Red Flags of Market Manipulation Causing a Collapse of the U.S. Economy[1]

A Report for Law Enforcement Investigators

Introduction

This report discusses extensive research[2] that shows significant 'red flags' of danger to the world's economy from what appears to be market manipulation in the global financial markets, which includes trading in common stock, options, futures, commodities, currencies, oil and bonds.

Two companies, Penson Financial Services, Inc. of Dallas, Texas and Wedbush Morgan Securities, Inc. of Los Angeles, California (herein referred to as "the firms"), are at the heart of this trading and they consistently work in concert. These firms became, virtually overnight, the largest traders in the U.S. financial markets. These companies provide a one-stop-shop for trade execution, back office clearing and bookkeeping that cater to hedge funds and small broker dealers. To give perspective, the amount of trading executed by these two firms in October 2008 exceeded the trading of securities firms Goldman Sachs, JP Morgan and Merrill Lynch combined in the NASDAQ market participant reports.[3]

Key Points

1) The firms have traded trillions of dollars worth of U.S. blue chip companies. They are the number one traders in **all** financial companies that collapsed or are now financially supported by the U.S. government. Trading by the firms has grown exponentially while the markets have lost trillions of dollars in value.

2) These firms appear to own few or no shares of blue chip companies they are the number one traders in. There is no doubt that the magnitude of their trading impacted the marketplace. Since the direction of the marketplace has been in a severe downward trend, the impact from the firms has been, and remains, negative to the marketplace.

3) There are numerous 'red flags' of illegal activity including but not limited to; market manipulation, sales of unregistered securities, washed and matched trading, violations of short selling rules including recently imposed emergency short selling rules and violations of anti-fraud provisions of the federal securities laws.

[1] This report assumes that the reader is familiar with the issues discussed and terminology used. Any conclusions are opinions that are subject to change as new information becomes available. Date: 03/02/09

[2] The data reviewed that comprises this report includes company SEC filings, options exchange data, historical market data, NYSE historical data, market participant liquidity reports, fails to deliver data from the NCSS, NASDAQ Market Participant Reports, short interest reports, published short sale data, DTCC, SEC and FINRA communications and regulatory actions, report of receiver Mr. Thomas Lennon along with other information described herein.

[3] NASDAQ Market Participant Reports – October 2008

Executive Summary

From December 2006 to date, Wedbush and Penson have concentrated very heavily on trading financial stocks in the U.S. Combined, they are the number one trader in all financial stocks that have collapsed or have required bailouts from the U.S. government. These firms are the number one traders in the Dow Jones Industrials and the general Financials, which includes key bank, finance, brokerage and insurance companies.[4]

It is important to note that the volume figures discussed in this report are derived from market participant reports from the NASDAQ system,[5] which only show the reporting market participant side of the trades and does not include the contra side of the trades, therefore the numbers discussed in this report are very understated for the trade volumes of Wedbush and Penson. In other words, the opposite side of the trade that cannot be seen at this time is believed to be heavily executed by these two firms and/or their client(s) and their share of the marketplace could easily be 20% or more than the numbers in this report reflect.

The NASDAQ has made these market participant reports available for public inspection for the last decade, but has recently announced that beginning March 6, 2009 the reports will no longer be published for public viewing; the data must be purchased after this date. Therefore, the links in this report to some of the data may not direct you to the information after March 6, however the information is provided through the exhibits to this report.

An example showing the magnitude of these two firms' trading is Citigroup, the largest global financial company, which was bailed out by the U.S. taxpayers on November 24, 2008. Wedbush and Penson have transacted over 4 billion shares of Citigroup from January through November 2008 (the last available data). The firms are the number one trader in Citigroup. Wedbush files ownership reports on form 13F with the SEC that show virtually no ownership by Wedbush of Citigroup and Penson owns no shares. From June through November 2008, the firms traded 2.7 billion shares of Citigroup, dominating

[4] See CD which includes the data and exhibits that this report was derived from.
[5] NASDAQ provides the following definition of Market Participant Reports (Monthly Share Volume Report): "The Monthly Share Volume Report provides volume and ranking for all participating market makers trading NASDAQ and other exchange listed securities, through the NASDAQ Execution System as well as those trades reported through the FINRA/NASDAQ Trade Reporting Facility." These Market Participant Reports reflect only the reporting side of the marketplace, therefore the contra market participants to these trades and the market participants trading volume outside of the NASDAQ is not reported, consequently the share volumes reported are understated.
http://www.nasdaqtrader.com/Trader.aspx?id=MPVolume

the trading while the stock was collapsing. This raises red flags that the firms were manipulating and shorting the stock of Citigroup, i.e. selling stock they did not own.

Citigroup's stock could not hold up under the pressure from the firms' trading and because of their decreased stock price, Citigroup could not raise capital in the traditional way through the sale of its stock. Interestingly, while these firms were trading very large volumes of Citigroup through what appears to be short sales, short interest in Citigroup declined from its peak in mid July by 35 million shares through September 2008.[6]

The firms appear to be short selling the stock, but marketing the shares long as if the shares were issued by Citigroup. Marketing of short shares as long shares is illegal and circumvents the laws of short selling designed to protect investors and companies from fraud. This type of trading is the most dangerous for U.S. publicly traded companies because the shares purchased are disguised to look as if the companies issued them, which ex-SEC Chairman Harvey Pitt explained, is analogous to counterfeiting money.[7]

Citigroup's fate is not unique for blue chip stocks heavily traded by the firms. They have been the number one volume traders in stocks that display characteristics of market manipulation and bear raid trading,[8] such as; Lehman Brothers, Bear Stearns, American International Group, Fannie Mae, Freddie Mac, Wachovia, National City, Countrywide Financial and Washington Mutual, which have all collapsed while the firms were their <u>number one</u> volume trader in market participant reports. In 2008, January through September, of just these 10 financial companies; the firms traded 18.7 billion shares.

To put this number of shares into perspective, data is available on six of the ten companies: Citigroup, Bear Stearns, American International Group, Fannie Mae, Freddie Mac and Washington Mutual. This data shows from January through September 2006 before Wedbush became a very large trader of blue chip stocks, these six publicly traded companies trade volume by **<u>all market participants</u>** amounted to 6.2 billion shares. In these six stocks in the same months during 2008, Wedbush and Penson traded <u>8.3 billion</u> shares or 24% more shares than all of the combined market participants' trading volume in 2006.

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[6] NASDAQ provides the following definition of short interest: The total number of shares of a security that have been sold short by customers and securities firms that have not been repurchased to settle outstanding short positions in the market; the net short positions outstanding in the stock as of the settlement date.

[7] See Exhibit 1 – At a speech at the Mayflower Hotel in Washington D.C. on November 16, 2007, former SEC Chairman Harvey Pitt stated, "Phantom shares created by naked shorting are analogous to counterfeit money."

[8] This is an illegal trading technique outlawed since the 1930s. Bear raids are executed by illegal short sellers with intent to push the price of a stock lower, which is extremely damaging to the value of a security and its public investors.

The stocks that have been bailed out by the U.S. taxpayers, such as American International Group ("AIG"), Fannie Mae and Freddie Mac are still being heavily traded by the firms and these stock prices remain depressed despite the backing of the U.S. government. For example, AIG had approximately 2.7 billion shares outstanding[9] in September 2008, but the September trade volume was 4.5 billion shares. The firms were the largest trader of AIG in September 2008 when the price of AIG declined from $21.96 ending the month at $3.33. They traded 872 million[10] shares of AIG during this massive price decline. On September 16th, AIG was in essence taken over by the U.S. taxpayers. In October, the firms were still heavily trading AIG averaging 11.7 million shares per day, after the U.S. taxpayers' bailout. The December 16th closing price of AIG was $1.80. AIG's declining price is ***not*** beneficial for its owners, the U.S. taxpayers.

Fannie Mae and Freddie Mac were taken into conservatorship by the U.S. government on September 7, 2008. The firms' September trade volume in these two stocks was 898 million shares. During the third quarter of 2008, the firms traded 1.8 billion shares of Fannie and Freddie, while the stock prices were collapsing. The trading in these stocks raises red flags of active market manipulation even after the U.S. taxpayers became owners of these corporations.

A very sophisticated pinpoint strategy of trading is employed by these two firms across the marketplace concentrating on blue chip companies that are key U.S. assets. There are over 20 red flags discussed in this report that indicate this strategy may be in place to depress the markets further.

On February 4, 2009, Jim Cramer of CNBC called for the abolishment of the Ultra Short Financial Exchange Traded Fund. The ultra short funds were clearly, in Cramer's opinion, the most dangerous trading vehicles being used to manipulate/trade/hedge against the health of the financial stocks. In Cramer's view:

> "Ultra-short exchange traded funds (ETFs) are destroying the financial system and socking it to taxpayers, says Jim Cramer. Because of their short selling, the government will have difficulty stabilizing banks - as well as the entire economy, Cramer charges on CNBC's Mad Money show. As bank shares fall, he explains, banks will have more trouble raising capital, which they need to survive and make loans. The government, in turn, will have to come to the rescue, costing billions of dollars."
>
> "We call it the ETF of mass destruction, he says. It's contributing to the wholesale destruction of the financial system. It's the stock version of the Salem witch trials. I can't believe the

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[9] See Exhibit 2 – American International Group Inc, Form 10-Q, filed 08/06/2008.
[10] See Exhibit 3 – American International Group NASDAQ Market Participant Report Volume, September 2008.

government doesn't stop it. If you want to get outraged about something, this should be it, Cramer says."

"Cramer is right this time, says Don Fishback, a derivatives expert who often disagrees with the television host. These products have become gigantic trading vehicles that allow people to exceed the Federal Reserve margin/leverage limits, Fishback writes in his Seeking Alpha blog."[11]

The firms are the largest trader of the financial Ultra Short fund that Cramer is gravely concerned with. They are also the largest traders of other Ultra Short Funds of blue chip companies such as the DOW, the NASDAQ QQQQ, S&P 500, Russell 2000, Real Estate and Oil & Gas.

On February 20, 2009, former Federal Reserve Chairman and current Presidential Advisor Paul Volker stated: "I don't remember any time, maybe even in the Great Depression, when things went down quite so fast, quite so uniformly around the world." [12]

Downward market manipulation is part mechanical in the execution of trades and part psychological fear based manipulation of investors. The current market conditions are creating fear and mistrust from investors. The volatility in the marketplace is unprecedented which raises red flags that these two firms, as the number one traders, are playing a central role in causing this volatility. These extreme times of volatility of 400, 500, or 900 point moves in the Dow Industrials have enticed honest investors to believe that bottoms were met in the market and it was safe to venture into U.S. investments, only to have their investments turn negative in a few days or even hours. The market volatility being experienced creates a lack of trust in the marketplace and is a psychological factor in a self-fulfilling down market because investors that are burned once or twice are less likely to come back to be burned again.

Confidence and trust in the U.S. is falling even with the recent financial actions taken by governments globally and by the United States. Through these two firms' trading, which has intensified while the markets have declined, they are increasingly discouraging investment in the U.S. financial markets. These firms have gained a large percentage of market share over very large Wall Street firms and are now the most powerful traders in U.S. stocks.

[11] See Exhibit 4 – Newsmax article, Cramer: Ultra-Short ETJ Funds Killing Us, February 25, 2009 by Michael Kling. http://moneynews.newsmax.com/streettalk/cramer_ultrashort_skf/2009/02/25/185505.html
[12] See Exhibit 5 – Crisis may be worse than Depression: Volcker, Reuters, February 20, 2009, By Pedro da Costa and Kristina Cooke. www.reuters.com/article/politicsNews/idUSTRE51J5JM20090220

Red flags of illegal short selling and market manipulation have been raised by very sophisticated Wall Street CEOs from Bear Stearns, AIG and Lehman Brothers. Lehman Brothers CEO Richard Fuld testified to Congress that Lehman Brothers would not have collapsed without the short sellers damaging their stock price and market confidence.[13] These seasoned Wall Street veterans could not identify the short sellers, but the two firms, using multiple identities, were the largest traders in their stocks. Lehman's CEO Fuld may be right in his conclusion that illegal activity brought Lehman down.

Lehman Brothers filed for bankruptcy on September 15, 2008. From June through September, the firms traded 1.04 billion shares of Lehman's stock while the stock price was collapsing from $33.83 to $ .21 on September 15th. Again, this is the same pattern of heavy trading by these firms found in all of the large capitalization stocks that have collapsed and those that continue to require assistance from the U.S. taxpayers.

As reported by Bloomberg in March 2008, very large and unusual options transactions were executed in Bear Stearns just prior to its demise, indicating that the options traders knew the future price of Bear Stearns would be almost zero within days.[14] As Bloomberg states; "The buyers were confident the stock would crash." A pattern of suspicious options transactions has been found in Fannie Mae, Freddie Mac and the other companies that have imploded. The firms have become very large options traders, executing 20 million options contracts worth 2 billion shares in October 2008 alone. The firms were the number one trader of Bear Stearns in March when the stock crashed from its high of $79 per share to under $5.

An example where the firms are the number one traders in a stock that has not yet collapsed, but is receiving assistance from the U.S. government, is Bank of America. Multiple identifying symbols were being used by the firms to trade this security. Between the two firms, there are at least 76 different symbols at their disposal to trade U.S. securities, Citigroup in comparison has 6. In September 2008 the number one trader in the stock of Bank of America was Wedbush symbol WEDB with 140 million shares traded. However, when the 9 symbols used by Wedbush and Penson to trade Bank of America during September 2008 are combined; they traded almost 313 million shares of Bank of America. From June through November 2008, the largest trader of the stock was these two firms, trading 1.6 billion shares while Bank of America's pricing went into a severe decline to a low of $11.25 on November 20th,

[13] See Exhibit 6 – Statement of Richard S. Fuld, Jr. Before The United States House Of Representatives Committee On Oversight And Government Reform, October 6, 2008.
[14] See Exhibit 7 – Bloomberg article, Bringing Down Bear Began as $1.7 Million of Options By Gary Matsumoto, August 11, 2008. www.bloomberg.com/apps/news?pid=20601109&sid=aGmG_eOp5TjE&refer=home

a 66% drop from its June 2nd pricing of $33.58. Bank of America is now trading in the $3 range and is an example of a pattern of the usage of <u>multiple IDs</u> found in <u>all</u> stocks being heavily traded by the two firms that are discussed in this report.

Bank of America is also an example of another disturbing pattern found in the trading of blue chip stocks. Over 80% of the trading or more than four of every five shares are being transacted away from the New York Stock Exchange, where Bank of America is listed. Therefore, four of five shares trading in Bank of America do not fall under the regulatory scrutiny of the New York Stock Exchange. For example, recent large trading days February 6th, March 2nd and March 3rd show that Bank of America trade volume was 1.5 billion shares, but only 240 million of those shares or 16% were traded on the New York Stock Exchange.

Bank of America shows further evidence of suspicious activity through large block trades executed on multiple markets at least three times each day in after hour trades with the trades originating in Vancouver. From October 7, 2008 to March 2, 2009 (100 trade days), there have been almost three quarters of a billion shares transacted in these after hour trades which all show a secondary exchange of Vancouver.

In summary, this appears to be a very sophisticated trading operation concentrating on the downside of the Dow Jones Industrials, the NASDAQ, the Indexes/Spiders/ETFs, core financial and blue chip companies in at least the United States, if not globally. The firms have become by far the largest trader of energy stocks in this country. They are now the number one trader with massive volumes in key and vital U.S. industries that are Dow component stocks. If their past trading is indicative of their future impact on the blue chip stocks they are now trading, then many more brand name companies in the U.S. may collapse.

As the firms increase their trade volume and other U.S. securities and investment firms continue to be weakened by their trading, the firms gain more share of the volume and trading power in the marketplace. Now, day after day, the firms are the largest and most significant traders of key U.S. companies. In theory, this massive market activity could only be carried out with a vast amount of collateral behind the trades. There seems to be no limit to their financial resources.

Trillions of dollars worth of blue chip stocks have been traded by the firms while the markets have lost trillions of dollars in investor value. Just the NYSE lost over 6 trillion dollars from June through November 2008. Money does not evaporate through trading it is transferred from the buyer to

the seller. If the seller is an illegal seller of stock they do not own, they profit at the expense of the purchaser.

The NYSE shows its top ten volume months in its entire history,[15] which were led by the largest traders Wedbush and Penson in market participant reports. There appears to be no way to return confidence in the markets without first addressing the massive trading being executed through these two firms.

The financial markets are extremely weak at this point in time and are on very unstable footings. A collapse of only a few more key blue chip companies or sectors in the U.S. financial markets could cause a domino effect in the economy. At this time the perfect "financial storm" is brewing for a global market collapse, which appears to be driven by the firms as the number one trader. If this is massive market manipulation, as it appears to be, any efforts to correct the current market crisis will be non-effective.

The participants appear to have the power to control markets in a large number of key financial sectors, including currencies. Further evidence of these two firms' domination of blue chip U.S. companies is detailed in this report. Please note the strategic trading of important U.S. assets while keeping in mind that trillions of dollars of trades have been transacted by these two firms.

Whoever is behind the trading of Wedbush and Penson, they could reap financial reward beyond what would have been previously too large to contemplate. When oil soared to $147 a barrel, T. Boone Pickens called it the greatest transfer of wealth in our nation's history (approximately $800 billion dollars yearly), however the stock markets transfer of wealth dwarfs this amount and to date, 30 trillion dollars of value has been removed from the global financial markets in a little over one year. If there are any illicit profits made from the trading by the firms, if pursued and prosecuted at this time, the money should be traceable because they are operating in real-time as you read this.

[15] See Exhibit 8 – NYSE Group Volume Records - Top 10 Months.

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Wedbush Morgan and Penson Financial Dominate the U.S. Financial System

Introduction of the Participants

Wedbush was formed by Ed Wedbush in 1955 and was a minor market participant until December 2006, when Wedbush went from trading approximately 53 million shares a month to 4.7 billion shares.[16] Penson Financial was founded in 1995 by Daniel P. Son and Phil Pendergraft[17] and was a very minor participant in the U.S. financial markets until November 2007, when their combined trading began dominating the U.S. markets. Wedbush is a Los Angeles based company with branch offices in the western states and Penson is a Dallas based company with branch offices in Canada, London and Hong Kong and a futures and commodities trader in Chicago and New York named Penson GHCO.[18]

The New York Stock Exchange ("NYSE") fined Wedbush $200,000 in May of 2008 for erroneous reporting of short sales marked long in their blue sheet reports (required reports used by regulators that detail trades). These blue sheet reports were submitted to regulators for investigations of fraud, market manipulation and improper trading. The NYSE concluded:

> "Due to the problem at the firm's vendors and the ineffective measures taken by the firm to correct the problem, in all likelihood, every blue sheet reflecting short sale transactions in a DVP/RVP account submitted by the firm to the NYSE from May 2002 until September 2006 contained erroneous short sale information."[19]

The NYSE stated that Wedbush was "put on notice as early as September 2003 of inaccurate information contained on a blue sheet it had submitted to the NYSE. However, the firm continued to submit erroneous blue sheets to the NYSE." The NYSE points out that the inaccurate information undermined the integrity of the information the NYSE used for its investigations.

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[16] Wedbush Morgan NASDAQ Market Participant Report volume.
[17] See Exhibit 9 – www.penson.com
[18] See Exhibit 10 – Wedbush Morgan Securities: 1000 Wilshire Boulevard, Los Angeles, CA 90017
Penson Financial Services, Inc.: 1700 Pacific Avenue, Suite 1400, Dallas, Texas, 75201.
Penson Financial Services Canada: 360 St. Jacques West, 11th Floor, Montreal, Quebec H2Y 1P5
Penson Financial Services Limited London: One Oliver's Yard, City Road, London, EC1Y 1HQ
Penson Asia Limited: Suite 1503, 15/F No. 9 Queens Road, Central, Hong Kong, China
Penson GHCO: 600 W. Chicago Avenue, Suite 775, Chicago, IL 60610
[19] See Exhibit 11 – Monthly Disciplinary Actions - May 2008 www.nyse.com/DiscAxn/discAxn_05_2008.html

A further indication that the activity described in this report is not random, but is a pattern and practice, is that the NASD fined Wedbush in February 2007, finding that Wedbush submitted inaccurate short interest positions to the NASD.

> "The findings also included that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning short interest reporting requirements contained in NASD Rule 3660"[20]

Another indication that the firms may subvert the securities regulations is found in August 2006 NASD disciplinary action against Penson Financial, finding:

> "that it accepted customer short sale orders in certain securities and, for each order, failed to make/annotate an affirmative determination that the firm would receive delivery of the security on the customer's behalf, or that the firm could borrow the security on the customer's behalf for delivery by the settlement date."[21]

Wedbush and Penson are clearing firms with approximately 300 small brokers using their services. Mostly, these firms trade with their own symbols and are minor traders in a variety of stocks, which are not the subject of this report or at the center of the current financial crisis.

However, 136 of Penson's small clients have been reviewed for violations of U.S. securities regulations and 33 were found to have serious violations. These include; illegal short selling, no anti money laundering policies, improper application of anti money laundering polices even when red flags are apparent in their books and records of potential money laundering, failures to provide supervision reasonably designed to achieve compliance with security laws and regulations and participation in manipulative, deceptive and fraudulent schemes.[22]

The Firms Appear to Work in Concert

The firms heavily trade virtually identical blue chip stocks, indexes and sectors of the U.S. markets. For the reasons discussed herein and this mirror image trading of select U.S. assets by the firms, the trading of the two firms is considered to be either for the same client or clients working together and is combined for the accounting of their trade volume. Wedbush is its own clearing

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[20] See Exhibit 12 – NASD NTM DISCIPLINARY ACTIONS FEBRUARY 2007. http://www.nasd.com/web/groups/enforcement/documents/monthly_disciplinary_actions/nasdw_018650.pdf

[21] See Exhibit 13 – NASD NTM DISCIPLINARY ACTIONS AUGUST 2006.

[22] See Exhibit 14 – Securities violations of the firms and their clients.

firm, a division that accounts for trades and monies and produces statements to brokers and their clients, performing these back office tasks for themselves and other brokers who need this service, but Wedbush also uses another clearing firm, Penson.[23]

How Are the Firms Disguising the Magnitude of Their Trading?

First, they are using multiple market making symbols to trade with. Penson alone has 47 different market maker symbols or 'identities'.[24] Between Wedbush and Penson, there are at least 76 different symbols at their disposal to trade U.S. securities. In contrast, companies like Citigroup have 6.

Second, although they are a market maker in all of the stocks in this report, they also trade through other market makers. Other than the lack of data available for the contra side of the trades, order routing is another reason why the data discussed in this report is considered to be very understated for the firms. Both Penson and Wedbush must file SEC Rule 606 reports and declare their order routing policy. The September data shows that Wedbush routes orders to other heavy traders, Knight Capital Markets[25] (61.5% - September 30, 2008) and Bernard L. Madoff Investment Securities, who, recently admitted to a 50 billion dollar fraudulent investment scheme[26] (31.5% - September 30, 2008).[27] These order routing percentages may be understated because in November 2008, FINRA (f/k/a NASD) found Wedbush to be non-compliant with these reporting procedures; [28]

> 'FINRA found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and FINRA rules relating to SEC Rule 606,[29] "regular and rigorous" reviews of orders routed to and executed by other parties and trading halts.'

In a House Financial Services Committee hearing on January 5, 2009, Representative Brad Sherman of California, reported that he was personally informed by the SEC that the

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[23] See Exhibit 15 – NSCC Member Directory, page 107. www.dtcc.com/downloads/membership/directories/nscc/numxref.pdf

[24] See Exhibit 16 - www.dtcc.com/downloads/membership/directories/nscc/numxref.pdf

[25] See Exhibit 17 - Knight's subsidiary, Deephaven Capital, settled on May 2, 2006 with the SEC without admitting or denying charges that it illegally short sold stocks from June 1, 1999 to March 2004, in violation of the anti-fraud provisions of the federal securities laws. SECURITIES AND EXCHANGE COMMISSION, v DEEPHAVEN CAPITAL MANAGEMENT, LLC, CASE NUMBER 1:06CV00805

[26] See Exhibit 18 - www.sec.gov/litigation/complaints/2008/comp-madoff121108.pdf

[27] See Exhibit 19 - Source: Wedbush Morgan.

[28] See Exhibit 20 - FINRA Disciplinary Actions, November 2008. www.finra.org/web/groups/industry/@ip/@enf/@da/documents/disciplinaryactions/p117408.pdf

[29] See Exhibit 21 – SEC Rule 606 relates to order routing regulations.

brokerage/market making arm of Madoff was also reporting to the SEC that they had $17 billion in assets when virtually none existed. Penson routes orders to Citadel Derivatives Group (58.7% - September 30, 2008) and Knight Equity Markets (19.0% - September 30, 2008).[30]

Third, they are trading through exchanges and electronic communication networks that display their own symbol for trading rather than the market maker's symbol. These trading platforms allow the market maker to trade anonymously while executing orders.[31]

Fourth, they are registered clearing firms and at least Wedbush is pre-netting and compressing trades, meaning that before the trades are sent to the clearing agency NSCC, they hold and account for trades in house, reporting to the NSCC a small number of trades rather than real-time trade by trade detail. The NSCC considers this practice to be a systemic operational risk to the marketplace.[32]

The NSCC proposed a rule change in 2006 subject to confirmation by the SEC, which required the rule to be published for public comment. This rule would eliminate pre-netting, compression and summarizations of trades submitted to the NSCC by clearing firms and require trades to be reported in real-time. A few proponents against this ruling included Wedbush Morgan, Knight Capital and Citadel. Because of their opposition to this rule, the SEC has yet to decide on the NSCC request for this change in trade reporting. There have been numerous correspondences documenting these parties' attempts to avoid trade by trade reporting.[33] The correspondences contain the following interesting argument from Wedbush, which indicates that the NSCC does not have a clue as to the actual amount of pre-netting at Wedbush and that it is <u>in fact enormous</u>.

> <u>"The analysis performed by the NSCC was based on inaccurate pre-netting assumptions."</u>
>
> "NSCC, in an effort to formulate the new rate structure, made certain assumptions as to the number of pre-netted trades using theoretical models that actually proved to be <u>grossly understated</u>. In conjunction with NSCC (after the filing), we jointly compared and analyzed Wedbush's pre-netted activity for sample months. In the process we discovered that the NSCC's pre-netted assumptions were <u>dramatically understated</u>. NSCC believed the proposal would cause

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[30] See Exhibit 22 - Source: S3 Matching Technologies.

[31] See Exhibit 23 – "The Cooperating Broker-Dealer often placed these sales through various electronic communications networks (ECNs), which provide anonymity to traders wishing to conceal their identity from the market." Securities and Exchange Commission v Rhino Advisors, Inc. and Thomas Badian, February 26, 2003.

[32] See Exhibit 24 – Letter from Larry E. Thompson, General Counsel, National Securities Clearing Corporation to the SEC, File No. SR-NSCC-2006-04, SEC Release No. 34-53742 (April 28, 2006). www.sec.gov/comments/sr-nscc-2006-04/nscc200604-9.pdf

[33] www.sec.gov/comments/sr-nscc-2006-04/nscc200604.shtml

no change in clearing charges, but actually it resulted in an increase to Clearing Services and Trade Comparison and Recording charges of more than 70% to Wedbush clients. Given the vast disparity between NSCC's assumptions about this firm's activity and its actual count of pre-netted trades, it stands to reason that NSCC may not grasp the magnitude of the impact their proposed changes will have on its member firms and ultimately investors."

"The difference between this firm's actual trade count and the count derived from NSCC's assumptions is so large that it causes us to question whether NSCC has adequately planned for the capacity needed to process the huge increase in transactions that will be submitted if pre-netting ceases."[34]

The Trading System Appears Very Sophisticated

To get a perspective of the sophistication of the trading system apparently used by the firms or their client(s), in October 2008 the firms traded 24.5 billion shares reported just in market participant reports. The average trade size on the NYSE for April 2008, the last available data, was a volume of 256 shares per trade. The firms' trading volumes appear to be comparable to this number, which is evidenced by Wedbush's enormous number of trades they claim to pre-net. Using the April data as a point to estimate from, means the firms executed on average approximately 641,000 trades per hour, every hour during normal market hours in October 2008.

It seems impossible that this many trades could be matched each hour between legitimate buyers and sellers trading with just these two firms. The sheer magnitude of the number of trades suggests that this is not a manual process.

These are obviously not small retail customers trading 641 thousand trades an hour. Institutional funds are very large traders in blue chip stocks, but generally buy and hold their position. Institutional funds, by their very nature, are designed not to churn their portfolios over at very rapid rates; certainly they are not responsible for these 641 thousand trades per hour.

This trading is so massive that the amount of volume that entered the marketplace through Penson and Wedbush clearly appears to be new volume and displayed itself with a large footprint in the market. It is this new volume entering the market that is of concern. Very sophisticated computer systems appear to be engaged in this trading effort.

[34] Letter from Wedbush Morgan to the SEC, May 25, 2006. www.sec.gov/comments/sr-nscc-2006-04/rjrichards1985.pdf

Interactions Within the Marketplace

The massive volume transacted by the firms and their clearing businesses raises these two issues about their relationship and interactivity within the marketplace. First, they are trading so many shares it could be questioned whether they should be regulated as an exchange. For a perspective on this issue, in 2006 the NASDAQ traded on average 2 billion shares per day and in October 2008, Wedbush and Penson market participant reports show an average of 1.1 billion shares traded per day, or over half the volume that was generated in the average month on the NASDAQ by all market participants combined in 2006.

Second, at least Wedbush is pre-netting so much volume they have actually taken over a role of the National Clearance and Settlement System. Therefore, these huge volumes that they are transacting and pre-netting would be cause to consider whether they should be regulated under the U.S. securities laws by the SEC like the DTCC is, as a clearing agency.

The Metrics Between Trading Volume and Revenues Seem Disproportionate

It is hard to explain how such massive volumes of trades can be executed at rates reaching, at times, over 641 thousand trades per hour without considering the possibility of washing and matching of trades between the firms' client(s). The volume injected by the firms appears to be new volume which raises red flags that much of the volume may be prearranged washed and matched trades. There does not appear to be legitimate buyers for all of this volume.

Washed trading is volume executed between related parties, for example; broker trades with firms A, B, and C and owns firms A, B, and C. Matched trading is artificial volume created by unrelated entities but illegally executed between cooperating market participants.

Both illegal strategies are for the purpose of creating artificial volume and are used to manipulate prices. These strategies have been used as an effective means to manipulate prices throughout the history of commercial trading markets. This market damaging practice violates the Exchange Act and was deemed illegal by exchanges before the regulation of U.S. markets in the 1930s.

The amount of volume compared to the reported revenues being generated by the firms is disproportionate to the clearing fees and execution commissions reported by the firms. For

example, Penson in the 3rd quarter of 2008 collected $40.2 million in clearing and commission revenue. Of just the trading that can be identified, Penson traded 21.3 billion shares during the 3rd quarter of 2008. Penson also clears for other brokers that trade with their own symbols. Thus, the entire $40.2 million in clearing and commission revenue did not flow just from Penson's volume of 21.3 billion shares.

Nevertheless, taking the $40.2 billion in revenue and dividing it by the 21.3 billion shares traded equates to less than one fifth of a penny per share in clearing fees and execution commissions. This equals 19 cents per 100 shares traded to pay employees, cover expenses and account for the trading, clearing and settlement of these shares. This amount suggests that they may be trading an excessive amount of transactions for little or no apparent fees. There are costs associated with a large number of transactions and an example of this is found in SEC v. Tuco Trading LLC and Douglas G. Frederick, where the SEC found that just Tuco's last consolidated account statement from Penson for February 2008, exceeded 10,000 pages.[35]

Wedbush also has disproportionate reported numbers in relationship to their trade volumes discussed below.

Allegations of Improper Activity – Clearing Through Penson

The SEC filed a complaint against Tuco Trading LLC ("Tuco") and Douglas Frederick on March 6, 2008, which becomes an important matter in this discussion. In August 2006, Douglas Frederick formed Tuco for the purpose of allegedly perpetrating an illegal scheme which the SEC claims violated Section 15(a) of the Exchange Act, 15 U.S.C. Section 78 as a nonregistered broker, NASDAQ & NYSE governing margin requirements and Section 10(b) and 10(b)5, the anti-fraud provisions of the federal Securities and Exchange Act.[36]

Frederick was a registered broker with GLB Trading ("GLB") of Chicago. Frederick did not register Tuco as a broker/dealer with regulators. Tuco maintained an office within GLB. Frederick lives in California as does the president of GLB Trading, Robert Lechman. The co-owner of GLB is Gus Katsafaros.

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[35] See Exhibit 25 – Securities and Exchange Commission vs. Tuco Trading, LLC and Douglas G. Frederick, paragraph 21. www.tflinc.com/media/ComplaintViolations_FederalSecuritiesLaws.pdf.
[36] See Exhibit 25 – Securities and Exchange Commission vs. Tuco Trading, LLC and Douglas G. Frederick, www.tflinc.com/media/ComplaintViolations_FederalSecuritiesLaws.pdf.

The court appointed Thomas F. Lennon as Receiver of Tuco. The accounting by the Receiver is complex, incomplete and ongoing without full cooperation from GLB Trading and the clearing firm Penson Financial Services. Therefore, the full extent of the allegations is unknown at this time. The detailed information discussed below was derived from documents developed by Receiver Lennon, his forensic accountant William Ling and partially from the SEC complaint.[37]

According to the documents this was a multifaceted scheme. The first part involved Tuco purchasing a day trading business called Evolution Capital LLC, which Frederick had been a consultant to. Frederick attracted day traders to Tuco/Evolution by allowing them to day trade with less than the required capital to qualify as a U.S. day trader, which is $25,000. Tuco also offered a higher margin rate than is legal under the U.S. securities laws, which allowed its clients to illegally trade many more shares than they could otherwise execute. A 20 to 1 margin ratio was applied on special accounts, when the legal limit is 4 to 1; in other words, for each dollar of asset, twenty dollars was able to be borrowed for trading. The majority of the small day traders' activity was very limited. The day trading business gave a somewhat legitimate disguise for a heavy trading account from China.

Tuco received commissions and fees from the smaller day traders and collectively they had deposited approximately $11 million with Tuco. Frederick then allegedly ran a Ponzi scheme, devouring 35% of this deposited money for his expenses using newly deposited monies to cover withdrawals made by other clients. This was the main fraudulent scheme by Frederick that the SEC concentrated on. He delivered statements to his clients that reflected the value of their assets, some of which he had already distributed for his own personal gain and to others within the scheme, including other brokers at GLB.

The second aspect of the alleged scheme was set up for six accounts that had multiple sub accounts used to trade U.S. securities. One account in particular, Lanai Ltd., which is headquartered in China, is of concern. This account has undisclosed ownership and while the Receiver does not believe his work in this area is complete, he has identified <u>1,176 sub accounts</u> attributable to Lanai. Per Frederick, beginning in December 2007 and continuing until their

[37] For a listing of all documents posted by the Receiver for SEC vs. Tuco Trading, LLC, see www.tflinc.com/cases_tuco.html.

accounts were frozen in March of 2008, Lanai traded over 1 billion shares per month through Tuco and its clearing firm, Penson.

GLB was named in a FINRA proceeding in November 2007 regarding certain trade practices. GLB identified these trade orders to FINRA as coming from Tuco which in turn identified them as coming from Lanai. A settlement was agreed to, under which GLB would terminate all customers who had engaged in these trades. Per Frederick, Lanai continued to trade over a billion shares of stock per month until March 6, 2008. This is when the Tuco accounts were frozen, a cease and desist order was issued and a temporary bar from the securities industry was ordered by the court. This bar became permanent against Tuco and Frederick by March 18, 2008.

Tuco used more than six trading platforms and seven different broker dealers. The traders of significance were GLB Trading, Wedbush Morgan, Lightspeed Trading, Viewtrade Securities and MB Trading Futures. All of these firms clear trades through Penson Financial.

The next facet of the alleged scheme took place within the books and records of Penson Financial. Large blocks of money were purported to be transferred as loans for one or a few day periods moving between accounts at Penson in order to make an appearance that the Tuco accounts in fact contained substantial monies when they did not. This scheme was similar to the age old check kiting scheme where a large amount of money was continually moved between different banks in order to make the appearance of a substantial amount of capital owned by the schemer, but in this case, the kiting was done within the same clearing firm.

This manifestation of capital where little existed allowed a large number of trades to be executed on margin supplied by Penson that would not have been executed absent the temporary appearance of assets generated by these transfers.[38]

GLB's president, Lechman, and another confederate, Frank McDonald, supplied the monies that moved from account to account at Penson. These were not random movements of money. These transactions could not be mistaken as movements of large amounts of money for any other reason but to make the appearance of value in an account. The Receiver, at this time, has identified 343 such transactions from November 2006 to the end of the Tuco trading; more are expected to be

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[38] See Exhibit 26 – "The amount loaned by McDonald would be transferred at McDonald's instruction from his accounts at Penson to the Tuco accounts at Penson…" Receiver Thomas F. Lennon, First Interim Report Of Permanent Receiver And Petition For Further Instruction.

reported by the Receiver. Penson has the full records of the individual money movements of up to $2.3 million in a day, which Penson profited from.

This alleged illegal activity should not have been executed and Penson as the bookkeeper must have known the complete aspect of the scheme, which is demonstrated by the fact that they allowed the kiting of the money from account to account creating the appearance of account value for over one year.

The Tuco volume does not appear to be a part of the large amount of volume executed by Penson beginning in November 2007 that is the subject of this report. Penson, however, did clear and account for the Tuco trades and account transfers of money beginning in November 2006.[39]

This appears to explain why, at least in part, when Penson entered the marketplace in November 2007 with heavy volume, an additional increase in new volume transacted in the markets above the new volume injected by Penson, which came from the Tuco accounts. From December 2007 through February 2008, per Frederick, Tuco increased its trading to 2 billion shares per month with one trader, Lanai of China, transacting over 1 billion of these shares.[40] To put this 2 billion shares into perspective, Penson averaged 3.8 billion shares in the market participant reports during these three months, which suggests that the Tuco volume was a significant increase for Penson that they would be aware of.

The trade volume of Penson in mostly blue chip companies and industries since March 2008 when Tuco was shut down by the SEC has doubled to almost 9 billion shares in September 2008.

Penson Financial controlled the books and records of the trades, money transfers, commissions, interest charges and margin allotments. This trading was so large it created a footprint in the marketplace. Penson knew that Tuco was using several trading platforms and brokers to execute the trades because Penson cleared the trades for the Tuco brokers and produced statements to Tuco. They controlled the books showing the money transfers between Lechman, McDonald and the Tuco accounts for over 16 months. If, in fact, Penson is allowing such wide-

[39] Prior to December 2007, Lightspeed cleared the trades through Southwest Securities.
[40] T3 Capital LLC, a company claimed to be partially owned by Frederick, which is disputed by the counsel for T3,was responsible for approximately 600 million shares of the 2 billion shares traded.

spread illegal activity to be operated through its clearing business, it is reasonable to ask what other illegal activity may be operating through its trading, execution and clearing businesses.[41]

Other than Frederick and Tuco, the U.S. securities regulators have not filed any further actions against any other party to these trades.[42]

Trading of the U.S. Financial Industry

It is obvious that anyone trading a large volume of U.S. financial stocks from June 2008 to November 2008 would have lost significant amounts of money if they were purchasing financial sector stocks as long investors. However, profits in these six months were enormous for short sellers of these securities.

These two firms are the number one traders in the financial sector and their trading dramatically increased from June through September of 2008, while the markets lost trillions of dollars in value.

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[41] See Exhibit 27 – In a FINRA arbitration, Empire Financial Group, Inc., v. Penson Financial Services, Inc., Phil Pendergraft, Dan Son and Roger Engemoen, filed on January 14, 2009, one of Penson's clients, Empire Financial Group, Inc., alleges, among other fraudulent activities, an active participation in market manipulation by Penson. The complaint summarizes a record of complaints against the principles of Penson.
Paragraph 24. According to Engemoen's (Chairman of the Board of Penson) CRD, charges of fraud, fraudulent inducement, breach of contract, gross negligence, excessive use of margin and breach of fiduciary duty are among the allegations contained in the 19 reported customer disputes that have been lodged against Engemoen. Allegations of knowledge of fraudulent sales practice involving collateralized mortgage obligations comprise the 14 customer disputes lodged against Pendergraft (Chief Executive Officer of Penson) in just the last two years. Actually, the fact that 19 and 14 respective customer disputes are reflected on Engemoen and Pendergraft's CRDs is a gross understatement. One of those items reported on both of their CRDs involved a group of 39 separate arbitration claims which were settled in 2008 for $16,200,000. Of that amount, $4,500,000 was contributed by Engemoen and $2,000,000 was contributed by Pendergraft. Moreover both of these individuals have disciplinary records for failing to maintain sufficient net capital. Pendergraft was fined $10,000 and suspended for one year as a series 28 Financial and Operations Principal. For his part, Son (President of Penson) was censured and fined $7,500 in 2005 for failing to properly fund the firm's reserve account. In November 2008, Son became the subject of an arbitration claim alleging that through its clearing relationship with an introducing firm, Penson permitted the overcharge of $480,000 of commissions. In addition, an arbitration claim was filed against Son in September 2007, alleging that he was involved, either directly or indirectly, in certain broker conduct including violating state registration and securities laws, breach of fiduciary duty and negligence. The damages sought in that matter are $8,000,000.

[42] Some of the other parties according to the Tuco Receiver's report: Michael Kestler acted as a "silent partner" in Tuco, a description used by Frederick. Lisa Hyatt as Kayo Financial maintained an office at Tuco via an oral agreement and was an apparent investor in Tuco, which her investment was later changed to a loan in the Tuco books. Hyatt and Kestler own Ocean View Capital, which now leases the same Tuco offices in California after the landlord terminated the Tuco lease.

This report was originally based on September 2008 ending data and since written, the October and November data became available and these firms maintained their number one volume position.[43]

It would be expected to find that such heavy trading volumes would result in significant ownership of these securities over time, but this is not the case. The indication is that the firms do not own many shares of these companies, yet the firms were the number one volume traders of these stocks. This is a red flag for suspicious transactions and the potential of market manipulation.

An SEC filing from Penson contains the following statement:

> "In addition, we do not maintain material inventories of securities for sale, and therefore are not subject to equity price risk."[44]

Table 1 shows Wedbush Morgan institutional holdings and the volume that was reported in market participant reports ("MPR") for Wedbush and Penson in ten large financial companies that have been taken over or invested in by the U.S. taxpayer or bankrupted. Penson, as reflected in their SEC filing, did not report any holdings in the companies listed.[45] Note that even after the companies have been helped by the U.S. taxpayers, the firms continued to aggressively trade these stocks without any apparent ownership of shares.

Table 1 – Lack of Ownership but High Trade Volumes – Wedbush Institutional Holdings

	9/30/2008	**Jul-Sep 2008**	**6/30/2008**	**Apr-Jun 2008**	**3/31/2008**	**Jan-Mar 2008**
Issue Name	Institutional Holdings	Volume Traded in MPRs by the Firms	Institutional Holdings	Volume Traded in MPRs by the Firms	Institutional Holdings	Volume Traded in MPRs by the Firms
American International Group Inc	0	1,120,906,609	0	171,667,669	9,124	81,688,722
Bear Stearns Cos	N/A	1,042,310,868	N/A	699,673,305	N/A	855,558,526
Citigroup Inc	13,692	1,061,114,751	25,102	80,615,399	24,056	88,727,571
Countrywide Financial Corp	N/A	1,134,552,835	N/A	43,737,977	N/A	65,238,667
Fannie Mae	N/A	824,885,881	0	283,498,780	0	123,644,252
Freddie Mac	18,303	953,484,773	0	305,269,153	0	178,942,003
Lehman Bros Holdings	N/A	1,036,008,202	N/A	352,676,687	0	282,333,081
National City Corp	27,166	3,225,990,187	13,666	1,008,251,410	0	1,119,722,473
Wachovia Corp	0	953,484,773	10,354	145,702,914	0	324,512,988
Washington Mutual	N/A	1,036,008,202	36,282	18,212,329	18,882	117,081,797

[43] See Exhibit 28 – The firms traded 43.5 billion shares in October and November 2008 according to NASDAQ Market Participant Reports.
[44] See Exhibit 29 – Penson Worldwide Inc., 10-K, filed 03/14/2008.
[45] See Exhibit 30 – American International Group, Fannie Mae and Freddie Mac Institutional Holdings for June 30, 2008.

Table 2 shows the exponential growth of trading by these two firms in the financial sector of stocks traded in the U.S. In November 2007, the exact month that Wedbush and Penson joined in trading the identical large U.S. financial stocks, the price direction of the financial sector has been in decline with enormous increases in trading volume. The amount of trading executed by the firms definitely impacted the financial sector stocks, even though the firms appear to have virtually no inventories of the securities in the financial sector. The obvious impact from the trading has been negative. This suggests that either the firms are executing a very large amount of transactions from their own account while they own virtually none of the securities, or they have clients that are trading a very large amount of inventory. It is very striking in the data when this massive change in trading occurred at Wedbush and Penson. If this massive volume change is not from the firms' proprietary accounts, it must have been a new client who brought a massive amount of new volume into the markets. This raises questions of potential market manipulation through short selling by the clients of the number one traders of these stocks.

Table 2 – Penson & Wedbush Market Participant Report Volume in the Financial Sector

Month	Wedbush/Penson MPR Volume	Total MPR Volume in the Financial Sector	Wedbush/Penson % of Total MPR Volume in the Financial Sector
Sep-08	8,153,194,284	**43,494,204,589**	19%
Aug-08	4,210,882,341	**23,047,897,853**	18%
Jul-08	5,659,014,129	**34,408,752,655**	16%
Jun-08	3,087,933,182	**22,473,034,034**	14%
May-08	1,606,055,111	**14,781,257,354**	11%
Apr-08	1,913,866,994	**17,257,980,702**	11%
Mar-08	2,665,675,527	**22,433,917,872**	12%
Feb-08	1,499,330,572	**14,722,162,823**	10%
Jan-08	3,798,201,231	**22,452,426,997**	17%
Dec-07	2,076,110,167	**13,667,935,922**	15%
Nov-07	2,064,598,530	**16,917,847,205**	12%
Oct-07	1,001,676,800	**11,721,830,274**	9%
Sep-07	603,771,988	**9,365,760,462**	6%
Aug-07	789,388,693	**16,849,570,108**	5%
Jul-07	411,410,192	**10,395,481,677**	4%
Jun-07	304,748,697	**8,372,374,225**	4%
May-07	148,855,719	**7,571,841,902**	2%
Apr-07	195,987,207	**6,953,389,557**	3%
Mar-07	160,588,614	**8,173,992,070**	2%
Feb-07	220,256,405	**6,233,730,370**	4%
Jan-07	571,095,171	**6,230,656,295**	9%
Dec-06	468,482,143	**4,757,597,378**	10%
Nov-06	2,261,508	1,724,381,135	0%
Oct-06	1,230,817	1,452,390,268	0%
Sep-06	350,328	965,407,945	0%
Aug-06	406,370	1,066,143,106	0%
Jul-06	358,529	1,082,474,110	0%
Jun-06	491,694	1,438,673,576	0%

Wedbush and Penson Trading

Wedbush Trading

The considerable increase in trading volume in the financial stocks could have been caused by a large increase in the shares outstanding or a large increase in the short interest. However, this was not the case. The shares outstanding from January 2008 to September 2008 on the NYSE remained relatively stable, around 425 billion shares for all NYSE issues.[46] During a very high increase in trade volume by the firms from June to September 2008, short interest in financial stocks declined.

[46] See Exhibit 31 – NYSE Shares Outstanding and Market Capitalization of Companies.

New Volume in the Financial Sector

The volume injected into the marketplace by the firms appears to be new volume in the financial stocks. When Wedbush entered the market with massive trade volumes in December 2006, it did not decrease the traded volumes executed in the financial sector by the other major Wall Street firms. This indicates the volume that the firms were trading did not come from very large clients of other securities firms transferring their business. This newly injected volume is a very important point to consider.

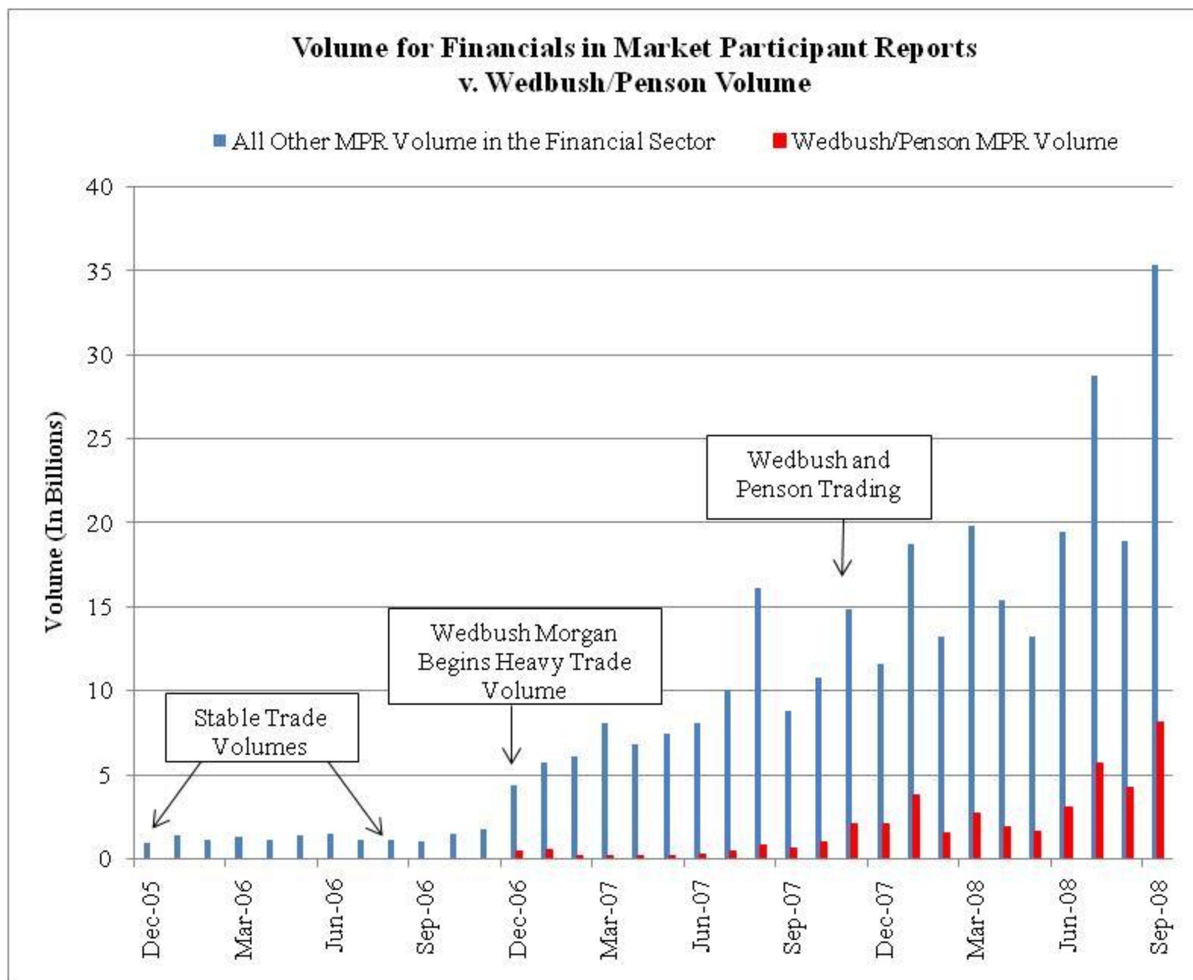
The large Wall Street firms hold most of the securities of blue chip U.S. companies in their brokerage accounts. The trading volumes of the large broker dealers did not decrease, therefore this appears to be very enormous newly injected volume entering the U.S. markets. Most blue chip companies are heavily owned by institutions who conduct business with the large Wall Street broker dealers. Since the firms were not large broker dealers at the time of this major infusion of volume transacted by them in the U.S. markets, how is it possible that they can trade this much volume when real shares were known to be heavily owned by institutions and in the hands of the large broker dealers? This raises a red flag that the newly injected volume may be suspiciously generated from sales of stock that did not exist.

The largest volume month in NYSE history was October 2008. This was also the largest volume month of the number one traders Wedbush and Penson in the market participant reports. The NYSE lost over 3 trillion dollars in value in October. Despite these record levels of trading, this was also the largest monthly decrease in short interest. Short interest declined by 4.2 billion shares or 24% on the NYSE. It is reported that because of the government emergency short selling rules, short sales declined, as is evidenced by the decrease in short interest. Illegal short selling may have continued, concealed as if they were long shares issued by the corporations.

Wedbush and Penson traded nearly one of every five shares in the financial stocks reported in the market participant reports and either they, or their client(s), were selling shares short that were not marketed short in violation of U.S. securities laws Rule 203(b) and the 2008 emergency orders or they had very significant undisclosed holdings of the securities that are required to be filed with the SEC. The firms have not filed SEC reports of significant ownership in any securities.

It is important to note that trade volumes in the financials were relatively stable prior to Wedbush becoming such a large trader in the marketplace. After their December 2006 massive injection of volume, trading in financials exponentially grew and it is expected that much of the volume increase is a result of the firms' trading that is not reported in market participant reports. Chart 1 shows the financial sector market participant report volume versus the firms' trading volume and the stable trading volumes prior to Wedbush becoming such a large market participant.[47]

Chart 1 – Exponential Growth in Trade Volumes of U.S. Financials



[47] Chart 1 may suggest that there may be other firms influencing the volume increase in the marketplace. However, it is expected that much of the other increase in volume will be attributable to the firms when the remainder of the trading is examined.

During the period of the firms' increasing volume, from June through October 2008, the NYSE market capitalization of companies was declining. Table 3 shows the NYSE market capitalization decline from $16 trillion to $10 trillion in six months compared to the increasing share volume traded by the firms in all issues.

Table 3 – 2008 NYSE Shares Outstanding and Market Capitalization v the Firms Volume

Month	Market Capitalization (Value)	Shares Outstanding	Volume Traded by Penson and Wedbush in All Issues
June	$16,123,771,859,266	425,506,310,992	11,953,154,666
July	$15,018,847,576,673	424,337,939,858	16,916,093,403
August	$15,128,954,458,008	424,517,514,259	14,902,357,154
September	$14,433,866,062,614	427,249,360,111	23,542,964,679
October	$11,368,663,995,459	443,243,615,237	24,547,483,282
November	$10,115,157,481,838	439,637,727,848	19,079,957,928

Liquidity Providers – Firms Trading with Large Capital Resources

Wedbush appears as a top liquidity provider starting in June 2006, five months prior to them appearing as a significant reporting market maker.[48] Prior to June 2006, Wedbush was not a significant trader of U.S. securities. Table 4 shows Wedbush Morgan's rank in the listing of the top ten NASDAQ liquidity providers in NYSE securities. Becoming a very large liquidity provider prior to showing up as a significant reporting market maker in November 2006 indicates that Wedbush trades a large amount of share volume from the non-reporting (contra) side of the trades. This also suggests that the market participant numbers discussed in this report are significantly understated.

[48] See Exhibit 32 – For NYSE-listed securities, liquidity provider ranking is calculated based on shares of NYSE-listed securities executed on NASDAQ. Liquidity providers were supplied by NASDAQ's Economic Research Department. www.nasdaqtrader.com/trader.aspx?id=topliquidityarchive

Table 4 – Wedbush Morgan Becomes the Largest U.S. Liquidity Provider

Month	Rank in Liquidity Providers	Month	Rank in Liquidity Providers	Month	Rank in Liquidity Providers
Nov-08	1	Jan-08	1	Mar-07	1
Oct-08	1	Dec-07	2	Feb-07	1
Sep-08	1	Nov-07	2	Jan-07	1
Aug-08	1	Oct-07	1	Dec-06	1
Jul-08	1	Sep-07	1	Nov-06	1
Jun-08	1	Aug-07	2	Oct-06	1
May-08	1	Jul-07	1	Sep-06	4
Apr-08	1	Jun-07	1	Aug-06	2
Mar-08	1	May-07	1	Jul-06	6
Feb-08	1	Apr-07	1	Jun-06	8

Being the largest liquidity provider affords the firms substantial influence over the trading of U.S. securities, which have been declining in price since the two firms have been trading the same U.S. securities.

The Firms are the Largest U.S. Traders

There was an extraordinary increase in the firms' market participant report volume beginning in November 2006 and most significant are the increases in volume from June 2008 to September 2008 with these firms trading 23.5 billion shares in September 2008. To put this trading in perspective, these firms are the number one traders in the September market participant reports with 23.5 billion shares and Goldman Sachs was number 2 with 12.4 billion shares traded.

The sharp increase in volumes traded by the firms in 2008 indicates that the firms are not decreasing their transactions in blue chip stocks, but rather they are increasing their trading intensity, while the financial sector and the markets of the U.S. are collapsing.

Prior to November 2006, Wedbush was a relatively small west coast regional securities firm with market participant reports showing an average trading of 53 million shares per month. During the month of December 2006, Wedbush traded an astounding 4.7 billion shares in the U.S. public markets. Table 5 shows the market participant report volume for the firms. There was a massive volume surge from Wedbush in November 2006 and Penson beginning in November 2007, trading the same U.S. securities as Wedbush trades.

Table 5 – Penson and Wedbush Market Participant Report Volume – All Issues

Date	Penson Financial & Wedbush Morgan Total
Sep-08	23,542,964,679
Aug-08	14,902,357,154
Jul-08	16,916,093,403
Jun-08	11,953,154,666
May-08	8,294,495,507
Apr-08	8,499,003,217
Mar-08	9,345,824,134
Feb-08	6,905,838,614
Jan-08	10,124,990,333
Dec-07	6,088,314,044
Nov-07	6,209,526,145
Oct-07	3,546,930,090
Sep-07	2,682,747,470
Aug-07	3,718,176,115
Jul-07	3,231,004,067
Jun-07	2,655,319,331
May-07	2,221,454,218
Apr-07	2,444,873,257
Mar-07	2,236,059,381
Feb-07	2,689,243,510
Jan-07	5,937,059,503
Dec-06	4,703,489,637
Nov-06	540,371,369
Oct-06	61,180,802
Sep-06	8,660,260
Aug-06	35,261,169
Jul-06	41,657,422
Jun-06	45,125,002

Wedbush and Penson Trading

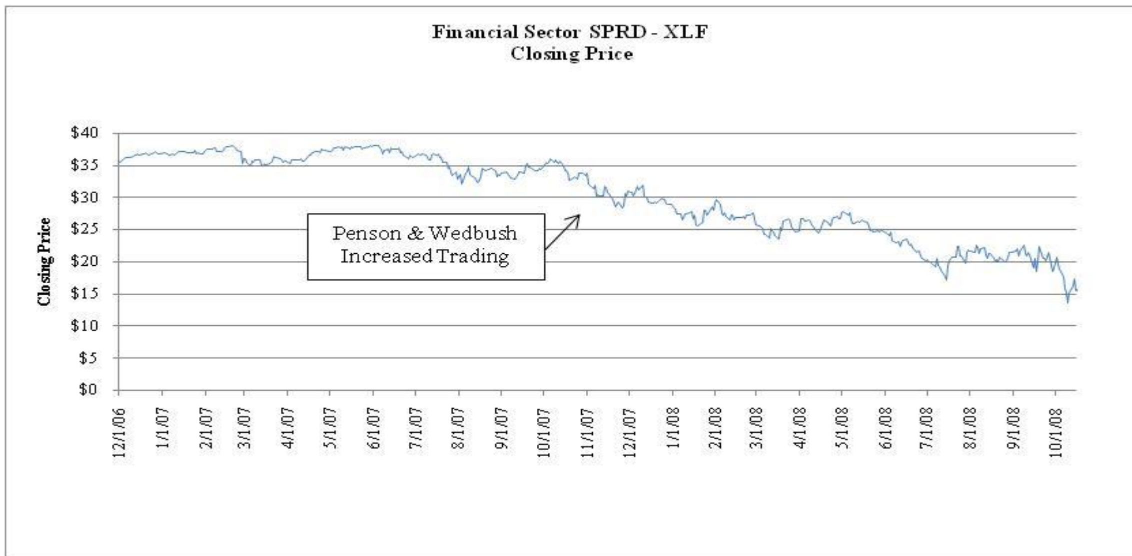
Wedbush Trading

Trading the Financial Spiders

The financial spider[49] indicates a direction in the trading of the major financial stocks in the U.S. It is indicative of the sentiment in the marketplace and it is a significant price discovery mechanism that provides a view of the financial industry on a macro level and it indicates where financial stocks are inclined to go in price. Chart 2 shows the price and the high volume traded by the firms in the financial spider (symbol "XLF").

[49] Spiders are units of an Exchange Traded Fund that track the performance of various indexes.

Chart 2 – Financial Sector Spider – XLF



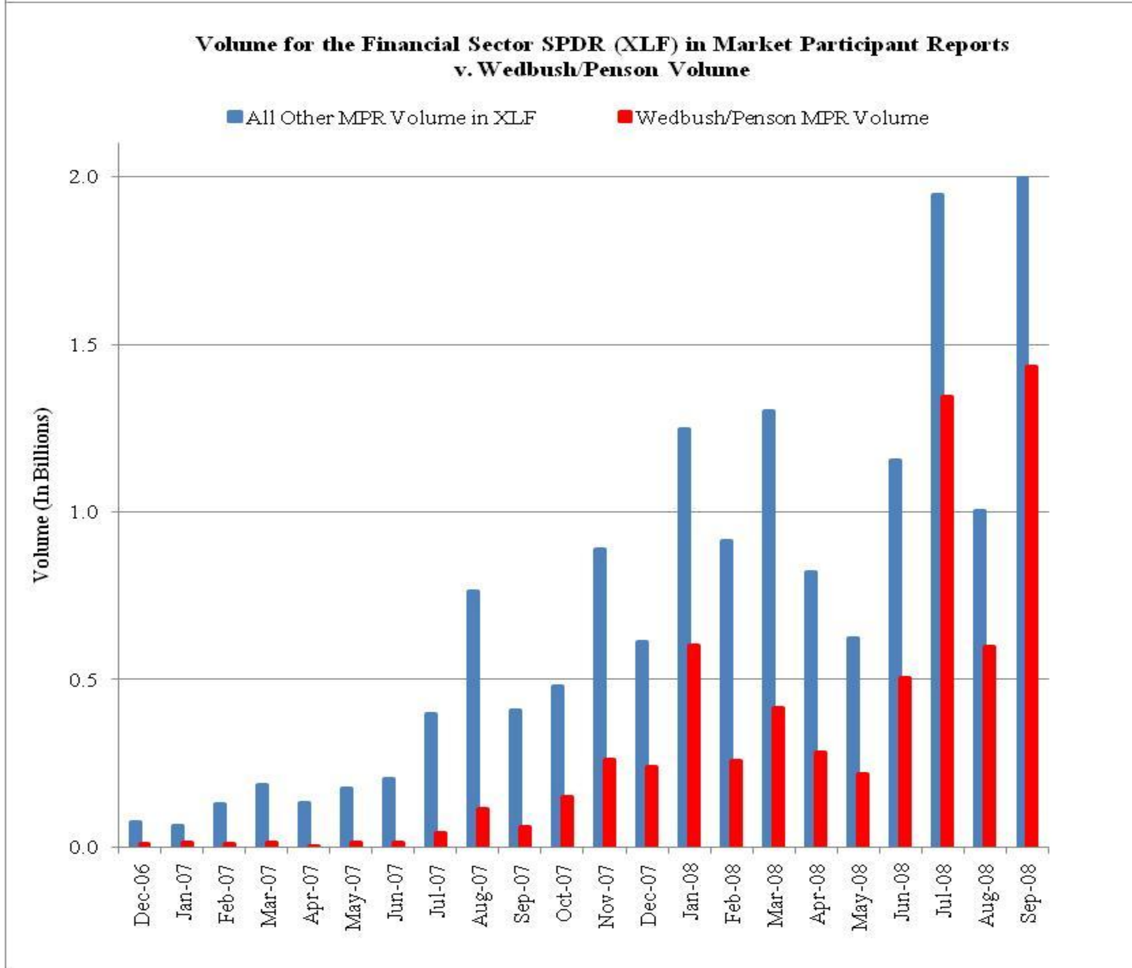


Table 6 shows an outright domination of the trading in the financial spider (XLF) by these firms that averaged 41% of the market participant report volume from June through November 2008.

Since November 2007, when Penson joined with Wedbush in their trading, the spider has declined from approximately $33 to a low of $9.39 on November 20, 2008, a decline of 71%.

At the same time they are dominating the financial spider, they are also dominating the trading in all the major U.S. financial stocks, of which they have virtually no inventory of, their client(s) must control a vast amount of inventory of blue chip companies or the firms client(s) are violating U.S. securities laws, including the emergency order against short selling in the financial sector, instituted by the SEC. Trading massive volumes in the financial sector, when the sector is in severe decline, raises red flags that the number one traders of these stocks are short sellers and may be part of a scheme to manipulate the financial market by controlling both the predictive indexes of stock prices and the individual securities.

Table 6 – Market Participant Report Volumes – U.S. Financial Select Spider - XLF

Month	XLF MPR Volume	Wedbush MPR Volume	Penson MPR Volume	Total Wedbush & Penson MPR Volume	Wedbush & Penson Percentage of MPR Volume
Nov-08	1,808,062,919	709,501,377	153,964,693	863,466,070	48%
Oct-08	2,402,528,279	1,040,193,504	154,356,046	1,194,549,550	50%
Sep-08	3,427,222,780	1,179,345,504	252,455,502	1,431,801,006	42%
Aug-08	1,601,040,162	490,956,381	107,247,292	598,203,673	37%
Jul-08	3,288,833,033	1,141,657,085	202,564,235	1,344,221,320	41%
Jun-08	1,660,594,720	396,747,268	109,742,135	506,489,403	31%
May-08	842,180,162	188,740,837	29,229,406	217,970,243	26%
Apr-08	1,105,031,224	244,850,734	38,943,530	283,794,264	26%
Mar-08	1,715,794,056	344,081,476	70,969,968	415,051,444	24%
Feb-08	1,171,668,106	237,056,945	22,328,924	259,385,869	22%
Jan-08	1,848,701,621	497,189,491	103,369,627	600,559,118	32%
Dec-07	851,527,339	205,030,798	35,250,669	240,281,467	28%
Nov-07	1,150,221,149	240,303,858	19,828,521	260,132,379	23%
Oct-07	631,764,981	149,838,616	42,340	149,880,956	24%
Sep-07	472,606,097	62,518,785	24,688	62,543,473	13%
Aug-07	876,836,032	113,561,186	60,414	113,621,600	13%
Jul-07	440,562,132	41,756,587	5,655	41,762,242	9%
Jun-07	217,766,617	13,932,195	2,015	13,934,210	6%
May-07	190,200,837	13,033,458	3,064	13,036,522	7%
Apr-07	136,563,603	4,543,676	675	4,544,351	3%
Mar-07	198,772,416	13,034,451	640	13,035,091	7%
Feb-07	137,462,430	9,801,215	24,276	9,825,491	7%
Jan-07	77,322,627	13,762,680	54,239	13,816,919	18%

Trading Financial Indicators

The firms are dominating the trading of other U.S. traded financial indicators such as Financial Select Sector SPDR, SPDR KBW Bank and SPDR KBW Regional Banking, IShares Russell 1000 Index, IShares S&P 500 Index, IShares S&P 100 Index, IShares Russell 2000 Index and IShares S&P SmallCap 600 Index.

Global Financial Indicators

IShares MSCI United Kingdom Index, IShares S&P Europe 350 Index and IShares FTSE/Xinhua China 25 Index.

This indicates that these firms may not be only concentrating on U.S. assets but financial assets around the globe.

Individual Financial Stocks Under Pressure from Wedbush and Penson

Table 7 shows financial stocks that appear to be targeted by the firms and the firms' volume ranking in each stock for September 2008 or during their collapse. All of these stocks have downward price direction during the time the two firms have been trading them. This indicates that the large volume leaders in these stocks may be pushing the prices of these stocks down.

Table 7 – Financial Sector Stocks Dominated by the Trading from the Firms

Issue ID	Issue Name	MPR Volume Ranking	Issue ID	Issue Name	MPR Volume Ranking
AIG	Amer Intl Group Inc	1	MTB	M&t Bank Corp	1
AXP	Amer Express Inc	1	NCC	Natl City Cp	1
BAC	Bk Of America Cp	1	NYB	New York Cmmty Bnc##	1
BBD	Banco Bradesco Ads	1	PFS	Provident Fnl Srvs	1
BBT	Bb&t Cp	1	PNC	P N C Fin Svcs Gr	1
BK	Bank Of Ny Mellon Cp	1	RF	Regions Financial Cp	1
BSC	Bear Stearns	1	RY	Royal Bank Of Canada	1
C	Citigroup Inc	1	SFI	Istar Finl Inc	1
CFC	Countrywide	1	SLM	Slm Corporation	1
CIT	Cit Group Inc (Del)	1	SNV	Synovus Finl Cp	1
CMA	Comerica Inc	1	SOV	Sovereign Bancorp	1
COF	Capital One Financia	1	STI	Suntrust Banks	1
CYN	City Natl Cp	1	STT	State Street Cp	1
DFS	Discover Fin Svcs	1	TCB	T C F Financial Corp	1
FCF	First Commonwlth Fin	1	TD	Toronto Dominion	1
FHN	First Horizon Ntl Cp	1	UBB	Unibanco Brasilrs Sa	1
FNM	Fannie Mae	1	UBS	Ubs Ag (New)	2
FRE	Freddie Mac	1	USB	Us Bancorp	1
IFN	India Fund (The)	1	VLY	Valley Natl Bancorp	2
ITU	Banco Itau Hldg Ads	1	WB	Wachovia Cp	1
JPM	Jp Morgan Chase Co	1	WFC	Wells Fargo & Co New	1
KEY	Keycorp	1	WM	Washington Mutual	1
LEH	Lehman Bros Hld	1	WTFC	Wintrust Financial Corp	8
MCO	Moody S Corp	2			
MI	New M&i Corporation	1			

Blue Chip Stocks Under Extreme Selling Pressure

Like the financial spider, the firms are heavily trading the Dow Industrials. These are key elements to the entire health of the U.S. markets and these two firms are the number one traders in the 30 Dow stocks in the market participant reports. The volume leader is not Goldman Sachs or Merrill Lynch or any of the other large Wall Street firms that would be expected to lead this trading, but rather is led by two formerly small firms from Texas (Penson) and California (Wedbush). This is unprecedented.

Historically, small market manipulating firms attack a stock or even a market sector, but trading all of these sectors at the same time with massive volumes when the sectors are all in decline suggests that a very sophisticated strategy of trading the entire blue chip market in a downward direction is being employed.

Chart 3 shows the decline in value of the Dow stocks since the firms teamed to trade the same stocks. The firms are the largest traders of the UltraShort Dow ETF. It is logical to suspect that with the massive trade volumes the firms are executing they are helping to push prices down.

Chart 3 – Dow Jones Industrial Average

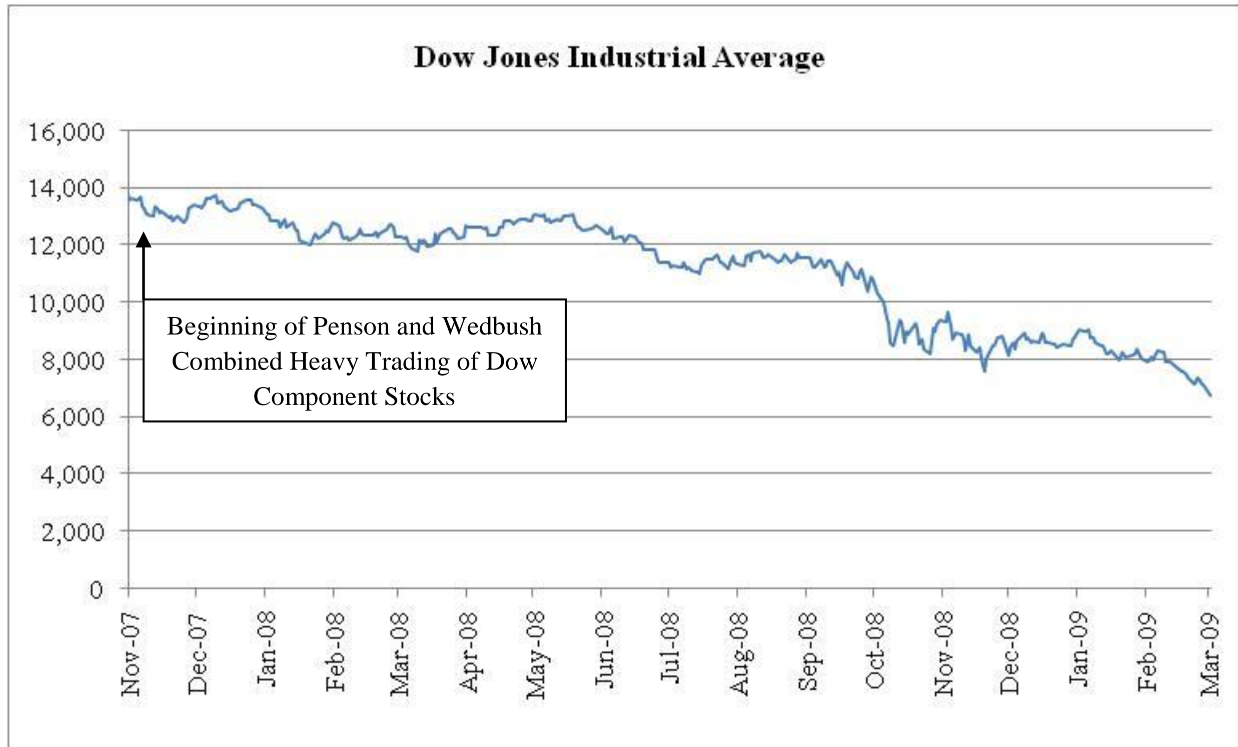


Table 8 shows the trade volumes by the firms reported in market participant reports for the Dow stocks. An almost doubling of volume occurred when Wedbush and Penson began trading the same blue chip stocks in November 2007. From July through November 2008, just the reported volume in market participant reports shows the firms traded a remarkable 12.4 billion shares of Dow stocks in just 106 trading days, averaging almost 124 million shares per day of blue chip Dow securities. It appears that when their other trading is taken into consideration, their volume of trading in just the Dow stocks will constitute, by far, the largest volumes ever reported in these securities. It is reasonable to conclude that their trading in fact did have and still has a significant negative impact on the pricing of the Dow stocks.

Table 8 – Penson & Wedbush Market Participant Report Volume in the Dow Jones Industrials

Month	Wedbush/Penson MPR Volume	Total MPR Volume in Dow Jones Industrials	Wedbush/Penson % of Total MPR Volume in Dow Jones Industrials
Nov-08	3,140,324,175	16,658,601,396	19%
Oct-08	3,100,609,431	16,286,259,951	19%
Sep-08	2,466,408,016	13,537,017,898	18%
Aug-08	1,615,682,397	8,875,723,093	18%
Jul-08	2,143,224,707	13,086,046,458	16%
Jun-08	1,626,562,573	10,677,453,554	15%
May-08	1,170,423,213	8,115,847,624	14%
Apr-08	1,199,898,522	8,511,887,914	14%
Mar-08	1,060,075,490	8,435,727,403	13%
Feb-08	840,717,466	8,040,623,520	10%
Jan-08	1,780,302,759	11,140,069,640	16%
Dec-07	1,034,164,384	6,372,828,701	16%
Nov-07	1,122,401,707	8,445,092,222	13%
Oct-07	594,043,219	7,150,237,988	8%
Sep-07	443,782,429	5,893,079,271	8%
Aug-07	552,502,785	8,881,504,232	6%
Jul-07	470,375,853	7,283,466,182	6%
Jun-07	428,599,018	6,400,156,007	7%
May-07	263,436,904	5,882,065,461	4%
Apr-07	356,247,706	5,309,403,191	7%
Mar-07	263,202,558	5,738,309,990	5%

Table 9 shows the Dow stocks and the firms' volume ranking in each stock for September 2008. All of these stocks have downward price direction during the time the two firms have been trading them. This suggests that the firms as the large volume traders in these stocks, who do not own any significant inventory, may be short selling the Dow and manipulating the U.S. market.

Table 9 – The Firms Market Participant Report Volume Ranking in Dow Stocks

Dow Stocks	Wedbush/Penson Volume Ranking in Market Participant Reports for September 2008
3M Company (MMM)	1
Alcoa Inc. (AA)	1
American Express Co. (AXP)	1
AT&T Inc (T)	1
Bank of America Corp. (BAC)	1
Boeing Co. (BA)	1
Caterpillar, Inc. (CAT)	1
Chevron Corp. (CVX)	1
Citigroup Inc. (C)	1
Coca-Cola Co. (KO)	1
DuPont (E.I.) deNemours (DD)	1
Exxon Mobil Corp. (XOM)	1
General Electric Co. (GE)	1
General Motors (GM)	2
Hewlett-Packard Co. (HPQ)	1
Home Depot, Inc. (HD)	1
Intel Corp. (INTC)	1
International Bus. Mach. (IBM)	1
J.P. Morgan Chase & Co. (JPM)	1
Johnson & Johnson (JNJ)	1
Kraft Foods Inc. Cl A (KFT)	1
McDonalds Corp. (MCD)	1
Merck & Co. Inc. (MRK)	1
Microsoft Corp. (MSFT)	49
Pfizer Inc. (PFE)	1
Procter & Gamble Co. (PG)	1
United Technologies Corp. (UTX)	1
Verizon Communications Inc. (VZ)	1
Wal-Mart Stores, Inc. (WMT)	1
Walt Disney Co. (DIS)	1

UltraShort the Markets

Wedbush and Penson are the largest traders in UltraShort funds (betting the values of the component stocks will decline) of Proshares Ultrashort, Pt Ultrshrt Dow30 Ps, Pt Ultrshrt Sp500 Ps, Pt Utlrshrt QQQ Ps, Ultrashort Financial, Ultrashort Russell20, Pt Ultrshr Mc400 Ps, Ultrashort Basic Mat, Ultrashort Real Esta and Ultrashort Oil & Gas. This is another indication that they are short sellers and this is another means of profiting from market declines.

Other Markets Under Pressure from the Firms

Table 10 shows the trading in the NASDAQ QQQQ was dominated by the firms and averaged 36% of the trade volume from August to November of 2008 when the NASDAQ indicator QQQQ declined from $48.25 to $25.56 or 47%. The QQQQ is an indicator to the future price direction of the NASDAQ. The price direction during the time the two firms have been trading the QQQQ has been down.

Table 10 – NASDAQ QQQQ Market Participant Reports

Month	Wedbush/Penson MPR Volume	Total MPR Volume in Powershares QQQQ	Wedbush/Penson % of Total MPR Volume in Powershares QQQQ
Nov-08	683,077,350	1,865,751,215	37%
Oct-08	1,291,526,053	3,082,706,330	42%
Sep-08	624,452,302	2,003,434,678	31%
Aug-08	374,089,151	1,132,608,434	33%
Jul-08	N/A	N/A	
Jun-08	369,150,527	1,467,501,752	25%
May-08	351,770,006	1,139,821,588	31%
Apr-08	322,785,456	1,073,539,759	30%
Mar-08	362,138,788	1,266,817,519	29%
Feb-08	283,421,256	1,228,830,717	23%
Jan-08	358,596,840	1,724,832,817	21%

Massive Trade and Dollar Volumes

In total, just the market participant reports show **203 billion** shares traded by these two firms, in mostly higher priced NYSE traded issues with the majority of their trading in the U.S. financial sector.

There were approximately 427 billion shares outstanding of all issues traded on the NYSE during this same period. The average share price of NYSE stocks was $40.27 in 2006 and 2007 and based on this average,[50] the firms traded a transactional value of 8.2 trillion dollars in 25 months of trading ending in November 2008; adjusting for the recent and rapidly declining prices an estimate of 5 trillion dollars transacted is reasonable. Without additional data such as the contra side of the trades, it is not possible to estimate the total transactional value traded by these firms at this time. It

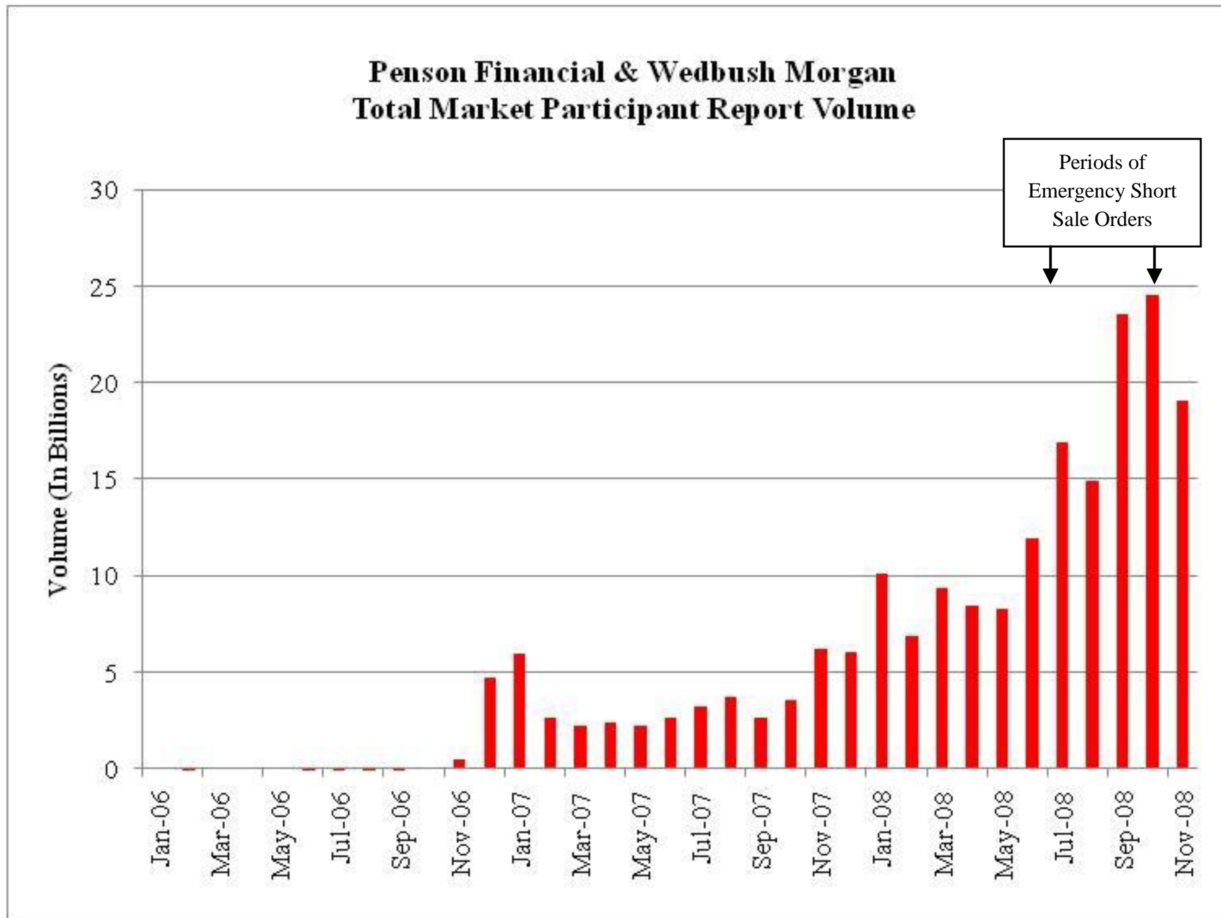
[50] See Exhibit 33 – NYSE Group Shares Outstanding and Market Capitalization of Companies Listed. www.nyxdata.com/nysedata/default.aspx?tabid=115

is logical to conclude that they have executed many trillions of dollars in trades of U.S. securities and that if any illegal profit may have been gained from this trading, it is traceable.

Emergency Short Selling Rules

From July through October there were global discussions and actions by regulators to stop abusive short selling. The first emergency order by the U.S. government was in effect from July 21 to August 12, 2008. A second emergency order was in place from September 18 to October 17, when a new U.S. regulation 10b-21 was adopted by the SEC, which further enhanced the already existing rules against illegal short selling. The rules enacted should have constrained trading. Chart 4 graphs the large changes in trading volumes by the firms.

Chart 4 – Growth in Market Participant Report Trade Volumes



Known Ownership

The large financial stocks have high institutional ownerships and are widely held by non-institutional investors. From the fourth quarter of 2007 through the reporting date of June 30, 2008, virtually all of the shares issued by Fannie Mae and Freddie Mac were owned just by the reporting institutional firms. The pension funds, other institutional holders and private shareholders have now been effectively wiped out in their Fannie and Freddie investments. The firms continue to aggressively trade Fannie and Freddie, for which prices are depressed, adversely affecting the U.S. taxpayers.

Table 11 shows the shares outstanding plus shorted shares and the institutional ownership of Fannie and Freddie. All of the shares issued and legally shorted were virtually 100% owned by the institutions.[51] Institutions owned significantly more shares than the shares outstanding, which shows that even institutional holders have purchased shares that were not issued by Fannie and Freddie. Most importantly, institutions owned virtually all shares outstanding plus legally shorted shares. This reported institutional ownership does not account for non-institutional investor ownership, both foreign and domestic, which is believed to be a significant number of shares owned by private investors, non reporting banks and investment funds

The (shares outstanding) added to the (short interest) equals the total legal amount of (shares available). (shares outstanding + short interest = all legally tradable shares)

On June 30, 2008, institutions owned more than all legally available shares of Fannie Mae. In other words, these excess owned shares by institutions were neither long nor short shares, but never-the-less, were shares sold into the market of these stocks, i.e. phantom or counterfeit financial instruments.

[51] See Exhibit 34 – Source: FactSet Research Systems Inc. (www.nasdaq.net).
Fannie Mae institutional holdings and Freddie Mac institutional holdings.

Table 11 - GSE Shares Outstanding Plus Short Interest vs. Institutional Ownership June 30, 2008

Quarter Ended	Short Interest	Shares Outstanding	Legal Shares Available to Own	Institutional Holdings	% of Available Shares (Outstanding Plus Shorted Shares) owned by Institutions
Fannie Mae					
2008-06-30	138,687,675	1,076,594,797	1,215,282,472	1,220,879,260	100.46%
Freddie Mac					
2008-06-30	82,804,409	647,008,105	729,812,514	729,247,840	99.92%

Since the firms began trading Fannie and Freddie heavily, the price has collapsed with very large increases in trade volumes. From November 2007 through June 30, 2008, trade volumes should have been significantly constrained because of the very high known ownership in these securities, but trade volumes exploded, led by Wedbush and Penson as the number one trader in these stocks. Other investors that are not reporting institutions also held shares, so the increased trading volumes from the firms is illogical considering that the reporting institutions and private investors owned all of the shares.

This raises red flags the firms were trading stock that did not exist. From July 2008 through September 2008, the firms traded more shares of Fannie and Freddie than were issued, while the share prices were collapsing.

The U.S. government took over Fannie and Freddie on September 7, 2008 and the firms continued to trade these stocks heavily after the takeover.

Despite the actions by the U.S. government to stop abusive short selling, which included protection for Fannie and Freddie, the firms trading of these companies dramatically intensified beginning in July 2008. While the firms trading increased in November 2007 by 6 fold, amazingly from June to July 2008 the firms trading increased by 600 million shares from 44 million shares of Fannie and Freddie to 640 million in July, or almost 15 times their June volume.

The October and November 2008 market participant reports show the firms traded another 457 million shares following the taxpayer takeover in September, or 18% of the Fannie and Freddie trade volume for these two months.

It is obvious that the price of the U.S. taxpayer owned companies would be significantly different without the heavy volumes of trading coming from these firms. The firms trading in all of the companies helped by the taxpayers appear to be in direct opposition to the public's interest, which is for an increased stock price. Declining values of blue chip companies has and is severely and negatively affecting the employment of the U.S. taxpayers.

Table 12 shows this explosive trading of Fannie and Freddie by the firms. There were only 1.6 billion shares issued by Fannie and Freddie and they were in the hands of known ownership.

Table 12 – Penson & Wedbush Market Participant Reports Volume

Fannie Mae and Freddie Mac

Month	**Total MPR Volume in Fannie Mae & Freddie Mac**	**Wedbush/Penson MPR Volume**	**Wedbush/Penson % of Total MPR Volume in Fannie Mae & Freddie Mac**
Sep-08	4,755,302,450	898,161,063	19%
Aug-08	3,239,057,404	657,330,937	20%
Jul-08	3,453,426,792	640,175,586	19%
Jun-08	412,547,649	**44,461,539**	11%
May-08	460,751,830	44,795,592	10%
Apr-08	376,704,818	35,096,245	9%
Mar-08	832,895,943	81,940,479	10%
Feb-08	477,102,547	39,825,624	8%
Jan-08	408,828,911	64,610,597	16%
Dec-07	332,715,715	45,486,013	14%
Nov-07	572,521,887	64,585,686	11%
Oct-07	156,800,097	11,209,858	7%
Sep-07	106,143,333	7,384,554	7%
Aug-07	318,118,704	7,189,245	2%
Jul-07	85,702,050	2,024,470	2%
Jun-07	118,955,596	2,177,062	2%
May-07	102,471,823	183,836	0%
Apr-07	76,752,642	581,485	1%
Mar-07	103,023,258	160,681	0%
Feb-07	87,862,493	1,364,483	2%
Jan-07	50,411,751	3,486,279	7%
Dec-06	79,458,040	4,427,501	6%

SEC Emergency Short Sale Orders

Selling Short Shares as Long Shares Issued by Corporations

Table 13 shows the short interest in large financial stocks decreasing in September 2008, while the SEC was instituting and contemplating a variety of short selling rules. During this period, the trading by the firms increased dramatically, but short sales declined, raising red flags that they may have violated the short selling rules by selling shares long as if the companies issued the shares and continued with their strategic trading despite these new rules. This raises concerns that their trading strategies may have intent to damage the U.S. financial system through trading large volumes of long sales of stock they do not own, which is the most damaging trading strategy to a supply and demand marketplace.

Table 13 – September Short Interest in Financial Stocks vs. September Market Participant Report Trade Volumes of Penson and Wedbush

Settlement Date	Short Interest American International Group	Short Interest Wachovia Corporation	Short Interest National City	Short Interest Fannie Mae	Short Interest Freddie Mac
8/29/2008	85,839,832	269,117,036	166,083,725	182,658,789	158,460,612
9/15/2008	96,626,949	267,577,010	172,780,343	163,468,911	142,087,613
9/30/2008	84,561,058	199,647,343	149,166,364	67,085,117	70,555,729
Wedbush/Penson September Volume	871,941,754	366,557,440	142,154,731	476,494,674	421,666,389

Citigroup

Citigroup is provided as an example to illustrate the effect of the firms trading on an individual security. Table 14 shows Citigroup's market participant reports total volume and the volume traded by the firms. To reiterate, only the reported side of the transaction is included in market participant reports and the contra side of the transactions that cannot be reviewed at this time are assumed to be heavily dominated by the firms and therefore their trading is significantly understated in these numbers.

The reporting side of the marketplace shows that these firms have been significant traders of Citigroup since December of 2006, when the price of Citigroup was between $50 and $60.[52] From

[52] See Exhibit 35 – Citigroup Historical Prices and Volume.

December 2006 to November 2007, Wedbush was not acting in concert with Penson. Beginning in November 2007, they began to trade identical stocks in the financial sector, including Citigroup. By November 2007, the firms were transacting over one of every five shares reported in the market participant reports for Citigroup.

Interestingly, the firms traded 328 million shares of Citigroup in November 2007, which were more shares traded in Citigroup by the two firms than by all market participants combined in November 2006. On November 24, 2008, Citigroup required funding from U.S. taxpayers.

Table 14 – Penson & Wedbush Market Participant Reports Volume in Citigroup

Month	**Total MPR Volume in Citigroup**	**Total Wedbush/ Penson MPR Volume**	**Wedbush/Penson % of Total MPR Volume in Citigroup**
Nov-08	4,196,429,721	900,355,007	21%
Oct-08	1,877,072,058	432,847,741	23%
Sep-08	1,923,281,756	419,739,575	22%
Aug-08	998,404,648	249,006,358	25%
Jul-08	1,812,449,105	373,564,935	21%
Jun-08	1,383,521,628	301,264,253	22%
May-08	995,649,702	182,684,845	18%
Apr-08	1,121,187,059	215,724,207	19%
Mar-08	1,498,645,265	295,755,487	20%
Feb-08	1,068,980,167	200,187,233	19%
Jan-08	1,792,111,696	463,198,399	26%
Dec-07	1,022,405,692	261,545,348	26%
Nov-07	1,647,387,019	328,579,192	20%
Oct-07	720,596,981	101,043,316	14%
Sep-07	357,260,755	43,213,309	12%
Aug-07	646,476,575	71,861,616	11%
Jul-07	397,540,773	43,920,805	11%
Jun-07	259,410,033	32,240,369	12%
May-07	304,935,135	18,973,961	6%
Apr-07	234,874,984	29,520,814	13%
Mar-07	240,705,663	18,988,641	8%
Feb-07	180,480,097	20,154,470	11%
Jan-07	215,451,159	51,966,496	24%
Dec-06	259,803,029	59,376,354	23%

The above Table 14 shows the high volume of trading by the firms, but short interest does not reflect this high volume trading and by the middle of July 2008, short interest began to decline. This indicates that the massive volumes of trading from the firms is not from short selling, but rather from long sales of stock issued by Citigroup. However, there is no indication that these firms own any significant amount of Citigroup stock, or any substantial number of shares of the

financial sector stocks that they are the number one trader in. Chart 5 shows Citigroup's price, volume and short interest.

Chart 5 – Citigroup Closing Price, Volume and Short Interest

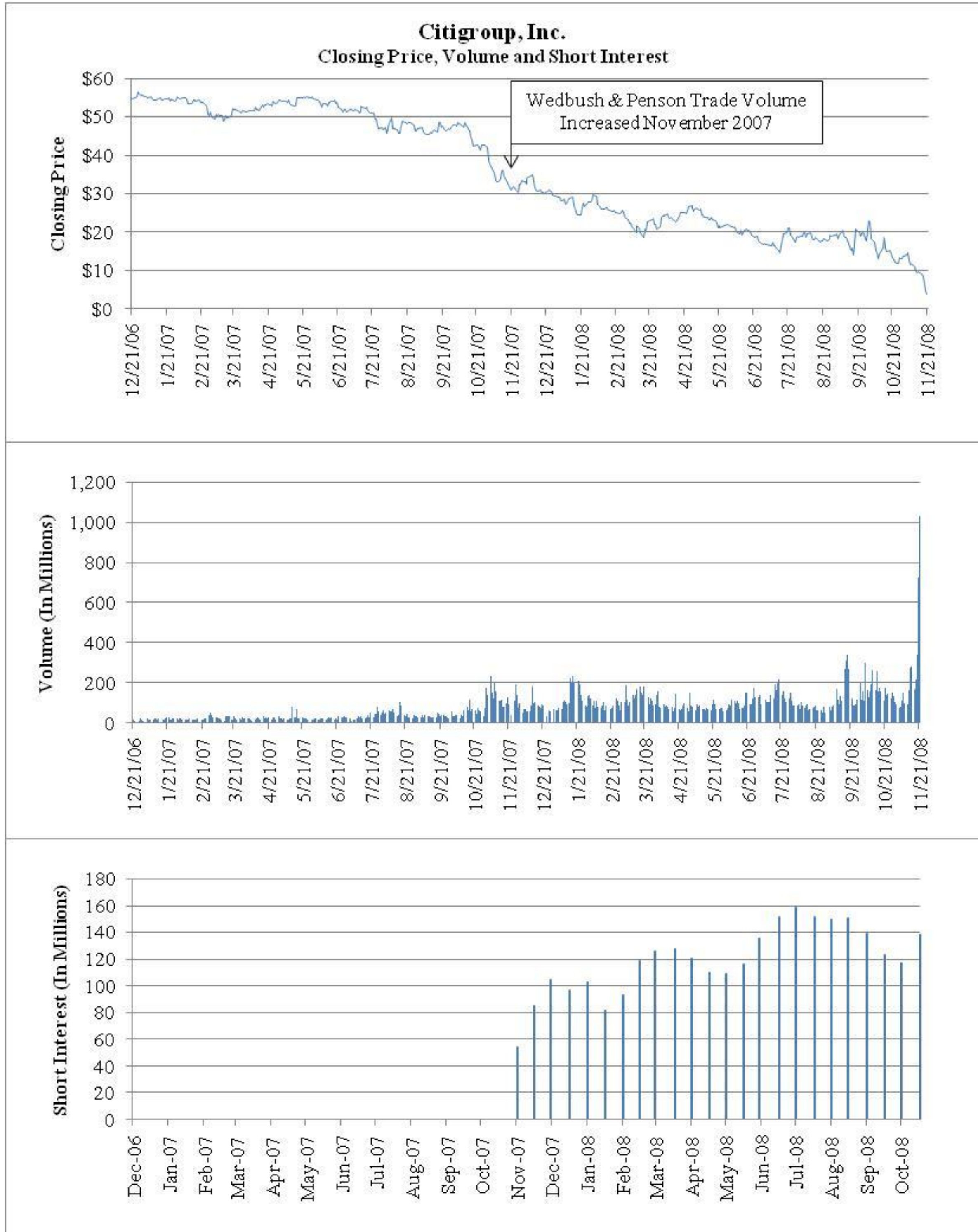
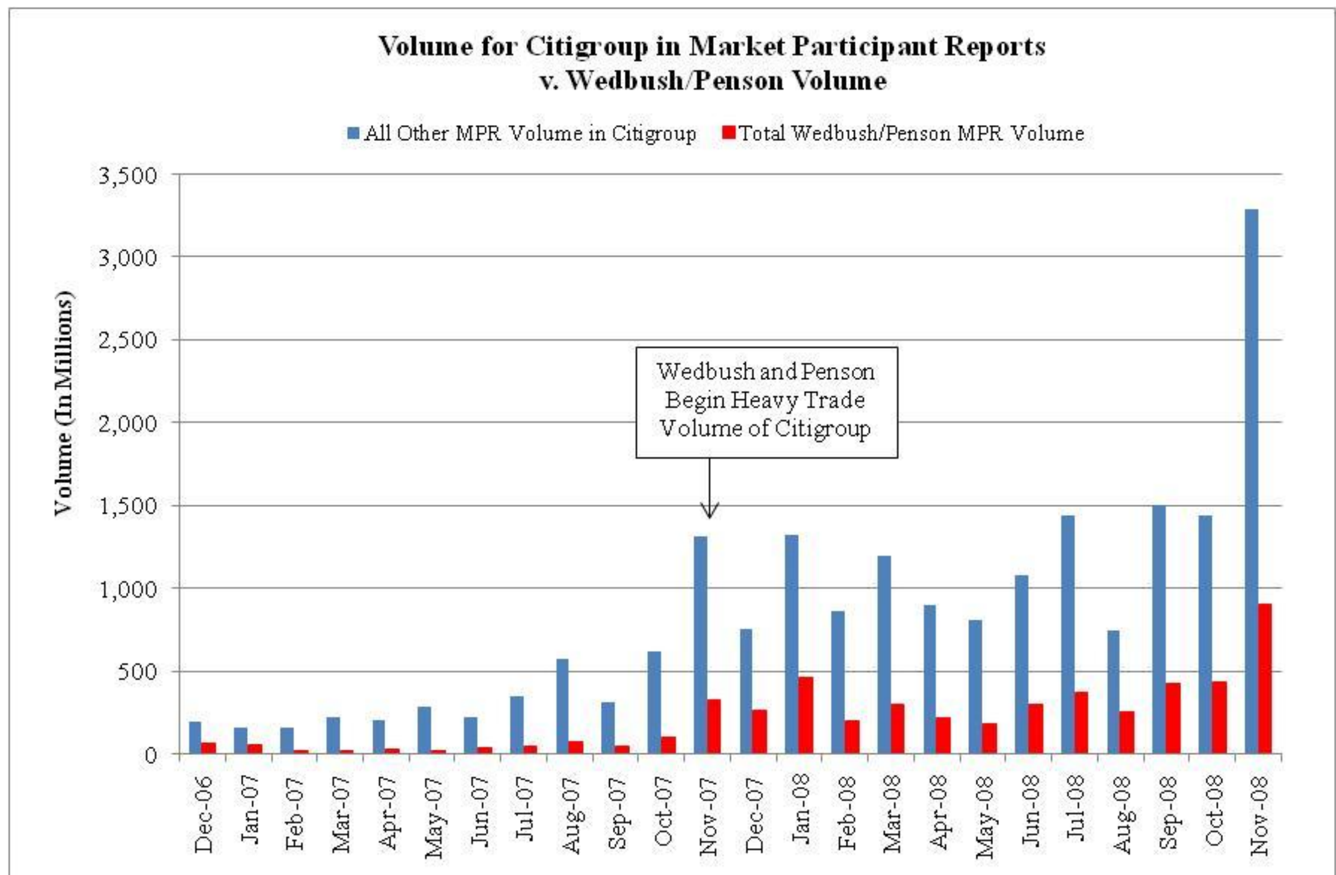


Chart 6 shows the market participant reports volume versus the firms' volume in Citigroup.

Chart 6 - Citigroup Market Participant Reports



Missed Opportunities

In March 2008, the SEC had an opportunity and a reason to further investigate trading activities at Penson and Wedbush because of the Tuco matter previously discussed and other violations previously found in the record. For the three months of December 2007, January and February 2008, Tuco cleared 2 billion shares through Penson and 1 billion of those shares were for the Lanai account. FINRA in November 2007 agreed to settle with GLB for no financial penalty so long as they terminated the Lanai account. Per Frederick, Lanai through Tuco/GLB began trading 1 billion shares per month, clearing through Penson in December 2007.

One year later, this remains a reason to investigate the transactions occurring through the firms. After November 2007, trading at least through the Lanai, Tuco/GLB/Penson accounts were in violation of the FINRA order.

SEC's Reliance on Fails to Deliver

The SEC uses fails to deliver data from the NSCC to assess the effectiveness of Regulation SHO Rule 203, monitor for naked short selling and potential market manipulation. The SEC Office of Economic Analysis ("OEA") concludes that Regulation SHO is working based on the NSCC data. This analysis is flawed.

In a November 26, 2008 memoranda, they point out an unexpected result from their findings, but they do not investigate why the unexpected result occurred. The following is the red flag in their memoranda:[53]

> "Assuming everything else constant, as the magnitude of trading (settlements) **increases** one would expect that the **magnitude of fails to deliver would also increase.** From April 1, 2004 to December 31, 2004 (Pre-Rule 203), the average daily fails were 810 million shares. From January 1, 2008 to October 31, 2008, the average daily fails were 1,048 million shares, an increase of about 29.4%. During the same periods, the average monthly dollar value of trading increased 209.3% from **$2.3 trillion** to **$7.1 trillion**. Therefore, **fails** have increased since 2004 at a much slower rate than trading volume."

This is a ***major*** 5 trillion dollar red flag. During this period, the shares available to trade did not substantially increase on the NYSE, the exchange where most of the firms' trading is concentrated. Year ending 2004 shares outstanding on the NYSE were 383 billion and at year end 2007 there were 420 billion shares outstanding, an increase of 37 billion shares in all issues traded on the NYSE or less than a 10% increase over the three year period.[54]

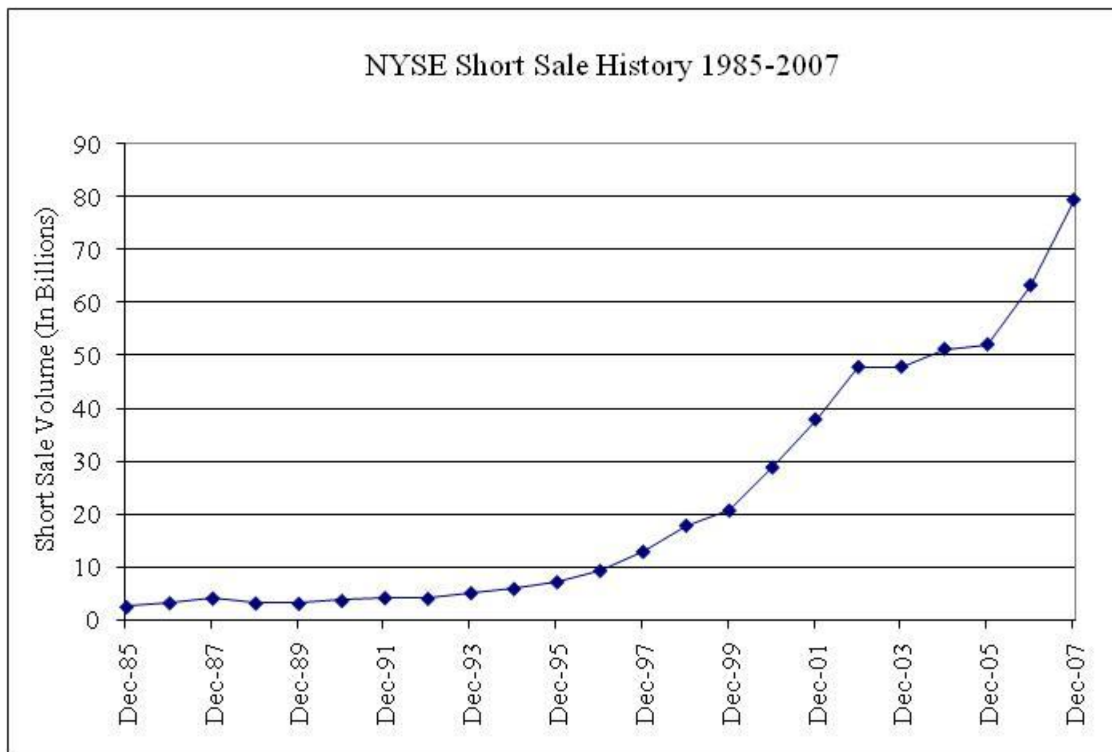
The average NYSE share price at 2004 year end was $35.43 and at year end 2007 the average price was $41.68. The value of all issues traded on the NYSE was 13.6 trillion dollars in 2004 and 17.5 trillion dollars at the end of 2007 or an increase of only 3.9 trillion dollars over the three year period.

Short selling increased dramatically on the NYSE. Chart 7 shows the NYSE short sales.

[53] See Exhibit 36 - O E A M E M O R A N D U M TO: File FROM: Office of Economic Analysis DATE: November 26, 2008, SUBJECT: Impact of Recent SHO Rule Changes on Fails to Deliver. www.sec.gov/comments/s7-30-08/s73008-37.pdf

[54] See Exhibit 37 - NYSE Group Shares Outstanding and Market Capitalization of Companies Listed. www.nyxdata.com/nysedata/default.aspx?tabid=115

Chart 7 – NYSE Short Sales History[55]



The Obvious Question to Ask the OEA

How did nearly 5 trillion dollars more each month trade without causing more fails to deliver?

Short sales were rising, shares outstanding were only increased by less than 10% and trading volumes were increased by trillions of dollars per month, while according to the SEC/NSCC's data, fails to deliver only increased by 238 million shares. The majority of this increase in fails to deliver were not fails in NYSE stocks but were fails to deliver in OTC and Pink sheet penny stocks.

This indicates that there is a sophisticated method at the clearing firm level to clear trades of massive volumes of stocks on the NYSE without failing to deliver at the NSCC. The compression, summarization and pre-netting of trades in massive numbers described by Wedbush could explain a significant portion of this phenomenon.

[55] See Exhibit 38 – New York Stock Exchange – Fact Book www.NYSE.com

Where are the Buyers Coming From

This large increase in monthly trade volume indicates a very large increase of buyers of U.S. blue chip securities. The declining prices in the marketplace indicate the opposite is true; there is a lack of buyers.

Confidence is waning in the markets causing a significant slowing of buyers of U.S. securities. Pension funds, mutual funds and other large institutional buyers of stock have had their financial resources seriously damaged because they invested for the long-term in blue chip stocks. These are reporting institutional holders and their holdings do not reflect significant increases in ownership in the companies discussed in this report, thus they do not appear to be the buyers of this volume. Numerous hedge funds have imploded, removing their volume from the prime brokers and the marketplace. Wall Street has had a large number of layoffs due to these factors, not because of increased business from trading. The news coverage from the floor of the exchanges show the traders watching TV and talking rather than trading huge volumes of shares. Beginning in November and continuing into 2009, CNBC has, at times, reported that stock exchange traders have had less and less to do.

Obviously, the trades are being generated electronically away from the major market of the NYSE floor exchange, where most blue chip stocks are listed. This pattern of off-exchange trading was previously discussed through the market activity in Bank of America. Citigroup shows the same pattern.

The big question is; who is buying these large volumes of blue chip shares traded each day by the firms? Trading very large volume in blue chip stocks without the apparent ownership of these securities suggests pre-arranged washed or matched trading to control the direction of the market.

The OEA Missed Opportunity

During the OEA's study period (April 1, 2004 to October 31, 2008), the market participant reports show the firms were the largest traders of blue chip stocks. Their trading volume and dollar volume of shares transacted increased exponentially, therefore they are responsible for a large portion of the increase in the dollar value traded that the SEC's OEA division opined about in its November 26, 2008 memorandum.

Several trillion dollars were traded by the firms, yet their trading did not cause increased fails to deliver relative to their increased trading volumes that would be expected, as the SEC's OEA points out. If the SEC would have questioned where the increase in dollar volume came from, they would have found that a significant amount of the increase is coming from Wedbush and Penson.

This very large differential in increased trade volumes versus virtually no fails to deliver raises concerns that there may be a strategy to hide the fails to deliver from the regulators and conceal the true nature and real value ($ = zero) of the securities transacted by the two firms.

Wedbush and Penson Trade Volumes vs. NSCC Fails to Deliver

In 2004, the SEC concluded that clearing outside of the NSCC was rare and therefore trades that were ex-cleared were not subject to Regulation SHO. Why this flawed decision was made is unknown, but this loophole in the law provides participants wishing to illegally trade shares a significant means to do so undetected while the fails to deliver remain at the clearing firms, outside the NSCC. The NSCC does not see these fails and does not report them in their Regulation SHO data.

Since the 'trade volumes have grown so large' at the firms, it is reasonable to assume as the OEA suggests in general, that 'more fails to deliver should be occurring' from the firms. It is possible that compression, summarization and pre-netting of trades on a large scale may be masking fails to deliver. The SEC simply appears to be wrong about the amount of ex-clearing occurring in the system and the letter from Wedbush to the SEC in 2006 verifies that the amount of clearing outside the NSCC at their firm is 'huge'.

> "The difference between this firm's actual trade count and the count derived from NSCC's assumptions is so large that it causes us to question whether NSCC has adequately planned for the capacity needed to process the huge increase in transactions that will be submitted if pre-netting ceases."[56]

Wedbush reported to the SEC on December 31, 2008 that they had failed to receive shares worth $1,132,000.[57] This is a very minute dollar value of shares that were failed to receive and is

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[56] Letter from Wedbush Morgan to the SEC, May 25, 2006. www.sec.gov/comments/sr-nscc-2006-04/rjrichards1985.pdf

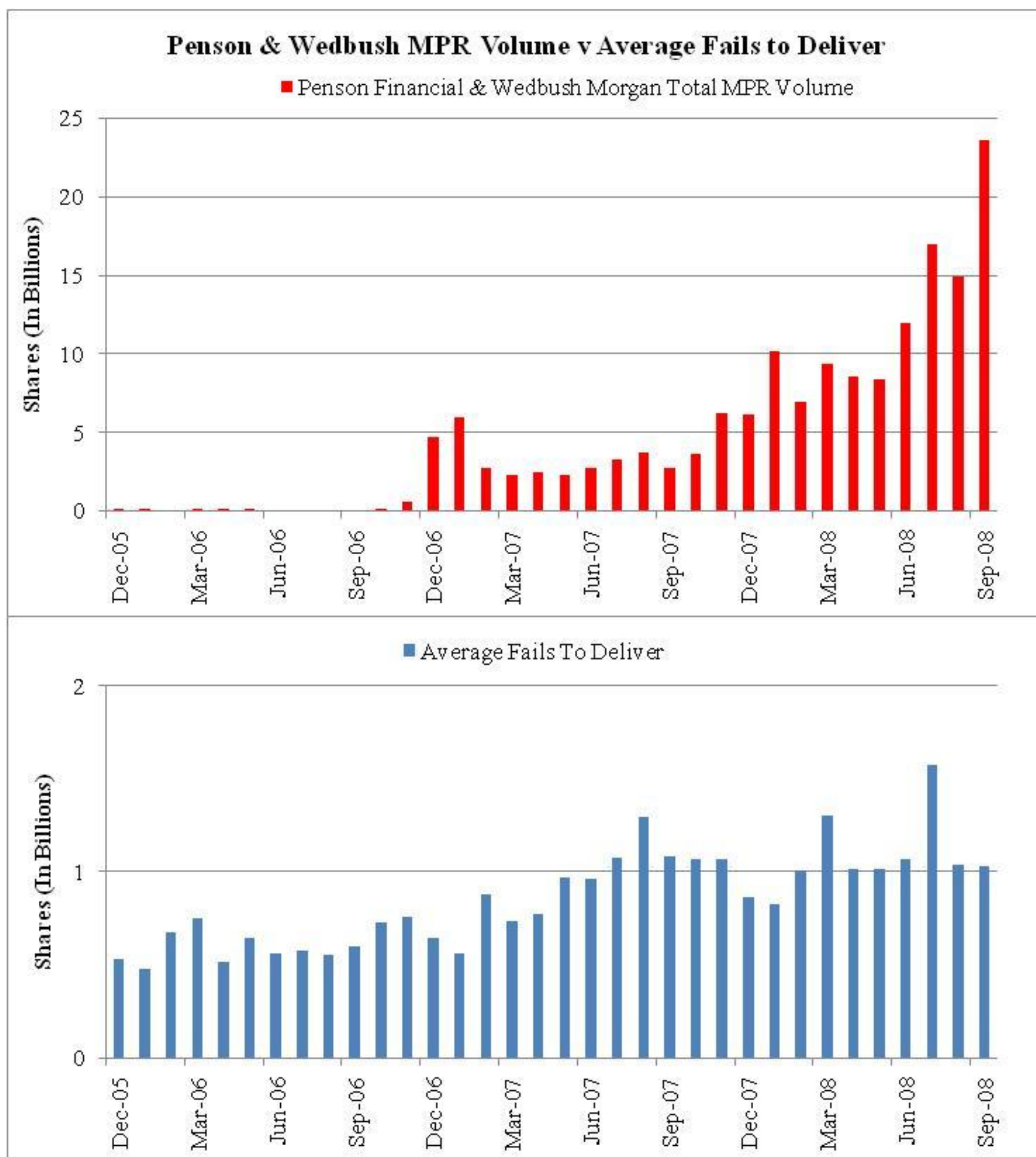
[57] Wedbush in their report states: '…Fails to receive represent the contractual value of securities that have not been received on or before the settlement date.'

grossly disproportionate to their massive trade volumes. Wedbush traded 95.8 billion shares in the first eleven months in 2008 (the available market participant report data).

According to Wedbush's SEC filings, virtually every share purchased by them or their client(s) was in fact properly delivered. This includes the shares involved in the October 2008 period where the firms traded an average of 641 thousand trades per hour.

Chart 8 shows the small changes in fails to deliver at the NSCC versus the exponential growth of trading by the firms.

Chart 8 – Penson and Wedbush Volume vs Fails to Deliver



Fatal Regulation SHO Flaw

Derivatives include options transactions, credit default swaps ("CDS") and a variety of other different forward looking contracts that have been designed by market participants. These contracts between dealers are on stocks, bonds, mortgage backed securities or other financial instruments (collectively referred to herein as 'securities'). Much like the UltraShort ETFs that Jim Cramer is so concerned with; the contracts can be hedged by short selling the securities at the current market value.

The traders do not need to own any of the underlying assets to trade the contract or short the stocks. The nature of many of these contracts is to profit from a future price decline of the underlying contract asset.

The most profit from these types of contracts is obtained if the security that is the asset for the contract declines to a price of zero. The derivative contracts are accounted for in the books of the broker-dealers as 'off balance sheet transactions', hidden from regulators and the investors in these broker-dealers.

A standard trade of these contracts is to trade a contract for a future delivery of a security (several years from the contract date), then hedge the contract by short selling the securities into the public markets or to investment funds, such as pension funds. These contracts can then be transferred in another trade that can again be hedged by selling the underlying securities.

In discussing CDS contracts on September 23, 2008, SEC Chairman Christopher Cox stated before the Senate Banking Committee:

> "I will conclude, Mr. Chairman, by **warning** of another similar regulatory hole in statute that must immediately be addressed or we will have similar consequences.
>
> "The $58 trillion notional market in credit default swaps to which several of you have referred in your opening comments that is double the amount that was outstanding in 2006, is **regulated by absolutely no one**. Neither the SEC nor any regulator has authority over the CDS market, even to require minimum disclosure to the market."
>
> "Holding a credit default swap is effectively or nearly effectively taking a short position in the underlying, but CDS buyers don't have to own the underlying, they don't have to own the bond or debt instrument upon which the credit default swap is based so they can effectively naked short it, this is a problem we have been dealing with, with our international

> regulatory counterparts around the world with straight equities and it's a big problem in a market that has no transparency and people don't know where the risk lies."
>
> "Because CDS buyers don't have to own the bond or the debt instrument upon which the contract is based **they can effectively naked short** the debt of companies without any restriction potentially causing market disruption and destabilizing the companies themselves."
>
> "**This market is ripe for fraud and manipulation** and indeed we are using the full extent of our anti-fraud authority, our law enforcement authority right now to investigate this market." [58]

These derivative products, recently discussed by legislators as 'fancy financial instruments', are not necessarily evil, but are very dangerous to the capital markets when used by participants to circumvent rules and regulations governing stock market activity. In most cases, when used illegally, they are designed for the sole purpose of creating securities out of thin air that are then sold into the public markets. This counterfeiting dilutes the value of corporations and assets of the U.S.

Another rather newly developed derivative Shariah-Compliant product, that appears disturbing, shows the clear intent of the traders to sell stock they do not own. In essence, some market participants are crafting their own rules and regulations while ignoring U.S. and other countries securities laws.

A Warning from Frank J. Gaffney

A December 24, 2008 Washington Times article by Frank J. Gaffney, Jr. who, during the Reagan administration, was the Assistant Secretary of Defense for International Security, the Deputy Assistant Secretary of Defense for Nuclear Forces and Arms Control Policy, and a Professional Staff Member on the Senate Armed Services Committee, raises concerns about Islamic financial products. Excerpts:

> "The next fiasco for the Securities and Exchange Commission may prove to be its systematic failure to address the insinuation into the U.S. capital markets of financial products that, by their reckoning, do not conform to American securities laws and regulations. These products have come to be known collectively as Shariah-Compliant Finance (SCF) and further threaten what is left of the integrity of our free market system.

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[58] Senate Committee: Banking, Housing and Urban Affairs Hearing in Washington D.C., September 23, 2008, U.S. Credit Markets and Federal Rescue Plan.

> Worse yet, they - and the theo-political-legal doctrine, Shariah, from which they spring - pose a real threat to our society and form of government, as well."
>
> "A legal memorandum prepared last spring for the Center for Security Policy by David Yerushalmi, an attorney specializing in securities law, determined that Shariah-Compliant Finance entails both civil liability and criminal exposure. These risks arise principally from the inherent character of what authoritative Islam calls Shariah. It espouses, among other unsavory things, the establishment of a global theocracy through the violent overthrow of all other governments, including that of the United States."[59]

There is a financial product being used to sell shares not owned, disguising them as shares previously purchased long, which are then sold in the U.S. and global markets. It is solely designed for Islamic short selling.

Short selling is not allowed under Islamic Shariah Law, but the prime brokers have developed a product to skirt around this prohibition against short selling. They have developed contracts referred to as Al Salam contracts or Ar bun (Arboon) along with other future type contracts.

For Islamic hedge funds, in essence, when a short sale is made, an electronic contract is established at the prime broker to purchase the security as long shares in the future. A small price for the right to purchase is paid to the prime broker and the sale of shares is then executed. Because short selling is illegal under Shariah Law, this method of executing a short sale creates ownership for the Islamic hedge funds, allowing them to sell shares they do not own while conforming to their own Shariah Law. U.S. laws and regulations would consider this type of contract a sham transaction designed for the purpose of illegally creating shares that do not exist. The very wealthy, sovereign Islamic funds (sovereign funds are a nations or in this case Royal families' funds) have arranged for a method to write their own securities laws and ignore securities regulations of sovereign countries.

[59] See Exhibit 39 – Washington Times article, The SEC's Next Shoe By Frank J. Gaffney, Jr., December 24, 2008. www.washingtontimes.com/news/2008/dec/23/the-secs-next-shoe/ Frank J. Gaffney, Jr. is the founder, president, and CEO of The Center for Security Policy. During the Reagan administration, Gaffney was the Assistant Secretary of Defense for International Security, the Deputy Assistant Secretary of Defense for Nuclear Forces and Arms Control Policy, and a Professional Staff Member on the Senate Armed Services Committee, chaired by Senator John Tower (R-Texas). He is a columnist for The Washington Times, Jewish World Review, and Townhall.com and has also contributed to The Wall Street Journal, USA Today, The New Republic, The Washington Post, The New York Times, The Christian Science Monitor, The Los Angeles Times, and Newsday.

There is a very large trading platform (that can accommodate an infinite number of Islamic hedge funds) in the Cayman Islands called Al Safi, which is designed to accommodate these types of transactions. The trading platform is a Cayman corporation administered by its lawyers Walkers Fund Services Limited (Cayman Islands) as the trustee and Citco (Dublin) as its fund administrator.

Vast pools of Islamic money known as sovereign wealth funds are actively involved in trading through Al Safi. The Arab sovereign wealth funds are estimated to have investment capital of up to $3 trillion, which is suspected to grow to $6-10 trillion over the next 10 years or less. This $3 trillion estimate of wealth may be vastly understated if they are short selling in world markets.

On just the New York Stock Exchange alone, a decline in value of $6 trillion has occurred from June 2008 through November 2008. Money in the markets does not simply evaporate; much of the decline in market value is a transfer of wealth from long investors to short sellers.

One of the prime brokers accommodating these transactions is Barclays Capital. The footnoted link is to an Islamic website which has this description of these transactions.[60]

> "Why is conventional short selling disallowed in Islamic Finance?
>
> Conventional short selling is unacceptable in Islamic Finance because Shariah Law prohibits an investor from selling something that he does not own. Under Shariah, an investor cannot borrow shares from a brokerage house or bank and sell them in the market for an eventual gain.
>
> How have you enabled the same results of short selling on Al Safi?
>
> Under the guidance and approval of Al Safi's Shariah Supervisory Board, different mechanics for the transaction have been developed. This process establishes ownership before the sale of the asset to the market. In order to accomplish this, a classical Shariah commercial model, known as the Arboon sale, has been used. Then while the mechanics of the sale may be different, the economics of the transaction are the same as a conventional short sale.
>
> How does this Arboon sale work practically with the Prime Broker?
>
> When a hedge fund manager wants to short a stock on Al Safi, his trader puts an order through to Barclays Capital Prime Brokerage, much the same way he normally would place such an order. The difference is that, on Al Safi, **Barclays Capital Prime Brokerage facilitates the transaction as a purchase,** not as a loan. This is done without any

[60] See Exhibit 40 – Zawya article
www.zawya.com:80/Story.cfm/sidZAWYA20080619063855/secIndustries/pagIslamic%20Finance.

administrative impact on the hedge fund manager or his portfolio. The result is that conventional hedge fund managers, using these tools, can manage Shariah compliant. They do not need to change their investment styles or procedures because Barclays ensures that the contracts underlying the transactions are Shariah compliant.

Al Safi hedge fund managers cannot short stocks in the conventional manner, using conventional contracts to borrow stocks. They cannot borrow shares from another bank or prime broker. Instead, they must order their short sales through Barclays Capital as it has the Arboon-based mechanism to achieve the same economics as a conventional short sale, but within the legal requirements of Shariah law."

Barclays' parent corporation, Barclays PLC, recently purchased the assets, including the brokerage and market making business, of collapsed Lehman Brothers.[61] Barclays refused help from the U.S. government TARP program for the acquisition. Barclays PLC has also turned down financial support from the U.K. government, choosing to remain independent with Middle Eastern monies as its base of capital.[62] On October 31, 2008, Barclays PLC announced that they were selling an additional 31.8% of the company to the following investors:[63]

1. Qatar Holding LLC (12.7% stake),
2. Challenger Universal Limited (2.8% stake), which is a special purpose vehicle in the British Virgins Islands created in June 2008 by the chairman of Qatar Holding and member of the Qatar royal family Sheikh Hamad Bin Jassim Bin Jabr Al-Thani, and
3. Sheikh Mansour Bin Zayed Al Nahyan of the United Arab Emirates, a member of the Abu Dhabi royal family (16.3% stake).

These members of the Royal families, and others similarly situated, are very sophisticated investors whose presence has become more apparent in the global economy. Dubai has developed a 'free zone' not governed by Shariah Law. It is being heralded as the 'Wall Street of the Middle East.'

The Qatar Investment Authority and Borse Dubai, the government-controlled exchange, now own 51% of the London Stock Exchange. Borse Dubai owns 20% of the NASDAQ stock exchange, which gives it substantial ownership in several global exchanges owned or invested in by

[61] See Exhibit 41 – Forbes article www.forbes.com/2008/09/16/barclays-lehman-update-markets-equity-cx_tw_0916markets52.html
[62] See Exhibit 42 – BBC News article http://news.bbc.co.uk/1/hi/business/7701405.stm
[63] See Exhibit 43 – Bloomberg article www.bloomberg.com/apps/news?pid=20601102&sid=abluUteaHGi8&refer=uk

the NASDAQ. As owners of exchanges, they will be able to influence securities regulations both foreign and domestically.[64]

In addition to Middle Eastern funds obtaining effective control over exchanges throughout the world and Barclays recent purchase of the market making and clearing business of Lehman Brothers, which has been one of the most powerful Wall Street firms, an Abu Dhabi fund entered into an agreement in December to buy the American International Group wealth management arm, AIG Private Bank Ltd., in Switzerland.[65] This is a very large private wealth investment company that was established by AIG in 1965.

These are key elements of global finance and under the control of Shariah lawmakers may be significantly changed, redefining how the financial systems operate.

Penson's View of Regulation

In November 2007, the same month Penson shows up as a substantial trader of U.S. blue chip companies, Penson petitioned Treasury Secretary Henry Paulson to adopt new regulations governing trading. A few days after the letter to Paulson, the Tuco/Lanai account at Penson, which was ordered by FINRA to be closed in November 2007, increased its trading dramatically to one billion shares in December 2007. In an eight page letter to Paulson, Penson calls for a consolidation of securities market regulators, the SEC and the Commodities Futures Trading Commission, operating the two agencies as one with separate roles. Penson calls for a rules based regulatory strategy except for market participants who they argue should be regulated on a principles based theory, i.e. hands off, disregard the U.S. securities laws. Penson explains:

> "In our proposed Twin Peaks structure, the CFTC and the SEC would ultimately be consolidated into two distinct divisions of a single agency with one division focused on capital formation, including the regulation of public companies, and the other division focused on market participation, marketplace conduct, and ensuring market integrity. This structure would allow us to apply regulatory strategies to the objections that they best fit. For example, our recommendation is that the division focused on capital formation be would primarily rules-based while the division focused on financial markets participation, **marketplace conduct**, and market integrity would be **principles-based**. A rules-based system for capital formation and the regulation of public companies provides clarity,

[64] See Exhibit 44 – Herald Sun article www.news.com.au:80/heraldsun/story/0,21985,22470317-5005961,00.html
And See Exhibit 45 – New York Times article
www.nytimes.com/2007/09/21/business/worldbusiness/21exchange.html?partner=rssnyt&emc=rss
[65] See Exhibit 46 – Associated Press article: AIG sells AIG Private Bank to Abu Dhabi firm, December 1, 2008.

security, and investor protection while regulating for safety and soundness. Further, a principles-based regulatory framework for the conduct of market participants provides flexibility, ensures market integrity, and is conducive to product innovation while it creates a dynamic environment where all market participants can organize their businesses efficiently. A principles-based regulatory framework will allow financial market participants the flexibility needed to meet the overlying principles in the way that best fits their business models without needlessly spending time, money, and energy ensuring that they don't inadvertently run afoul of prescriptive rules that may or may not be relevant to their particular business and conduct in financial markets."

> "We advocate merging the SEC and CFTC **only** if the combined agency relies on principles-based oversight in at least the areas concerning market regulation and marketplace conduct."[66]

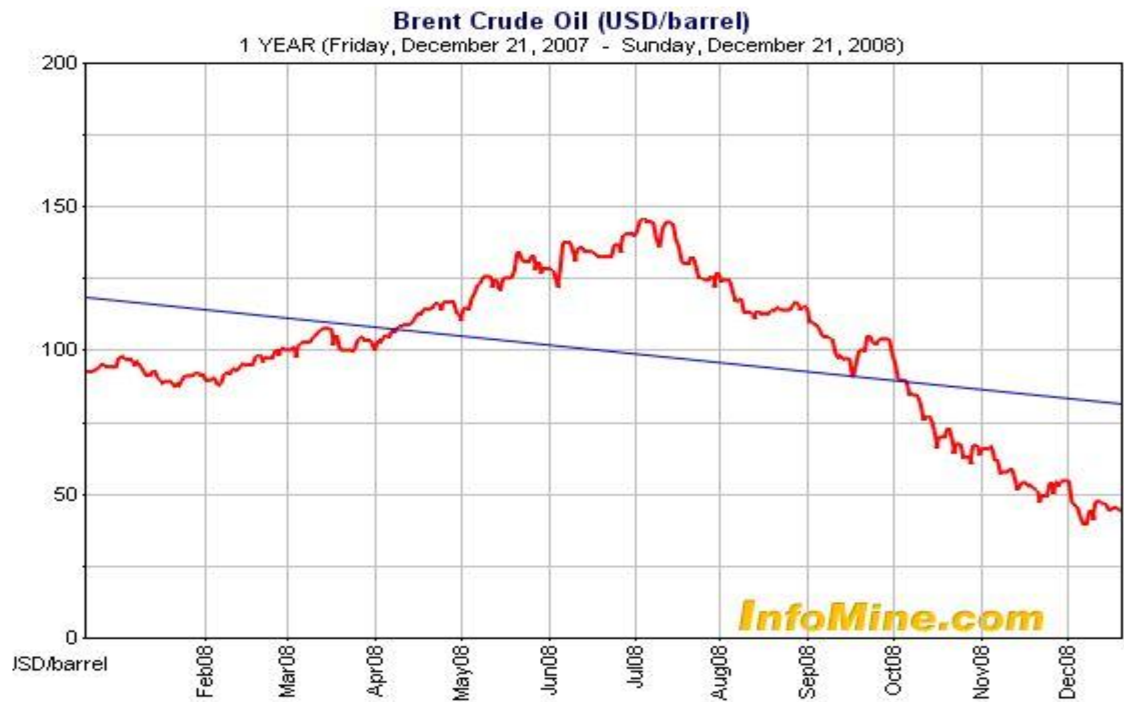
Oil Markets

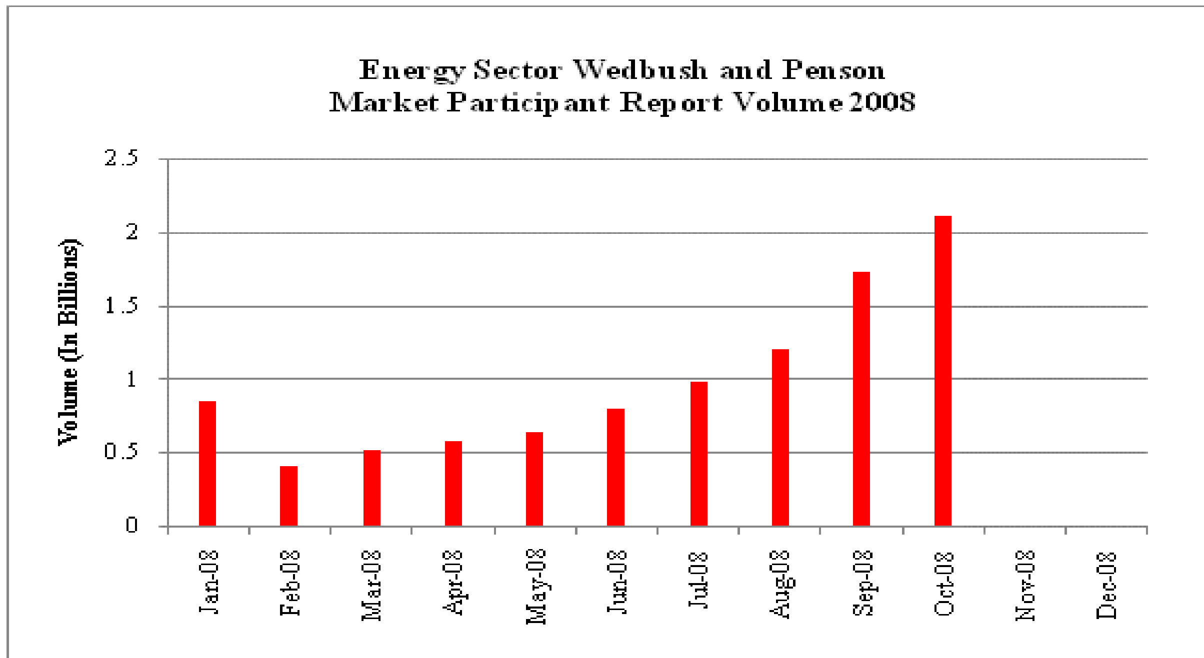
In February 2007, Penson Financial purchased a commodities trader, Goldenberg, Hehmeyer & Co., and began trading significant amounts of commodities. The firm they purchased was a small Chicago firm and Penson brought in a very large amount of capital to trade the futures markets. Because Penson is operating globally and caters to hedge funds with unknown ownerships, concerns are raised that they may have played a significant role in moving the price of oil to $147 a barrel, adding to the 2008 financial crisis. "Penson GHCO is a registered futures commission merchant (FCM) that offers access and clearing services to clients trading in domestic markets and global exchanges."[67]

Chart 9 shows the price of crude oil compared to the volume traded by the firms in the energy sector. To profit from increasing volume in the energy sector while crude oil declines from $147 per barrel to below $50 per barrel would normally involve short sale trades, not buying into the long side of the energy market. The firms more than doubled their volume from July through October, when the price of oil was collapsing. In order to be profitable in their trading of the energy companies, they would have to be short sellers of the energy sector. It is reasonable to suggest that if the firms are such large traders of energy stocks, they may also be large traders in energy futures contracts affecting the price of oil.

[66] See Exhibit 47 – Letter to Henry M Paulson, Jr. Secretary of the Treasury from Penson GHCO, November 21, 2007.
[67] See Exhibit 48 - http://www.pensonghco.com/learnAboutUs_businessOperations.aspx?subSection=businessOperations

Chart 9 – Crude Oil Price vs. Wedbush and Penson Trading in the Energy Sector





The following companies are oil sector stocks that are dominated by the firms' trading. In almost every instance, the firms are the number one traders of these securities in the market participant reports. In the few exceptions to this number one ranking, the firms are still within the

top few traders of these securities. To be a top trader in all of these stocks, trading legally would take a vast amount of financial resources.

It is important to note that the declining oil prices put some of these companies at great risk of not being profitable. It is simply a matter of historical fact that when oil becomes priced below the level of profitability required to discover new resources, the oil drilling industry dramatically constricts, refineries are financially affected and the search for new sources of renewable energy is curtailed. Reliance upon foreign oil is increased. On Friday, December 5, 2008, Merrill Lynch projected the price of oil will drop to $25 per barrel or lower.[68]

Energy Companies Dominated by the Firms Trading

Anadarko Petroleum Corp., Baker Hughes Inc., Berry Petroleum Co., BJ Services Company, BP plc (United Kingdom), Cabot Oil & Gas Corp., Cameron International Corporation, Canadian Natural Resources Limited (Canada), Chesapeake Energy Corp., Chevron Corp., Cimarex Energy Co., Comstock Resources Inc., ConocoPhillips, Continental Resources Inc., Denbury Resources Inc., Devon Energy Corporation, Diamond Offshore Drilling Inc., Eni SpA (Italy), El Paso Corp., EnCana Corp. (Canada), Encore Acquisition Co.. Enerplus Resources Fund (Canada), Ensco International Inc., EXCO Resources Inc., Exxon Mobil Corp., FMC Technologies, Inc., Forest Oil Corp., Frontier Oil Corp., Grey Wolf Inc., Halliburton Company, Helix Energy Solutions Group, Inc., Hess Corporation, Marathon Oil Corporation, Nabors Industries Ltd. (Bermuda), National Oilwell Varco, Incorporated, Newfield Exploration Co., Noble Corp., Noble Energy, Inc., Occidental Petroleum Corporation, Oceaneering International, Inc., Oil States International Inc., Penn Virginia Corp., Petro-Canada (Canada), Petrohawk Energy Corporation (Canada), Petroleo Brasileiro (Brazil), Pioneer Natural Resources Co., Plains Exploration & Production Company, Precision Drilling Trust (Canada), Pride International Inc., Questar Corp., Quicksilver Resources Inc., Range Resources Corp., RenTech, Rowan Companies Inc., Royal Dutch Shell PLC-B SHS (Netherlands), SandRidge Energy, Inc., Schlumberger Limited, Smith International Inc., Southwestern Energy Co., Spectra Energy Corp., Suncor Energy Inc. (Canada), Sunoco Inc., Swift Energy Co., Talisman Energy Inc. (Canada), Tesoro Corporation, TETRA Technologies Inc., Total SA (France), Transocean, Inc., Ultra Petroleum Corp., Unit Corp., Valero Energy Corp., W&T Offshore Inc., Weatherford International Ltd., Whiting Petroleum Corp., Williams Companies, Inc., XTO Energy Inc. and Tidewater Inc.[69]

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[68] See Exhibit 49 - China slowdown could see oil at $25 a barrel, bank predicts, December 5, 2008. www.guardian.co.uk/business/2008/dec/05/oil-commodities.
[69] See Exhibit 50 – Tab 15

Trading Options

Phil Pendergraft, CEO of Penson Worldwide, projected on a third quarter 2008 earnings conference call that Penson was going to be involved in 20 million options contracts in October 2008, which represents 2 billion shares in the options markets. The 20 million options contracts were a 10% increase from their options contracts in September 2008.[70] Wedbush can also trade options, but their option trading is not known at this time. It is suspected that their option trading is significant. Options are another trading method that can be used to manipulate markets.

Credit Default Swaps (CDS)

The DTCC listed credit default swaps on Dow stocks show almost 700 billion dollars have been written in CDS contracts.[71] CDS contracts are a bet that the companies will default. While, at this time, it cannot be determined what the ultimate payout would be if various stocks in the Dow defaulted, it is reasonable to assume that the U.S. taxpayer would ultimately be the payer for the CDS defaults because the U.S. Treasury is committed to financially support the securities firms that are contractually obligated to these CDS contracts. Because of their large trading volume, it is possible that the firms large client(s), are involved in these CDS contracts against Dow stocks, which would be another means of profiting from the decline in these securities.

Trading in Foreign Currencies

Wedbush and Penson appear to be large traders in foreign currencies. Through their trading of U.S. market currency investments, they are the dominant traders in Crncyshrs Jpn Yen Tr, Crrncyshr Aus Dlr Tr, Crrncyshr Bp Ster Tr, Crrncyshr Sw Fr Tr, Crrncyshr Sw Krn Tr, Crrncyshrs Can Dl Tr and Currencyshares Euro.[72]

The Firms are Dominating the Trading in Other Blue Chip Companies

Of concern are the stocks the firms are currently trading. They are strategically dominating blue chip companies such as 3M Company, United Technologies, General Electric and Textron, which are conglomerates involved in vital sectors of the U.S. economy. These investments are widely held by mutual funds, pension funds, state-run investment monies and other long-term

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[70] See Exhibit 51 – Penson Worldwide Inc. Q3 2008 Earnings Call Transcript, November 4, 2008. http://seekingalpha.com/article/103790-penson-worldwide-inc-q3-2008-earnings-call-transcript?page=8
[71] See Exhibit 52 – Dow Stocks Credit Default Swaps Value
[72] See Exhibit 50 – Tab 1

conservative investors. The losses from these blue chip investments could become financially devastating to the investors.

In almost every instance, the firms are the number one traders of the following securities in the market participant reports. In the few exceptions to this number one ranking, the firms are still within the top few traders of these securities.

This is a very strategic list of major U.S. and global companies to make a market in and to dominate the trading. These are important economic assets in the U.S. and other countries. Some of the stocks these firms have been the number one trader in have already collapsed. Red flags are raised that if history repeats itself, some of these vital assets to the economy may be at considerable risk from the trading by these two firms.

These select companies are the key participants in their industry and the demise of some companies could cause systemic risk to their industry. A domino effect causing deeper financial stresses within the U.S. is likely if only a few of these key industries are severely disrupted.

The Firms Dominate the Trading in the Following Securities

Insurance Companies

Of great concern at the present time is the insurance industry. These companies are extensively invested in U.S. blue chip stocks. The decline in the price of these investment stocks has significantly lowered the value of these insurance companies. Further significant declines in the pricing of blue chip stocks could put some insurance companies at risk of failure. The heavy trading by the firms of the insurance companies themselves seems to pose a further risk of failure. Failure of the insurance industry could be devastating to the global economy and this is not an option if a financial depression is to be avoided.

Allstate Corp., Ambac Financial Group, Inc., American International Group, Inc., Aon Corp, The Chubb Corporation, Fidelity National Financial, Inc., Genworth Financial Inc., Hartford Financial Services Group Inc., Lincoln National Corp., Loews Corp., MBIA Inc., MGIC Investment Corp., Manulife Financial Corporation, Marsh & McLennan Companies, Inc., Metlife Inc., Progressive Corp., Prudential Financial Inc., The Travelers Companies, Inc., Unum Group and XL Capital Ltd.[73]

[73] See Exhibit 50 – Tab 2

Airlines

AMR Corporation, AirTran Holdings Inc., Continental Airlines, Inc., Delta Air Lines Inc., Southwest Airlines Co. and US Airways Group, Inc.[74]

Shipping

FedEx Corporation and United Parcel Service, Inc.[75]

Aerospace/Defense

Boeing Co., Fluor Corporation, General Dynamics Corp., Honeywell International Inc., Lockheed Martin Corporation, McDermott International Inc., Northrop Grumman Corp., Quanta Services Inc., Raytheon Co. and Rockwell Collins Inc.[76]

Media

CBS Corporation, Gannett Co., Inc., Interpublic Group of Companies Inc., The McGraw-Hill Companies, Inc., News Corp., Omnicom Group Inc., RH Donnelley Corp., Rogers Communications Inc., Time Warner Cable Inc., Time Warner Inc., Valassis Communications Inc., ValueClick Inc. and Walt Disney Co.[77]

Railroads

Burlington Northern Santa Fe Corp., CSX Corp., Canadian National Railway Company (Canada), Canadian Pacific Railway Limited (Canada), Norfolk Southern Corp., Trinity Industries Inc., Union Pacific Corp. and Westinghouse Air Brake Technologies Corp.[78]

Communication

Agilent Technologies Inc., Alcatel-Lucent (France), American Tower Corp., America Movil S.A.B. de C.V. (Mexico), AT&T, Inc., Corning, Juniper Networks, Inc., Mobile Telesystems OJSC (Russia), Motorola Inc., Nokia Corp. (Finland), Powerwave Technologies Inc., Qwest Communications International Inc., Siemens AG, Sonus Networks, Inc., Sprint Nextel Corp., Telefonos de Mexico, S.A.B. de C.V. (Mexico), DIRECTV Group, Inc., Thermo Fisher Scientific, Inc., Verizon Communications Inc., Vimpel-Communications (Russia), Vivo Participacoes S.A. (Brazil), Vodafone Group plc (United Kingdom) and Windstream Corporation.[79]

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[74] See Exhibit 50 – Tab 4
[75] See Exhibit 50 – Tab 7
[76] See Exhibit 50 – Tab 11
[77] See Exhibit 50 – Tab 6
[78] See Exhibit 50 – Tab 5
[79] See Exhibit 50 – Tab 8

Drug Manufacturing

Bristol-Myers Squibb Co., Elan Corp. plc (Ireland), Forest Laboratories Inc., Johnson & Johnson, King Pharmaceuticals Inc., Eli Lilly & Co., Merck & Co. Inc., Mylan, Inc., Pfizer Inc., Schering-Plough Corp., Watson Pharmaceuticals Inc. and Wyeth.[80]

Metals

AK Steel Holding Corp., Alcoa, Inc., Allegheny Technologies Inc., Arcelor Mittal (Luxembourg), BHP Billiton Ltd (Australia), BHP Billiton plc (United Kingdom), Cameco Corp. (Canada), Coeur d'Alene Mines Corporation, Companhia Siderurgica Nacional (Brazil), CONSOL Energy Inc., Eldorado Gold Corp. (Canada), Foundation Coal Holdings Inc., Freeport-McMoRan Copper & Gold Inc., Gerdau AmeriSteel Corp., Gerdau S.A. (Brazil), Gold Fields Ltd. (South Africa), Goldcorp Inc. (Canada), Golden Star Resources, Ltd., Harmony Gold Mining Co. Ltd. (South Africa), Hecla Mining Co., IAMGOLD Corp. (Canada), International Coal Group, Inc., Precision Castparts Corp., Reliance Steel & Aluminum Co. and United States Steel Corp.[81]

Industrial Equipment

Black & Decker Corp., Brunswick Corp., Emerson Electric Co., GrafTech International Ltd., Illinois Tool Works Inc., Ingersoll-Rand Co. Ltd., Parker Hannifin Corporation and Rockwell Automation Inc.[82]

Construction Machinery

Caterpillar Inc., Deere & Co., Manitowoc Co. Inc. and Terex Corp.[83]

Chemicals

Agrium Inc., Chemtura Corp., Compass Minerals International Inc., Dow Chemical Co., EI DuPont de Nemours & Co., Monsanto Co., Mosaic Co., Nova Chemicals Corp. (Canada), Potash Corp. of Saskatchewan, Inc. (Canada), Praxair Inc., Rohm & Haas Co., Sherwin-Williams Co., Chemical & Mining Co. of Chile Inc. (Chile) and Terra Industries Inc.[84]

Computer Related Companies

Advanced Micro Devices Inc., Analog Devices Inc., Broadcom Corp., Cypress Semiconductor Corporation, DST Systems Inc., EMC Corporation, Electronic Arts Inc., Emulex Corp., Fairchild Semiconductor International Inc., Hewlett-Packard Company, Intel Corporation, Intersil Corp., International Business Machines Corp., International Game Technology, Intuit Inc., Jabil Circuit Inc., Lexmark International Inc., LSI Corporation, Marvell Technology Group Ltd.,

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[80] See Exhibit 50 – Tab 3
[81] See Exhibit 50 – Tab 14
[82] See Exhibit 50 – Tab 13
[83] See Exhibit 50 – Tab 12
[84] See Exhibit 50 – Tab 16

McAfee, Inc., MEMC Electronic Materials Inc., Micron Technology Inc., National Semiconductor Corp., Nortel Networks Corp., Nuance Communications, Inc., NVIDIA Corporation, ON Semiconductor Corp., Oracle Corp., Red Hat Inc., RF Micro Devices Inc., Salesforce.Com Inc., Symantec Corporation, Taiwan Semiconductor Manufacturing Co. Ltd. (Taiwan), Teradyne Inc., Texas Instruments Inc., THQ Inc., Trident Microsystems Inc., Trina Solar Ltd., Tyco Electronics, Ltd., Tyco International Ltd., Unisys Corp., United Microelectronics Corp., VeriSign Inc., Vishay Intertechnology Inc., WMS Industries Inc. and Western Digital Corp.[85]

Residential Construction

Beazer Homes USA Inc., Centex Corporation, Champion Enterprises Inc., DR Horton Inc., Gafisa S.A. (Brazil), Hovnanian Enterprises Inc., KB Home, Lennar Corp., MDC Holdings Inc., M/I Homes, Inc., Masco Corp., Meritage Homes Corporation, Mohawk Industries Inc., Pulte Homes, Inc., Ryland Group Inc., Standard Pacific Corp. and Toll Brothers Inc.[86]

In Conclusion,

A very large amount of volume has been injected into the marketplace of U.S. blue chip stocks by two small firms that should be raising red flags. The firms have been the number one trader of all of the large financial stocks that have collapsed to date.

Profiting from companies or markets that are collapsing normally requires the trades to be short sales of stock. The firms are trading large volumes of stock in companies whose short sales are in decline raising concerns that they are simply selling shares they do not own as long shares, as if they were issued by the companies.

Regulators have previously sanctioned these firms for violations of securities laws and, as alleged by regulators, the two firms appear to be willing to circumvent U.S. laws and regulations.

The firms trading intensified, when the U.S. government adopted emergency regulations against abusive short selling for the protection of key financial companies.

The firms do not fail to deliver securities at the NSCC, while they are trading massive volumes of blue chip U.S. securities. This indicates that they are by-passing the national clearance and settlement system and regulatory scrutiny. Wedbush admits that they are pre-netting huge amounts of trades and that the NSCC is grossly in error as to the amount of trades Wedbush pre-nets.

[85] See Exhibit 50 – Tab 9
[86] See Exhibit 50 – Tab 10

The firms continue to trade very large volumes of stock in companies that have been helped by the U.S. government, and these stock prices remain depressed. These depressed prices are not in the best interest of the investors, the U.S. taxpayers.

The trading is massive and growing hyper-exponentially. There does not seem to be a financial limit to their resources.

The continuing volume that was injected into the marketplace by Wedbush in November 2006 and from Penson in November 2007 appears to be damaging U.S. assets.

In October 2008, when the firms were trading an average of 641 thousand trades per hour for 23 days, where did these shares come from? Who were all the buyers? What was being delivered for settlement? Matching buyers and sellers for this huge number of trades continuously is in contradiction to the way a supply and demand market should, or could, operate.

Red flags are raised because this appears to be an extremely sophisticated trading strategy. If this is a strategy of market manipulation, the selection of stocks appears tactically designed to damage key U.S. companies.

Since the firms do not own any significant quantities of blue chip stocks, it is logical to conclude that their client(s) are responsible for their massive trade volumes of the blue chip stocks.

It has been shown at this time that governments' injecting large amounts of capital into the global financial system does not stabilize the markets. There are significant indications that this lack of stabilization may be a result of the trading by these two firms.

The power of this trading cannot be underestimated because of their apparent financial resources and their number one volume position in these important U.S. assets.

These red flags may be predictive as to the future of the other stocks and markets around the world that these firms or their client(s) are concentrating their trading in, which has been economically negative for U.S. markets.

As the decline in value continues for blue chip stocks, U.S. companies, pension and mutual funds and municipalities invested in these companies move closer to financial insolvency. Even if

only a few of the large important U.S. companies collapse, a very deep economic depression could follow.

The hyper-exponential growths of these two firms' trading volumes, transactional values amounting to trillions of dollars, their number one trading position in all companies collapsed or receiving assistance from the U.S. taxpayers, their continued aggressive trading of these taxpayer assets and the rapid takeover of market share and other issues discussed herein are clear and compelling reasons to immediately investigate the firms' activity.

If, in fact, the client(s) of the firms are illegally trading U.S. stocks, they will likely move their trading and use other means to complete what may be a strategy to control the global markets. This will require very close monitoring of the trading in the markets in order to protect the U.S. economy. This all suggests that law enforcement needs to work in concert to quickly investigate this vast amount of trading coming from Penson and Wedbush.