

MEMO# 24530

September 8, 2010

SEC and FinCEN Announce Settlements with Pinnacle Capital Markets L.L.C. for Deficient Customer Identification Program Procedures

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TO: COMPLIANCE MEMBERS No. 19-10
SEC RULES MEMBERS No. 87-10
SMALL FUNDS MEMBERS No. 49-10
AML COMPLIANCE WORKING GROUP No. 12-10
BROKER/DEALER ADVISORY COMMITTEE No. 37-10
OPERATIONS COMMITTEE No. 25-10
TRANSFER AGENT ADVISORY COMMITTEE No. 53-10 RE: SEC AND FINCEN ANNOUNCE SETTLEMENTS WITH PINNACLE CAPITAL MARKETS L.L.C. FOR DEFICIENT CUSTOMER IDENTIFICATION PROGRAM PROCEDURES

On September 1, 2010, Pinnacle Capital Markets L.L.C. ("Pinnacle") and its managing director and chief compliance officer, Michael A. Paciorek, agreed to settle an action by the Securities and Exchange Commission ("SEC") for violating Section 17(a) of the Securities Exchange Act of 1934 and Rule 17a-8 thereunder by failing to document accurately its customer identification and verification procedures. [\[1\]](#) Section 17(a) and Rule 17a-8 require a broker-dealer to comply with the reporting, recordkeeping and retention requirements in regulations implemented under the Bank Secrecy Act (BSA), including the requirements in the customer identification program ("CIP") rule for broker-dealers. [\[2\]](#)

Pinnacle is a registered broker-dealer whose business primarily involves order processing with direct market access (DMA) software for foreign institutions comprised mostly of banks, brokerage firms and foreign individuals. According to the Order, many of Pinnacle's corporate customers were foreign entities that also held omnibus accounts through which, in some cases, the foreign entities carried subaccounts for their own corporate or retail customers. The foreign entity omnibus accounts were not the foreign entities' own proprietary accounts. Pinnacle, however, treated the subaccount holders in the same manner as its regular account holders, i.e., the regular account holders and the subaccount

holders used the DMA software to enter securities transactions directly through their own computers. As a result, the omnibus subaccount holders had direct, unfiltered control over how their securities transactions were effected in the account without any intermediation by the foreign entity holding the omnibus account.

The SEC found that Pinnacle had a documented anti-money laundering program that specified procedures for the identification and verification of the corporate and individual accounts. According to the SEC, while Pinnacle did collect identifying information for its regular account holders between 2003 and November 2009, it did not verify information regarding corporate accounts as described in its CIP and it did not collect or verify identifying information for the majority of its omnibus subaccount holders. For example, for a significant number of corporate accounts Pinnacle either did not or could not verify the identities of the corporate account holders, e.g., documents were in foreign languages not understood by Pinnacle staff. Pinnacle also did not record any non-documentary steps to verify the identities as specified under its CIP procedures. For many omnibus subaccount holders, Pinnacle only collected limited information, such as a name or occupation but no address or other identifying information. With limited exceptions, Pinnacle did not know the identities of the omnibus subaccount holders even though, according to the SEC, the omnibus account subaccount holders were Pinnacle's customers for purposes of the CIP rule since the subaccount holders were able to effect securities transactions directly for their own accounts and without the intermediation of the foreign entity. The SEC noted that the relationship between Pinnacle and its omnibus account holders was different from the circumstances contemplated under a staff "question and answer" under which a broker-dealer could treat an omnibus account holder as the customer for purposes of the CIP rule and would not be required to treat the underlying beneficial owner as a customer. [\[3\]](#) The SEC stated that under the Q&A the staff contemplated an omnibus account (or subaccount) where all securities transactions were initiated by the intermediary holding the omnibus account and that the beneficial owner or owners of the omnibus account (or subaccount) would have no direct control of transactions effected through the account. The SEC stated that Pinnacle's foreign entity omnibus accounts were not true intermediated relationships as Pinnacle treated the subaccount holders as its own customers, i.e, the subaccount holders directly effected transactions through the subaccounts with the DMA software, routing trades to relevant markets without intermediation.

Accordingly because Pinnacle neither verified the identities of its corporate accounts nor recorded non-documentary methods, Pinnacle did not accurately document its CIP as required under the CIP rule. In addition, because Pinnacle did not identify the omnibus subaccount holders or verify their identities, Pinnacle did not accurately document its CIP as required the rule.

Under the terms of the settlement, Pinnacle agreed to pay \$25,000 in financial penalties without admitting or denying the allegations. As part of an action taken by the Financial Industry Regulatory Authority (FINRA) in February 2010, Pinnacle also has agreed to certain undertakings, including extensive AML training for its employees, as well as the hiring of an independent consultant to review its AML compliance program.

In a parallel action, the Financial Crimes Enforcement Network ("FinCEN") also assessed a \$50,000 penalty against Pinnacle for violating the BSA. FinCEN concluded that Pinnacle had failed to establish and implement an adequate anti-money laundering program, establish an adequate due diligence program for foreign correspondent accounts, obtain and verify required customer identification program information for account holders and establish and implement adequate procedures for monitoring suspicious transactions that

resulted in a failure to file suspicious activity reports. [4] In particular, FINCEN noted Pinnacle's failure to conduct adequate due diligence under its customer identification program when dealing with non-US persons that were subaccount holders with direct access to the US securities markets. FinCEN also noted Pinnacle's failure to adequately tailor its AML policies and procedures to its business and known risks including adequate risk-based procedures, e.g., a risk-rating methodology to evaluate correspondent accounts, based on specific customer information, with balanced consideration of all relevant factors including country/jurisdictional risks, products and services provided, nature of the customer's business, and volume of transactions.

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endnotes

[1] In the Matter of Pinnacle Capital Markets LLC and Michael A. Paciorek, Securities Exchange Act Release 62811 (Sept. 1, 2010) ("Order"), available at <http://www.sec.gov/litigation/admin/2010/34-62811.pdf>.

[2] 31 C.F.R 103.122.

[3] Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule (31 CFR 103.122), Guidance from the Staffs of the Department of the Treasury and the U.S. Securities and Exchange Commission (October 1, 2003) ("Q&A") available at <http://www.sec.gov/divisions/marketreg/qa-bdidprogram.htm>.

[4] In the Matter of Pinnacle Capital Markets, L.L.C., Department of Treasury, FinCEN, Number 2010-4 (September 1, 2010) available at http://www.fincen.gov/news_room/ea/files/Final%20Pinnacle%20Assessment%20for%20FinCEN%20Internet%20with%20Date%20and%20No%20Signature.pdf.