

**UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
FINANCIAL CRIMES ENFORCEMENT NETWORK**

IN THE MATTER OF:

**PINNACLE CAPITAL MARKETS, L.L.C.
RALEIGH, NC**

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Number 2010-4

ASSESSMENT OF CIVIL MONEY PENALTY

I. INTRODUCTION

Under the authority of the Bank Secrecy Act (“BSA”) and regulations issued pursuant to that Act,¹ the Financial Crimes Enforcement Network (“FinCEN”) has determined that grounds exist to assess a civil money penalty against Pinnacle Capital Markets, L.L.C. (“Pinnacle” or the “Firm”). To resolve this matter, and only for that purpose, Pinnacle has entered into a CONSENT TO THE ASSESSMENT OF CIVIL MONEY PENALTY (“CONSENT”) without admitting or denying the determinations by FinCEN, as described in Sections III and IV below, except as to jurisdiction in Section II below, which is admitted.

The CONSENT is incorporated into the ASSESSMENT OF CIVIL MONEY PENALTY (“ASSESSMENT”) by this reference.

II. JURISDICTION

Pinnacle, a North Carolina limited liability company, headquartered in Raleigh, North Carolina, is a securities broker-dealer. Pinnacle focuses its business activities on providing foreign individuals and institutions access to securities markets in the United States. The Firm has been registered as a broker-dealer with the U.S. Securities and Exchange Commission (“SEC”) pursuant to Section 15(b) of the Securities Exchange Act of 1934, since October 10, 2002. At all relevant times, Pinnacle was a “financial institution” under 31 U.S.C. § 5312(a)(2)(G) and 31 C.F.R. § 103.11(n), a “covered financial institution” under 31 C.F.R. § 103.175(f), and a “broker or dealer in securities” under 31 C.F.R. § 103.11(f). Pinnacle is subject to examination by the SEC and the Financial Institutions Regulatory Authority (“FINRA”).²

FinCEN may impose civil money penalties or take additional enforcement action against a financial institution for violations of the BSA and the regulations issued pursuant to that Act.³

¹ 31 U.S.C. § 5311 et seq. and 31 C.F.R. Part 103.

² 31 C.F.R. § 103.56.

³ 31 U.S.C. § 5321 and 31 C.F.R. § 103.57.

III. DETERMINATIONS

A. Summary

FinCEN has determined that Pinnacle violated the anti-money laundering (“AML”) program and suspicious activity reporting requirements of the BSA and its implementing regulations. The Firm’s business model encompassed heightened AML risk due to concentrated exposure to high risk foreign jurisdictions. The violations Pinnacle engaged in were systemic: (i) lack of adequate internal controls combined with deficient training and independent testing, resulting in an ineffective AML compliance program not tailored to the risks of Pinnacle’s business, (ii) failure to verify the identity of customers by not obtaining required customer identification program (“CIP”) information for accountholders, and (iii) deficiencies in the Firm’s procedures and monitoring for suspicious transactions leading to failure to file suspicious activity reports in accordance with the BSA. This civil money penalty assessment is the result of AML program deficiencies, CIP failures, and BSA reporting violations that occurred, in large part, between October 2002 and September 2009.

B. Violations of the Requirement to Implement an AML Program

FinCEN has determined that Pinnacle violated the requirement to establish and implement a reasonably designed AML program. Under 31 C.F.R. § 103.120(c), a broker-dealer registered with the SEC, and subject to regulation by FINRA (formerly known as NASD), must establish an anti-money laundering program.⁴ A broker-dealer complies with this requirement if the broker-dealer establishes and implements (i) an AML program that complies with the rules, regulations, or requirements of its self-regulatory organization, (ii) a due diligence program for any correspondent accounts maintained with foreign financial institutions, and (iii) a due diligence program for private banking accounts.⁵

NASD Rule 3011 lists the basic elements that each AML program must contain. The elements are similar to those enumerated in 31 U.S.C. 5318(h)(1), with the addition of a specific requirement that each AML program address the reporting of suspicious transactions. Furthermore, NASD Rule 3011 states explicitly that each AML program must be approved, in writing, by a member of the broker-dealer’s senior management. The aforementioned basic elements of NASD Rule 3011 include: (1) policies, procedures, and internal controls, including those that can be reasonably expected to detect and cause the reporting of suspicious transactions; (2) policies, procedures, and internal controls, including those that can be reasonably expected to achieve compliance with the BSA and the implementing regulations thereunder; (3) independent testing for compliance; (4) the designation of an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program; and (5) training for appropriate personnel.

⁴ 31 U.S.C. § 5318(h)(1).

⁵ 31 U.S.C. § 5318(h)(1) and 31 C.F.R. § 103.120(c). Pinnacle did not maintain private banking accounts during the relevant review period.

The Firm failed to implement four (4) core elements of an adequate AML program to ensure compliance with the BSA and manage the risk of money laundering or other illicit activity.

1. Policies, Procedures and Internal Controls to Detect and Cause Reporting of Suspicious Transactions

From January 2006 to September 2009, Pinnacle failed to implement adequate procedures and internal controls for detecting and timely reporting suspicious transactions.⁶ Pinnacle's business model of providing direct control over accounts and direct access to U.S. securities markets by foreign customers through omnibus accounts presents uncommon risks that needed to be identified and managed for potential misuse by customers. Pinnacle did not have a system reasonably designed to address the BSA risks inherent to the Firm's business. While Pinnacle did employ a monitoring program, that program did not employ automated systems, or make use of exception reports made available by its clearing firm. In light of the volume and scope of Pinnacle's transaction activity, manual reviews could not adequately detect suspicious wire activity, irregular trading patterns, and transactions without an apparent business or lawful purpose.

2. Policies, Procedures and Internal Controls to Achieve Compliance with the BSA and Implementing Regulations

During the relevant period, Pinnacle failed to establish adequate policies, procedures and internal controls reasonably designed to ensure compliance with the BSA. Pinnacle failed to implement anti-money laundering procedures that recognized the heightened risks posed by certain elements of its foreign customer base. Even though Pinnacle acquired anti-money laundering procedures from a third party, the procedures were not appropriately modified to reflect Pinnacle's business model. As a result, the procedures did not compile a list of "red flags" or otherwise provide measures to manage the heightened risk of illicit activity present in Pinnacle's business model and foreign customer base. Furthermore, Pinnacle did not conduct a BSA/AML risk assessment to evaluate and distinguish correspondent accounts with heightened BSA/AML risks, including accounts from Eastern Europe, South America and the Middle East. According to the International Narcotics Control Strategy ("INCSR"), certain countries in these regions were classified as "Jurisdictions of Primary Concern" or "Jurisdictions of Concern" known for heightened money laundering risk.⁷ Pinnacle violated the BSA by failing to tailor its procedures to its business and known risks.

⁶ 31 U.S.C. § 5318(g) and 31 C.F.R. § 103.19.

⁷ Each year, the U.S. Department of State issues a report to Congress classifying foreign jurisdictions based on degree of money laundering risk. The report is known as the International Narcotics Control Strategy Report ("INCSR"). The INCSR identifies money laundering priority jurisdictions and countries using a classification system that consists of three different categories: "Jurisdictions of Primary Concern," "Jurisdictions of Concern," and "Other Jurisdictions Monitored."

3. Independent Testing for Compliance

Pinnacle failed to implement independent testing under its AML program until 2006, four years after it was required to, under 31 U.S.C. § 5318(h)(1) and 31 C.F.R. § 103.120(c). Once implemented, testing did not identify gaps in the Firm's policies, procedures and internal controls, and failed to address heightened risks associated with the Firm's business model and foreign customer base. The scope of testing was not adequate to ensure compliance with the BSA, as evidenced by Pinnacle's failure to discover and respond to thousands of continued CIP violations over an extended period of time. Lack of effective independent testing resulted in non-compliance with the BSA, and heightened the risk for money laundering.

4. Training for Appropriate Personnel

From 2002 through 2007, Pinnacle failed to implement ongoing BSA training in violation of 31 U.S.C. § 5318(h)(1) and 31 C.F.R. § 103.120(c). Pinnacle failed to ensure that the four or more individuals responsible for AML compliance at the Firm received appropriate BSA training. These individuals directly supported activities related to the Firm's AML and CIP programs, such as gathering customer identification information, performing customer verification through the use of external databases, disseminating CIP disclosures to customers, reviewing accounts for suspicious transactions, reviewing and/or approving wire transfers, and maintaining records in accordance with BSA requirements. Moreover, the Firm did not provide job-specific training for the AML Compliance Program Officer, or other individuals designated for purposes of BSA compliance.

The Firm failed to establish a due diligence program for correspondent accounts as part of the AML program.

Pinnacle failed to establish and implement risk-based due diligence procedures for correspondent accounts reasonably designed to enable the Firm to detect and report known or suspected money laundering activity, and failed to identify and perform heightened risk-based due diligence for the vast majority of correspondent accounts with foreign financial institutions, including sub-account relationships.

Due diligence for correspondent accounts with foreign financial institutions is an essential element of an adequate anti-money laundering program.⁸ Pinnacle lacked adequate risk-based procedures, and failed to establish and implement an adequate due diligence program for its correspondent accounts with foreign financial institutions.⁹ As defined by the U.S. Department of State in the INCSR report, higher risk customers include those that may be involved in money-laundering activities, or are connected to jurisdictions that are especially susceptible to money laundering. During the relevant period, nearly half of Pinnacle's fully-disclosed customers resided in Jurisdictions of Primary Concern and half resided in Jurisdictions

⁸ 31 C.F.R. § 103.120(c)(1) and 31 C.F.R. § 103.176(a).

⁹ 31 C.F.R. § 103.176. Pinnacle operated as an introducing broker under a fully-disclosed clearing agreement with its clearing firm. FinCEN has issued guidance on the application of 31 C.F.R. §103.176 under these circumstances. "Application of the Regulations Requiring Special Due Diligence Programs for Certain Foreign Accounts to the Securities and Futures Industries" (FIN-2006-G009, May 10, 2006).

of Concern. Similarly, of 92 foreign financial institutions with correspondent accounts at Pinnacle, nearly half were domiciled in Jurisdictions of Primary Concern and half were domiciled in Jurisdictions of Concern.

BSA implementing regulations explicitly state that broker-dealers may need to implement procedures for, among other things, addressing the anti-money laundering and supervisory regimes of foreign jurisdictions and the anti-money laundering record of foreign financial institutions.¹⁰ Pinnacle failed to implement an adequate risk-rating methodology that evaluated 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. Pinnacle's methodology for risk rating foreign financial institutions was undocumented, and the Firm maintained inconsistent documentation within customer accounts to support risk ratings. For example, some due diligence documents referenced "low" or "medium" risk, while others referenced "level one," "level two," or "level three." Absence of a uniform risk rating methodology impaired Pinnacle's ability to adequately assess the risks associated with particular customers and adequately monitor for suspicious transactions. Moreover, information gathered from non-U.S. customers was often in a foreign language without English translation, rendering it unusable to compliance personnel in the United States.

C. Violations of the Requirement to Implement a Customer Identification Program

FinCEN has determined that Pinnacle violated the requirement to implement an adequate CIP, during the period October 2003 to September 2009.¹¹ Rules implementing the BSA require each broker-dealer to establish, document, and maintain a written CIP appropriate for its size and business as part of its anti-money laundering program.¹² A CIP must include procedures for opening new accounts that specify the identifying information the broker-dealer will obtain from each customer. At a minimum, prior to opening an account for a customer, the broker-dealer must obtain the customer's name, date of birth, address, and identification number.¹³ The CIP must include risk-based procedures for verifying the identity of the customer, to the extent reasonable and practicable.¹⁴ The procedures must enable the broker-dealer to form a reasonable belief that it knows the true identity of the customer.¹⁵

¹⁰ 31 C.F.R. § 103.176(a)(2)(iv) and (v).

¹¹ 31 U.S.C. § 5318(l) and 31 C.F.R. § 103.122.

¹² 31 C.F.R. 103.122(b)(1). The CIP rule applies by its terms to both introducing brokers and clearing brokers. FinCEN subsequently issued a no-action position on the application of the CIP rule to introducing brokers that operate under fully-disclosed clearing agreements. Application of the CIP rule depends on how the function of order, receipt and acceptance are allocated contractually in the fully-disclosed clearing agreement. In this case the function of order, receipt and acceptance were allocated exclusively to Pinnacle in the fully-disclosed clearing agreement, and therefore the CIP rule applies only to Pinnacle. "Customer Identification Program Rule No-Action Position Respecting Broker-Dealers Operating Under Fully Disclosed Clearing Agreements According to Certain Functional Allocations" (FIN-2008-G002, March 4, 2008).

¹³ The CIP rule includes an exception for customers that have yet to receive a taxpayer identification number. 31 C.F.R. § 103.122(a)(2)(i)(B).

¹⁴ 31 C.F.R. 103.122(b)(2).

¹⁵ *Id.*

A “customer” is defined in the CIP rule as a person that opens a new account.¹⁶ Since at least 2003, Pinnacle opened master accounts for foreign financial institutions (“Master Account Holders”) and these Master Account Holders or Pinnacle opened a few thousand sub-accounts. Owners of sub-accounts (“Sub-account Owners”) could transmit orders directly to, or through, Pinnacle or its clearing broker using passwords and identification numbers that Pinnacle provided. Sub-account Owners were “customers” of Pinnacle since they had direct control over how trades were made in their accounts and did not require the Master Account Holders to intermediate securities transactions on their behalf.¹⁷ Pinnacle failed to obtain required CIP information to verify the identity of these Sub-account Owners who were foreign investors. Required information for non-U.S. person customers include name, date of birth, address, and identification number, such as a taxpayer identification number, a passport number and country of issuance, an alien identification card number, or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.¹⁸ Without this information, Pinnacle could not form a reasonable belief that it knew the true identity of each customer.

In addition, Pinnacle failed to implement adequate procedures for verifying identity using information obtained in accordance with 31 C.F.R. § 103.122(b)(2)(i). Between January 2004 and August 2006, Pinnacle did not verify the identity of a significant number (at least 34 out of 55 sampled) of its corporate customer account holders. Pinnacle either did not collect the required information, or it obtained documents in foreign languages without English translation. Moreover, Pinnacle did not use any non-documentary methods, such as checking references with other financial institutions or obtaining a financial statement to verify the identities of these corporate account holders.

D. Violations of the Requirement to Report Suspicious Transactions

FinCEN has determined that Pinnacle violated the suspicious transaction reporting requirements of the BSA and regulations issued pursuant to that Act.¹⁹ The BSA regulations impose an obligation on brokers and dealers of securities to report transactions that involve or aggregate to at least \$5,000, are conducted or attempted by, at, or through the broker-dealer, and the broker-dealer “knows, suspects or has reason to suspect” are suspicious.²⁰ A transaction is

¹⁶ 31 C.F.R. § 103.122(a)(4). Banks and other financial institutions that are subject to functional regulation in the United States are excluded from the definition, as are entities whose equity interests are listed on one or more exchanges in the United States. 31 C.F.R. § 103.122(a)(4)(ii) and 31 C.F.R. § 103.22(d)(2).

¹⁷ There exists guidance on the application of the CIP rule under these circumstances. In the preamble to the CIP rule, FinCEN and the SEC stated that a broker-dealer is not required “to look through the intermediary to the underlying beneficial owners [of an omnibus account].” Customer Identification Programs for Broker-Dealers, 68 FR 25114, 25116 (May 9, 2003). In subsequent guidance, the U.S. Department of the Treasury and the SEC discussed the reference to “omnibus accounts.” The guidance involves a situation in which “all transactions in an omnibus account are initiated by the financial intermediary, and the beneficial owner has no direct control over the omnibus account.” In this situation, the financial intermediary, not the beneficial owner, is treated as the customer. “Question and Answer Regarding the Broker-Dealer Customer Identification Program Rule” (Guidance from the Staff of the U.S. Department of the Treasury and the U.S. Securities and Exchange Commission, October 1, 2003). Pinnacle was not operating in accordance with this guidance.

¹⁸ 31 C.F.R. § 103.122(b)(2)(i)(A)(4).

¹⁹ 31 U.S.C. § 5318(g) and 31 C.F.R. § 103.19.

²⁰ 31 C.F.R. § 103.19(a)(2).

“suspicious” for this purpose if the transaction: (1) involves funds derived from illegal activities, or is conducted to disguise funds derived from illegal activities; (2) is designed to evade reporting or record keeping requirements under the BSA; (3) has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the broker-dealer knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction; or (4) involves use of the broker-dealer to facilitate criminal activity.²¹

Broker-dealers must report suspicious transactions by filing suspicious activity reports and must generally do so no later than thirty (30) calendar days after the date of initial detection of facts that may constitute a basis for filing a suspicious activity report.²² If no suspect is identified on the date of detection, a broker-dealer may delay filing a report for an additional thirty (30) calendar days to identify a suspect, but in no event may a broker-dealer file a suspicious activity report more than sixty (60) calendar days after the date of initial detection.²³

The absence of effective policies, procedures, and internal controls at the Firm resulted in violations of the requirement to timely report suspicious transactions, as required by the BSA. Between October 2005 and March 2007, Pinnacle failed to report suspicious transactions involving millions of dollars. This represents a twenty-nine (29) percent failure to file rate for the Firm.

Credible publicly available information dated March 7, 2007, indicated that foreign customers of Pinnacle were subjects of an international “pump and dump” investigation by the SEC. Several of these customers resided in a country that was classified by the U.S. Department of State in the INCSR publication as a Jurisdiction of Primary Concern known for heightened money laundering risk. Pinnacle failed to identify the risks, implement risk-based monitoring for suspicious activity, and review transactions originating from these customers. As a result, Pinnacle violated the reporting requirements of the BSA.

Pinnacle also failed to report suspicious transactions by an individual who utilized the Firm’s services through a fully disclosed account. During a period of approximately seven months (October 2005 through April 2006) this customer received and subsequently sent wires in excess of \$2.5 million through Pinnacle. The account application for this individual reflected liquid and total net worth of less than \$1 million. Even though this customer was also located in a country classified by the U.S. Department of State in the INCSR publication as a Jurisdiction of Concern known for heightened money laundering risk, and apparently did not have net worth that could support the substantial account activity, Pinnacle failed to identify or review this customer’s account for suspicious transactions.

The ineffective nature of the Firm’s system to monitor for and detect suspicious activity denied a number of suspicious activity reports to law enforcement for an extended period of years. Resulting delays impaired the usefulness of the suspicious activity reports by not providing law enforcement with timely information.

²¹ 31 C.F.R. §§ 103.19(a)(2)(i)-(iv).

²² 31 C.F.R. § 103.19(b)(3).

²³ *Id.*

IV. CIVIL MONEY PENALTY

FinCEN may impose a civil money penalty against a financial institution for violations of the BSA and the regulations implementing that Act.²⁴ FinCEN has determined that a civil money penalty is due for the violations of the BSA and its implementing regulations described in this ASSESSMENT.

After considering the seriousness of the violations and the financial resources available to Pinnacle, FinCEN has determined that the appropriate aggregate penalty in this matter is \$50,000. This civil money penalty shall be satisfied by two \$25,000 payments to the United States Department of the Treasury, which include the payment of a concurrent assessment of \$25,000 by the SEC.

V. CONSENT TO ASSESSMENT

To resolve this matter, and only for that purpose, Pinnacle, without admitting or denying either the facts or determinations described in Sections III and IV above, except as to jurisdiction in Section II, which is admitted, consents to the assessment of a civil money penalty in the sum of \$50,000, which shall be satisfied by two \$25,000 payments to the United States Department of the Treasury.

Pinnacle recognizes and states that it enters into the CONSENT freely and voluntarily and that no offers, promises, or inducements of any nature whatsoever have been made by FinCEN or any employee, agent, or representative of FinCEN to induce Pinnacle to enter into the CONSENT, except for those specified in the CONSENT.

Pinnacle understands and agrees that the CONSENT embodies the entire agreement between the Firm and FinCEN relating to this enforcement matter only, as described in Section III above. Pinnacle further understands and agrees that there are no express or implied promises, representations, or agreements between the Firm and FinCEN other than those expressly set forth or referred to in this document and that nothing in the CONSENT or in this ASSESSMENT is binding on any other agency of government, whether Federal, State, or local.

VI. RELEASE

Pinnacle understands that execution of the CONSENT, and compliance with the terms of this ASSESSMENT and the CONSENT, constitute a complete settlement and release of the Firm's civil liability for the violations of the BSA and regulations issued pursuant to that Act as described in the CONSENT and this ASSESSMENT against Pinnacle.

²⁴ 31 U.S.C. § 5321 and 31 C.F.R. § 103.57.

By:

/s/

James H. Freis, Jr., Director
FINANCIAL CRIMES ENFORCEMENT NETWORK
U.S. Department of the Treasury

Date: August 26, 2010