BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Jaoshiang Luo Flushing, NY, Respondent.	DECISION Complaint No. 2011026346206 Dated: January 13, 2017

Registered representative made material misrepresentations and omissions in connection with the sale of notes, sold the notes without a reasonable basis for believing they were suitable for any investor, and sold the notes to two investors for whom they were unsuitable. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Jeffrey Pariser, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Jaoshiang Luo, Pro Se

Decision

Respondent Jaoshiang Luo appeals an October 28, 2014 Hearing Panel Decision. The Hearing Panel barred Luo in all capacities for making material misrepresentations and omissions in connection with the sale of promissory notes issued by his member firm's parent company, in violation of Securities Exchange Act of 1934 ("Exchange Act") Section 10(b) and Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. The Hearing Panel imposed a second bar on Luo based on its findings that he recommended the notes without a reasonable basis for believing they were suitable for any investor and for recommending the notes to two customers for whom the notes were unsuitable, in violation of NASD Rule 2310 and FINRA Rule 2010.

After an independent review of the record, we affirm the Hearing Panel's findings and modify the sanctions to include an order of restitution. The record shows that Luo sold high interest rate promissory notes to two unsophisticated investors with conservative risk tolerances and investment objectives without a reasonable basis for determining that the notes were suitable for any investor or for these specific investors. The evidence also shows that he made material misrepresentations and omissions concerning the risks of the notes in connection with the sales to these customers.

I. Background

Luo entered the securities industry in 1991 when he registered as a general securities representative and national commodity futures representative. Over the next 23 years, Luo was associated with ten different firms. During the relevant time period, from April 2002 to October 2010, Luo was registered with Westrock Advisors, Inc. ("Westrock"). Luo is not currently associated with any FINRA member firm.

Westrock was a retail brokerage firm based in New York and one of two wholly owned broker-dealer subsidiaries of Westrock Group, Inc. ("WGI"). Westrock is no longer in business, and WGI ceased operations in 2010 and is currently in bankruptcy.

During the relevant time period, Westrock employed about 50 to 60 brokers who mostly sold equities and engaged in cold calling. In 2007, Westrock increasingly began selling private placement offerings, including debt securities issued by its parent, WGI.

II. Facts

A. The 2009 Notes

From 2007 to 2009, Westrock sold four private placement offerings issued by WGI, including a 2007 note and the 2009 20 percent notes ("2009 Notes") at issue in this case. The 2009 Notes carried a 20 percent interest rate due to be paid semiannually, with the principal due two years after the date on which the note was sold. All of the offerings, except the 2009 Notes, included disclosures in the form of a private placement memorandum ("PPM") or subscription agreement.[1] In contrast, the 2009 Notes were issued without any disclosure documents. WGI also did not provide financial statements to customers or Westrock brokers selling the 2009 Notes.

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[1] For example, in 2007, Westrock sold WGI 12 percent subordinated notes and eight percent preferred stock to its customers. These WGI offerings were issued with a 90-page PPM which described the investments. The PPM contained more than 10 pages describing the risks of the investments, which it described as "highly speculative and subject to a high degree of risk." The PPM also cautioned that "[o]nly those [investors] who can bear the risk of the entire loss of their investment should participate" in the offerings. The PPM disclosed that as of 2008, WGI had a history of significant losses.

In February 2009, shortly before the 2009 Notes offering, WGI had more than $5 million in outstanding principal debt. Prior to 2009, WGI had periodically failed to make interest and dividend payments to existing note and preferred stock holders. By November 2008, WGI had stopped making payments to most investors and stopped paying any interest by early 2009. WGI continued to experience losses throughout the relevant period.

Between March and December 2009, several Westrock brokers, including Luo, sold approximately $3.5 million of the 2009 Notes to more than 50 Westrock retail customers. Prior to the 2009 note offering, DH, Luo's supervisor and the chief operating officer and president of both Westrock and WGI, held a meeting with Westrock brokers that Luo attended. At this meeting, DH informed the brokers that WGI was going to be acquired by a Native American tribe. DH claimed that after the acquisition, WGI would no longer be required to pay taxes, would be able to manage tax-deferred investments outside an IRA account, and would be entitled to certain minority-owned business preferences in syndicates and with institutional clients. DH claimed that the acquisition would allow Westrock to grow, and the expansion made the 2009 Notes "a good investment."

The acquisition of WGI by the Native American tribe was consummated in August 2009. WGI then became a wholly-owned subsidiary of LBC Western, Inc. ("LBCW"). WGI was LBCW's only asset and source of income. LBCW did not pay any money for WGI. Instead the acquisition involved the assumption of debt. After the acquisition, WGI carried more than $14 million in debt, including more than $11 million in outstanding notes and other debts and $3 million owed to a former CEO whose shares were purchased prior to the acquisition.

B. Luo's Knowledge About the 2009 Notes

When recommending the 2009 Notes to customers, Luo relied on DH's representations about Westrock's and WGI's prospects after the acquisition by the Native American tribe, and Luo's own general observations about how the firm was doing. Luo testified that after the broker meeting with DH, he believed the tribal acquisition would allow the firm to do "big business." Luo also testified that he saw the firm expanding, with nice new offices and new employees who dressed well and looked like, in his words, "big shots." This included the hiring of a new CFO and a public relations firm. Luo also said he saw Bloomberg press releases about the firm.

Luo acknowledged, however, that he had doubts about Westrock's and WGI's prospects and admitted that he was aware of several red flags concerning the 2009 Notes. Luo testified that he thought DH's representations about Westrock's and WGI's future were "a little too good to be true." In fact, Luo testified that he consulted an attorney friend to ask if the tribal acquisition would really bring the benefits DH claimed.

Luo, who had sold several private placements prior to the 2009 Notes, knew that the lack of a risk disclosure document and financial statements was highly unusual. He relied, however, on DH's assurances that the 2009 Notes were "legal" and a "good investment." He did so

despite admitting that financial statements were important to him in evaluating a security and his doubts about DH's claims.

Luo also was aware when he sold the 2009 Notes that WGI had missed interest payments on previous notes offerings. Luo knew that several of his customers to whom he had sold previous WGI offerings had not received interest payments. Luo testified that when he asked DH about the missed payments, DH was evasive. Luo also said that he himself sometimes had trouble getting paid his commissions by the firm, and he felt the firm was discriminating against him and his clients.

C. Luo's Sales of the 2009 Notes to GD and CWC

Luo sold the 2009 Notes to two customers, GD and CWC. GD became Luo's customer in about May 2008. Luo dealt with GD, who lived in Texas, by telephone and email. GD told FINRA staff that she was comfortable working with Luo because he was able to speak Chinese, GD's first language. Shortly after opening her account, Luo sold GD the 2007 12 percent WGI notes. GD had suffered previous losses in the stock market and was concerned with safety and protecting her principal. Luo admitted that he knew of these losses and that GD would not purchase stock from him because of them.

Account documents signed by Luo and dated March 9, 2009 reflect that GD had an annual income of $100,000, a net worth of $80,000, a conservative risk tolerance, and limited investment knowledge. Approximately four months later, Luo signed a new document for GD dated July 15, 2009. The July 2009 account document showed that GD had an annual income of $200,000, a net worth of $1 million, an aggressive risk tolerance, and investment objectives of capital appreciation and speculation. At the hearing, Luo acknowledged that the July 2009 account document contained two different handwritings and appeared to be completed by two different people, but he could not explain who completed the form or why it was updated just four months after the previous form.

Luo also dealt with GD concerning an account Luo had opened for GD's sister, CWC, who lived in Hong Kong. GD had discretionary authority over CWC's accounts in the United States. CWC's account documents showed that in 2009 she was 66 years old, had a net worth of $500,000, and annual income of $10,000. At the hearing, Luo testified that the account documents for GD and CWC were not accurate because, in his opinion, the Chinese routinely understate their wealth. Luo claimed he "knew" that GD and CWC were wealthier than the documents reflected.

In May 2009, after a discussion between GD and Luo, Luo sold $100,000 of the 2009 Notes to CWC, earning a $10,000 commission. Luo never spoke directly with CWC about investing in the 2009 Notes. In October 2009, Luo again spoke with GD about the 2009 Notes, and GD purchased $100,000 of the notes for her own account.

Although Luo testified that he explained "everything" about the 2009 Notes to GD before selling them, his testimony was vague and inconsistent, and he admitted to not disclosing several material facts that were known to him at the time. For example, Luo told GD about the firm's

expansion, the acquisition by the Native American tribe, and the supposed benefits to the firm of the acquisition. Luo admitted, however, that he did not tell GD that the tribe had not paid any money to acquire WGI or that he had doubts about the benefits of the acquisition. He also did not tell GD that WGI had missed interest payments on other debt offerings or that the 2009 Notes offering lacked disclosure documents. Luo also acknowledged that he did not tell GD that he had not seen financial statements for WGI in connection with the offering. Significantly, Luo admitted that he never told GD that the 2009 Notes were risky and speculative investments. Rather, GD told FINRA staff that Luo told her on several occasions that the 2009 Notes were a "safe" investment.

D. FINRA's Investigation

FINRA's investigation arose out of a cycle examination of Westrock. During this examination, FINRA staff discovered the lack of financial statements and private placement memorandum or other disclosure document for the 2009 Notes. As part of its investigation, FINRA contacted GD. Over the course of several telephone conversations, GD was cooperative with FINRA staff and expressed her willingness to testify in a disciplinary hearing.

On October 4, 2013, GD signed an affidavit prepared by FINRA staff based on her discussions with FINRA staff. The affidavit said both GD and her sister, CWC, were concerned with the safety of their investments, and that CWC wanted to invest the money to pay tuition for her son who was attending college in the United States. The affidavit also described Luo's assurances to GD that the 2009 Notes were "safe." GD represented in the affidavit that she had funded her 2009 Note purchase with the proceeds of a certificate of deposit and that she had invested in the notes to save for retirement. FINRA staff invited GD to make any necessary changes to the affidavit. GD signed the sworn affidavit without any modifications.

In his hearing testimony, Luo admitted that after receiving a copy of GD's affidavit as part of Enforcement's prehearing submissions, he contacted GD to tell her the affidavit was "wrong" and to urge her to change it. Luo convinced GD to submit a new affidavit retracting her previous sworn statement and exonerating Luo. Luo admitted that he went through the affidavit paragraph by paragraph dictating new language to GD because, as Luo put it, he and GD "agreed" the original affidavit was not the "real story." Luo said he told GD the "real story."

On November 1, 2013, GD signed a statement retracting the original October 2013 affidavit and claiming FINRA had "tricked" her into signing it. The statement represented that she was "pressured" and "confused" when she signed the original affidavit. At the hearing, Luo acknowledged that he had suggested the word "tricked" to GD. A week later, on November 7, 2013, GD signed a revised affidavit that had been prepared by Luo. Contrary to her earlier sworn statement, the new affidavit represented that GD was looking for a high rate of return, not safety, and that the 2009 Notes were a "side investment," not retirement funds. Much of GD's revised affidavit is identical or very similar to an affidavit that Luo himself submitted.

After speaking with Luo in connection with her retraction of the affidavit and submission of the revised affidavit, GD, who had previously cooperated with FINRA staff and indicated that she would be willing to testify at the disciplinary hearing, declined to testify and no longer took

telephone calls from FINRA staff. At the hearing, Luo admitted that GD would have testified if he asked her to appear, but he chose not to ask her.

III. Procedural History

On February 20, 2013, FINRA's Department of Enforcement ("Enforcement") filed a six-cause complaint against Luo and two other Westrock registered representatives.[2] Four causes of action were asserted against Luo. In cause one, Enforcement alleged that Luo knowingly and recklessly made material misstatements and omissions concerning WGI's financial condition, Luo's own lack of understanding and investigation of WGI's financial condition, and the safety of the 2009 Notes, in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. In cause two, Enforcement alleged that, in the alternative, Luo negligently made these material misrepresentations and omissions in violation of FINRA Rule 2010. In cause three, Enforcement alleged that Luo recommended the 2009 Notes without a reasonable investigation or understanding of the financial condition of WGI, and thus, without a reasonable basis for recommending the notes to any investor, in violation of NASD Rule 2310 and FINRA Rule 2010. In cause four, Enforcement alleged that Luo recommended the 2009 Notes to GD and CWC, for whom the notes were not suitable on the basis of their disclosed financial situation and needs, in violation of NASD Rule 2310 and FINRA Rule 2010. Luo denied the alleged violations.

At the hearing below, Luo argued that he had seen Westrock financial statements from 2006 and 2007, tried to conduct some due diligence, and relied on assurances from management and the fact that the 2009 Notes had been approved by Westrock's Compliance Department. Luo denied representing to his two customers that the 2009 Notes were a "safe" investment and claimed to have told them Westrock was not making money.

The Hearing Panel rejected Luo's defenses and declined to credit his testimony where it was not corroborated by other evidence because it found Luo's testimony to be "evasive, vague, and contradictory." The Hearing Panel found Luo liable for the misconduct alleged in causes one, three, and four.[3] For the misconduct, the Hearing Panel imposed two separate bars. This appeal followed.

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[2] The other respondents settled the claims against them prior to the hearing and the case proceeded as to Luo only.

[3] The Hearing Panel also found, in the alternative, that Luo was liable for negligent misrepresentations, as alleged in cause two.

IV. Discussion

A. Luo's Testimony Was Not Credible

The Hearing Panel found that Luo's testimony with respect to a number of key issues was not credible. We agree. While we conduct a de novo review of the Hearing Panel's decision, we give substantial weight and deference to the Hearing Panel's credibility findings. *See Eliezer Gurfel*, 54 S.E.C. 56, 62 n.11 (1999), *aff'd*, 205 F.3d 400 (D.C. Cir. 2000). It is well settled that the "credibility determinations of an initial fact-finder, which are based on hearing the witnesses' testimony and observing their demeanor, are entitled to considerable weight and deference, and can be overcome only where the record contains substantial evidence for doing so." *John Montelbano*, 56 S.E.C. 76, 89 (2003). We find no evidence in the record to warrant overturning the Hearing Panel's credibility determinations. To the contrary, the record amply supports those findings, and we affirm them.

As the Hearing Panel noted, Luo's testimony at the hearing was largely "evasive, vague, and contradictory" and demonstrated "a cavalier attitude towards the truth and the accuracy of disclosures [on account] forms." As discussed above, Luo claimed that the account documents for both GD and CWC were not accurate and that he made investment decisions based on what he supposedly knew about GD's and CWC's true financial conditions and investment objectives. We agree with the Hearing Panel that the later account document indicating that GD was an accredited investor is not reliable. Luo could not explain why the document was updated just four months after the previous document was filled out, and the timing of the update before GD's purchases of the 2009 Notes is suspect. Moreover, as Luo agreed, the document appears to have been filled out by two different people, and Luo could not say who filled out the form or when.

We also agree with the Hearing Panel that Luo acted to impede the disciplinary process when he induced GD to retract the affidavit she provided to FINRA and sign the one dictated by Luo instead. There is no evidence that GD was "tricked" or pressured into signing the first affidavit. To the contrary, Luo's own testimony that he told GD "the real story" supports that it was he who pressured GD to change her account and no longer cooperate with FINRA. The first affidavit, which GD signed, was consistent with her numerous previous statements to FINRA staff. On the other hand, the second affidavit, was substantially similar to an affidavit Luo submitted on behalf of himself, and was admittedly dictated to GD by Luo. Accordingly, we, like the Hearing Panel, credit GD's assertions in her first affidavit in which she attested to her concern about the safety of her investment and the assurances Luo made to her that the 2009 Notes were safe.

B. Luo Made Material Misrepresentations and Omissions in Connection with His Sales of the 2009 Notes to GD and CWC

We affirm the Hearing Panel's finding that Luo made material misrepresentations and omissions in connection with his sales of the 2009 Notes to GD and CWC in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5(b), and FINRA Rules 2020 and 2010. Luo made material misrepresentations when he told GD that the 2009 Notes were safe and a good investment in connection with his sales of the 2009 Notes to GD for GD's and CWC's

accounts. Luo made material omissions when he failed to disclose that: (1) WGI had missed interest payments on previous offerings; (2) the 2009 Notes were issued without the usual disclosures and financial statements; and (3) Luo had not seen any recent or relevant financial statements prior to recommending the 2009 Notes.

Exchange Act Section 10(b) and Exchange Act Rule 10b-5 prohibit fraudulent and deceptive acts and practices in connection with the purchase or sale of a security.[4] When making affirmative representations with respect to the purchase or sale of a security there is an "ever-present duty not to mislead." *Basic Inc. v. Levinson*, 485 U.S. 224, 241 n.18 (1988). An omission is actionable under the securities laws when a person is under a duty to disclose. *See id*. at 239 n.17. A registered representative has a duty to disclose material information fully and completely when recommending a securities investment. *See De Kwiatkowski v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002) (a registered representative "is obliged to give honest and complete information when recommending a purchase or sale"); *Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969); *SEC v. Hasho*, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992); *Richard H. Morrow*, 53 S.E.C. 772, 781 (1998); *Dep't of Mkt. Regulation v. Field*, Complaint No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *32-33 (FINRA NAC Sept. 23, 2008). This duty is based upon the broker's "special relationship" to the investor. *Hanly*, 415 F.2d at 597. A broker must disclose all significant facts necessary for an investor to assess the nature and reliability of an investment recommendation. *See Morrow*, 53 S.E.C. at 781 (requiring a broker who recommends a security to disclose "material adverse facts"); *Field*, 2008 FINRA Discip. LEXIS 63, at *32-33; *Dep't of Enforcement v. Cipriano*, Complaint No. C07050029, 2007 NASD Discip. LEXIS 23, at *27 (NASD NAC July 26, 2007).

Brokers who recommend private placements have an obligation to conduct a reasonable investigation of the issuer and the securities in the offering. *See FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43, at *1 (Apr. 2010). By recommending a private placement investment, a broker represents to the investor "that a reasonable investigation has been made and that [the] recommendation rests on the conclusions based on such investigation." *Hanly*, 415 F.2d at 597; *see FINRA Regulatory Notice 10-22*, 2010 FINRA LEXIS 43, at *6 (Apr. 2010). A broker "cannot deliberately ignore facts [about] which he has a duty to know and recklessly state facts about matters of which he is ignorant." *Cipriano*, 2007 NASD Discip. LEXIS 23, at *34.

To establish that Luo misrepresented information, or omitted information he had a duty to disclose, in violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5(b),

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[4] Exchange Act Section 10(b) makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5(b) makes it unlawful "[t]o make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading." 17 C.F.R. § 240.10b-5(b).

Enforcement must prove by a preponderance of the evidence that Luo: (1) made a false statement or omission; (2) of a material fact; (3) in connection with the purchase and sale of a security; (4) with the requisite scienter; and (5) using a jurisdictional means.[5] *See SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *Gonchar*, 2008 FINRA Discip. LEXIS 31, at *27. FINRA Rule 2020 proscribes fraud in language similar to Exchange Act Rule 10b-5, but FINRA Rule 2020 captures a broader range of activity than Rule 10b-5.[6] *See Dep't of Enforcement v. Fillet*, Complaint No. 2008011762801, 2013 FINRA Discip. LEXIS 26, at *37-40 (FINRA NAC Oct. 2, 2013). Conduct that violates other Commission or FINRA rules is inconsistent with the high standards of commercial honor and just and equitable principles of trade and therefore also violates FINRA Rule 2010.[7]

1. Luo Misrepresented that the 2009 Notes Were Safe and Omitted Material Information When Recommending the Notes

Luo misrepresented to GD that the 2009 Notes were a safe investment. For the reasons discussed above, we credit GD's original and repeated statements to FINRA staff that, because of her prior stock market losses, she was concerned with the safety of her investment. Luo acknowledged GD's prior stock market losses, admitted that GD did not want to buy stock because of them, and admitted that he had a discussion with GD during which he represented that debt is generally "safer" than equity. He also stated that he did not want to "scare" GD by talking about the risks associated with the 2009 Notes. We agree with the Hearing Panel that Luo's statements that debt is generally safer than equity were misleading and gave GD the impression that the 2009 Notes were safer than stocks when in fact they were highly speculative and high risk investments. We also agree with the Hearing Panel that Luo's characterization of the 2009 Notes as a "good" investment was false in light of WGI's history of missed interest payments and other red flags, including the absence of disclosure documents and financial statements.

Luo's alleged reliance on his supervisor's representations that the 2009 Notes were a "good" investment does not insulate Luo from liability for the untrue statement. Indeed, a broker

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[5] It is undisputed that Luo's conduct occurred in connection with the sale of securities—the 2009 Notes—to GD and that the jurisdictional means requirement is satisfied because Luo conducted his business with GD using the telephone and email.

[6] FINRA Rule 2020 states that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance."

[7] FINRA Rule 2010 states that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." FINRA Rule 2010, which generally applies to FINRA "members," is applicable to associated persons pursuant to FINRA Rule 0140(a).

cannot blindly rely on information from an issuer when making an investment recommendation. *See Nasser & Co.* 47 S.E.C. 20, 22 (1978) (stating that a broker cannot rely on an issuer's "self-serving statements"); *Dep't of Enforcement v. Meyers*, Complaint No. C3A040023, 2007 NASD Discip. LEXIS 4, at *37 (NASD NAC Jan. 23, 2007); *see also Cipriano*, 2007 NASD Discip LEXIS 23, at *34 (stating that statements by an issuer are not an adequate basis for making representations to customers).

Luo also omitted several facts when he recommended the 2009 Notes to GD. Luo knew but did not disclose to GD that WGI had missed interest payments on previous offerings. He also knew, but did not disclose, that the 2009 Notes were being sold without any disclosure documents, something Luo acknowledged was highly unusual. Luo also failed to disclose that he had not seen any recent financial statements for the issuer, something Luo admitted normally would be important to him in recommending an investment.

We agree with the Hearing Panel that Luo's misrepresentations and omissions were material. Information is material if a reasonable investor would consider it important in making an investment decision or if its disclosure would "significantly alter[] the 'total mix' of information made available." *Basic*, 485 U.S. at 232. Facts concerning the safety and quality of an investment would be material to any reasonable investor. Information about missed interest payments and the absence of disclosure documents and financial statements also would be important in making an investment decision. Accordingly, we find that Luo made material misstatements and omissions when recommending the 2009 Notes to GD.

2. Luo's Misrepresentations and Omissions Were Made with Scienter

We, like the Hearing Panel, find that Luo acted with scienter. Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if a respondent acted intentionally or recklessly. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007); *Irfan Mohammed Amanat*, Exchange Act Release No. 54708, 2007 SEC LEXIS 2558, at *35 (Nov. 3, 2007), *aff'd*, 269 F. App'x 217 (3d Cir. 2008). Reckless conduct includes "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted); *see also Meadows v. SEC*, 119 F.3d 1219, 1226 (5th Cir. 1997). Scienter can be satisfied if a broker has "actual knowledge of the material information." *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 239 (3d Cir. 2004); *Fenstermacher v. Philadelphia Nat'l Bank*, 493 F.2d 333, 340 (3d Cir. 1974); *see also Kenneth R. Ward*, Exchange Act Release No. 47535, 2003 SEC LEXIS 3175, at *39 (Mar. 19, 2003) (finding scienter established when representative was aware of material information and failed to make appropriate disclosures to customers), *aff'd*, 75 F. App'x 320 (5th Cir. 2003); *Field*, 2008 FINRA Discip. LEXIS 63, at *33-34 (same).

Luo had actual knowledge of the material information. He acknowledged that he knew but failed to disclose material facts with respect to WGI's previous missed interest payments and

that the 2009 Note offering lacked disclosure documents and financial statements. He also acknowledged that he knew private placements were risky, but that he did not disclose this to GD because he did not want to "scare" her. Accordingly, we agree with the Hearing Panel that Luo knowingly and recklessly misrepresented that the 2009 Notes were safe and knowingly or recklessly failed to disclose material information about WGI and the offering.[8]

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In sum, Luo engaged in fraud, in violation of Exchange Act Section10(b), Exchange Act Rule 10b-5(b), and FINRA Rules 2020 and 2010 when he made false statements and failed to disclose material information to GD with scienter in connection with the sale of the 2009 Notes.

C. Luo's Recommendations of the 2009 Notes Were Unsuitable

The Hearing Panel found that Luo sold the 2009 Notes without a reasonable basis for believing the investment was suitable for any investor and without reasonable grounds to believe that the investment was suitable specifically for GD and CWC, in violation of NASD Rule 2310 and FINRA Rule 2010. We affirm.

NASD Rule 2310 requires that "[i]n recommending the purchase, sale or exchange of a security," a broker "must have reasonable grounds for believing that the recommendation is suitable for that customer based on the facts . . . disclosed by the customer as to his other securities holdings and the customer's financial situation and needs." *Dep't of Enforcement v. Xagoraris*, Complaint Nos. 20080127674 & 20080133768, 2014 FINRA Discip. LEXIS 34, at *18 (FINRA NAC Aug. 1, 2014). There are two types of analysis under NASD Rule 2310. First, a broker must conduct a reasonable investigation and conclude that a recommendation could be suitable for at least some investors. *Id.* at 18-20; *see also Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *26-32 (May 27, 2011). This reasonable diligence is referred to as "reasonable-basis" suitability. Second, the broker must assess whether an investment recommendation is suitable for the specific customer to whom it is made, and to tailor recommendations to a customer's financial profile and investment objectives. *See Xagoraris*, 2014 FINRA Discip. LEXIS 34, at *18-20; *see also F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989). This "customer-specific" suitability turns on the particular facts and circumstances of the customer's situation.

A broker must also disclose the risks associated with a recommended security to a customer, but "[m]ere disclosure of risks is not enough. A [broker] must 'be satisfied that the

[8] The Hearing Panel alternatively found that Luo's misconduct constituted negligent misrepresentation in violation of FIRNA Rule 2010. We agree with the Hearing Panel that Luo's misrepresentations to GD were at a minimum negligent and, accordingly, fell short of the standards required of securities industry professionals and violated FINRA Rule 2010.

customer fully understands the risks involved and is . . . able . . . to take those risks.'" *James B. Chase*, 56 S.E.C. 149, 159 (2003). Even if a broker understands the specific risks and explains them to a customer in making a recommendation, the customer's understanding of the risks and acquiescence in following the recommendation does not "relieve [a broker] of his obligation to make reasonable recommendations." *Jack Stein*, Exchange Act Release No. 47335, 2003 SEC LEXIS 338, at *14 (Feb. 10, 2003). "A broker's recommendations must be consistent with his customer's best interests, financial situation, and needs, and he or she must abstain from making recommendations that are inconsistent with the customer's financial situation." *Dane S. Faber*, Exchange Act Release No. 49216, 2004 SEC LEXIS 277, at *23-24 (Feb. 10, 2004).

Here, Luo violated NASD Rule 2310 because he had no basis for believing the 2009 Notes were suitable for any investor and because his recommendations to GD and CWC in particular were unsuitable. First, Luo failed to conduct a reasonable investigation of the 2009 Notes before recommending them. Luo acknowledged that he did not review disclosures or financial statements for WGI before recommending the 2009 Notes. By his own account, his recommendations were based largely on his supervisor's assurances and his own vague observations that his firm was growing and doing well. Moreover, he was aware of several red flags, including missed interest payments, the absence of disclosures and financial statements, and his own difficulty getting paid.

Second, Luo's specific recommendations of the 2009 Notes to GD and CWC also were unsuitable. The 2009 Notes were highly speculative investments. Although Luo acknowledged that the 2009 Notes should only have been sold to accredited investors, he sold them to GD and CWC. GD's initial account opening documents indicated that she was not an accredited investor. The evidence supports that GD was concerned with safety, used the proceeds of a certificate of deposit, a conservative investment, to buy the 2009 Notes, and told FINRA staff the investment was for retirement. CWC's account documents likewise indicated that she was not an accredited investor. CWC was retired, had limited income, and made the investment to fund tuition payments for her son. Luo's claims that CWC, to whom he never spoke, was wealthier than the documentation reflects are not credible. Based on these particular facts and circumstances, Luo's recommendations of the 2009 Notes to GD and CWC were unsuitable.

V. Sanctions

We have considered FINRA's Sanction Guidelines ("Guidelines"),[9] including the Principal Considerations in Determining Sanctions (the "Principal Considerations"), in determining the appropriate sanctions for Luo's violations. For the reasons set forth below, we affirm the bars imposed by the Hearing Panel and modify the sanctions to include an order of restitution.

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[9] *See FINRA Sanction Guidelines* (2015) ("Guidelines").

A. Fraud

Luo made material misrepresentations and omissions with respect to his recommendations to GD of the 2009 Notes. For intentional or reckless misrepresentations or omissions of material fact, the Guidelines recommend a fine of $10,000 to $146,000.[10] The Guidelines also recommend strong consideration of a bar except in situations where mitigating factors predominate.[11] The Hearing Panel found a number of applicable aggravating factors and no mitigating factors. The Hearing Panel also found that Luo's misconduct was egregious and warranted a bar. After an independent review of the record, we agree.[12]

We, like the Hearing Panel, are particularly troubled by Luo's evasive, shifting, and not credible testimony and Luo's actions to persuade GD to retract her first affidavit. We agree that Luo manipulated his customer to impede the disciplinary process and share the Hearing Panel's concerns about Luo's future ability to abide by regulatory requirements designed to protect the investing public.

Luo's misconduct is exacerbated by several aggravating factors. Luo made two sales of the 2009 Notes to GD and engaged in a pattern of repeated misrepresentations and omissions.[13] Luo's misconduct was intentional and caused harm to unsophisticated customers.[14] Luo also benefited financially from his misconduct through the commissions he received from the sales of the 2009 Notes and he has failed to take any responsibility for his misconduct.[15] Given the totality of the aggravating factors, a bar is appropriate for Luo's false statements and omissions in connection with his sales of the 2009 Notes to GD and CWC.

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10 *Id.* at 88.

11 *Id.*

12 As discussed above, the Hearing Panel also found and we affirm that, in the alternative, Luo's misrepresentations and omissions were made negligently. For negligent misrepresentations or omissions of material fact, the Guidelines recommend a fine of $2,500 to $73,000 and a suspension in any or all capacities of up to 31 calendar days to two years. *Id.* The Hearing Panel found that a $50,000 fine and 30 business-day suspension would be appropriate for Luo's misconduct, but declined to impose this sanction in light of the bars. We agree and affirm.

13 *Id.* at 6 (Principal Considerations No. 8).

14 *Id.* at 6-7 (Principal Considerations Nos. 11, 13, 19).

15 *Id.* (Principal Considerations Nos. 2, 17).

B. Suitability

For suitability violations, the Guidelines recommend a fine of $2,500 to $110,000, and a suspension in all capacities of 10 business days to two years.[16] Where aggravating factors predominate, the Guidelines strongly recommend barring the respondent.[17]

We, like the Hearing Panel, impose a unitary sanction for Luo's reasonable basis and customer-specific suitability violations. Luo's conduct was egregious. Luo recommended the 2009 Notes without conducting any reasonable due diligence to determine whether they were suitable for any investor. He never asked any questions about WGI's financial condition, never asked to review financial statements or risk disclosures, despite having received such disclosures in connection with previous offerings and admitting that financial information previously was important to him when recommending investments. Luo acknowledged that he instead based his recommendation solely on his supervisor's assurances and on his own vague, subjective sense that Westrock's business was going well based on his observations of the office space and hiring of new employees. Luo recommended the notes despite being aware of a number of red flags, including that WGI had already missed interest payments, that he himself had trouble getting paid, that the offering was made without the usual PPM, and his own admitted suspicions that his supervisor's assurances about the firm's future seemed too good to be true. He also recommended the 2009 Notes specifically to GD and CWC despite his knowledge of his customers' concern with safety.

Luo's conduct falls far short of the standards required of securities professionals. We are particularly troubled by Luo's continuing failure throughout this proceeding to recognize the inadequacy of his investigation of red flags and suitability determinations. A bar is an appropriately remedial sanction.

C. Restitution

Restitution is appropriate to remediate Luo's misconduct. The Guidelines instruct adjudicators to order restitution where it is appropriate to remediate misconduct and necessary to "restore the status quo ante for victims who would otherwise unjustly suffer loss."[18] We may order restitution "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct."[19]

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16 *Id.* at 94.

17 *Id.*

18 *Id.* at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

19 *Id.*

We conclude that the losses suffered by GD and CWC were the foreseeable, direct, and the proximate result of Luo's misconduct. *See Dep't of Enforcement v. Brookstone Secs., Inc.*, Complaint No. 2007011413501, 2015 FINRA Discip. LEXIS 3, *147-153 (FINRA NAC Apr. 16, 2015) (ordering respondents to pay restitution where the customers' losses were the "foreseeable, direct, and proximate result" of the respondents' fraudulent and unsuitable sales of collateralized mortgage obligations). The record identifies the amount of this loss. The record reflects that GD and CWC were able to exchange their 2009 Notes for others issued by the Native American tribe and received a partial return on their investments. However, GD suffered a loss of $63,648.31 and CWC a loss of $46,121.57. Given WGI's bankruptcy and the fact the Westrock is no longer in business, there is no indication that these losses will be repaid. Accordingly, we order Luo to pay restitution to GD in the amount of $63,648.31 and to CWC in the amount of $46,121.57, plus prejudgment interest calculated from the date of each sale to GD and CWC.

VI. Conclusion

We find that Luo made material misrepresentations and omissions in connection with sale of the 2009 Notes, in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and FINRA Rules 2020 and 2010. For this misconduct, we bar Luo from associating in any capacity with any FINRA member. We also find that Luo recommended the 2009 Notes without a reasonable basis for believing they were suitable for any investor and recommended the notes to two customers for whom the notes were specifically unsuitable, in violation of NASD Rule 2310 and FINRA Rule 2010. For this misconduct, we separately bar Luo from associating in any capacity with any FINRA member. We further order Luo to pay $109,769.88 in restitution to his customers as described above, plus prejudgment interest from the dates of each sale of the 2009 Notes to each customer—i.e., from May19, 2009 for CWC and October 1, 2009 for GD. We also affirm the Hearing Panel's order that Luo pay $4,703.15 in hearing costs and order him to pay appeal costs in the amount of $1,432.18.

On behalf of the National Adjudicatory Council,

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Marcia E. Asquith
Senior Vice President and Corporate Secretary