FINANCIAL INDUSTRY REGULATORY AUTHORITY[1]
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, vs. PAUL ZENKE Registered Representative (CRD No. 3254506), Respondent.	Disciplinary Proceeding No. 20060043777 Hearing Officer - Sara Nelson Bloom **Hearing Panel Decision** **May 2, 2008**

Respondent violated Rule 2110 by charging commissions for no-load mutual funds without seeking and receiving his firm's approval. For this violation, Respondent is suspended for 20 business days, fined $5,000, and required to re-qualify in all capacities.

Appearances

Richard A. March, Esq., and Richard S. Schultz, Esq., Chicago, IL, appeared for the Department of Enforcement.

Respondent appeared on his own behalf.

I. Procedural History

On July 16, 2007, the Department of Enforcement ("Enforcement") filed a one-count Complaint against Paul-Bryan Zenke ("Respondent"), alleging that he violated Rule 2110 by charging impermissible commissions in connection with the sale of six no-load mutual funds to seven customers in nine transactions. Respondent filed an Answer requesting a hearing, admitting that he charged commissions on the mutual fund sales as alleged, and denying that the charges were prohibited by the mutual fund prospectuses, or otherwise improper. The Hearing

[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of the NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA").

was held on October 30, 2007, before a hearing panel composed of a Hearing Officer, and two former members of the District 8 Committee.[2] The parties filed Post-Hearing Briefs on December 17, 2007.

II. Respondent

After practicing law for over 13 years, in December 2000, Respondent registered as a general securities representative with FINRA member Investment Centers of America ("ICA"). He remained there until December 2006, when he resigned due to his disagreement with the firm over the circumstances alleged in the Complaint. CX-14; Tr. 13-14, 63. Respondent is currently registered with another member firm. Id.

III. Facts

This case involves Respondent's charge of commissions on no-load mutual funds. At the hearing, Respondent explained that he preferred to place his customers in fee-based accounts and to recommend that they purchase no-load mutual funds in those accounts; however, ICA did not permit such accounts for customers with assets less than $50,000. Tr. 14-18, 142-143. Nonetheless, Respondent told his customers with accounts under $50,000 that they could either buy no-load mutual fund shares directly from the distributor without receiving any specific recommendation from Respondent and without paying Respondent any fee, or, they could rely upon Respondent to recommend and purchase no-load mutual fund shares for them. For this service, he told them, he would charge a commission. Tr. 44-48. Respondent reasoned that this approach could be more favorable for those customers who wanted his assistance, rather than selling them the load funds that he would otherwise be forced to recommend in order to receive

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[2] References to the testimony of the hearing are designated as "Tr.__," with the appropriate page number. References to the exhibits provided by Enforcement are designated as "CX-___." References to the parties' stipulations are designated as "Stip. __." CX-1–3 and 5–14 were admitted into the record. Respondent offered no exhibits.

compensation. CX-7 p. 21. Some customers agreed to this arrangement; as a result, Respondent sold shares of six no-load mutual funds to seven customers in nine transactions, charging total commissions of $2,790. Tr. 19.

While customers in fee-based accounts executed an advisory agreement with ICA providing that they would pay a specified quarterly fee based on a percentage of assets in an account, Respondent's agreement was an informal and oral agreement. Tr. 38-40, 109. Respondent's charges were unsystematic. For some transactions he charged commissions ranging between 0.5% and 3.0% of the principal amount invested. For others, he charged nothing. CX-7 p. 21; Tr. 19, 40.

Respondent did not tell ICA what he was doing or receive ICA's permission to take this approach, and added the charges without ICA's knowledge. Tr. 53. Respondent assessed charges by manually inputting the commissions into a field entitled "commission override" in ICA's clearing broker's system. CX-5 p. 6; Tr. 19-20, 91-92. For mutual fund transactions, ICA intended this field to be used to recoup ticket charges imposed by ICA's clearing broker, although ICA did not have a written procedure explaining this, and Respondent was unaware of it. Tr. 66, 71. Respondent was able to add commissions manually because there was no dollar amount limit on the "commission override" field at the time. ICA's clearing firm has now changed this situation. Tr. 89-93, 118-119.

Respondent's charges for no-load mutual funds came to light in February 2006, when Respondent noted that a commission he had input was not charged, and he requested by electronic mail that the trade be re-booked to include it. CX-7 p. 18-19; Tr. 84-86. ICA's Trading Department attempted to accommodate Respondent's request; however, the Mutual Fund Department at ICA's clearing firm rejected the commission charge as impermissible, based

upon the clearing firm's agreement that no ticket charge would be assessed for the particular mutual fund family for transactions over $2,500. CX-7 p. 14-16; Tr. 86-89.

Respondent inquired further by electronic mail, noting that he had been able to charge commissions on many other no-load fund transactions. CX-7 p. 14. ICA's Director of Products and Services responded, advising Respondent that he was not permitted to charge a commission on a no-load fund. Id. Respondent pressed his argument, asserting that it would be better for his customers to pay a commission for a no-load fund, than to buy a load fund with a higher sales charge. CX-7 p. 13. ICA Management did not agree, and reimbursed the commissions charged. Tr. 106-108. Respondent ultimately resigned over this issue. Tr. 63-64.

IV. Discussion

The Complaint alleges that Respondent violated Rule 2110 by charging impermissible commissions in connection with the sale of six no-load mutual funds to seven customers in nine transactions. Respondent admits that he charged the commissions alleged, but denies that the charges were prohibited by the mutual fund prospectuses, or were otherwise improper.

Rule 2110 provides that "[a] member, in the conduct of business shall observe high standards of commercial honor and equitable principles of trade." Rule 2110 is violated not only when a member violates the federal securities laws, regulations, or FINRA rules, but also when a member engages in unethical behavior, even if it is not "unlawful." Dep't of Enforcement v. Shvarts, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12-13 (NAC June 2, 2000).

Enforcement advanced several theories in support of its argument that Respondent's conduct was unethical, in violation of Rule 2110. First, Enforcement argued that mutual fund prospectuses specifically prohibit a brokerage firm from charging fees or commissions on the

sale of no-load funds. However, the Panel was not persuaded by this argument. In fact, several prospectuses in the record include disclosures that contemplate the possibility of additional charges. See, e.g., Ave Maria prospectus disclosure: "[Brokerage firms] may charge you transaction fees on purchases of fund shares and may impose other charges or restrictions or account options that differ from those applicable to shareholders who purchase shares directly through the Funds"; Royce Opportunity Fund prospectus disclosure: "If you purchase Fund shares through a third party…commissions, fees, and procedures may differ."

The Panel finds, however, that even assuming it would have been permissible for ICA to have charged commissions for some or all of these transactions without violating the terms of the mutual funds' prospectuses, it was improper for Respondent to have imposed those charges on his own. A registered representative is the agent for the firm with which he or she is associated; and, like any agent, has only such authority as the firm delegates. Thus, Respondent could impose commissions or other charges on the sale of no-load funds (or any other investment), only insofar as ICA had authorized him to do so. In this case, Respondent neither sought nor obtained authority to impose the commissions he charged.

Moreover, Respondent had no reasonable basis for believing that he had authority to impose those charges.[3] On the contrary, of ICA's 650 registered representatives, Respondent was the only one who imposed any charges on sales of no-load mutual funds in excess of the ticket charge imposed by ICA's clearing broker. FINRA's Staff examiner testified that in his review of thousands of no-load mutual fund transactions in twenty firms, he had never seen such charges. Tr. 110-112, 165-168. Because this approach deviated so dramatically from industry practice, Respondent knew or should have known that the arrangement was, at the least,

[3] It is hornbook law that, "[a]n agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal's manifestations to the agent, that the principal wishes the agent so to act." Restatement (Third) of Agency, Section 2.01 (2006).

unconventional; nevertheless, he did not tell his firm what he was doing or seek its permission to impose the charges. Nor did he document these arrangements, despite his knowledge of his firm's practice of documenting its charges with respect to fee-based accounts. Moreover, the fees Respondent charged varied widely; in some cases he charged 3% of the cost of a no-load fund, and in other cases he charged less, or nothing. As a result, it was likely that customers received unjustifiably disparate treatment as to the commissions Respondent imposed.

Based upon the foregoing, the Hearing Panel finds that Respondent's imposition of unauthorized commissions on no-load mutual funds was unethical and therefore violated Rule 2110.

V. Sanctions

There are no specific FINRA Sanction Guidelines ("Guidelines") applicable to Respondent's violative conduct. Enforcement requests that Respondent be suspended for 30 calendar days[4] and fined $5,000, and Respondent urges that no sanctions be imposed.

The Panel finds that a 20 business day suspension, a $5,000 fine, and a requirement to re-qualify in all capacities is warranted. In reaching this determination, the Panel considered that Respondent entered into unauthorized, undocumented and unstructured arrangements with customers whereby he used his discretion to charge varying commissions for sales of no-load mutual funds. The Panel also considered that Respondent was an attorney, who should have appreciated the issues that his conduct raised. Moreover, Respondent's misconduct spanned almost two years and resulted in a monetary gain to Respondent. Further, the Panel was particularly troubled that, even with the benefit of hindsight, Respondent has refused to

[4] Although Enforcement requested a 30 calendar day suspension, the Guidelines provide that suspensions for 30 days or less should be measured in business days. Guidelines at 9 (2007 ed.). Accordingly, the 20 business day suspension imposed by the Panel is generally consistent with Enforcement's request.

acknowledge that he should have consulted with ICA and received approval before imposing his own unconventional pricing policy.

Accordingly, Respondent is suspended for 20 business days, fined $5,000 for charging commissions for no-load funds without seeking and receiving his firm's approval, and required to re-qualify in all capacities.[5]

VI. Conclusion

For charging commissions for no-load funds without seeking and receiving his firm's approval, in violation of Rule 2110, Respondent is suspended for 20 business days, fined $5,000, and required to re-qualify in all capacities. The suspension shall begin at the opening of business on July 7, 2008, and end at the close of business on Aug. 1, 2008. In addition, Respondent is ordered to pay costs of $2,198.56, which include an administrative fee of $750 and the cost of the hearing transcript. These sanctions become effective at a time set by FINRA, but not sooner than 30 days after this Decision becomes the final disciplinary action of FINRA.

HEARING PANEL

By: Sara Nelson Bloom
Hearing Officer

Copies to: Paul Bryan Zenke *(via facsimile and first-class mail)*
Richard A. March, Esq. *(via electronic mail and first-class mail)*
Richard S. Schultz, Esq. *(via electronic mail and first-class mail)*
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[5] The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.