

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

Respondent.

Disciplinary Proceeding  
No. 2008014969001

Hearing Officer – SNB

**HEARING PANEL DECISION**

April 27, 2012

**The Hearing Panel dismissed the Complaint following a hearing. The Department of Enforcement failed to prove by a preponderance of the evidence that Respondent caused his firm to maintain false records in violation of NASD Rules 3110 and 2110.**

**Appearances**

Noel C. Downey, Esq., and Mark P. Dauer, Esq., for the Department of Enforcement.

Mark J. Astarita, Esq., for the Respondent.

**DECISION**

**I. PROCEDURAL HISTORY<sup>1</sup>**

Enforcement filed the Complaint with the Office of Hearing Officers on November 29, 2010, and Respondent filed his Answer on December 27, 2010. The sole cause of action charges Respondent with a violation of NASD Rules 3110 and 2110 for causing his firm to maintain false records in connection with mutual fund purchases.

The hearing was held in New York City on July 19 and 20, 2011, before a hearing panel composed of the Hearing Officer and two current members of the District 11 Committee. Two

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<sup>1</sup> As of July 30, 2007, NASD began operating under a new corporate name, the Financial Industry Regulatory Authority (“FINRA”). References in this decision to FINRA include, where appropriate, NASD. On December 15, 2008, certain consolidated FINRA rules became effective, replacing parallel NASD rules, and in some cases the prior rules were re-numbered and/or revised. *See* Regulatory Notice No. 08-57, FINRA Notices to Members, 2008 FINRA LEXIS 50 (Oct. 2008). This Decision refers to and relies on the NASD rules that were in effect at the time of the Respondent’s alleged misconduct and cited in the Complaint as the basis for the charges against him.

compliance personnel from the Firm and a FINRA investigator testified at the hearing, along with Respondent, who also testified on his own behalf.<sup>2</sup> The parties filed post-hearing briefs on October 31, 2011.

After a thorough review of the record, the Hearing Panel finds that Enforcement failed to prove by a preponderance of the evidence that Respondent violated NASD Rules 3110 and 2110 by causing his firm to maintain false firm records. Accordingly, the Hearing Panel dismisses the Complaint.

## **II. FINDINGS OF FACT**

### **A. Origin of the Proceeding**

The investigation leading to this proceeding followed a Form 3070 filing with FINRA disclosing that Respondent had been terminated for failing to follow firm policies regarding branch office records and advisory accounts.<sup>3</sup>

### **B. The Respondent's Employment History**

Respondent entered the securities industry in 1985.<sup>4</sup> He was registered as an Investment Company and Variable Contracts Products Representative, an Investment Company and Variable Contracts Products Principal, and Municipal Securities Principal with [Firm] (collectively with its successor [firm], the "Firm") from January 2005 until September 2008.<sup>5</sup> He is now registered with another member firm.<sup>6</sup>

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<sup>2</sup> Enforcement's exhibits CX-1-2, CX2A, CX-2B, CX-2C pp. 1-6, CX-3, CX-3A, CX-4, CX-4A, CX-5, CX-5A, CX-6, CX-6A, CX-7, CX-7A, CX-8, CX-8A, CX-9, CX-9A, CX-10, CX-10A, CX-11-13, CX13A, CX-14, CX-14A, CX-14B, CX-14C, CX-15-18, CX-18A, CX-19-21, CX-21A, CX-22, CX-22A, and CX-23, and Respondent's exhibits RX-1-5, RX-7, RX-16 pp. 1, 3, and RX-17 were admitted into evidence. Tr. 542-544. In this decision, "Tr." refers to the transcript of the hearing; "CX" to Enforcement's exhibits; and "RX" to Respondent's exhibits.

<sup>3</sup> Tr. 201, 247-248; CX-1 p. 30; CX-2 p. 1.

<sup>4</sup> CX-1 p. 6.

<sup>5</sup> CX-1.

<sup>6</sup> *Id.*

### C. The Alleged Violation – Causing the Firm to Maintain False Books and Records

Rule 3110 provides: “[e]ach member shall make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17a-3.” Among other things, SEC Rule 17a-3 requires broker-dealers to make and keep current “[a] memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted.”<sup>7</sup> The Rule permits records to be maintained electronically.<sup>8</sup>

The accuracy of a firm’s books and records is vitally important to FINRA’s oversight function. “The entry of accurate information on official firm records is a predicate to [FINRA’s] regulatory oversight of its members. It is critical that associated persons, as well as firms, comply with this basic requirement.”<sup>9</sup> As the SEC has recognized, “preserved records are the primary means of monitoring compliance with applicable securities laws.”<sup>10</sup>

Under NASD Rule 115, Rule 3110 is applicable to persons associated with FINRA members. A registered representative violates Rule 3110 when he or she submits false information that causes books and records preserved by a FINRA member firm to be inaccurate.<sup>11</sup>

Here, Enforcement charges that Respondent caused records maintained by the Firm to be inaccurate. Enforcement claims that this occurred when Respondent placed electronic orders to

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<sup>7</sup> 17 C.F.R. §240.17a-3(a)(6)(i).

<sup>8</sup> *Id.*, See SEC Rel. No. 34-44238; 2001 SEC LEXIS 799 \*7-8 (May 1, 2001).

<sup>9</sup> *Dep’t of Enforcement v. Cohen*, No. EAF0400630001, 2010 FINRA Discip. LEXIS 12, at \*36 (NAC Aug. 18, 2010) (quoting *Charles E. Kautz*, 52 S.E.C. 730, 734 (1996)). See also *Edward Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977), *aff’d*, 591 F.2d 588 (10th Cir. 1979).

<sup>10</sup> See SEC Rel. No. 34-44238; 2001 SEC LEXIS 799 \* 6-7.

<sup>11</sup> *Dep’t of Enforcement v. Taylor*, No. 20070094468, 2011 FINRA Discip. LEXIS 17, at \*13 n.12 (NAC Aug. 5, 2011).

purchase Class A shares of 30 mutual funds at their net asset value (“NAV”) for 15 non-advisory accounts rather than imposing a sales load. However, as discussed below, Enforcement failed to meet its burden of proof because it was unable to produce an inaccurate record preserved by the Firm.

#### **D. The Firm’s Procedures Regarding Mutual Fund Orders**

During the relevant period, from July 2005 through August 2007, the Firm’s registered representatives placed mutual fund orders on an electronic order entry system. To place a trade, registered representatives entered the mutual fund’s CUSIP number, the customer’s account number, whether it was a buy or a sell, and whether the transaction was solicited or unsolicited.<sup>12</sup> In the case of mutual funds, registered representatives were required to indicate if the transaction was priced at NAV.<sup>13</sup>

For example, if the purchase was at NAV, the representative would change the NAV field from a “no” answer to “yes.” This would cause a drop down window to appear, and the representative would indicate the reason for the purchase at NAV.<sup>14</sup> Enforcement offered no document into evidence to reflect the appearance of either the order entry computer screen or the wording that appeared in the drop down window. However, as it relates to the facts of this case, testimonial evidence established that one of the options presented for the drop down window - the option “5” - was generally associated with a “wrap account” or an “advisory account.”<sup>15</sup>

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<sup>12</sup> Tr. 45.

<sup>13</sup> Mutual fund prospectuses generally permit purchases at NAV for advisory accounts because the investor is paying an advisory fee. Tr. 238-246.

<sup>14</sup> Tr. 46.

<sup>15</sup> Tr. 47, 58; CX-10A pp. 1-2.

### **E. The Firm's December 2007 Audit**

In December 2007, following its acquisition by LPL Financial, the Firm conducted its first audit of Respondent's branch.<sup>16</sup> Based on records maintained by the Firm, the auditors found that Respondent, as well as representatives from other offices, placed orders to purchase mutual funds at NAV in non-advisory accounts.<sup>17</sup> However, the auditors found no records maintained by the Firm to explain the basis for the pricing of the mutual fund transactions at NAV.<sup>18</sup> Accordingly, the auditors contacted Pershing, the Firm's clearing agent. One of the Firm's auditors testified that Pershing provided him with information indicating that Respondent coded the subject purchases with the "5" designation in order to purchase the funds at NAV.

Following the internal audit, the Firm terminated Respondent for failing to follow firm policies regarding branch office records and advisory accounts and reported this to FINRA.<sup>19</sup> This prompted an investigation by FINRA. On September 22, 2008, FINRA Staff requested, among other things, information and documents surrounding the Firm's decision to terminate Respondent. The Firm responded, in part, by preparing a chart summarizing information that it obtained from Pershing.<sup>20</sup> The chart indicated that Respondent had selected option "5" to price 30 mutual fund purchases at NAV for 15 customers who did not have advisory accounts.<sup>21</sup>

On May 4, 2009, following its review of the information provided by the Firm, Staff requested that the Firm provide "order tickets associated with the 41 mutual fund purchases (at NAV) which were part of the original findings from the firm's internal auditors."<sup>22</sup> On May 29,

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<sup>16</sup> Tr. 180.

<sup>17</sup> Tr. 51-53, 112, 129.

<sup>18</sup> Tr. 91-92, 114.

<sup>19</sup> CX-1.

<sup>20</sup> Tr. 69-73, 89; CX-2C p. 6.

<sup>21</sup> *Id.*

<sup>22</sup> CX-4 p. 1.

2009, the Firm responded to the request. However, instead of providing order tickets as requested, it provided confirmations.<sup>23</sup> At the hearing, the Firm's compliance specialist took the position that the confirmations normally contain the same information as order tickets.<sup>24</sup> However, when he was asked to identify inaccurate information appearing on the confirmation statements for the transactions at issue, he was unable to do so. Instead, he testified that the records of the transactions were "100% accurate" because they showed NAV sales for non-advisory accounts<sup>25</sup>

#### **F. There Was No Evidence that Records Maintained by the Firm Were Inaccurate**

In order to establish its claim, Enforcement was required to establish that Respondent caused records maintained by the Firm to be false. However, Enforcement failed to offer into evidence any false records maintained by the Firm, whether in the form of a screen print of electronic records or a hard copy of a record. FINRA's examiner speculated that the Firm's order tickets for the transactions at issue may have reflected the "5" coding in non-advisory accounts. However, he testified that "one of the difficulties is that the firm never produced the order tickets."<sup>26</sup>

In an effort to address this issue, Enforcement presented testimony from the Firm's Compliance Specialist that the Firm had an unwritten policy requiring its registered representatives to print a copy of each order ticket so that the representative could compare it to the confirmation and verify that the confirmation was accurate.<sup>27</sup> Accordingly, Enforcement argued, Respondent should not be able to avoid liability for causing the Firm's records to be false by failing to print these required documents.

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<sup>23</sup> CX-4A p. 1; Tr. 105.

<sup>24</sup> Tr. 105.

<sup>25</sup> Tr. 108-109.

<sup>26</sup> Tr. 329-333.

<sup>27</sup> Tr. 146.

Enforcement's argument is unavailing. First, it is speculation as to what the order tickets might have revealed as none was produced. It is also speculation that any order tickets were printed out as there was no testimony that the tickets involved in these transactions were ever printed. In addition, contrary to Enforcement's suggestion, registered representatives were not responsible for maintaining the Firm's records required under SEC Rule 17a-3.<sup>28</sup> Moreover, no evidence was presented as to why the Firm was unable to produce electronic records of the transactions. Thus, there is insufficient evidence to conclude that Respondent's selection of option "5" on the order entry screen was captured and maintained in the Firm's records, whether electronic or otherwise.<sup>29</sup>

Enforcement contended that Respondent's use of the "5" coding was inappropriate. Respondent offered a defense to this contention, asserting that it was consistent with Firm policy and approved by the Firm's Compliance Department. The Panel, however, reached no determination as to the appropriateness or inappropriateness of the use of the "5" coding since it was not charged in the complaint.

Enforcement also argued that the facts of this case were analogous to those in *Dep't of Enforcement v. Correro*.<sup>30</sup> However, in that case, there was no dispute that the documents at issue were maintained as records of the Firm. Here, the evidence offered at the hearing established the opposite fact. The Firm's auditor testified that he was required to go outside the Firm's records to the Firm's clearing firm to obtain documents indicating the "5" coding.

Moreover, the records that the Firm did maintain regarding the transactions at issue were accurate.<sup>31</sup> In particular, the Firm's records of the transactions indicated, accurately, that

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<sup>28</sup> Tr. 144, 152.

<sup>29</sup> The facts of this case are distinguishable from the facts in *Dep't of Enforcement v. Correro*, No. E102004083702, 2008 FINRA Discip. LEXIS 29, at \*15 (NAC Aug. 12, 2008).

<sup>30</sup> No. E102004083702, 2008 FINRA Discip. LEXIS 29, at \*15 (NAC Aug. 12, 2008).

<sup>31</sup> Tr. 108-109.

Respondent's mutual fund purchases at NAV were for non-advisory customers because they showed that the transactions at issue were priced at NAV, and the account numbers did not include the prefix used to indicate advisory accounts.<sup>32</sup>

After a careful consideration of the evidence, the Hearing Panel concluded that Enforcement failed to establish an essential element of its claim – that the Firm maintained false records. Accordingly, the Panel found that Enforcement failed to meet its burden to establish that Respondent violated Rules 3110 and 2110.

### **III. CONCLUSION**

Enforcement failed to prove by a preponderance of the evidence that Respondent caused his firm to maintain false records, in violation of NASD Rules 3110 and 2110. Accordingly, the Complaint is dismissed.

### **IV. ORDER**

For the reasons set forth above, the Hearing Panel dismisses the Complaint.<sup>33</sup>

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Sara Nelson Bloom  
Hearing Officer  
For the Hearing Panel

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<sup>32</sup> Tr. 107-109.

<sup>33</sup> The Hearing Panel has considered and rejects without discussion all other arguments of the parties.