

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

C. L. KING & ASSOCIATES, INC.,  
(CRD No. 6183),

and

GREGG ALAN MILLER  
(CRD No. 4163500),

Respondents.

Disciplinary Proceeding  
No. 2014040476901

Hearing Officer—MJD

**ORDER DENYING RESPONDENTS' MOTION UNDER RULE 9252  
FOR ISSUANCE OF REQUESTS FOR DOCUMENTS AND INFORMATION**

**I. Background**

Respondents C.L. King & Associates, Inc., and Gregg Alan Miller filed a motion under FINRA Rule 9252 requesting an Order directing the Department of Enforcement to issue requests for documents and information under FINRA Rule 8210 to member firms Wedbush Securities Inc. and Hilltop Securities, Inc. (formerly known Southwest Securities Inc.). Enforcement objects to the motion.

Respondents want the documents and information from Wedbush and Hilltop to defend against allegations that C.L. King improperly assisted a hedge fund customer and its managing member to redeem proceeds from survivor bonds to which they were not lawfully entitled.<sup>1</sup> The firm allegedly violated the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and FINRA's supervision rules. Respondents filed an Answer denying they committed the violations alleged in the Complaint. A hearing is scheduled to begin February 6, 2017.

As explained below, I deny Respondents' motion.

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<sup>1</sup> The Complaint charges Respondents with misconduct in two distinct areas of C.L. King's securities business. The other area of business, which is not relevant to Respondents' motion, involves the firm's participation in the liquidation of billions of shares of speculative penny stocks by two customers. Causes three and four allege that C.L. King and Miller, the firm's AML Compliance Officer, violated FINRA's AML rules.

## II. The Complaint

The Complaint charges that C.L. King engaged in fraudulent misconduct when it redeemed survivor bonds from issuers on behalf of the hedge fund customer and its managing member. The hedge fund and managing member pursued a strategy of investing in discounted bonds that contained a survivor option. Instruments with this feature—known as survivor bonds—permitted a surviving joint tenant in the bond to exercise the survivor option by selling the security back to the issuer at par plus interest upon the death of a beneficial co-owner of the bond.

To effectuate this strategy, the managing member recruited other joint tenants to invest in survivor bonds by identifying terminally ill persons (the “Participants”) and paying them between \$10,000 and \$15,000 in exchange for their agreement to open a joint brokerage account at C.L. King with the managing member. According to the Complaint, from 2012 to 2015, C.L. King opened 36 joint accounts for the hedge fund in the name of its managing member and a Participant. C.L. King redeemed \$60 million in survivor bonds for the customers, generating \$1.2 million in margin interest and profits.

Cause one charges C.L. King with violating FINRA Rule 2010 by violating Sections 17(a)(2) and (3) of the Securities Act. In connection with the redemption of the survivor bonds, Enforcement alleges that the firm had a legal obligation to disclose to issuers of the securities all material facts and not make any material misrepresentations. The Complaint charges that the firm withheld from issuers the true economic relationship between the managing member and Participants who invested in the survivor bonds. Enforcement contends their relationship was not a true co-tenancy under the law because Participants did not beneficially own the survivor bonds. The Complaint says C.L. King did not disclose to issuers that Participants had limited rights to the accounts that held the bonds while the managing member retained many more rights to the accounts.<sup>2</sup> This unequal relationship, Enforcement argues, invalidated the purported joint tenancy and therefore the managing member's right to the benefits under the survivor option.

Cause two charges the firm with supervisory deficiencies relating to its actions surrounding the redemption of the survivor bonds, resulting in violations of NASD Rule 3010 and FINRA Rules 3110 and 2010. Enforcement alleges the firm failed to ensure that it maintained written supervisory procedures addressing its survivor bond business and it did not review documents executed among the Participants, the hedge fund, and the managing member

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<sup>2</sup> According to the Complaint, C.L. King did not disclose to the issuers, for example, that: the Participants and the managing member were not related; the Participants' profit was limited to the one-time payment of \$10,000 to \$15,000; should the managing member pre-decease a Participant, the Participant was limited to receiving five percent of the account proceeds after expenses while the remaining 95 percent would go ultimately to the hedge fund; Participants did not receive monthly account statements, confirmations, interest payments or other indicia of ownership in the accounts. The Complaint further alleges that C.L. King did not disclose to issuers that the hedge fund funded the joint accounts that invested in the survivor bonds while Participants had no responsibility for funding the accounts. Furthermore, Participants had no rights to withdraw, borrow, or transfer funds from the joint accounts; in contrast, the managing member was permitted to buy, sell, pledge, or transfer funds and securities from the accounts.

to determine if there was a legally valid joint tenancy to qualify for redemption of the survivor bonds.

### **III. Standard for Issuance of Requests for Information Under Rule 9252**

Under Rule 9252, a respondent may request that the Hearing Officer order Enforcement to invoke Rule 8210 to compel the production of documents or testimony from entities or individuals that are subject to FINRA's jurisdiction. Rule 9252(a) states that the request must describe with specificity the documents or category of documents sought, state why they are material, describe the requesting party's previous good faith efforts to obtain the documents or testimony through other means, and state whether the custodian of the documents or the person requested to testify is subject to FINRA's jurisdiction.

Pursuant to Rule 9252(b), "[t]he Hearing Officer may grant such a request only upon a showing that the information sought is relevant, material, and non-cumulative; that the requesting party has previously attempted to obtain the documents or testimony through other means, but has been unsuccessful; and that the person from whom the documents or testimony is sought is subject to FINRA jurisdiction."<sup>3</sup> Rule 9252(b) also requires the Hearing Officer to consider whether the request is unreasonable, oppressive, excessive in scope, or unduly burdensome, and whether the request should be denied, limited, or modified.<sup>4</sup> Rule 9252(c) gives the Hearing Officer the authority, after consideration of all the circumstances and after determining that a request is "unreasonable, oppressive, excessive in scope or unduly burdensome," to grant the request "only upon such conditions as fairness requires."

### **IV. Discussion**

Respondents represent that in October 2016 they asked member firms Hilltop and Wedbush to voluntarily produce documents and information. Both firms responded that they would not consider producing the information without a request from FINRA made pursuant to Rule 8210.<sup>5</sup>

Respondents have identified nine categories of documents and information they want Hilltop and Wedbush to produce. The first eight categories request the production of documents about the two firms' due diligence, supervision of survivor bond transactions and redemptions, reviews of documents exchanged among the Participants, the hedge fund, and the managing member, and documents provided to or requested by the issuers of survivor bonds. The last request, Item No. 9, asks that Hilltop and Wedbush generate a written summary of the hedge

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<sup>3</sup> OHO Order 08-12 (2005003188901) (Aug. 27, 2008), at 2, [http://www.finra.org/sites/default/files/OHODecision/p118011\\_0.pdf](http://www.finra.org/sites/default/files/OHODecision/p118011_0.pdf).

<sup>4</sup> OHO Order 15-05 (2012034936005) (Jan. 27, 2015), at 7, [http://www.finra.org/sites/default/files/OHO-Order-15-05-ProceedingNo.2012034936005\\_0.pdf](http://www.finra.org/sites/default/files/OHO-Order-15-05-ProceedingNo.2012034936005_0.pdf).

<sup>5</sup> Motion at 8.

fund and managing member's redemption requests. The following are the nine categories of documents and information Respondents seek.

1. Copies of all checklists and other due diligence procedures applicable to any accounts held (jointly or wholly) by [the hedge fund] and/or [the managing member], or to the redemption of certain corporate bonds with survivor's options ("Survivor Bonds") which were purchased and held by [the hedge fund] and/or [the managing member] jointly with terminally ill patients;
2. All documents reflecting due diligence conducted on [the hedge fund], [the managing member], or their Survivor Bond redemption business;
3. All documents describing or reflecting [Hilltop and Wedbush's] analysis of [the hedge fund's] business model or of the due diligence described in Request No. 2, its assessment of any perceived risk relating to [the hedge fund's] business model, or its process of determining whether to accept [the hedge fund] and/or [the managing member] as a client;
4. All documents relating to [Hilltop and Wedbush's] onboarding and account-opening processes applicable to accounts held (jointly or wholly) by [the hedge fund] and/or [the managing member], or to accounts through which Survivor Bonds were (or were anticipated to be) redeemed;
5. All documents relating to [Hilltop and Wedbush's] supervisory systems applicable to accounts held (jointly or wholly) by [the hedge fund] and/or [the managing member], or to accounts through which Survivor Bonds were (or were anticipated to be) redeemed;
6. All documents reflecting [Hilltop and Wedbush's] redemption procedures applicable to accounts held (jointly or wholly) by [the hedge fund] and/or [the managing member], or to accounts through which Survivor Bonds were (or were anticipated to be) redeemed;
7. All documents relating to [Hilltop and Wedbush's] redemption of Survivor Bonds from accounts held (jointly or wholly) by [the hedge fund] and/or [the managing member];
8. All documents and information provided to and/or requested by the corporate bond issuers during the process of [Hilltop and Wedbush's] redemption of Survivor Bonds from accounts held (jointly or wholly) by [the hedge fund] and/or [the managing member]; and
9. A written summary of all Survivor Bond redemptions made on behalf of [the hedge fund] and/or [the managing member], including, at minimum, the date on which the relevant account was opened, the date of redemption, the name of

the redeeming issuer, and a list of supporting documents provided to the redeeming issuer.<sup>6</sup>

Respondents argue the documents and information are relevant and material to the issue of Respondents' liability because "they help to demonstrate the applicable industry standards and customs regarding reasonable supervision of such joint tenancy accounts and Survivor Bond-related transactions and redemption."<sup>7</sup> Like C.L. King, both Hilltop and Wedbush served as custodians and clearing brokers for accounts through which the hedge fund and managing member invested in and redeemed survivor bonds. According to the motion, Hilltop and Wedbush took on the survivor bond business of the hedge fund and managing member after they closed their accounts at C.L. King.

Respondents suggest that, even though the survivor bond business is widespread, with many sophisticated issuers offering the investments, there is little reported precedent and guidance from regulators on this area of the securities industry. For this reason, documents from other firms that shed light on the supervision of accounts that transact in such bonds, and then redeem them from issuers, "are an important indicator of where to set the bar for 'reasonableness.'"<sup>8</sup> Respondents further contend that, because Hilltop and Wedbush serviced the same two customers, the due diligence and supervisory processes they implemented before accepting the hedge fund and the managing member as customers and redeeming survivor bonds on their behalf are relevant "because they help to both establish and reveal the applicable standards and customs of the securities industry."<sup>9</sup>

Enforcement opposes the motion on the grounds that it does not meet the requirements of Rule 9252 because it seeks documents and information that are not relevant or material to the allegations of the Complaint and is unduly burdensome on Hilltop and Wedbush.

In FINRA disciplinary proceedings, "material evidence" is evidence relating to liability or sanctions that might be considered favorable to the respondent's case, which, if suppressed, would deprive the respondent of a fair hearing.<sup>10</sup> Rule 401 of the Federal Rules of Evidence provides that evidence is relevant if "it has any tendency to make a fact more or less probable than it would be without the evidence" and "the fact is of consequence to determining the action." The documents requested seek to elicit information that is not relevant to this action. How Hilltop and Wedbush supervised the accounts and survivor bond investments of the hedge fund and its managing member is neither relevant nor material to the issue of whether C.L. King

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<sup>6</sup> Motion, Exs. A and B.

<sup>7</sup> Motion at 2.

<sup>8</sup> Motion at 6.

<sup>9</sup> Motion at 7.

<sup>10</sup> See OHO Order 15-05 (2012034936005), at 2; OHO Order 12-04 (2010023367001) (Aug. 30, 2012), at 2-3, <http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/ohodecisions/p229424.pdf>.

reasonably supervised the customers' activities.<sup>11</sup> Stated differently, there is no basis to assume that because they serviced the same customers Hilltop and Wedbush properly followed industry standards and customs in this area.

Respondents' requests are also burdensome in scope. They seek production of nine categories of documents and information that would require Hilltop and Wedbush to spend considerable time and effort to collect and produce.<sup>12</sup> Furthermore, Respondents do not know whether such documents would in fact aid in their defense. Respondents effectively ask that FINRA, through Hilltop and Wedbush, conduct a fishing expedition for potentially helpful documents. A respondent may not use Rule 8210's authority for that purpose.<sup>13</sup>

Finally, Item No. 9 of Respondents' motion is improper on its face. It is an interrogatory, which is not permitted under Rule 9252, and for this reason alone it is objectionable.<sup>14</sup> Respondents ask that I order Enforcement to require Hilltop and Wedbush to create a written summary of all of the bonds they redeemed from issuers on behalf of the hedge fund and managing member—including identifying dates joint accounts holding the survivor bonds were opened and dates the corresponding bonds were redeemed, the names of the bonds' issuers, and a list of documents they provided to issuers. Like Respondents' document requests, Item No. 9 is also irrelevant to the allegations against them.

Respondents have not met their burden under Rule 9252 because they have not established that the documents and information they seek from Hilltop and Wedbush are relevant and material.

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<sup>11</sup> *Patricia H. Smith*, 52 S.E.C. 346, 348 (1995) (“[I]t is not a defense that others in the industry may have been operating in a similarly illegal or improper manner”) (citing *Donald T. Sheldon*, 51 S.E.C. 59, 66 n.32 (1992), *aff'd*, 45 F.3d 1515 (11th Cir. 1995)).

<sup>12</sup> Although Rule 9252(b) gives me the authority to limit or modify Respondents' requests, I decline to do so in this case because they are not relevant to this disciplinary action.

<sup>13</sup> See OHO Order 06-05 (CLI050016) (Jan. 10, 2006), at 3, <http://www.finra.org/sites/default/files/OHODecision/p016220.pdf>; OHO Order 06-08 (C07050029) (Jan. 12, 2006), at 3, <http://www.finra.org/sites/default/files/OHODecision/p016223.pdf>.

<sup>14</sup> See OHO Order 98-24 (CAF970002) (May 18, 1998) at 9, <https://www.finra.org/sites/default/files/OHODecision/p007757.pdf>.

**This Order has been published by FINRA's Office of Hearing Officers and should be cited as OHO Order 16-30 (2014040476901).**

**V. Conclusion**

For the reasons set forth above, I **DENY** Respondents' motion.

**SO ORDERED.**

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Michael J. Dixon  
Hearing Officer

Dated: November 14, 2016