, deference, . . . support and empathy" in Enforcement's favor. In support of its assertion, Silver Leaf cites the Hearing Officer's rulings admitting nine of Enforcement's exhibits and denying admission of nine of Silver Leaf's exhibits. Silver Leaf failed to object to six of the nine Enforcement exhibits at the hearing. Nevertheless, we have reviewed all nine and see no hint of bias in the Hearing Officer's decision to admit them. Each was a summary exhibit created by Enforcement staff based on evidence contained in other properly admitted documents. Summaries like these routinely are admitted in FINRA disciplinary proceedings and in other forums. Of the nine Silver Leaf exhibits the firm claims the Hearing Officer unfairly excluded, our review of the record shows that one was admitted, Silver Leaf withdrew another because a similar exhibit already was in evidence, and it appears four were not offered at the hearing. The Hearing Officer's rulings on the remaining three do not show bias; none of the documents appears relevant, and the Hearing Officer denied their admission on those grounds.[35] Additionally, our de novo review would cure the Hearing Officer's bias or prejudice if any had existed. *See Dep't of Enforcement v. Dunbar*, Complaint No. C07050050, 2008 FINRA Discip. LEXIS 18, at *33 n. 23 (FINRA NAC May 20, 2008).

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[35] One of the proposed exhibits was a paper from a think tank about reforming FINRA; one was the text of a speech to an industry group by FINRA's former Executive Vice President for Enforcement; and one was an email from FINRA to Khan containing a "FINRA Small Firm Governor Update."

IV. Sanctions

The Hearing Panel fined Silver Leaf a total of $100,000, barred it from facilitating "stock loan or block trading transactions," and ordered it to retain an independent consultant to conduct a comprehensive review of its policies, systems, and procedures. We affirm the fine and the order to retain an independent consultant; however, rather than a business-line bar, we suspend Silver Leaf from engaging in its Corporate Advisory business, as defined herein, until the firm certifies its implementation of the independent consultant's recommendations. We believe a suspension is appropriately remedial to ensure Silver Leaf's compliance with its supervisory responsibilities, and that a bar is not necessary provided Silver Leaf complies with the independent consultant's recommendations.

A. Principal Considerations in Determining Sanctions for All Violations

FINRA's Sanction Guidelines ("Guidelines") identify Principal Considerations in Determining Sanctions that adjudicators should consider when imposing sanctions for all violations.[36] Several of those factors apply to each of Silver Leaf's violations. We find it aggravating that Silver Leaf refuses to accept responsibility for its patent misconduct. Instead, it seeks to impugn the integrity of FINRA staff and the Hearing Panel. *See Dep't of Enforcement v. Reeves*, No. 2011030192201, 2014 FINRA Discip. LEXIS 41, at * 24 (FINRA NAC Oct. 8, 2014) (finding it "decidedly aggravating that [respondent] continues to refuse to take responsibility for his misconduct, [and] blames" others, including "FINRA for his current disciplinary troubles"), *aff'd*, Exchange Act Release No. 76376, 2015 SEC LEXIS 4568 (Nov. 5, 2015). We also find it aggravating that Silver Leaf engaged in misconduct over an extended period.[37] Last, we find it aggravating that Silver Leaf's misconduct was the result of recklessness, at least.[38]

B. Payment of Transaction-Based Compensation to Nonmembers

The Guidelines do not address violations of NASD Rule 2420 or its successor, FINRA Rule 2040. We therefore look to the Guidelines for the most analogous rule violation.[39] We agree with the Hearing Panel that registration violations under FINRA Rule 1122 and NASD Rules 1000 through 1120 are most analogous. For these violations, the Guidelines recommend a fine of $2,500 to $77,000.[40]

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36 *FINRA Sanction Guidelines* 7-8 (March 2019) http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf [hereinafter "Guidelines"].

37 *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 9).

38 *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 13).

39 *See id.* at 1

40 *Id.* at 45.

[Footnote continued on next page]

Like the Hearing Panel, we find highly aggravating Silver Leaf's decision to pay the Nonmember Entities after the SEC staff notified the firm that such payments were not allowed, and after Khan told the SEC staff the firm would discontinue the practice.[41] We also find it aggravating that Silver Leaf obtained a monetary benefit from its misconduct.[42]

Unlike the Hearing Panel, we do not take into consideration the payments to SH in connection with the 2013 transactions (the allegations of violation that Enforcement withdrew), or the firm's payment of transaction-based compensation to nonmember entities pre-dating the Relevant Period and going back as far as 2005. We acknowledge that we may take into account for sanctions purposes "[e]vidence of misconduct that is not alleged in the complaint, but is similar to the misconduct charged in the complaint[.]" *Dep't of Enforcement v. Ahmed*, Complaint No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at *121 n. 107 (FINRA NAC Sept. 25, 2015), *aff'd*, Exchange Act Release No. 81759, 2017 SEC LEXIS 3078 (Sept. 28, 2017). We decline to do that under the circumstances of this case.

We find no mitigating factors. The Hearing Panel gave credit to Silver Leaf because it found the payments to the Nonmember Entities "benefitted the persons who rightfully earned the compensation, namely, the [f]irm's brokers who owned the LLCs." We disagree. As discussed above, contrary to the firm's assertions, Silver Leaf did not establish that each of the Nonmember Entities was a single-member entity belonging to one registered representative. Moreover, Silver Leaf paid the Nonmember Entities after the SEC staff warned the firm those payments were not allowed. Silver Leaf therefore is not entitled to mitigation credit.

Based on these factors, we fine Silver Leaf $50,000 for its violations of NASD Rule 2420 and FINRA Rule 2010.

C. Silver Leaf's Supervisory Violations

Silver Leaf's supervisory failures were significant and occurred over an extended period. Accordingly, we have considered the Guidelines for systemic supervisory failures, which recommend a fine of $10,000 to $310,000 for the firm.[43] Where aggravating circumstances predominate, the Guidelines instruct us to consider "a suspension of the firm with respect to any or all relevant activities or functions for a period of 10 business days to two years, or consider expulsion of the firm."[44] Additionally, the Guidelines instructs us to consider "imposing undertakings, ordering the firm to revise its supervisory systems and procedures, or ordering the

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41 *Id.* at 8 (Principal Considerations in Determining Sanctions, No. 14).

42 *Id.* (Principal Considerations in Determining Sanctions, No. 16).

43 *Guidelines*, at 105.

44 *Id.* at 106.

[Footnote continued on next page]

firm to engage an independent consultant to recommend changes to the firm's supervisory systems and procedures."[45]

For deficient WSPs, the Guidelines recommend a fine of $1,000 to $39,000.[46] In egregious cases, the Guidelines instruct us to "consider suspending the firm with respect to any or all relevant activities or functions for up to 30 business days and thereafter until the supervisory procedures are amended to conform to rule requirements."[47]

We agree with the Hearing Panel's decision to aggregate for sanctions purposes Silver Leaf's supervisory violations because they stem from a common cause—the firm's lax approach to supervision. *Dep't of Mkt. Regulation v. Naby*, Complaint No. 2012032080301, 2017 FINRA Discip. LEXIS 27, at *28 (FINRA NAC July 24, 2017) (finding it appropriate to impose a unitary sanction because respondent's violations resulted from the same course of conduct).

Like the Hearing Panel, we find several aggravating factors. We find it aggravating that Silver Leaf failed to respond to numerous red flags indicating supervisory deficiencies, including the SEC staff's warnings regarding payment to nonmember entities; emails indicating that Silver Leaf was paying transaction-based compensation to SH; and the problems associated with the BHP transactions.[48] We find it aggravating that Silver Leaf's supervisory deficiencies allowed violative conduct to occur.[49] We find it aggravating that Silver Leaf failed to allocate its resources appropriately to prevent or detect its supervisory failures, despite knowing the potential impact on markets.[50] We find it aggravating that the dollar value of the transactions Silver Leaf did not adequately supervise was substantial.[51] Additionally, we find it aggravating that Silver Leaf failed to supervise its Corporate Advisory Business even though it was aware of the substantial risks involved.[52]

Based on these factors, we agree with the Hearing Panel that significant sanctions are needed to ensure that Silver Leaf, and other firms engaging in the types of business at issue here, comply with their supervisory obligations. Accordingly, we fine Silver Leaf $50,000 for its violations of NASD Rule 3010 and FINRA Rules 3110 and 2010. We also order the firm to comply with the following procedures relating to the retention of an independent consultant:

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45 *Id.*

46 *Id.* at 107.

47 *Id.*

48 *Guidelines* at 105 (Principal Considerations in Determining Sanctions, No. 2)

49 *Id.* (Principal Considerations in Determining Sanctions No. 1).

50 *Id.* (Principal Considerations in Determining Sanctions No. 3).

51 *Id.* (Principal Considerations in Determining Sanctions No. 5).

52 *Id.* at 106 (Principal Considerations in Determining Sanctions No. 6).

1. Silver Leaf shall retain, within 60 days of this decision becoming FINRA's final disciplinary action, an independent consultant, not unacceptable to Enforcement. The independent consultant will conduct a comprehensive review of each of the firm's policies, systems, and procedures (written and otherwise).

2. Silver Leaf shall exclusively bear all costs, including compensation and expenses, associated with the retention of the independent consultant.

3. Silver Leaf shall cooperate with the independent consultant in all respects, including providing staff support. The firm shall place no restrictions on the independent consultant's communications with FINRA staff and, upon request, shall make available to FINRA staff any and all communications between the independent consultant and the firm and documents reviewed by the independent consultant in connection with his or her engagement. Once retained, the firm shall not terminate its relationship with the independent consultant without Enforcement's written approval.

4. Silver Leaf shall not have an attorney-client relationship with the independent consultant and shall not seek to invoke the attorney-client privilege or other doctrine or privilege to prevent the independent consultant from transmitting any information, reports, or documents to FINRA.

5. Silver Leaf shall require that the independent consultant enter into a written agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the independent consultant shall not enter into any other employment, consultant, attorney-client, auditing, or other professional relationship with the firm, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. In addition, any firm with which the independent consultant is affiliated in performing his or her duties pursuant to this decision shall not, without prior written consent of FINRA staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the firm or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

6. At the conclusion of the independent consultant's review, which shall be no more than 90 days after retention of the independent consultant, Silver Leaf shall require the independent consultant to submit to the Firm and FINRA staff an Initial Report. At a minimum, the Initial Report shall provide (i) a description of the review performed and the conclusions reached; and (ii) recommended changes to the firm's policies, systems, procedures, and training.

7. Within 60 days after delivery of the Initial Report, Silver Leaf shall adopt and implement the recommendations of the independent consultant.

8. Within 30 days after the issuance of the independent consultant's Initial Report, Silver Leaf shall provide to FINRA staff a written Implementation Report, certified by an officer of the Firm, attesting to, containing documentation of, and setting forth the details of the firm's implementation of the independent consultant's recommendations.

9. Twelve months after Silver Leaf provides its Implementation Report to FINRA staff, the independent consultant shall review Silver Leaf's compliance with the Implementation Report. At the conclusion of this follow-up review, Silver Leaf shall require the independent consultant to submit to the Firm and FINRA staff a Final Report. At a minimum, the Final Report shall provide (i) a descripion of the review performed; and (ii) an evaluation of Silver Leaf's compliance with the Implementation Report.

Silver Leaf is suspended from engaging in its Corporate Advisory business, as defined herein, including making introductions to stock loans and block trades, until it provides its Implementation Report to FINRA staff.

V. Silver Leaf's Financial Inability to Pay

The Hearing Panel found that Silver Leaf failed to demonstrate an inability to pay. We affirm the Hearing Panel's finding. Under the Guidelines, "[a]djudicators are required to consider a respondent's bona fide inability to pay when imposing a fine or ordering restitution."[53] The respondent bears the high burden of demonstrating an inability to pay. *See Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, Complaint No. 2009017195204, 2015 FINRA Discip. LEXIS 4, at *15 (FINRA NAC Apr. 29, 2015). Silver Leaf does not dispute that it failed to introduce evidence sufficient to demonstrate its financial inability to pay. Instead, the firm argues that it had "no clear understanding of what was necessary to establish its inability to pay," and the Hearing Panel "should have advised Silver Leaf that it required additional information." We disagree. The Guidelines state plainly "[a]djudicators should require respondents who raise the issue of inability to pay to document their financial status through the use of standard documents that FINRA staff can provide."[54] Silver Leaf was represented by counsel at the hearing. Under the circumstances, no one but Silver Leaf is responsible for the firm's failure to meet its burden. We therefore affirm the Hearing Panel's finding that Silver Leaf failed to demonstrate a financial inability to pay.

VI. Conclusion

We find that Silver Leaf paid transaction-based compensation to nonmember brokers or dealers, in violation of NASD Rule 2420 and FINRA Rule 2010. For this misconduct, we fine Silver Leaf $50,000. We also find that Silver Leaf failed to establish and maintain a system to supervise its business reasonably designed to achieve compliance with applicable securities laws,

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53 *Id.* at 6.

54 *Guidelines* at 6.

regulations, and FINRA rules, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010. For this misconduct, we (1) fine Silver Leaf $50,000; (2) order the firm to retain an independent consultant and comply with the procedures described herein relating to the retention of the independent consultant; and (3) suspend Silver Leaf from engaging in its Corporate Advisory business, as described herein, including making introductions to stock loans and block trades, until it certifies its implementation of the independent consultant's recommendations.[55] Silver Leaf is ordered to pay hearing costs in the amount of $19,651.94.[56]

On behalf of the National Adjudicatory Council,

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Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

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[55] Under FINRA Rule 8320, after seven days' notice in writing, FINRA may summarily suspend or expel from membership a member that fails to pay promptly a fine or other monetary sanction imposed pursuant to Rule 8310 or cost imposed pursuant to Rule 8330 when such fine, monetary sanction, or cost becomes finally due and payable.

[56] We have considered and reject without discussion all other arguments advanced by the parties.