

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59437 / February 24, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13377

In the Matter of

**LEUMI INVESTMENT
SERVICES INC.,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15(b) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Leumi Investment Services Inc. (“LISI” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. Summary

From May 2003 to August 2004 (the "relevant period"), LISI failed reasonably to supervise Victor P. Machado ("Machado"), a former fixed income trader at LISI, with a view to preventing and detecting Machado's violations of the federal securities laws. During this period, Machado and Frank Lu, a former salesperson at Oppenheimer & Co. Inc. ("OPCO"), a registered broker-dealer and investment adviser, engaged in a fraudulent scheme that resulted in a substantial increase of order flow from Leumi to OPCO. As a fixed income trader, Machado was responsible for executing LISI's customer orders. Pursuant to their scheme, Lu provided Machado with secret gratuities and entertainment and Machado, in violation of his duties to LISI and its customers, directed a substantial flow of orders to OPCO for execution at prices that were favorable to OPCO and detrimental to LISI's customers. As a result of this arrangement, on certain trades, Machado and Lu also positioned OPCO between LISI and other broker-dealers offering better prices that Machado could have obtained for LISI. Machado's and Lu's scheme caused significant harm to LISI's customers.²

During the relevant period, LISI did not implement reasonable procedures to prevent and detect unauthorized changes to trade tickets by its personnel. Machado frequently improperly changed and falsified order tickets in an effort to conceal the fraudulent scheme. Had LISI implemented reasonable procedures concerning changes to trade tickets, Machado's supervisor could have detected Machado's falsification of the trade tickets and uncovered Machado's fraudulent scheme. Accordingly, LISI failed reasonably to supervise Machado, within the meaning of Section 15(b)(4) of the Exchange Act, with a view to preventing and detecting Machado's violations of the federal securities laws. LISI also violated Exchange Act Section 17(a) and Rule 17a-3 thereunder because false information was entered into LISI's books and records by Machado.

B. Respondent

Leumi Investment Services Inc. is a New York corporation with its principal office in New York, New York. LISI is a wholly-owned subsidiary of Bank Leumi USA, a New York State chartered, Federal Deposit Insurance Corporation insured, full service commercial bank. LISI has been registered with the Commission as a broker-dealer since May 2001.

¹ The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

² During the relevant period, Machado was a dual employee of LISI and Bank Leumi USA ("BLUSA"), a commercial bank that is the parent company of LISI. Machado's fraudulent conduct arose from both his execution of customer orders as an employee of LISI and as an employee of BLUSA.

C. Facts

From September 1999 until he was dismissed on August 31, 2004, Machado was a fixed income trader on LISI's trading desk, primarily engaged in executing orders in emerging market fixed income securities. Upon receiving a customer order, Machado was responsible for determining the best prices available in the market and executing trades on behalf of LISI's customers.

During the relevant period, Lu specialized in emerging market securities. Lu's compensation was based solely on a percentage of the revenue generated by his customers' orders.

Machado and Lu began trading emerging market securities in 2000. In mid-2003, Machado and Lu secretly agreed that Machado would direct orders to Lu for execution at prices favorable to OPCO and, in exchange, Lu would provide Machado with gratuities and entertainment. The arrangement ensured that Lu received increased order flow, which, in turn, meant that Lu's compensation increased.

During 2003 and 2004, Lu entertained Machado numerous times per year. Each evening of entertainment typically cost at least a thousand dollars and was paid for by Lu in cash. In addition, approximately half a dozen times per year, Lu gave Machado gifts. Neither Lu nor Machado reported these gratuities and entertainment, as required under OPCO's and Leumi's respective policies.³

Under their secret arrangement, Machado frequently changed Lu's quoted price to make it more favorable to OPCO and, consequently, less favorable to LISI and its customers. For example, if LISI placed an order to buy a security and Lu quoted a price for that security to Machado at \$99.50, Machado instead would pay OPCO \$100 for the security.

As part of their arrangement, Machado and Lu also positioned OPCO between LISI and other broker-dealers that offered better prices to LISI. For example, after Machado received a favorable price quote from another broker-dealer, instead of executing the trade directly with that firm, Machado would direct Lu to contact that broker-dealer to buy or sell the securities in question at the favorable quoted price. Thereafter, Machado would execute LISI's order with Lu at a price that was less favorable to LISI and its customers than the price initially quoted by the other broker-dealer.

As a result of this secret arrangement, the average number of monthly trades that Machado executed with Lu through OPCO increased by approximately 450 percent during the relevant period. As a result of Machado's and Lu's scheme, LISI and its customers were harmed

³ FINRA Rule 3060 (which was in effect during the relevant period) prohibits a person associated with a broker-dealer from directly or indirectly giving anything of value, including gratuities, in excess of one hundred dollars per individual per year to any person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity. The rule also requires that the broker-dealer retain a record of all payments or gratuities in any amount known to it.

by approximately \$785,208. The scheme also harmed customers of BLUSA by approximately \$317,828.⁴

In order to carry out his improper trading with Lu, Machado violated LISI's policies and procedures with regard to LISI's trade blotter and trade tickets. Machado omitted information and entered false and misleading information into LISI's trade blotter in an effort to prevent his supervisor from detecting that he was trading repeatedly with Lu. Machado often would not enter OPCO's name on LISI's trade blotter and, instead, would insert the name of another broker-dealer that was not involved with the trade.

Machado also falsified LISI's trade tickets in order to conceal his trades with Lu from his supervisor. After executing a trade with Lu, Machado often prepared a counterparty trade ticket that falsely stated that he had closed the trade with a different counterparty. After obtaining the initials of his supervisor (or another LISI trader) on the falsified counterparty trade ticket, Machado changed the name of the bogus counterparty on the trade ticket to the correct counterparty by inserting the names of OPCO and Lu. Frequently, Machado changed the falsified ticket after it had been submitted for processing to LISI's back office. In these instances, Machado would retrieve the trade ticket from the back office himself or the back office would return it to him after discovering that the incorrect counterparty had been listed on the ticket. After crossing out the bogus counterparty name and inserting the names of OPCO and Lu on the trade ticket, Machado would return the changed ticket to the back office without having his supervisor initial the changed ticket, as required by LISI's policy.

Also, Machado and LISI's back office personnel repeatedly did not comply with LISI's written policy for changes to trade tickets, which required that a Trade Amendment Form ("TAF") be prepared each time an order ticket was changed. Neither Machado nor LISI's back office personnel prepared a TAF for each order ticket that Machado improperly changed.

By the conduct described above, Machado violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aided and abetted LISI's violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

E. Violations

Section 15(b)(4)(E) of the Exchange Act gives the Commission the authority to censure, suspend, or revoke the registration of any broker or dealer who has failed reasonably to supervise associated persons, with a view toward preventing and detecting violations of the federal securities laws. Section 15(b)(4) states that a broker-dealer may discharge its supervisory responsibilities by having "established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect" these violations.

"The Commission has repeatedly emphasized that the duty to supervise is a critical component of the federal regulatory scheme." *In the Matter of Oechsle International Advisors*,

⁴ After learning of the scheme, LISI and BLUSA reimbursed their customers by approximately \$1.2 million (including interest) for the harm attributable to the conduct of Machado and Lu.

L.L.C., Admin. Proc. File No. 3-10554, 5 (August 10, 2001). “Where there has been an underlying violation of the federal securities laws, the failure to have or follow compliance procedures has frequently been found to evidence a failure reasonably to supervise the primary violator.” *In the Matter of William V. Giordano*, Admin. Proc. File No. 3-8933 (January 19, 1996). In addition to adopting effective procedures for supervision, broker-dealers “must provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised.” *In the Matter of Mabon, Nugent & Co.*, Admin. Proc. File No. 3-6207 (January 13, 1983).

During the relevant period, LISI did not implement reasonable procedures for preventing traders from tampering with trade tickets. In particular, LISI did not develop a system for implementing the requirement in LISI’s written policy that a Trade Amendment Form be prepared for each change made to an order ticket. The procedures required the trader to complete the TAF and explain the reason for the change. The TAF had to be signed by both the trader and the supervisor, and maintained in the trade processing area of the firm. Notwithstanding its written policy and procedures, LISI never created the TAF, and never trained its employees on the policy and procedures. For example, LISI’s trading desk supervisors had never used TAFs to document and explain changes made to trade tickets, and LISI’s back office personnel were unaware of the requirement. If LISI had implemented reasonable procedures for preventing unauthorized changes to trade tickets, Machado’s supervisor would have been made aware of Machado’s repeated falsification of the trade tickets, and uncovered or prevented Machado’s fraudulent scheme.

By engaging in the conduct described above, LISI failed reasonably to supervise Machado with a view toward preventing and detecting Machado’s violations of the federal securities laws.

Section 17(a) of the Exchange Act and Rule 17a-3 thereunder require that registered brokers and dealers make and keep current certain specified books and records relating to their business. Among the records broker-dealers are required to make and keep are: (1) blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities [Rule 17a-3(a)(1)]; and (2) “[a] memorandum of each purchase and sale for the account of the member, broker, or dealer showing the price and, to the extent feasible, the time of execution” [Rule 17a-3(a)(7)].

By engaging in the conduct described above, LISI willfully⁵ violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

⁵ A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

F. Respondent's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent (including reimbursement to its customers) and cooperation afforded the Commission staff.

G. Undertakings

LISI has undertaken to review its policies, procedures and systems regarding the (i) processing, changing, and supervisory review of trade tickets; (ii) monitoring of LISI's trade blotter; and (iii) monitoring of electronic communications by LISI's Trading Room personnel. Within ninety days of the issuance of this Order, unless otherwise extended by the staff of the Commission for good cause shown, LISI shall submit a report to the Commission describing the review performed and the conclusions and changes made as a result of this review. Further, at the time that LISI submits the report, LISI shall certify to the Commission in writing that it has established procedures, and a system for applying such procedures, which are reasonably expected to prevent and detect, insofar as practicable, the violations described in this Order.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.
- B. Respondent be, and hereby is censured.
- C. Respondent shall comply with the undertaking enumerated in Section III, paragraph G above.

By the Commission.

Elizabeth M. Murphy
Secretary