BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Megurditch Patatian Granada Hills, CA, Respondent.	DECISION Complaint No. 2018057235801 Dated: September 28, 2023

Registered representative recommended unsuitable purchases of non-traded real estate investment trusts and unsuitable surrenders and exchanges of variable annuities, caused his firm to maintain inaccurate books and records, and impersonated a customer in a communication with an insurance company. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Jennifer L. Crawford, Esq., John-Michael Seibler, Esq., Brody Weichbrodt, Esq., Jessica Zetwick-Skryzhynskyy, Esq., Financial Industry Regulatory Authority

For Respondent: Pro se

Decision

Megurditch Patatian appeals a June 10, 2022 Extended Hearing Panel decision. The Hearing Panel found that Patatian violated FINRA's suitability rules with respect to recommendations he made to customers to purchase non-traded real estate investment trust products ("REITs") and to surrender and exchange variable annuities. The Hearing Panel further found that in order to obtain his firm's approval for the REIT purchases he recommended, Patatian overstated his customers' financial resources and investment experience on firm documents, thereby causing his employing firm to maintain inaccurate books and records. Finally, the Hearing Panel found that Patatian impersonated a customer in a telephone call with an insurance company. For these violations, the Hearing Panel barred Patatian from associating

with any FINRA member in any capacity and ordered him to disgorge commissions, pay restitution to certain customers, and offer rescission to other customers.

After an independent review of the record and the parties' submissions and arguments, we affirm the Hearing Panel's findings of violations and modify the sanctions it imposed.

I. Background and Facts

A. Megurditch Patatian

Patatian joined the securities industry in 1999 as a general securities representative. At the beginning of his career, Patatian cold called to build his book of business and sold stocks, bonds, and mutual funds. In January 2002, Patatian registered with FINRA member WM Financial Services, Inc. ("WM Financial"), where he started selling variable annuities to customers in 2003.

In March 2004, Patatian was employed by Los Angeles County's Water and Power Community Credit Union (the "Credit Union") and registered as a general securities representative with CUSO Financial Services, L.P. ("CUSO"), the Credit Union's broker-dealer affiliate. Patatian was compensated by salary from the Credit Union and commissions from CUSO. At CUSO, Patatian's clients were individuals who worked for or had retired from the Los Angeles County Department of Water and Power (the "DWP"). Patatian's clients were typically 50-70 years old and predominately retired from the DWP. The majority of Patatian's business at CUSO was the sale of variable annuities and mutual funds. In March 2013, CUSO permitted Patatian to resign. CUSO disclosed in a Form U5 filing that Patatian was permitted to resign because of his "failure to follow firm policy with regards to firm transactions [sic] documentation."

Patatian joined Western International Securities, Inc. ("Western") in April 2013 and registered as a general securities representative. Patatian's recommendations at Western are the subject of this appeal. Patatian had approximately 100 accounts at Western, the vast majority of which belonged to customers who transferred from CUSO and were DWP retirees. The majority of Patatian's business at Western involved the recommendation and sale of non-traded REITs to these customers. Patatian left Western in March 2020 and currently is not associated with a FINRA member firm.

B. Patatian Begins Selling Non-Traded REITs at Western

Soon after joining Western, Patatian began recommending and selling non-traded REITs to his customers. Patatian testified that prior to joining Western, he was "unfamiliar" and "inexperienced" with REITs. From April 2013 through March 2017, Patatian recommended 81 purchases of more than $7.8 million in non-traded REITs to 59 customers.[1] At least one third of these customers were age 65 or older at the time Patatian sold them the non-traded REITs. For

[1] These 81 transactions are identified in Exhibit A to the Complaint.

the years 2013 through 2015, almost all the commissions earned by Patatian—approximately $450,000—were from sales of non-traded REITs.[2]

REITs "pool the capital of numerous investors to purchase a portfolio of properties—from office buildings to hotels and apartments, even timber-producing land—which the typical investor might not otherwise be able to purchase individually."[3] While some REITs are traded on national exchanges, the REITs Patatian sold were not. Such non-traded REITs present serious risks, including that they are "generally illiquid, often for periods of eight years or more."[4] Early redemption of shares of non-traded REITs is often restricted and sometimes available only at a discount. Ordinarily, a shareholder seeking to redeem shares of a non-traded REIT must wait for a "liquidity event" such as when the shares are listed on an exchange or the REIT sells its assets.

In addition to illiquidity, non-traded REITs pose numerous other risks. Generally, the REIT's Board of Directors decides whether to make distributions at all and, if so, in what amount. Moreover, distributions may consist of borrowed funds or returns on capital rather than profits. Finally, even if there is an eventual liquidity event, the value of the shares may have declined or become worthless.

Because of the risky nature of non-traded REITs, many states, including California where Patatian's customers resided, limit the amount of money customers can invest in them. During the relevant period, California limited a customer's non-traded REIT investment to 10 percent of the customer's net worth, exclusive of their home, home furnishings, and automobiles ("net worth exclusive"). To ensure compliance with these suitability requirements, Western required Patatian to submit a signed a document called a "Client Disclosure Form" (the "Disclosure") for each transaction.[5] By signing the Disclosure, customers acknowledged, among other things, that the REITs were long-term investments and that the customer had "the financial status, including net worth and annual gross income, that meets the suitability standards of the [i]ssuer or [their] state of primary residence."

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[2] For the years 2013 through 2016, sales of non-traded REITs constituted 96 percent, 95 percent, 88 percent, and 52 percent of Patatian's net commissions from Western, respectively.

[3] *See FINRA Issues Investor Alert on Public Non-Traded REITs*, https://www.finra.org/media-center/news-releases/2011/finra-issues-investor-alert-public-non-traded-reits (Oct. 4, 2011).

[4] *Id*.

[5] The Disclosure contained a section asking for the amount of the REIT purchase, the amount of the customer's "[e]stimated [l]iquidate [sic] [n]et [w]orth (excluding home(s), auto)," and the percentage of the client's liquid net worth represented by all REITs the customer purchased. Western's chief compliance officer testified that "liquidate [sic] net worth" referred to the amount of a customer's assets if they were to liquidate those assets, excluding the customer's home, personal property, and automobiles. Because the same definition applies to "net worth exclusive," we will hereinafter refer to this amount on the Disclosure as "net worth exclusive."

The non-traded REITs Patatian sold were sponsored or co-sponsored by the American Realty Capital group of companies and by an affiliated group of companies using the Cole Capital trade name (together "ARC"). The prospectuses for the ARC non-traded REITs Patatian sold each contain more than 40 pages of risk disclosures. The prospectuses caution that the issuers have limited or no operating history and, in most cases, no established financing sources. The documents also warn that distributions are not certain and, even if declared, the amount could change or be eliminated at any time. Additionally, distributions could be paid from any source including offering proceeds and borrowings, and the issuers were permitted to incur substantial amounts of debt, all of which could decrease the value of investors' investments.

The prospectuses further warn investors about the illiquidity of an investment in the REITs. The documents state that no public market for shares of the REITs exists, nor may ever exist, and "shares are, and may continue to be, illiquid." The documents also state that there is no guarantee that there ever will be a liquidity event, and shares should be considered a long-term investment. In addition, the prospectuses warn that shares are speculative and involve a high degree of risk with no guarantee of any return, and investors can lose their entire investment.[6]

Finally, each prospectus contains a section entitled "Investor Suitability Standards," which includes the California state suitability limit. This section of many of the prospectuses opens with a warning that "[a]n investment in our common stock involves significant risk and is suitable only for persons who have adequate financial means, desire a relatively long-term investment and will not need immediate liquidity from their investment." This section further cautions that "persons who require immediate liquidity or guaranteed income, or who seek a short-term investment" are not appropriate investors for the REITs. As a result, all potential investors "should note that investing in shares of our common stock involves a high degree of risk and should consider all the information contained in this prospectus, including the 'Risk Factors' section contained herein, in determining whether an investment in our common stock is appropriate."[7]

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[6] The offering documents also warn that the offering price had been established on an arbitrary basis, that the actual value of the investment may be substantially less than what investors pay, and that substantial conflicts of interests exist between the issuer and investors.

[7] Similarly, the Cole Capital prospectuses warn that "[a]n investment in our common stock is only suitable for persons who have adequate financial means and desire a long-term investment (generally, an investment horizon in excess of seven years). The value of your investment may decline significantly. In addition, the investment will have limited liquidity, which means that it may be difficult for you to sell your shares. Persons who may require liquidity within several years from the date of their investment or seek a guaranteed stream of income should not invest in our common stock."

C. Patatian's Non-Traded REIT Sales to Specific Customers

Four customers testified at the hearing and a fifth, who died before the hearing, was represented by her son, who testified on her behalf. The customers testified about their communications and dealings with Patatian and their purchases of the non-traded REITs Patatian recommended.

1. Patatian Recommends Non-Traded REITs to CN

CN worked for the City of Los Angeles and the DWP as an electrician for 31 years, before retiring in 2000. Prior to entering an apprenticeship program to become an electrician, CN completed high school and a few junior college courses.

CN met Patatian in 2006, after she had retired, while she was in line at a Credit Union branch where Patatian maintained an office. CN opened a CUSO account with Patatian at the end of 2006. CN testified that she had no investment experience before opening her CUSO account. On Patatian's recommendation, CN invested approximately $500,000 that she had inherited from a family member in variable annuities. CN also testified that, from the time she first invested with Patatian, she told him she wanted to earn returns but keep her money liquid and available for her use at any time. CN testified that she was surprised when she later found out there were restrictions on withdrawals from the annuities. She complained to Patatian, who claimed he had misunderstood her.

CN testified that after he joined Western, Patatian began telling her about a "good investment in real estate." CN said that Patatian described it as an investment in building strip malls and that she would make money when the property was sold. CN and Patatian had multiple conversations about the real estate investment and Patatian told her all the other advisors in his office were "jumping on" this good investment.

CN opened an account with Western on June 4, 2013. CN testified that at that time, her annual income was approximately $94,000, consisting of a pension, income from a rental property, and a small social security payment. CN further testified that her assets at the time totaled approximately $1.1 million, including the home she lived in worth $400,000 (on which there was a $240,000 mortgage). Excluding her primary residence, CN testified that her net worth totaled approximately $575,000-$600,000. Her only liquid assets were $150,000 in cash savings.

CN testified that when she opened her Western account, she had virtually no investing experience. She had never selected a stock or bond on her own and had invested $10,000 in a mutual fund on one occasion only. As of June 2013, the only investments she had ever made were in that single mutual fund and the variable annuities recommended by Patatian.

CN's Western account agreement reflected far greater assets and investment experience. The agreement, which was filled out by Patatian, stated that CN had $2 million in assets, liquid

assets of $500,000, and 25 years of experience investing in stocks, bonds, and mutual funds.[8] CN testified that Patatian did not discuss the financial data and investment experience information he had written on the form and she signed it without reviewing it because she trusted him. CN denied ever telling Patatian that she had $2 million in assets or that she had 25 years of investment experience. CN's testimony revealed her lack of investment sophistication. She did not appear to understand the difference between mutual funds and money market funds and testified she did not know what a REIT was other than an investment in real estate.

In early July 2013, CN followed Patatian's recommendation to surrender an annuity she had purchased from him at CUSO and invest the proceeds—approximately $60,000—in an ARC non-traded REIT. The Disclosure Patatian filled out for CN reflected a net worth exclusive of $3 million—$1 million more than the $2 million Patatian recorded on CN's Western account agreement just a month earlier and five times more than the $600,000 CN testified was her actual net worth exclusive.[9] Patatian also incorrectly noted on the Disclosure that CN's $60,000 investment in the non-traded REIT represented five percent of her estimated net worth.

CN testified that Patatian did not discuss the risks of investing in REITs with her and told her she would get her investment back in five years or less. CN also testified that when she noticed and questioned the $3 million net worth number Patatian had listed on the Disclosure, Patatian told her no one would check the number and it did not matter. Patatian did not discuss the state suitability limitations on REIT purchases with CN and, when asked about the limitation at the hearing, CN stated, "I don't even know what that means." CN said that Patatian showed her where to initial and sign the Disclosure and she did so without reading it or discussing it with Patatian. CN said she never received a prospectus for the investment and did not know what a prospectus was. CN received monthly payments from ARC that she believed were dividends, but later learned were returns of principal. CN sold the REIT in November 2021 at a loss of more than $13,000.

2. Patatian Recommends Non-Traded REITs to JO

JO worked for the DWP as a water treatment supervisor for almost 36 years. She met Patatian at a Credit Union branch in approximately 2006 and subsequently opened a CUSO account with him. In April 2007, JO invested $300,000 from the sale of her home in a variable annuity Patatian recommended. JO testified that at the time she met Patatian, she had no investment experience.[10]

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[8] The CUSO account opening application Patatian signed in 2006—more than six years earlier—inconsistently listed CN as having 30 years of experience investing in stocks, bonds, and mutual funds, and 15 years of experience investing in annuities.

[9] CN testified that Patatian initially recommended that she invest $300,000 in the REIT, but she refused to do so.

[10] Despite this Patatian recorded on the CUSO account opening documents that JO had 15 years of experience investing in stock, bonds, and mutual funds, and 10 years of experience with annuities.

JO opened a Western account with Patatian in July 2013. At that time, JO was going through a divorce, had sold her marital home, and did not know where she and her four children would live. She was also being treated for cancer. Because of these circumstances, she told Patatian that she needed her money to be safe and readily accessible if she needed it. JO signed the Western client agreement during a meeting with Patatian. When JO signed the form, it was blank other than her name and contact information and she trusted Patatian to fill out the rest of the information. Patatian later recorded that JO had annual income of $100,000, net worth of $2.5 million, and 20 years of experience investing in stocks, bonds, and mutual funds. Patatian recorded her time horizon as more than 10 years.

In May 2014, on Patatian's recommendation, JO surrendered her variable annuity and invested the approximately $360,000 in proceeds in an ARC non-traded REIT. As a result of the surrender, JO paid approximately $34,000 in federal and state taxes. JO testified that Patatian did not discuss the potential tax consequences with her when he recommended the surrender.

In connection with the REIT purchase, JO signed a Disclosure. JO testified that, as with previous documents, the Disclosure was blank when she signed it. Patatian subsequently filled out the Disclosure, listing JO's net worth exclusive as $4 million—$1.5 million more than the net worth he had recorded on her Western client agreement less than a year earlier—and wrote that her $360,000 REIT purchase represented 9 percent of her estimated net worth.

JO testified that her actual net worth, including the amounts in her pension and deferred compensation accounts, was less than $1 million and that she had virtually no investment experience. JO had never selected any specific investment. JO also testified that Patatian never discussed the risks of the ARC REIT with her and she did not understand until after she had invested that the REIT involved a real estate investment. JO discovered that the REIT involved real estate approximately one month after her investment when she received literature from the issuer. She contacted Patatian, complaining that she wanted her money safe and accessible. Patatian responded that her money would be tied up for a year only. JO repeatedly asked for her money back, ultimately selling the REIT in July 2015 at an almost $26,000 loss.

3. Patatian Recommends Non-Traded REITs to WD and JD

WD and JD (together, the "Ds") are a married couple who became Patatian's customers in 2008 while Patatian was associated with CUSO. WD testified at the hearing. At the time of the hearing, WD was 67 years old and ran a family lighting business with JD, for which WD did bookkeeping and sales work. Prior to inheriting this family business, WD completed a year of junior college and worked as an usher in a stadium.

The Ds opened a CUSO account with Patatian in January 2008. At CUSO, the Ds invested $50,000 in a variable annuity on Patatian's recommendation. The Ds subsequently opened a Western account with Patatian in April 2013. On the Western client agreement, Patatian wrote that the Ds' annual income was $200,000 and their net worth was $2.5 million with liquid assets of $750,000. Patatian also wrote that the Ds had 25 years of experience investing in stocks, bonds, and mutual funds, a time horizon of more than 10 years, and moderate

risk tolerance. WD testified that the Western client agreement was blank when she and JD signed it.

Around the time Patatian moved to Western, the Ds decided to surrender the annuity Patatian had sold them at CUSO and began discussing with Patatian their desire for another investment in which to invest the proceeds. WD testified that she and her husband repeatedly told Patatian that they were not interested in a long-term investment and that they wanted their money to remain liquid. Patatian recommended that the Ds invest in an ARC non-traded REIT. WD testified that Patatian told them the REIT would yield 5-6 percent and that their money would only be tied up for one year, after which they could get their money back.

The Ds met with Patatian at their business office to complete the Disclosure for the REIT purchase. During that meeting, Patatian again reassured them that they would be able to access their money in a year. WD testified that when they signed the Disclosure it was blank. WD said that it did not seem important that they signed a blank form and that they trusted Patatian to complete it. When Patatian later completed the Disclosure, he wrote that the Ds' $45,000 REIT investment represented 1.5 percent of their $3 million net worth exclusive.

WD testified that the information Patatian recorded on the Western client agreement and the Disclosure did not accurately reflect their financial data, investment experience, or desires. Rather than the more than 10-year time horizon and moderate risk tolerance recorded, WD testified that their time horizon was "very short" and they wanted a conservative investment. WD also testified that she and her husband had very limited investing experience. The Ds had only ever invested in the annuity Patatian sold them, apart from mutual funds in their retirement accounts, and had never selected a stock or bond to purchase. The Ds' annual joint income was $150,000 and their assets were substantially less than $3 million. WD testified that she and JD owned a home worth approximately $650,000 (with a mortgage on it), $100,000 in savings, and $500,000 in retirement funds. WD testified that she did not consider the lighting business as a significant asset because the business was never profitable, consistently operated at a loss, and carried a large loan.

WD further testified that Patatian did not discuss the risks of the REIT with them and they did not know that the REIT involved real estate until after they had invested. Patatian did not disclose to them that the REIT was a long-term investment, but rather assured them they could get the money back in a year. After a year, the Ds repeatedly tried to withdraw their money, but Patatian did not return their calls, delayed, and eventually told them the time for withdrawal had passed. The Ds eventually contacted ARC directly and were told their money would be inaccessible for several more years. As of the hearing, the Ds still held their ARC REIT, which remained illiquid.

4. Patatian Recommends Non-Traded REITs to JR

JR opened a CUSO account with Patatian in 2004, and she invested in variable annuities at Patatian's recommendation. JR retired from her job as a security guard with the DWP in 2006. JR died in 2018, and her son DK testified at the hearing.

DK testified that JR began showing symptoms of dementia in 2012 and he obtained a power of attorney for her that same year. In 2015, JR lived in a retirement community, but moved in with DK and his wife when she began to need constant care. In May of 2016, JR entered a residential care facility. DK testified that he often "vented" to Patatian about JR's declining physical and cognitive health. DK told Patatian the situation was stressful and that he needed the distributions from her annuities to pay for her care.

Patatian recommended that JR surrender her annuities and purchase a non-traded REIT. DK said Patatian told him the REIT would not lose money and would provide JR with the monthly income she needed to pay for her care. DK said that while he was content with the annuities, Patatian "pushed" the investment in the REIT. DK testified that he did not recall any discussion with Patatian about the risks associated with REITs, that the REITs were a long-term investment, or the California state suitability standards.

On April 19, 2016, 11 days before she moved into the care facility, JR opened a Western account with Patatian and signed the Disclosure for the REIT purchase. DK was present when his mother signed the documents. Patatian filled out both forms. On JR's Western client agreement, Patatian wrote that JR's annual income was $80,000, and that she had a net worth of $2.1 million and liquid assets of $500,000. Patatian also indicated that JR had "good" experience investing in stocks, bonds, and mutual funds and "extensive" experience investing in annuities. On the Disclosure, Patatian indicated that her $200,000 investment in a non-traded REIT represented 9.8 percent of her net worth exclusive of $2.1 million. The $200,000 JR invested in the REIT consisted of the proceeds from her surrender of her variable annuities.

DK testified that at the time his mother opened the Western account and purchased the REIT, he was in charge of meeting her financial needs and, because of the increasing costs of her care, they were not willing to take any risk with her money and needed to keep her funds easily accessible. DK testified that his mother's investment experience was "poor" and, to his knowledge, she had never selected a stock to invest in on her own. Moreover, because of her declining cognitive health, JR was unable to manage her checking or savings account in 2016.

DK also testified that the financial data on JR's Western documents was significantly overstated. He testified that JR's annual income was actually $60,000 and her net worth exclusive was approximately $250,000—only ten percent of the $2.5 million Patatian recorded. DK also said that JR's liquid assets included $10,000 in a checking account and $240,000 in the variable annuities—not the $500,000 that Patatian had recorded. DK testified that he looked over the documents when his mother signed them and the financial data was not filled out. DK said he trusted Patatian to fill in the correct numbers. JR still held her REIT when she died in 2018.

5. Patatian Recommends Non-Traded REITs to RC

At the time of the hearing, RC was 73 years old and retired from working as a security guard for 20 years for the City of Los Angeles and, later, the DWP. RC met Patatian at a Credit Union branch, became his customer in 2007, and invested $77,000 in a variable annuity on Patatian's recommendation. RC testified that he saved the money he invested in the annuity

working double shifts at the DWP and that he had no investment experience before purchasing it. RC had never selected a stock, bond, or mutual fund on his own.

RC testified that after he joined Western, Patatian contacted him about purchasing a non-traded REIT, which Patatian described as a "fantastic deal" perfect for RC's retirement plan, and urged RC to "act fast" because "everybody [was] joining." RC met with Patatian at his home in July 2014 to complete the paperwork to open a Western account and invest in the ARC REIT Patatian had recommended. RC testified that, at that meeting, he signed and initialed forms that were blank and did not read them because he trusted Patatian "a hundred percent" and considered him a friend.[11] RC testified that the money he invested in the REIT was for his retirement and thus he wanted no risk and for the funds to be available to him because he was planning to retire soon.

Patatian filled out RC's Western client agreement and the Disclosure for his REIT purchase. On the client agreement, Patatian wrote that RC's annual income was $95,000 and he had a net worth of $2.4 million, liquid assets of $300,000, and 30 years of experience investing in stocks, bonds, and mutual funds. Patatian also recorded an investment objective of "moderate" and a time horizon of more than 10 years. On the Disclosure, Patatian wrote that RC's net worth exclusive was $1 million and that his $95,000 ARC investment represented 9.5 percent of his liquid net worth. The $95,000 RC invested in ARC on Patatian's recommendation represented all the proceeds from the surrender of the variable annuity Patatian had sold him at CUSO.

RC testified that Patatian overstated his investment experience, annual income, liquid assets, and net worth exclusive on the forms. In 2014, RC's income was $76,000 and his assets, excluding his home, included $35,000 in savings, the $95,000 he invested in the REIT, and approximately $241,000 in retirement funds from the DWP—a total of approximately $371,000.[12] RC testified that he and Patatian did not discuss this financial information and the client agreement and Disclosure were blank when he signed them. RC said Patatian told him he would enter amounts to "fulfill the requirement" and make the data "fit" so RC could buy this "fantastic investment." RC said Patatian never explained what he meant by making the numbers "fit." Nor did Patatian discuss with RC the features or risks of the REIT with him, including that it could remain illiquid for many years. As of the hearing, RC still held the REIT and it remained illiquid.

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[11] RC made and retained a copy of the blank form he had signed. RC's copy was admitted as evidence at the hearing.

[12] At the hearing, Patatian made much of the fact that RC's California home in a beach neighborhood had appreciated in value substantially since he bought it and, thus, the net worth exclusive amount he recorded on the disclosure was true. Whether or not it is true that the value of RC's home had appreciated in value is immaterial, however, because the Disclosure asked for RC's net worth exclusive—i.e., his net worth excluding the value of his home.

D. Patatian Recommends Variable Annuity Exchanges and Surrenders to Customers

1. Patatian Recommends Variable Annuity Surrenders Without Considering Tax Consequences or Applicable Surrender Penalties

Between 2013 to 2015, Patatian recommended variable annuity exchanges to several customers, for whom the surrenders resulted in significant, unplanned tax consequences and, in one case, a surrender fee which Patatian failed to consider.

In July 2013, Patatian's customers RS and BS (together the "Ss"), a married couple, followed Patatian's recommendation to surrender a variable annuity and use the proceeds to purchase a non-traded REIT. Taxes were not withheld on the variable annuity surrender. As a result of the surrender, RS and BS received a tax bill in excess of $20,000, which included a $3,300 understatement penalty. When the Ss' accountant asked about the tax, Patatian told him that the couple should tell the Internal Revenue Service that they had "deferred taxes for now" because the surrender of the variable annuity and purchase of the REIT qualified as a non-taxable "1035 exchange," and that the tax would be owed and paid when the REIT was sold or liquidated.[13]

In May 2014, Patatian's customer AT followed his recommendation to surrender a variable annuity and invest the $96,000 proceeds in a non-traded REIT. No taxes were withheld on the surrender. As a result of the surrender, AT incurred a $19,000 federal tax bill, including a more than $3,000 understatement penalty. AT also incurred a surrender penalty in excess of $2,100. When AT asked Patatian why she owed the tax, he told her that the surrender of the variable annuity and purchase of the REIT qualified as a "1035" tax-free exchange of one insurance product for another.

In 2015, Patatian recommended that his customers, JE and ME (together the "Es"), a married couple, surrender a variable annuity they still held at CUSO and invest the $85,000 proceeds in a non-traded REIT with Patatian at Western. The Es' surrender incurred a more than $4,000 surrender charge. Patatian testified that when he learned about the surrender charge, he was "surprised" and "uncomfortable," and he admitted that if he had known about the surrender charge amount, he would not have recommended the surrender.

Finally, as discussed above (*see* supra I.C.2). JO testified that when she followed Patatian's recommendation to surrender her variable annuity to purchase a REIT, she incurred $34,000 in tax liabilities. JO testified that Patatian had not discussed with her the tax consequences of surrendering her variable annuity when he recommended that she do so.

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[13] Section 1035 of the Internal Revenue Code ("Section 1035") allows the tax-free exchange of certain insurance products, including annuity contracts, life insurance policies or long-term care products with another one of like kind, when certain conditions are met. *See* 26 U.S.C. § 1035. The surrender of a variable annuity for a REIT, which is a real estate investment, does not qualify for tax deferral under Section 1035.

2. Patatian Recommends Variable Annuity Exchanges Without Considering Cost Differences and Without Understanding Certain Features

In November 2017, Patatian recommended that his customers DG and AG (together, the "Gs"), a married couple, exchange two variable annuities he had previously sold them at CUSO for two other variable annuities with new surrender periods. As part of his recommendation, Patatian discussed with DG and AG, and disclosed on a firm form, the cost differences between the annuities, informing them that the new variable annuities would cost an additional five basis points annually. The cost information Patatian provided was incorrect because it included in the fee comparison a fee the customers were no longer paying on the existing annuities at the time of the exchange because it was for a rider that had been discontinued. In fact, the new variable annuities cost approximately $4,000 more annually than those the Gs exchanged, far more than the amount Patatian had disclosed. A review of the features of the Gs' existing annuities and the contracts for the new annuities would have revealed the actual cost differences.

In 2017 and 2018, Patatian recommended that four customers, including a married couple, exchange their existing variable annuities for new annuities in order to obtain a higher death benefit. For all the exchanges, Patatian was required, but failed, to select the optional rider that provided the additional death benefit at an additional cost. Patatian learned about his failure to select the death benefit for these transactions when FINRA pointed it out during an OTR years later.

3. Patatian Impersonates a Customer in a Telephone Call with an Insurance Company

As noted above (*see supra* Part I.D.1), in 2015 Patatian recommended that the Es surrender a variable annuity they held at CUSO and invest the proceeds in a non-traded REIT with Patatian at Western. At the time, Patatian was not the agent of record for the annuity. After the surrender, Patatian impersonated JE on a call with the annuity insurance company in order to ask about the contract value and surrender charge. In doing so, Patatian provided JE's date of birth and the last four digits of his social security number to the insurance company representative.

E. FINRA's Investigations

1. FINRA's 2013 Investigation

Enforcement began an investigation of Patatian in May 2013, styled FINRA Matter No. 20130364747, concerning the statements in CUSO's Form U5 that Patatian had been terminated for failing to follow firm policy with respect to transaction documentation (the "2013 Investigation"). As part of that investigation, Enforcement issued several FINRA Rule 8210 requests for documents and information, and Patatian appeared for sworn, on-the-record testimony ("OTR"). On January 1, 2018, Enforcement notified Patatian by letter (the "2013 Investigation Closing Letter") that, based on the information in its possession at that time, staff had determined that it would not recommend the commencement of disciplinary action against him in connection with FINRA Matter No. 20130364747. The letter cautioned, however, that

Enforcement's decision related solely to FINRA Matter No. 20130364747 and "should not in any way be construed as indicating that [Patatian had] been exonerated of any wrongdoing or that no wrongdoing may have occurred." The letter further cautioned that Enforcement "may use any information obtained in this matter in connection with this or any other matter."

2. The 2018 Investigation

During the investigation of Patatian's conduct at CUSO, Enforcement learned about conduct at Western that warranted additional investigation. Accordingly, Enforcement opened a new matter in 2018, styled FINRA No. 20180572358 (the "2018 Investigation"), to investigate Patatian's activities at Western, including his recommendations that customers surrender variable annuities and purchase non-traded REITs. As part of this investigation, Patatian appeared for OTR testimony on April 30 and May 1, 2020 (the "2020 OTR").

3. Patatian's 2020 OTR

During the 2020 OTR, Patatian testified that before joining Western, he had no interest in or experience with REITs. Patatian admitted that Western provided him with virtually no training about REITs and that so-called "due diligence" trips hosted by the issuer were in fact recreational trips to "grease the wheel" and "just . . . pump[] up their product," and served as a "payoff" to brokers selling the REIT. Patatian testified that other than talking to other brokers in the office and attending the issuer-sponsored trips, he did nothing to learn about the REITs.

Patatian described the REITs as a "black box" and repeatedly admitted that he did not understand the investment. Patatian also admitted that if he had understood how the REITs worked, he never would have recommended them to his customers. Specifically, Patatian said that he changed his mind about REITs when he understood that they were illiquid and concluded that the commissions and fees were too high for his customers. Patatian said he would never sell REITs again. He explained:

> Like I didn't know. I was too stupid to really understand what it was really all about, and I guess I was guilty of looking away. And I mean, if I really had dug deep and learned all the gory details, it would have been r----ded for me, but I was looking away hoping for the best. And if I could have just got in there, be in there for two, three years max, get the money back, I got seven percent, the client made money, and just get away with it.

Patatian testified that while the REITs "officially" had a seven-year hold period, he "was hoping that [the REITs were not] really tied up for seven to 10 years," and that his customers would get their money back in "two, three years maximum, a lot of times less than that," like the investors in earlier ARC offerings had. But, when the REITs remained illiquid and lost value "it was just a nightmare, it was a disaster" for his customers. Patatian noted that the commissions on the REITs were seven percent and admitted, "I got greedy."

Patatian also testified about his practices when completing the Disclosures. Patatian admitted that he manipulated the net worth exclusive numbers he recorded based on the amount the customer was investing in the REIT. He explained:

> I mean, if you wanted to invest $200,000 into a REIT you had to make a client's net worth at least 2 million dollars. If you say a client's net worth is a million five, that's going to be above the ten percent so we are going to have an issue. So[,] the easiest work around or the easiest solution right up front is to make a client's net worth above the number that you want to invest, you want to make the investment for.

As Patatian explained, he "had to make the numbers fit the puzzle."

With respect to determining investment experience for his DWP customers, Patatian testified that he used their years working for the DWP as a proxy for investment experience because all DWP employees were required to participate in its deferred compensation plan. Patatian admitted, "I would ask [customers employed or retired from the DWP] how many years were you at the [DWP] and I would write that number in those boxes. Right or wrong, that's how I would do it."

II. Procedural History

A. The Complaint

On February 26, 2021, the Department of Enforcement ("Enforcement") served Patatian with a five-cause complaint alleging that he had engaged in misconduct in connection with his recommendations to customers of REITs and variable annuities. Under cause one, Enforcement alleged that Patatian violated FINRA Rules 2111 and 2010 by recommending 81 transactions in non-traded REITs to 59 customers when he "did not have a reasonable basis to believe, based on reasonable diligence, that his recommendations to purchase non-traded REITs were suitable for at least some customers because he failed to conduct a reasonable investigation into the risks and rewards of the products, including the risk that the product would remain illiquid for longer than three years"—i.e., without complying with his "reasonable basis" suitability obligations. Additionally, Enforcement alleged under cause one that Patatian recommended the non-traded REITs to six specific customers without having a reasonable basis to believe that the transactions were suitable for those particular customers—i.e., without meeting his "customer-specific" suitability obligations.

Under cause two, Enforcement alleged that Patatian also violated FINRA Rules 2111 and 2010 when he recommended variable annuity surrenders to six customers without a reasonable basis for believing the surrenders were suitable because "he failed to understand the adverse financial consequences of the surrenders, including that the customers would lose existing benefits or be subject to increased fees or charges."

Enforcement alleged under cause three that Patatian made unsuitable recommendations to six customers to exchange variable annuities, in violation of FINRA Rules 2330(b) and 2010. Enforcement alleged that Patatian recommended the transactions without understanding the consequences of the transactions, including failing to consider whether the customer would incur surrender charges, lose existing benefits, or be subject to increased fees or charges. Accordingly, Patatian lacked a reasonable basis to believe, based on reasonable diligence, that the exchanges were suitable.

Under cause four, Enforcement alleged that Patatian acted unethically and in violation of high standards of commercial honor in violation of FINRA Rule 2010 by impersonating a customer, without the customer's knowledge or authorization, in a telephone call with an insurance company.

Finally, under cause five, Enforcement alleged that Patatian caused his firm to create and maintain inaccurate books and records, in violation of FINRA Rules 4511 and 2010, by overstating customer investment experience and financial data on account forms and client disclosure forms that the firm was required to maintain.

On May 7, 2021, Patatian filed an answer to the complaint, generally denying the allegations of misconduct and asserting several affirmative defenses. Patatian admitted, however, that "in one instance, [he] . . . impersonated a customer—without the customer's knowledge or consent—in a telephone call with an insurance company to obtain the contract value and surrender fee for the variable annuity" and that this conduct violated FINRA Rule 2010.

B. The Extended Hearing Panel Decision

After a seven-day hearing, the Extended Hearing Panel issued a decision on June 10, 2022 (the "Decision") finding that Patatian engaged in the alleged misconduct. The Hearing Panel found that Patatian violated FINRA Rules 2111 and 2010 with respect to all 81 non-traded REIT transactions because he did not understand the REITs and, accordingly, did not have a reasonable basis, based on reasonable diligence, to believe that the REITs were suitable for at least some customers. With respect to six customers—CN, JO, the Ds, JR, and RC—the Hearing Panel found that Patatian further violated FINRA Rules 2111 and 2010 because the REITs he recommended were not suitable for these customers. The Hearing Panel further found that Patatian violated FINRA Rules 2111 and 2010 when he recommended variable annuity surrenders to four customers—AT, JO, the Ss, and the Es—without understanding the tax liabilities or surrender fees those customers would incur. In addition, the Hearing Panel found that Patatian violated FINRA Rules 2330(b) and 2010 by recommending variable annuity exchanges to six other customers without understanding the true costs of the exchanges, thereby undermining the justification for the exchanges and thus the suitability of the recommendations.

The Hearing Panel further found, based on the admissions in his answer, that Patatian violated the ethical standards of FINRA Rule 2010 by impersonating customer JE in a telephone call with an insurance company. Finally, the Hearing Panel found that Patatian violated FINRA

Rules 4511 and 2010 by causing his firm to maintain inaccurate records by overstating his customers' investment experience, net worth exclusive, and liquid net worth on firm documents.

The Hearing Panel imposed a unitary sanction for Patatian's violations related to the REITs. The Panel found that Patatian's violations were egregious and warranted a bar and other sanctions that included disgorgement, restitution, and recission. For the violations related to the variable annuity exchanges, the Panel imposed a second bar.

This appeal followed.[14]

III. Discussion

A. Patatian Recommended REIT Purchases Without Conducting Reasonable Diligence Sufficient to Form a Reasonable Basis to Believe the REITs Were Suitable for Any Customers

FINRA Rule 2111 provides that a "member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer." The rule imposes both "reasonable-basis" and "customer-specific" suitability obligations on FINRA members and their associated persons. *See* FINRA Rule 2111, Supplementary Material .05 ("Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability."); *see also Dep't of Enf't v. Reyes*, Complaint No. 2016051493704, 2021 FINRA Discip. LEXIS 29, at *29-30 (FINRA NAC Oct. 7, 2021).[15]

Reasonable-basis suitability focuses on the particular security recommended and requires that the representative have a basis to believe that the recommendation is suitable for at least some customers. *See Dep't of Enf't v. Siegel*, Complaint No. C05020055, 2007 NASD Discip. LEXIS 20, at *37-38 (NASD NAC May 11, 2007). A registered representative's "recommendation may lack 'reasonable[-]basis' suitability if the broker . . . fails to understand the transaction, which can result from, among other things, a failure to conduct a reasonable

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[14] In his appeal brief, Patatian, who appears pro se on appeal, asks to incorporate by reference the post-hearing brief submitted by his attorney during the hearing proceedings below. FINRA Rule 9347 sets forth the requirements for briefs before the NAC and provides that briefs must contain "exception[s] to findings, conclusions, or sanctions [that] shall be supported by citation to the relevant portions of the record . . . and by concise argument, including citation of such statutes, decisions, and other authorities as may be relevant." Nonetheless, we have considered Patatian's post-hearing brief as part of our de novo review of the record in this matter.

[15] A violation of FINRA Rule 2111 also constitutes a violation of FINRA Rule 2010, which requires registered representatives to observe high standards of commercial honor and just and equitable principles of trade. *See Dep't of Enf't v. Taddonio*, Complaint Nos. 2015044823501, 2015044823502, 2019 FINRA Discip. LEXIS 3, at *40 n.24 (FINRA NAC Jan. 29, 2019).

investigation concerning the security." *Id.* at *38; *see also Dep't of Enf't v. McGee*, Complaint No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *59-60 (FINRA NAC July 18, 2016) (finding that representative failed to satisfy the due diligence requirements of reasonable-basis suitability). "We therefore look at the adequacy and reasonableness of the diligence and investigation that a broker undertakes prior to recommending a security to determine whether he possesses a reasonable basis to believe such recommendations are suitable for at least some customers." *Reyes*, 2021 FINRA Discip. LEXIS 29, at *36. Moreover, evidence that the representative lacked an understanding of the features or risks of a recommended investment is a violation of the reasonable-basis suitability obligations. *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *23-25 (May 27, 2011).

The Hearing Panel found that Patatian violated FINRA Rules 2111 and 2010 because he recommended the non-traded REITs to 59 customers without meeting his reasonable-basis suitability obligations. This finding is based predominately on Patatian's admissions in his sworn testimony during the 2020 OTR. During the 2020 OTR, Patatian testified that: (1) he had no experience with REITs prior to joining Western; (2) when he started selling REITs, he did nothing to learn about them other than talking to other brokers in the office and attending issuer-sponsored trips, which were recreational rather than educational; (3) the REITs were a "black box" that he did not understand and that he would not have recommended if he had; and (4) he did not understand how long the REITs would remain illiquid.

At the hearing and on appeal, Patatian contradicts his 2020 OTR testimony and offers various excuses for why we should not rely on it. Patatian claims that his testimony at the 2020 OTR was "pretty outlandish" and "everything [he] said was twisted and manipulated by FINRA." He also claims he was under personal stress and "confused." He now claims that he did research the REITs before recommending them, including by attending trainings, meetings, and conference calls, and that he understood REITs better than any other broker in his office.

The Hearing Panel considered Patatian's conflicting testimony at the 2020 OTR and the hearing and concluded that "Patatian was unpersuasive that the Panel should believe his testimony at the hearing instead of his 2020 OTR testimony." Patatian has not established any reason, much less the substantial evidence necessary, for us to disturb the Hearing Panel's credibility determination. *See Eliezer Gurfel*, 54 S.E.C. 56, 62 n.11 (1999) (explaining that "[c]redibility determinations by the fact finder are entitled to substantial deference and can be overcome only where the record contains substantial evidence for doing so"), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000). To the contrary, the record amply supports that Patatian testified truthfully at the 2020 OTR.

Patatian argues that he thought he was appearing at the 2020 OTR as a cooperating witness to provide information against Western. There is nothing in the record, however, that indicates that anyone at FINRA suggested to Patatian that he was a cooperating witness who would be immune from a disciplinary action based on his testimony. In any event, even if Patatian genuinely believed he was a cooperating witness, this supports that his testimony at the 2020 OTR was truthful. Moreover, Patatian's OTR testimony was consistent with the testimony of his customers, who testified that Patatian told them their money would be tied up for periods of five years or much less, and with the fact that Patatian recommended the REITs to customers

who required liquidity and who desired a low-risk investment or one that would provide regular income. Additionally, in most cases the net worth exclusive numbers Patatian recorded on the Disclosures were almost exactly aligned so that the proceeds of annuity surrenders that customers invested in REITs would represent just under 10 percent of the customers' net worth exclusive, supporting his 2020 OTR testimony that he came up with numbers to come within the state suitability limit. Patatian's fundamental lack of understanding of the REITs was also apparent at the hearing, as his testimony reflected that he thought his REIT customers were investing directly in real estate rather than in common stock, as explained in the prospectuses. There is no basis to disturb the Hearing Panel's credibility findings with respect to the 2020 OTR and, accordingly, we affirm them.[16]

Patatian's other complaints about the 2020 OTR are also baseless. A review of the 2020 OTR transcript reveals that FINRA staff mostly asked open-ended questions and Patatian gave long narrative responses that included statements that admitted partial or complete liability. Nothing suggests that FINRA staff "twisted" or "manipulated" Patatian's testimony. Nor can Patatian avoid the consequences of his testimony because he appeared at the OTR without an attorney. The record demonstrates that FINRA repeatedly told Patatian at the start of the 2020 OTR that he could have an attorney present and when staff asked follow-up questions about whether he had consulted an attorney for assistance, Patatian became exasperated, saying:

> Look, I have a lot of attorney friends. My wife is an attorney. I mean, I have ample legal counsel if I need it or want to. I have plenty of legal representation if I need it or want it. I don't need to discuss with you what I talked to my attorneys or not.

Patatian chose to appear at the 2020 OTR without an attorney and his decision to do so does not undercut its credibility or constrain our ability to rely on the sworn statements he made during it.

Patatian's 2020 OTR testimony and the other record evidence demonstrates that he recommended non-traded REITs to his customers without conducting adequate due diligence to understand the features and risks associated with the REITs.[17] There is no support in the record

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[16] Patatian also claims he was "self-medicating" for back pain and that this affected his testimony, but he offers no evidence to support this self-serving statement. Moreover, even if this is true, he does not explain what medication he was taking and how it impacted his ability to testify truthfully. We see no reason to disturb the Hearing Panel's credibility finding on this basis.

[17] Patatian complains that 54 of the customers to whom he was found to have sold unsuitable non-traded REITs did not testify at the hearing. Patatian misunderstands the nature of this claim. The sales to these customers were unsuitable because Patatian recommended the REITs without a basis for believing they were suitable for *any* customers. This inquiry focuses on what *Patatian* knew about the REITs and was established primarily by Patatian's own admissions. Thus, testimony from the additional customers was not necessary to establish the violations of reasonable basis-suitability here. Nor is it necessary for the customers to have suffered losses in order to conclude that Patatian's recommendations lacked reasonable-basis

[Footnote continued on next page]

for Patatian's claim that FINRA unfairly used his admissions in that testimony against him. Accordingly, Patatian violated his reasonable-basis suitability obligations with respect to the 81 REIT purchases he recommended to 59 customers, and thereby violated FINRA Rules 2111 and 2010.

B. Patatian's REIT Recommendations to Six Customers Were Not Suitable

The customer-specific suitability obligations under FINRA Rule 2111 state that "[a] member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." FINRA Rule 2111(a); *see also* FINRA Rule 2111 Supplementary Material .05(b). The recommendation must be consistent with the customer's best interests and financial situation, and the representative must disclose the risks associated with the investment in order to be satisfied that the customer is willing to take those risks. *See Reyes*, 2021 FINRA Discip. LEXIS 29, at *30-31. In determining customer-specific suitability, FINRA Rule 2111 directs associated persons to consider a customer's investment profile, which "includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."

The Hearing Panel found that Patatian violated his customer-specific suitability obligations under FINRA Rule 2111 when he recommended non-traded REITs to CN, JO, RC, JR, and the Ds. We agree and affirm.

All six customers had limited investment experience. They all testified that they invested in annuities on Patatian's recommendation and had virtually no experience investing in other products. Patatian argues that the four customers who worked for or had retired from the DWP—CN, JO, RC, and JR—actually had decades of experience by way of their participation in the DWP's deferred compensation program. But the record reflects that the deferred compensation program only required participants to select classes of investments—not any particular investment. Patatian was aware of this because one of his duties at the Credit Union was to advise DWP employees on asset-class selection in the deferred compensation plan. None of the customers had ever invested in a REIT and they all testified that they did not understand the REITs.

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suitability. It is well settled that a recommendation may be unsuitable even if it is ultimately profitable. *See Cody*, 2011 SEC LEXIS 1862, at *28 (explaining that "[s]uitability is determined at the time the recommendation is made [and] unsuitable recommendations do not become suitable if they later result in a profit").

All the customers also testified that they were not interested in risky investments and all expressed a desire or need for liquidity that they communicated to Patatian.[18] RC was planning to retire and had few liquid assets aside from the funds he invested in the REIT. JR was retired, suffering from dementia, and had moved into a residential care facility and required funds to pay for her care. JO had recently divorced and sold her home and was suffering from cancer. She testified that she was looking for a new home for herself and her four children and she told Patatian she needed her money to be accessible. Similarly, CN testified that she told Patatian she wanted her money to remain accessible. The Ds were running a struggling family business, and WD testified that she and JD did not want their money tied up for a long period of time. In short, the illiquidity of the non-traded REITs made the investment unsuitable for all six customers.

The customers testified consistently that Patatian did not discuss the risks associated with REITs, but rather touted the investment as great for them and something "everybody" was buying. He promised them they would get their money back in periods of time ranging from one to five years, when the prospectuses warned that the REITs could remain illiquid for seven years or more. While the customers acknowledged that they signed the Disclosures, most testified that Patatian had them sign the Disclosures and Western client agreements as blank forms and they all simply signed and initialed where Patatian indicated without reading the documents because they trusted him.

The non-traded REITs Patatian recommended to CN, JO, RC, JR, and the Ds were unsuitable given their investment objectives, risk tolerance, and needs for liquidity. Accordingly, Patatian violated FINRA Rules 2111 and 2010 when he made those unsuitable recommendations.

C. Patatian Recommended Unsuitable Variable Annuity Surrenders

When recommending the surrender of a variable annuity, an associated person must consider the associated surrender fees or penalties and the amount of those fees or penalties. *See, e.g.*, *Dep't of Enf't v. Orlando*, Complaint No. 2014043863001, 2020 FINRA Discip. LEXIS 26, at * 40 (FINRA NAC Mar. 16, 2020) (finding that representative's recommendation of a variable annuity surrender was unsuitable where, among other factors, the customer "paid several thousand dollars in fees and charges" as a result of the surrender); *McGee*, 2016 FINRA Discip. LEXIS 33, at *40 (finding that a representative's recommendation that a customer surrender variable annuities to purchase another investment was unsuitable where, among other factors, the

[18] At the hearing and in his appeal brief, Patatian insisted that the testifying customers lied about their net worth, investment experience, and other matters. But the Hearing Panel found the customers credible, finding that "[t]hey described their experience with Patatian consistently, credibly, and with specificity." Moreover, their testimony was consistent with Patatian's admissions at the 2020 OTR. Patatian has not pointed to any evidence, much less the substantial evidence necessary, to overturn the Hearing Panel's credibility findings. *See Taddonio*, 2019 FINRA Discip. LEXIS 3, at *38 (affirming Hearing Panel's findings that customers were credible where they "answered questions in a straightforward, direct manner" that was internally consistent and consistent with each other).

customer "incurred expenses worth nearly eight percent of the value of her variable annuities in surrendering" them). In addition, FINRA Rule 2111(a) includes a specific requirement that an associated person consider a customer's "tax status" when recommending a transaction. In recommending variable annuity surrenders to four customers, including two married couples—AT, JO, the Ss, and the Es—without understanding the tax consequences or surrender fees that would result, Patatian violated these obligations.

Patatian recommended that JO, AT, and the Ss surrender their variable annuities in order to invest the proceeds in the non-traded REITs he recommended they purchase. When he did so, he did not consider, or select the option to withhold, applicable taxes. As a result, the customers incurred substantial tax bills, including underpayment penalties, that they did not know about when they followed Patatian's recommendation. JO testified that she had to pay $34,000 in state and federal taxes from the surrender of her variable annuity and that Patatian never discussed the possible tax consequences when he recommended the surrender.[19] AT incurred $19,000 in taxes, including a $3,000 underpayment penalty, an amount equal to almost 20 percent of the proceeds of the variable annuity surrender. The Ss received a tax bill of more than $20,000, including a $3,300 underpayment penalty.

Patatian admitted that he believed that the surrender of a variable annuity and the purchase of a REIT qualified as a tax-free exchange under Section 1035 and the record supports that he told certain customers that this provision applied. Patatian also admitted, however, that he never sought advice from his compliance officer or an insurance carrier about the applicability of Section 1035 and never saw any IRS guidance supporting the application of Section 1035 to such an exchange. Patatian's failure to understand and consider the tax consequences of the surrenders when he recommended them violated his suitability obligations under FINRA Rules 2111 and 2010.

In addition to taxes, AT's surrender also resulted in a surrender penalty of $2,100. The Es' variable annuity surrender cost them $4,000 in surrender charges. Patatian admitted that he did not know about the surrender charges when he recommended the surrender to the Es and was "surprised" to learn of it afterwards. He also admitted that if he had known of the surrender fee, he would not have recommended the surrender to the Es. Patatian's recommendation of variable annuity surrenders without knowing about the applicable surrender fees was unsuitable under FINRA Rules 2111 and 2010.

D. Patatian Recommended Unsuitable Variable Annuity Exchanges

Because variable annuities present particular potential sales practice concerns, FINRA Rule 2330 was adopted to set forth members' and associated persons' suitability obligations specifically for variable annuity transactions.[20] FINRA Rule 2330(b) requires that when making

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19 The Hearing Panel found JO's testimony credible.

20 *See Notice of Filing Proposed Rule and Amendment No. 1 Thereto Relating to Sales Practice Standards and Supervisory Requirements for Transactions in Deferred Variable*

[Footnote continued on next page]

a recommendation to purchase or exchange a variable annuity, an associated person must have reason to believe that the transaction is suitable in accordance with FINRA Rule 2111 and, specifically in the case of an exchange, must also consider whether:

> the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements). FINRA Rule 2330(b)(1)(B)(i).

The rule also requires that associated persons consider whether "the customer would benefit from product enhancements and improvements." FINRA Rule 2330(b)(1)(B)(ii). Compliance with these considerations must be documented and signed by the associated person making the recommendation. *See* FINRA Rule 2330(b)(1).

When Patatian recommended that the Gs exchange two variable annuities for two others, he completed and disclosed to his customers an analysis of the cost differences, indicating that the new variable annuities would cost an additional five basis points annually. Patatian's cost comparison was incorrect because he included in his calculation a rider fee the Gs were no longer paying on their existing annuities. As a result, the new annuities cost the Gs $4,000 more per year than Patatian disclosed. Patatian admitted that his exchange recommendation was based on an inaccurate comparison of costs and that these costs were relevant to determining whether the exchanges made sense. Patatian had an obligation to ensure that the variable annuity exchange he recommended was suitable in terms of additional costs and all the cost information Patatian needed to accurately complete this calculation was available to him. He recklessly failed to understand the transactions he recommended, however, and his recommendation was unsuitable and violated FINRA Rules 2330 and 2010.[21]

In the case of four other recommendations of variable annuity exchanges, Patatian's justification for the exchanges was to obtain higher death benefits. Patatian failed, however, to select the optional rider on the forms he completed that provided that increased death benefit and, as a result, the cost comparisons he completed for the exchanges did not include the cost of the death benefits rider. Patatian characterized the failure to select the death benefit as a "clerical error" and testified that he was able to correct this after FINRA pointed it out to him in an OTR. Patatian, however, had an obligation to conduct adequate due diligence to understand the

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Annuities, 70 Fed. Reg. 42126 (July 21, 2005) (discussing NASD Rule 2821, now codified as FINRA Rule 2330).

[21] A violation of any FINRA rule, including Rule 2330, also constitutes a violation of FINRA Rule 2010. *See Dep't of Enf't v. Merrimac Corp. Sec., Inc.*, Complaint No. 2011027666902, 2017 FINRA Discip. LEXIS 16, at *11 n.7 (FINRA NAC May 26, 2017).

features and costs of the existing and new annuities before recommending the exchange. He did not do so. His failure resulted not from a "clerical error" but rather from his recklessness in conducting due diligence in connection with his recommendations. We agree with the Hearing Panel that Patatian's selection of the death benefits years after he made the recommendations does not change the unsuitability of his initial recommendation. The suitability of a recommendation is determined at the time it is made. *See Dep't of Enf't v. Escarcega*, Complaint No. 2012034936005, 2017 FINRA Discip. LEXIS 32, at *53 (FINRA NAC July 20, 2017). As the Hearing Panel explained, Patatian's failure to select the death benefit rider and include its cost in the cost comparison disclosure "undermined his justification for the exchanges, as well as the cost comparison he used to recommend the exchanges," and thus violated FINRA Rules 2330 and 2010.

E. Patatian Acted Unethically by Impersonating a Customer

FINRA Rule 2010 provides that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."[22] FINRA Rule 2010 is a broad ethical rule that covers a wide range of unethical conduct, even if that conduct is not connected with a securities transaction. *See Dep't of Enf't v. Olson*, Complaint No. 2010023349601, 2014 FINRA Discip. LEXIS 7, at *7 (FINRA Bd. of Governors May 9, 2014), *aff'd*, Exchange Act Release No. 75838, 2015 SEC LEXIS 3629 (Sept. 3, 2015); *see also Vail v. SEC*, 101 F.3d 37, 39 (5th Cir. 1996) (affirming the finding that an associated person violated just and equitable principles of trade by misappropriating funds from a political organization for which he served as the treasurer). FINRA Rule 2010 applies to conduct that is unethical or done in bad faith and "frequently . . . focus[es] on whether the conduct implicates a generally recognized duty owed to clients or the firm." *Dante J. DiFranceso*, Exchange Act Release No. 66113, 2012 SEC LEXIS 54, at *19 (Jan. 6, 2012).

We have previously held that impersonating a customer to obtain confidential customer information is unethical conduct "in complete disrespect of the duty to maintain the confidentiality of customer information." *Dep't of Enf't v. Golonka*, Complaint No. 2009017439601, 2013 FINRA Discip. LEXIS 5, at *24 (FINRA NAC Mar. 4, 2013). Indeed, "[t]hat duty is one of the most fundamental ethical standards in the securities industry." *Id.*, *quoting Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at *10 (Jan. 9. 2009).

The Es held a Prudential annuity at CUSO and Patatian was not the broker of record for it.[23] Patatian admitted in his answer that after the Es surrendered their variable annuity on his recommendation, he "impersonated [JE] in a telephone call with the insurance company to obtain the contract value and surrender charge of the variable annuity." Patatian further admitted that,

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[22] FINRA Rule 0140 provides that all FINRA rules, including FINRA Rule 2010, also apply to persons associated with a member.

[23] Patatian previously applied for, but was denied, approval by Prudential to sell its annuities.

"[a]t the beginning of the call, Patatian claimed to be [ME], a woman. When the insurance company representative asked him to clarify his identity, Patatian stated that he was [JE], [ME's] husband, and then provided [JE's] date of birth and the last four digits of his social security number to authenticate [JE's] identity." Patatian's admitted unethical conduct violates FINRA Rule 2010.

On appeal, Patatian complains that Enforcement obtained and used at the 2020 OTR a recording of his telephone call with the insurance company, which he claims was made without warning him that the call was being recorded and, he argues, thus violates California law. Patatian further argues that his 2020 OTR testimony was the "fruit" of this allegedly illegal recording and thus should be excluded.

The Hearing Panel based its finding that Patatian violated FINRA Rule 2010 by impersonating JE solely on the admission in his answer and thus declined to reach the issues concerning the legality of the telephone recording. Enforcement did not play the recording at the hearing and did not offer it for admission as evidence. Moreover, the Hearing Panel stated that it did not rely on Patatian's 2020 OTR testimony in finding that he violated FINRA Rule 2010. We agree that the admissions in Patatian's answer are sufficient to establish that he violated FINRA Rule 2010 by impersonating JE on a call with an insurance company to obtain information about his variable annuity.[24]

F. Patatian Caused His Firm to Maintain Inaccurate Books and Records

FINRA Rule 4511 provides that members "shall make and preserve books and records as required under the FINRA rules, the [Securities Exchange Act of 1934 (the "Exchange Act")] and the applicable Exchange Act rules," and to preserve those records for certain specified periods. A violation of FINRA Rule 4511 is also a violation of FINRA Rule 2010. *See Escarcega*, 2017 FINRA Discip. LEXIS 32, at *64. FINRA Rule 4511 incorporates Exchange Act Rule 17a-3(a)(6), which requires member firms to "make and keep . . . [a] memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of a security . . . whether executed or unexecuted." 17 CFR § 240.17a-3(a)(6). FINRA Rule 4511 also incorporates Exchange Act Rule 17a-3(a)(17), which requires member firms to keep and maintain an account record including identifying information about a customer that includes, among other things, the customer's "annual income, net worth (excluding value of primary residence), and the account's investment objectives." 17 CFR § 240.17a-3(a)(17)(i)(A). The books and records rules contain an implicit requirement that the records be accurate. *See Meyers Assocs., L.P.*, Exchange Act Release No. 86497, 2019 SEC LEXIS 1869, at *22-23 (July 26, 2019); *see also Dep't of Enf't v. Fillet*, Complaint No. 2008011762801, 2013 FINRA Discip. LEXIS 26, at *42 (FINRA NAC Oct. 2, 2013), *aff'd* Exchange Act Rel. No. 75054, 2015 SEC

[24] Patatian also claimed at the hearing that he had JE's "express" authority to obtain the variable annuity information on his behalf. Patatian, however, presented no evidence to support this claim other than pointing to the client agreements and related documents all customers complete. Moreover, Patatian does not claim that any such authority included permission from JE for Patatian to impersonate him.

LEXIS 2142 (May 27, 2015) ("Individuals may violate [FINRA Rules 4511 and 2010 predecessors] when they fail to comply with Exchange Act Rules . . . or are otherwise responsible for creating and maintaining inaccurate books and records.").

Patatian recorded inaccurate information on Western client agreements and Disclosures related to REIT purchases. CN, JO, RC, JR, and the Ds all credibly testified that they had limited or no investment experience and that the investment experience Patatian recorded on their client agreements was false. For the customers who worked for the DWP, Patatian testified that he used the customer's tenure with the DWP as a proxy for investment experience because all DWP employees participated in the company's deferred compensation program. This testimony supports the customers' testimony that Patatian never had conversations with these customers about their actual investment experience. Moreover, participation in the DWP was a poor proxy for investment experience because the plan only required participants to select classes of assets and all the customers testified, with a single minor exception, that they never selected a particular investment on their own. Patatian's falsification of investment experience remained largely undetected because he had his customers sign blank firm documents.

Patatian admitted in his 2020 OTR testimony that when he completed the Disclosures, he manipulated the net worth exclusive number based on the amount the customer was investing in order to meet the California suitability limit of 10 percent of a customer's net worth exclusive. Patatian's admission is corroborated by the customers' credible testimony that their actual net worth exclusive was significantly lower than the amounts listed on the Disclosures. Additionally, the documentary evidence shows that in some cases the net worth numbers Patatian recorded on the Disclosure were significantly higher than numbers he had recorded on client agreements shortly before, further supporting that the Disclosure numbers were fictions so that, in Patatian's words, "the numbers fit into the investment that I was trying to do."

For example, CN testified that her net worth exclusive was approximately $575,000 to $600,000 and her only liquid assets were $150,000 in savings. On her account agreement, however, Patatian stated that she had $2 million in assets and $500,000 in liquid assets. On the Disclosure completed a month later, Patatian stated that CN's net worth exclusive was $3 million, the number that would support the $300,000 Patatian initially recommended she invest in REITs.[25]

For JO, Patatian wrote on her Western client agreement, after she signed it blank, that JO's net worth was $2.5 million. JO testified that her actual net worth at the time was just under $1 million. A little less than a year later when JO purchased a REIT, the net worth exclusive Patatian noted on her Disclosure was $4 million, a number that met the California suitability limit for her $360,000 REIT investment.

Likewise, JR invested $200,000 in a REIT. Thus, on her Western client agreement and Disclosure, Patatian listed her net worth exclusive as $2.1 million, enough to bring her REIT investment just under the California suitability limit. But her son, who was managing the

[25] CN testified that she refused this amount, and eventually agreed to invest $60,000.

finances for his mother at the time, testified that her actual net worth exclusive was $240,000, a fraction of the number Patatian recorded.

Patatian recommended that RC invest all the proceeds from his variable annuity surrender—approximately $95,000—into a non-traded REIT. Patatian wrote on the Disclosure that RC's net worth exclusive was $1 million, an amount that would bring the REIT investment to just under the 10 percent California limit. RC testified that his actual net worth exclusive at the time was approximately $371,000 and that when he signed the blank Disclosure, Patatian told him he would enter an amount to "fulfill the requirement" and make the data "fit."[26]

To explain the plethora of discrepancies in the net worth exclusive numbers on his customers' documents, Patatian claimed at the hearing, for the first time, that he included an estimation of the present value of the DWP customers' pensions in their net worth numbers. We agree with the Hearing Panel that this claim "does not [with]stand scrutiny." First, Patatian never mentioned doing this at the 2020 OTR. To the contrary, he testified that the net worth numbers he recorded were driven by the amount the customers were investing, in order to meet California's 10 percent limit and obtain firm approval for the transactions. Moreover, Patatian was not able to point to any corroborating evidence that he performed a contemporaneous net present value calculation when he completed the Disclosures.[27] The record demonstrates that Patatian's claim is a self-serving, after-the-fact effort to avoid responsibility for his misconduct.

The record abundantly supports that Patatian violated FINRA Rules 4511 and 2010 by falsifying information on Western client documents. *See Escarcega*, 2017 FINRA Discip. LEXIS 32, at *63-64 (finding that an associated person violated FINRA Rule 4511 by omitting information that caused the customer's net worth to be overstated); *Fillet*, 2013 FINRA Discip. LEXIS 26, at *43-44 (finding that an associated person violated the predecessors to FINRA Rules 4511 and 2010 by falsifying customer new account forms, applications, and other forms related to variable annuity transactions and thereby caused his firm to maintain inaccurate books and records).

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[26] The D's $45,000 REIT investment met the California suitability limit because WD testified that their actual net worth exclusive was approximately $600,000. Nevertheless, WD testified that Patatian substantially overstated the couple's net worth on firm documents. Patatian recorded their net worth as $2.5 million on their Western client agreement and, a little more than a year later, as $3 million on the Disclosure.

[27] Patatian also included pension payments in the customers' income on firm documents, a fact that undercuts his assertion that he accounted for pension payments as part of net worth.

G. Patatian's Defenses and Other Arguments

Patatian asserts two affirmative defenses—laches and ratification—and claims that the hearing proceedings were unfair. We reject these arguments.

1. Laches

Patatian argues that the entire disciplinary proceeding against him should be dismissed based on the doctrine of laches. Laches refers to an equitable doctrine that "bars . . . claims that are not timely pursued." *Talon Real Estate Holding Corp.*, Exchange Act Release No. 87614, 2019 SEC LEXIS 4796, at *22 (Nov. 25, 2019). "A successful laches defense requires a lack of diligence by the party against whom the defense is asserted, and prejudice to the party asserting the defense." *Stephen J. Gluckman*, 54 S.E.C. 175, 188 (July 20, 1999). Thus, in order to prevail on a defense of laches Patatian must prove both that FINRA lacked diligence in its investigation *and* that he was prejudiced by that lack of diligence. *See Robert Tretiak*, 56 S.E.C. 209, 230 (Mar. 19, 2003). Patatian bears the burden of proof for establishing an affirmative defense like laches. *See Dep't of Enf't v. Cantone Research, Inc.*, Complaint No. 2013035130101, 2019 FINRA Discip. LEXIS 5, at *102-03 (FINRA NAC Jan. 16, 2019).

The Commission applies a doctrine of fundamental fairness to FINRA disciplinary proceedings when evaluating an argument like Patatian's. *See Dep't of Enf't v. Mantei*, Complaint No. 2015045257501, 2023 FINRA Discip. LEXIS 10, at *38 (FINRA NAC May 30, 2023). When assessing a claim of unfair delay, the Commission and the NAC look to "the entirety of the record," and to whether the respondent has shown that his "ability to mount an adequate defense was harmed by any delay in the filing of a complaint against him." *Mark H. Love*, 57 S.E.C. 315, 324-25 (2004). While the Commission has rejected the application of a mechanical test in assessing overall fairness, it has considered, as part of its review of the entirety of the record, a variety of time lags, including the times between the filing of the complaint and: (i) the initial misconduct; (ii) the last misconduct; (iii) notice to the SRO of the misconduct; and (iv) the initiation of the investigation. *See Dept' of Enf't v. Rooney*, Complaint No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *89 (FINRA NAC July 23, 2015). Whether we apply laches or the principles of fundamental fairness, we find that Patatian has failed to establish either unfair delay or lack of diligence by Enforcement or prejudice to himself. Accordingly, there is no basis to dismiss these disciplinary proceedings.

The complaint in this matter was filed on February 26, 2021—a date approximately 6 years and 7 months after the first unsuitable REIT purchase (in July 2013) and 4 years and 6 months after the last unsuitable REIT purchase (in August 2016).[28] With respect to when FINRA first had notice of Patatian's violations, Patatian points to the start of the 2013 Investigation and claims that Enforcement had documentation for 75 percent of the unsuitable REIT transactions by November 2014, and documentation for all but one of the unsuitable REIT transactions by January 2017.

[28] For this purpose, we have disregarded a single REIT purchase Patatian recommended in March 2017.

Patatian's argument misses two key points. First the 2013 Investigation was prompted by CUSO's U5 Filing and was for the purpose of investigating Patatian's conduct at CUSO. Indeed, when that investigation was opened in May 2013, Patatian had yet to recommend a single non-traded REIT. While FINRA received documents about Patatian's ongoing REIT sales during the 2013 Investigation, it was not until five years later, in 2018, that Enforcement sent the 2013 Investigation Closing Letter and opened a new investigation into Patatian's sales practices at Western. Second, Patatian's argument ignores that the basis for the reasonable-basis suitability claim was his own testimony at the 2020 OTR. Thus, it was not until April 30 and May 1, 2020 that Enforcement learned that Patatian recommended REITs without a reasonable basis for believing they were suitable for any customer. Enforcement filed the complaint less than 10 months after the 2020 OTR. Additionally, with respect to the customer-specific suitability claims, Patatian's misconduct in falsifying his customers' investment experience and net worth on firm documents concealed from FINRA that these transactions may have been unsuitable.

We find that these time periods do not demonstrate a lack of diligence by Enforcement. Indeed, while some of these periods may appear long if viewed in the light most favorable to Patatian, they are significantly shorter than time periods that FINRA and the Commission have found to be fundamentally unfair in other cases. For example, in *Hayden* the SEC found that a proceeding was fundamentally unfair when there was a delay of almost 14 years between the first instance of misconduct and the filing of complaint, more than six years between the last instance of misconduct and the filing of complaint, and five years between when the NYSE first had notice of misconduct and the filing of the complaint. *See Jeffrey Ainley Hayden*, 54 S.E.C. 651, 653-54 (2000). In *Morgan Stanley*, the NAC found that the delay "exceeded the bounds of fairness" where there were eight years between first instance of misconduct and the filing of complaint, seven years between the last instance of misconduct and the filing of complaint, and five years and nine months between notice of potential misconduct and the filing of complaint. *See Dep't of Enf't v. Morgan Stanley DW Inc.*, Complaint No. CAF000045, 2002 NASD Discip. LEXIS 11, at *18-21 (NASD NAC July 29, 2002). Viewing the entirety of the record and considering all the circumstances, we find that the time periods in this case, which fall well within the limits in *Hayden* and *Morgan Stanley*, do not constitute undue delay or a lack of diligence.

Nor has Patatian established that he has been prejudiced, or that his ability to mount a defense was harmed, by the length of the investigation. Patatian argues that he was prejudiced in three ways. First, he claims that because of the delay, the customer witnesses' memories "faded." We agree with the Hearing Panel that this argument is unpersuasive. A review of the customers' testimony reflects that on the important matters related to suitability, the witnesses recollected the facts, and their testimony was consistent with Patatian's admissions in the 2020 OTR and supported by the documentary evidence. Thus, Patatian has failed to show that witnesses could not recall information important to his defense. *See Rooney*, 2015 FINRA Discip. LEXIS 19, at *93-95 (rejecting claim of evidentiary prejudice because the findings were supported by documentary evidence and uncontested facts).

Second, Patatian argues that his defense was harmed because he no longer had access to notes, customer records, and other transaction documentation that would have helped him to support his position that the REIT recommendations were suitable. Patatian fails, however, to identify any documents he needed, but did not have. Enforcement produced, and the record contains, the relevant client agreements and Disclosures and other relevant documents. Moreover, Patatian was associated with Western until April 2020, well after FINRA began its investigation, and Patatian does not explain what documents he could not have accessed while he worked at Western. *See Tretiak*, 56 S.E.C. at 230 (finding that the respondent "ha[d] not identified any additional, material evidence that he could have obtained and presented had the complaint been filed earlier").

Finally, Patatian claims that he was unable to locate his former sales assistant, who he claims was a potential witness who could have helped his defense. However, as the Hearing Panel explained, Patatian fails to show how her testimony would have helped his defense, or how its absence hampered that defense. *Meyers v. Asics Corp.*, 974 F.2d 1304, 1308 (Fed. Cir. 1992) (rejecting defendants' prejudice claim based on the alleged loss of key witnesses and documentary evidence when they failed to state "exactly what particular prejudice [they] suffered from the absence of these witnesses or evidence" and explaining that "[c]onclusory statements that there are missing witnesses, that witnesses' memories have lessened, and that there is missing documentary evidence, are not sufficient"). The violations here are based on Patatian's own admissions, his customers' credible testimony, and the documentary evidence. Other than blaming her for the unsuitable recommendations that he mischaracterizes as "clerical mistakes," Patatian has not explained what relevant information his sales assistant could add to evaluating whether Patatian complied with his suitability obligations. *See Gluckman*, 54 S.E.C. at 188 (finding that given the evidence of the respondent's violations, a missing witness's testimony would not have had a material effect on the proceeding).

We find that there is no basis to dismiss this proceeding on the grounds of laches or fairness.

2. Ratification

Patatian also asserts as a defense that customers ratified the REIT transactions by signing the Disclosure, on which the customers represented that they understood the risks of the investment. It is well settled, however, that a representative's suitability obligations are not excused because the customer acquiesces to the recommendation. As the Commission has explained, "[a] recommendation is not suitable merely because the customer acquiesces in the recommendation, rather, the recommendation must be consistent with the customer's financial situation and needs." *Dane S. Faber*, 57 S.E.C. 297, 310-11 (Feb. 10, 2004).

Moreover, even if the Disclosure adequately advised the customers of the risks of the REITs, "[a] registered representative does not satisfy the suitability requirement simply by disclosing the risk of an investment that he or she has recommended." *Jack H. Stein*, 56 S.E.C. 108, 113 (Feb. 10, 2003). Rather, the "representative is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile." *Id.*; *see also Dep't of Enf't v. Kelly*, Complaint No. E9A2004048801, 2008 FINRA Discip. LEXIS 48, at *23-

24 (FINRA NAC Dec. 16, 2008) (finding that the respondent had an obligation to determine the suitability of a high-risk investment strategy even where the customer signed a document acknowledging the strategy).

The cases Patatian cites are inapposite. Both cases concern a defense of ratification in the context of unauthorized trading, in which the courts found that a customer may be adequately informed of and accept the benefits of trades to signify ratification. *See Pavlovich v. Nat'l City Bank*, 435 F.3d 560, 566 (6th Cir. 2006) (finding that even if certain disputed transactions were beyond the scope of the trading authority, the customer ratified the trades because she knew about the trades and accepted the benefits of the trades over several years); *Richardson Greenshields Sec., Inc. v. Lau*, 819 F. Supp. 1246, 1259 (S.D.N.Y. 1993) (explaining that in the case of unauthorized transactions, a customer may be deemed to have ratified trades when it is clear from the circumstances that the customer intended to adopt the trades as his or her own).

The issue in this case is not whether the REIT transactions were authorized, but whether they were suitable. Patatian cannot shift his responsibility for determining whether his recommendations are suitable to his customers. *See, e.g.*, *Dep't of Enf't v. Kesner*, Complaint No. 2005001729501, 2010 FINRA Discip. LEXIS 2, at *39 n.33 (FINRA NAC Feb. 26, 2010) (rejecting a respondent's attempt to shift his own responsibility for determining suitability to another); *Dep't of Enf't v. Frankfort*, Complaint No. C02040032, 2007 NASD Discip. LEXIS 16, at *36 (NASD NAC May 24, 2007) (same). Accordingly, Patatian's ratification defense also fails.

3. Fairness Arguments

Patatian claims that there was "severe misconduct" by FINRA at the hearing because he claims that Enforcement produced thousands of unorganized documents that caused one of his attorneys to withdraw.[29] The record reflects, however, that Enforcement complied with the requirements of FINRA Rule 9251 by producing electronically all documents prepared or obtained in connection with its investigation and provided a copy of the documents it intended to use at the hearing. Additionally, Patatian does not identify any documents or categories of documents necessary for his defense that were not included in Enforcement's exhibits. *See Edward Beyn*, Exchange Act Release No. 97325, 2023 SEC LEXIS 980, at *40-42 (Apr. 19, 2023) (rejecting respondent's complaints about the size and format of Enforcement's document production). Patatian's complaints about the document production are baseless.

Patatian also complains about the Hearing Officer's decision denying his motion to issue a FINRA Rule 8210 request to Western for information about the firm's REIT business, particularly in the branch office where he was located. Patatian argues that this information would have put his misconduct "in context" and showed that he did "just as Western instructed [him] to do." FINRA Rule 9252 allows a respondent to request that FINRA compel production of documents and information from a FINRA member "if a requesting party demonstrates that the information sought is relevant, material, and non-cumulative and the requesting party has

[29] Patatian's second attorney continued to represent him at the hearing.

previously attempted in good faith to obtain the documents but has been unsuccessful." *Dep't of Enf't v. Busacca*, Complaint No. E072005017201, 2009 FINRA Discip. LEXIS 38, at *32 (FINRA NAC Dec. 16, 2009).

The Hearing Officer found that, in addition to his motion being untimely, Patatian "did not establish that the documents he seeks are relevant, material and noncumulative" because Patatian had an independent obligation to make suitable recommendations that he cannot shift to Western. *See Cody*, 2011 SEC LEXIS 1862, at *43. Accordingly, even if the documents Patatian sought supported his claim that Western encouraged the sales of non-traded REITs, this would not relieve Patatian of his obligations to make suitable recommendations. We agree with the Hearing Officer's analysis and find that he did not abuse his discretion by denying Patatian's motion. *See Dep't of Enf't v. Kielczewski*, Complaint No. 2017054405401, 2021 FINRA Discip. LEXIS 22, at * 41-42 (FINRA NAC Sept. 30, 2021) (an abuse of discretion standard applies to a hearing officer's decision denying a motion to compel production of documents under FINRA Rule 9252).

IV. Sanctions

The Hearing Panel imposed a unitary bar for Patatian's unsuitable REIT recommendations (cause one), unsuitable variable annuity surrenders (cause two), impersonating a customer (cause four), and causing his firm to maintain inaccurate books and records (cause five). The Hearing Panel found that a unitary sanction was appropriate because these violations all arose from Patatian's strategy of recommending REITs. The Hearing Panel imposed a second bar for Patatian's unsuitable variable annuity exchanges (cause three). For Patatian's unsuitable REIT recommendations under cause one, the Hearing Panel also ordered that Patatian pay $262,958.73 in restitution to customers who had sold their REITs at a loss and offer rescission to customers still holding their REITs. The Hearing Panel also ordered that Patatian disgorge $458,418.07 in commissions he received from his unsuitable REIT recommendations.

We agree that a unitary bar is appropriate for causes one, two, four, and five. We also agree with the Hearing Panel that a bar is appropriate for Patatian's unsuitable variable-annuity-exchange recommendations under cause three and that disgorgement is appropriate for his misconduct under cause one. We do not believe it is appropriate, however, to order Patatian to offer rescission under the circumstances here and thus we dismiss this portion of the Hearing Panel's sanctions. Additionally, on March 10, 2023, Enforcement filed a "Supplemental Notice of Restitution," informing us that Western had paid restitution to customers in compliance with an October 31, 2022 Letter of Acceptance, Waiver and Consent ("AWC").[30] Accordingly, the restitution requested by Enforcement and ordered by the Hearing Panel has been paid by Western and ordering Patatian to also do so would result in a double recovery by the customers. We therefore eliminate the Hearing Panel's order that Patatian pay restitution.

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[30] In the AWC, Western consented to findings that it failed to adequately supervise its non-traded REIT business and that its supervisory system was not reasonably designed to review sales of REITs to achieve compliance with the firm's suitability obligations.

A. Patatian Is Barred for Recommending Unsuitable REITs and Variable Annuity Surrenders, Causing Western to Maintain Inaccurate Books and Records, and Impersonating a Customer (Causes 1, 2, 4, and 5)

In determining appropriate sanctions, we consider FINRA's Sanction Guidelines, including the General Principles Applicable to All Sanction Determinations (the "General Principles") and the Principal Considerations in Determining Sanctions (the "Principal Considerations").[31] Here, we consider the specific Guidelines for suitability violations, books and records violations, and forgery.

The Guidelines for unsuitable recommendations provide that, when aggravating factors predominate, we "strongly consider a bar."[32] The Guidelines for recordkeeping violations state that, where aggravating factors predominate, we consider a suspension of up to two years or a bar.[33] In assessing sanctions for recordkeeping violations, the Guidelines direct us to consider: (1) the nature and materiality of the inaccurate or missing information; (2) the type and number of records at issue; (3) whether the inaccurate or missing information was entered or omitted intentionally, recklessly, or as the result of negligence; (4) whether the violations occurred over an extended period of time or involved a pattern or patterns of misconduct; and (5) whether the violations allowed other misconduct to occur or to escape detection.[34] We find that these and other serious aggravating factors apply to Patatian's misconduct and thus a bar is an appropriately remedial sanction.

Over a period of four years, Patatian recommended more than $7.8 million in non-traded REITs to 59 customers in 81 transactions when he did not have a reasonable basis to believe that the REITs were suitable for any customer.[35] Patatian's misconduct was intentional and resulted in monetary gain to him.[36] Many of Patatian's affected customers were over the age of 65 and his recommendations of risky and illiquid REITs resulted in injury to them.[37] Indeed, Patatian's

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31 *See FINRA Sanction Guidelines* (2022), https://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf [hereinafter "Guidelines"]. We apply the Guidelines in effect at the time of the NAC's decision.

32 *Guidelines*, at 121.

33 *Id.* at 91.

34 The applicable Guidelines also recommend fines, but given the bars imposed we decline to assess a fine for Patatian's violations.

35 *Id.* at 7-8 (Principal Consideration Nos. 8, 9, 17).

36 *Id.* at 8 (Principal Consideration Nos. 13, 16). Nearly all Patatian's commissions during the relevant period—an amount exceeding $450,000—were from his unsuitable REIT recommendations.

37 *Id.* at 7-8 (Principal Consideration Nos. 11, 20).

misconduct demonstrates that he is willing to harm clients in service of his own monetary self-interest.

In the case of Patatian's unsuitable REIT recommendations to CN, JO, the Ds, JR, and RC, the customers were unsophisticated and had limited investment experience.[38] Even at the hearing, many of the customers still did not understand the REITs and testified that they had virtually no prior experience selecting particular investments.

Patatian inflated by large amounts CN's, JO's, the Ds', and JR's investment experience and net worth on important firm documents in order to make the REIT investments appear suitable. Thus, Patatian intentionally circumvented the most important purpose of these documents, as well as circumventing state law requirements meant to prevent unsuitable REIT investments just like the transactions here. Thus, Patatian's falsification of these records enabled and concealed his suitability violations.[39]

Finally, Patatian has not taken responsibility for his serious misconduct, deflecting blame to his customers, Western, and even FINRA.[40] *See Mitchell H. Fillet*, Exchange Act Release No. 79018, 2016 SEC LEXIS 3773, at *18 (Sept. 30, 2016) (finding that the respondent's failure to accept responsibility "or otherwise acknowledge his misconduct" and attempts to shift blame to others "increase the likelihood that he would engage in similar misconduct in the future"). Patatian has consistently accused the testifying customers of lying, made statements minimizing the harm he caused them, and belittled them during the hearing.[41] It was Patatian's obligation to ensure the suitability of his recommendations, and he cannot avoid this responsibility by attempting to shift blame to his customers.

Nor can Patatian shift responsibility to Western. Patatian claimed that Western pushed him to sell non-traded REITs and knew about and encouraged the inflation of net worth numbers on firm documents in order to do so. Even if Patatian's claims are true, however, this would not

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38 *Id.* at 8 (Principal Consideration No. 18).

39 *Id.* at 7 (Principal Consideration No. 10).

40 While Patatian states several times in his brief on appeal that he takes responsibility for his actions, he continues to characterize his misconduct as simply "mistakes"; mischaracterize his customers as "unique," "highly compensated," and "wealthy DWP executives," who were sophisticated and understood the risks and features of the REITs; and to blame Western and FINRA for his misconduct. Accordingly, we give no weight to Patatian's disingenuous statements about taking responsibility.

41 In the face of the customers' credible testimony and other documentary evidence, Patatian insisted that the customers were sophisticated and wealthy investors. In contesting his customers' testimony, he made such outrageous statements as minimizing JO's cancer and claiming that RC photocopied a blank document years earlier in order to frame Patatian down the road. Instead of taking responsibility, he accused his customers of wasting money.

excuse his own misconduct. Patatian has an independent obligation to ensure the suitability of his recommendations and cannot shift this obligation to his firm. *See Beyn*, 2023 SEC LEXIS 980, at *19-20 (rejecting respondent's attempt to shift blame for his misconduct to his firm and supervisors and explaining that "[t]he fact that others also might have been remiss in their duties does not mitigate [the respondent's] responsibility"). The same is true of his attempts to blame FINRA, who Patatian accuses, without evidence, of "singling him out" and twisting and manipulating his statements.[42] *See Dep't of Enf't v. Pellegrino*, Complaint No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *50 n.34 (FINRA NAC Jan. 4, 2008) (stating that the Commission has repeatedly held that responsibility for compliance cannot be shifted to regulators). There is no evidence to support these claims and they are another attempt by Patatian to avoid responsibility for his misconduct.

With respect to impersonating JE in a call with an insurer, Patatian admitted his unethical conduct in his answer.[43] Patatian impersonated JE on a call with the insurance company for the Es' variable annuity, initially claiming to be ME, a woman, and when questioned saying he was JE and providing JE's date of birth and last four digits of his social security number, all personal confidential information. Patatian impersonated JE to obtain contract value and surrender charges for the Es' annuity, which the Es held at CUSO and for which Patatian was not the broker of record. Patatian's conduct was intentional and he did not, and could not have believed

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[42] To the extent Patatian is claiming selective prosecution, this claim also fails. FINRA has wide discretion in deciding when to bring a disciplinary case. *See Nicholas T. Avello*, 55 S.E.C. 1197, 1209 n.19 (2002) (rejecting a claim of selective prosecution), *aff'd*, 454 F.3d 619 (7th Cir. 2006). To establish selective prosecution, Patatian must demonstrate that he was singled out for enforcement while others similarly situated were not and that such prosecution was motivated by arbitrary or unjust considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right. *See Dep't of Enf't v. Casas*, Complaint No. 2013036799501, 2017 FINRA Discip. LEXIS 1, at *39-41 (FINRA NAC Jan. 13, 2017) (*citing Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at *28-29 (Apr. 26, 2006), *aff'd*, 235 F. App'x 475 (9th Cir. 2007)); *see also Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *53 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010) (rejecting a claim of selective prosecution where respondent failed to show that he was unfairly singled out for prosecution based on improper considerations such as race, religion, or the desire to prevent the exercise of a constitutionally protected right). Patatian has not presented any evidence to support such a claim.

[43] There is no specific guideline for impersonating a customer. We agree with the Hearing Panel that the most analogous guideline is that for forgery. *See Golonka*, 2013 FINRA Discip. LEXIS 5, at *27-28 (applying the guideline for forgery to misconduct that involved an impersonation scheme for the purpose of obtaining confidential customer information). The Guidelines provide that where aggravating factors predominate, and particularly in cases resulting in customer harm, that we "consider suspending the respondent for a period of six months to two years or barring the respondent." The relevant specific considerations under this Guideline include whether the respondent had a good faith, but mistaken, belief of express or implied authority.

reasonably, that he had express or implied authority from JE to impersonate him.[44] Patatian's unethical act demonstrates a complete disregard for his customer's confidential information and his obligation to act ethically when dealing with other financial institutions and also involved troubling dishonesty by him. *See Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 SEC LEXIS 2401, at *29 (Aug. 22, 2008) ("The public interest demands honesty from associated persons of NASD members; anything less is unacceptable."). Moreover, his claim that he had authority from his customer and his refusal to accept responsibility for his actions, further demonstrates his unwillingness to understand and comply with his ethical obligations.

We further agree with the Hearing Panel that there are no applicable mitigating factors here. Patatian points to his lack of disciplinary history, but this is not mitigating. *See Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *53 (Jan. 30, 2009) (explaining that a lack of disciplinary history "is not a mitigating factor for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional"). Nor is a bar inappropriate because, as Patatian claims, it makes our order of disgorgement unenforceable. The enforceability of monetary penalties is not relevant to whether a bar is an appropriately remedial sanction for Patatian's violations. Patatian's misconduct demonstrates a cavalier disregard for the most fundamental obligations of a registered representative to his customers. Thus, we find that a bar in all capacities is necessary to protect the investing public.[45]

The Guidelines also direct us to "consider a respondent's ill-gotten gain when determining an appropriate remedy" and, when appropriate "order[] disgorgement of some or all of the financial benefit [the respondent] derived, directly or indirectly" from his misconduct.[46] The purpose of disgorgement is to deter violations by making them unprofitable. *See Dep't of Enf't v. Vungarala*, Complaint No. 2014042291901, 2018 FINRA Discip. LEXIS 26, at *116 (FINRA NAC Oct. 2, 2018) (explaining that disgorgement "remediate[s] . . . misconduct by eliminating the financial benefit directly resulting from it" and thus deters others from engaging in similar misconduct).

The record reflects that Patatian earned $458,418.07 in commissions from his sales of unsuitable non-traded REITs. We agree with the Hearing Panel that disgorgement of these commissions is an appropriate part of the sanctions here.[47] We also affirm the Hearing Panel's

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44 *Guidelines*, at 8 (Principal Consideration No. 13).

45 *See Guidelines*, at 2 (General Principle No. 1) (stating that the "purpose of FINRA's disciplinary sanctions is to protect the investing public, support and improve the overall business standards, and decrease the likelihood of recurrence of misconduct by the disciplined respondent").

46 *Id.* at 5 (General Principle No. 6).

47 At the hearing, Patatian relied on the United States Supreme Court's decision in *Kokesh v. SEC* to argue that disgorgement is an impermissibly punitive sanction. 581 U.S. 455 (2017). The SEC, however, held that "[n]othing in *Kokesh*, which involved whether a civil action for

[Footnote continued on next page]

order that Patatian pay prejudgment interest on the disgorgement amount, calculated from the dates he earned his ill-gotten commissions until the date disgorgement is paid. *See Dep't of Enf't v. Davidofsky*, Complaint No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *42 (FINRA NAC Apr. 26, 2013) (explaining that prejudgment interest achieves "the proper deterrence for the misconduct because disgorgement alone does not reflect the time value of ill-gotten gains, and in effect, provides the respondent with an interest free loan until the disgorgement order is final"). Because Western has paid restitution to customers with realized and unrealized losses, we order that the disgorgement be paid to FINRA.[48]

B. Patatian Is Barred for Recommending Unsuitable Variable Annuity Exchanges (Cause 3)

There is no specific guideline for violations of FINRA Rule 2330, so we apply the Guidelines for unsuitable recommendations.[49] As discussed above, the Guidelines direct us to "strongly consider" a bar when aggravating factors predominate. We find that aggravating factors predominate and there are no applicable mitigating factors, and thus we find that a bar is an appropriately remedial sanction for Patatian's unsuitable recommendations of variable annuity exchanges.

Patatian recommended six unsuitable variable annuity exchanges to customers because he failed to conduct the due diligence necessary to understand the cost differences and other features of the exchanged and new variable annuities.[50] The Ds' new annuity cost approximately $4,000 more annually than Patatian disclosed to them because, when he calculated the cost comparison, Patatian included a fee for a rider that the Ds were no longer paying.

In the case of the other variable annuity exchange recommendations, Patatian recommended the transactions for the purpose of securing a higher death benefit, but he failed to select the optional rider that provided that benefit and did not account for the cost of that rider when he disclosed the cost differences to his customers. Again, Patatian's unsuitable recommendation resulted from his failure to understand the transactions before he recommended

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[cont'd]

disgorgement could be brought after a certain period of time, overturns [the] holdings that disgorgement may be imposed in a FINRA disciplinary action." *Kimberly Springsteen-Abbott*, Exchange Act Release No. 88156, 2020 SEC LEXIS 2684, at *49 (Feb. 7, 2020).

[48] On appeal, Enforcement argued that under the specific circumstances of this case, it is impracticable to order Patatian, an individual respondent no longer associated with a member firm, to offer rescission to his customers who still hold the non-traded REITs. We agree and modify this portion of the Hearing Panel's sanctions to eliminate the rescission order.

[49] *Guidelines*, at 121.

[50] *Id.* at 8 (Principal Consideration No. 17).

them, and we agree with the Hearing Panel that Patatian acted recklessly by ignoring basic information in the prospectuses and annuity applications for the annuities he recommended.[51] Patatian's misconduct resulted in harm to the customers in the form of paying higher fees without securing the benefit purportedly justifying the transactions.

Patatian's recklessness in making recommendations to customers without understanding basic facts relevant to whether the recommended transactions were suitable demonstrates that he is unfit to remain in the securities industry. Accordingly, we find that a bar is appropriate to protect the investing public.

V. Conclusion

Patatian violated FINRA Rules 2111 and 2010 by recommending unsuitable non-traded REITs to his customers. In order to facilitate these unsuitable investments, Patatian recommended unsuitable variable annuity surrenders, in violation of FINRA Rules 2111 and 2010, and caused his firm to maintain inaccurate books and records, in violation of FINRA Rules 4511 and 2010. Patatian also impersonated a customer in violation of FINRA Rule 2010. For these violations, Patatian is barred from associating with a FINRA member in any and all capacities. For the violations related to unsuitable REIT recommendations, Patatian is also ordered to disgorge $458,418.07 in commissions he earned from the relevant transactions, plus prejudgment interest calculated from the dates he earned the commissions until the date disgorgement is paid.[52]

Patatian also recommended unsuitable variable annuity exchanges, in violation of FINRA Rules 2330 and 2010. For these violations, we impose on Patatian a second bar in all capacities.[53]

We also affirm the Hearing Panel's order that Patatian pay $19,083.33 in hearing costs, and order that he pay $1,582.30 in appeal costs.

On Behalf of the National Adjudicatory Council,

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Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

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[51] *Id.* at 8 (Principal Consideration No. 13).

[52] Prejudgment interest shall be paid at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a).

[53] The bars will be effective immediately upon issuance of this decision.