

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

THOMAS HOMER MORROW II
(CRD No. 2515316),

Respondent.

Disciplinary Proceeding
No. 2008015617902

Hearing Officer – LBB

**HEARING PANEL
DECISION**

August 23, 2012

Respondent is barred from associating with any member firm in any capacity for failing to register with FINRA while engaging in the securities business of a FINRA member firm, in violation of NASD Rules 1031 and 2110, and FINRA Rule 2010. Respondent is also barred for failing to appear and testify at an on-the-record interview, in violation of FINRA Rules 8210 and 2010.

Appearances

UnBo Chung, Senior Regional Counsel, Chicago, Illinois, for the Department of Enforcement.

Thomas Homer Morrow II, *pro se*.

DECISION

I. Procedural History

The two-cause Complaint in this disciplinary proceeding was filed on January 5, 2011. The First Cause of Action charges Respondent Thomas Homer Morrow II (“Respondent”) with failing to register with FINRA while engaging in the securities business of FINRA member firm TradeRight Securities, Inc. (“TradeRight” or “Firm”), in violation of NASD Rules 1031 and 2110, and FINRA Rule 2010. The Second Cause of Action charges Respondent with failing to

appear and testify at an on-the-record interview (“OTR”), in violation of FINRA Rules 8210 and 2010.¹

Respondent answered the Complaint on June 28, 2011. His answer disputed many of the facts in the Complaint, alleged that he was a customer of TradeRight and not engaged in the securities business, and that FINRA had no jurisdiction over him.

Although Respondent did not appear for the hearing, a full hearing was conducted in Chicago on May 30, 2012, before a Hearing Panel composed of two former members of the District 8 Committee and a Hearing Officer.

II. Summary

The principal issue in this proceeding is whether Respondent traded in the Firm’s proprietary account on behalf of the Firm, as alleged in the Complaint, or was merely a customer, as Respondent asserted in his answer.² The evidence establishes that from April 2007 through January 2009, Respondent purchased bonds in TradeRight’s proprietary account through his securities industry contacts, sold the bonds through other personal contacts, and shared in the profits he earned for the Firm.

¹ On July 26, 2007, the Securities and Exchange Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to the Financial Industry Regulatory Authority, Inc. (“FINRA”), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522, 523. Following the consolidation, FINRA began developing a new “Consolidated Rulebook” of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57174 (Oct. 1, 2008). FINRA’s disciplinary action was instituted after the consolidation of NASD and NYSE, but some of the conduct at issue took place before the consolidated rules took effect. Accordingly, NASD conduct rules apply to conduct that occurred before December 15, 2008, and FINRA conduct rules apply to conduct after that date. FINRA’s procedural rules apply. References to FINRA include references to NASD.

² Answer ¶¶ 1, 3, 4, 11. Respondent maintained throughout the proceeding that he was a TradeRight customer. *See* Pre-Hearing Conference Transcript June 17, 2011, at Tr. 6, 10, 22; Pre-Hearing Conference Transcript January 17, 2012, Tr. 7, 12; Thomas Morrow’s Response to FINRA’s Department of Enforcement’s Memorandum of Points and Authorities in Support of Complaint at 4, 7 (filed Oct. 13, 2011).

As charged in the First Cause of Action, Morrow was engaged in the securities business on behalf of TradeRight by engaging in proprietary trading on behalf of the Firm. Accordingly, he was required to register as a representative, pursuant to NASD Rule 1031. The Hearing Panel imposes a bar for Respondent's failure to register.

As charged in the Second Cause of Action, Morrow violated FINRA Rules 8210 and 2010 by failing to appear and testify at an OTR. The Hearing Panel also imposes a bar for this violation.

III. Jurisdiction Over This Proceeding

The transactions that are the subject of the Complaint occurred from April 2, 2007, through January 26, 2009. As discussed below, the Hearing Panel finds that Respondent was an associated person of TradeRight during that period, under Article I of FINRA's By-Laws.

Although Morrow is not currently registered with a FINRA member firm, FINRA has jurisdiction to bring this disciplinary proceeding pursuant to Article V, Section 4 of FINRA's By-laws because: (1) the Complaint was filed within two years following the termination of his association with a FINRA member firm; and (2) the Complaint charges him with a violation that occurred while he was associated with a member firm, and with failing to respond to FINRA's requests for testimony made during the two-year period following the termination of his association with a member firm.³

IV. Findings of Fact

A. Origin of Investigation

This matter arises out of FINRA's December 2008 cycle examination of TradeRight, during which the examiner noticed wire transfers from TradeRight's bank account to an entity called Nassau Capital Corporation ("Nassau Capital"). The examiner asked the Firm about the

³ Article V, Sec. 4(a), FINRA By-Laws, available at www.finra.org/rules.

transfers, and was told that the wires were transfers of funds to Morrow, who was trading in the Firm's proprietary account. Tr. 79. At the time, the firm was a "\$5,000 broker-dealer," and could not make more than ten proprietary trades in one year, except as a riskless principal.⁴ Tr. 92, 94. After reviewing the trading, the examiners determined that the trades were not made as a riskless principal, and that more than ten trades had occurred in a calendar year. Tr. 92, 101, 105-106. A FINRA examiner also verified the trading took place in TradeRight's proprietary account by reviewing statements from TradeRight's clearing firms. Tr. 103.

B. Respondent

Respondent was registered with FINRA member firms from 1994 until 1999, and has not been registered with a member firm since that time. CX-1. Although Respondent traded on behalf of TradeRight for 21 months, the Firm did not file a Form U4 on Respondent's behalf, and he was never registered with TradeRight. Tr. 22, 59; CX-1.

Respondent conducted his securities trading business through Nassau Capital. Tr. 12, 59. Nassau Capital was never registered with FINRA. Tr. 83. Nassau Capital's Articles of Incorporation list Respondent as the incorporator, sole director, and registered agent for the company. CX-3.

C. Respondent's Trading in TradeRight's Account

Sometime in 2005, Michael Rakujzo, TradeRight's president, received a referral, asking if the Firm was interested in speaking with someone who wanted to engage in bond trading. Rakujzo said the Firm was interested, and Morrow called TradeRight. Morrow said he was a

⁴ "A broker-dealer that does not receive or hold customer funds or securities and does not carry customer accounts is required to maintain net capital of not less than \$5,000. Exchange Act Rule 15c3-1(a)(2)(vi). A broker-dealer operating under the \$5,000 minimum net capital requirement is not permitted to engage in more than 10 transactions in any one calendar year for its proprietary investment accounts." *Dep't of Market Reg. v. Proudian*, No. CMS040165, 2008 FINRA Discip. LEXIS 21, at *3 n.3 (N.A.C. Aug. 7, 2008).

bond trader who had built up industry relationships over the years, and could facilitate bond sale transactions. He said he could buy new issue bonds from bond market contacts that would allocate a share of their new issue bonds to him, and then sell them through other industry contacts, such as banks and other broker-dealers. Morrow said the transactions were completed before they were booked, and there would be a markup as a profit. Tr. 8-9. Morrow said he was doing the transactions at the time, and was receiving 50% of the profit. Rakujzo testified that he was not certain where Morrow was engaged in trading before coming to TradeRight. Tr. 9-10. In late 2006 or early 2007, Morrow and TradeRight agreed that Morrow would trade in TradeRight's proprietary account. They agreed that Morrow would receive 65% of the net profits from his trading for TradeRight, and the Firm would receive 35%. He was not required to contribute any funds for the trading. Tr. 13-14, 54, 58.

TradeRight provided Morrow with the Firm's TRACE identifiers to facilitate the trading.⁵ Morrow had access to Bloomberg information services prior to the relationship with TradeRight, and the Firm agreed to pay for his continued access to Bloomberg. Respondent used the Bloomberg service to learn that new issue bonds were available. Tr. 15-16, 25, 55; CX-8. The Firm paid Bloomberg about \$20,000 to provide Bloomberg service to Respondent. CX-5, CX-6; Tr. 25.

Morrow began trading in TradeRight's account on April 2, 2007, buying and selling a utility bond and a treasury security on April 2 and 3. CX-7. In the early days of Morrow's association with TradeRight, Morrow arranged transactions, then called TradeRight so the Firm could execute the transactions with its clearing firms. Tr. 16-17, 55, 67-68. It became

⁵ "The Trade Reporting and Compliance Engine is the FINRA developed vehicle that facilitates the mandatory reporting of over the counter secondary market transactions in eligible fixed income securities. All broker/dealers who are FINRA member firms have an obligation to report transactions in corporate bonds to TRACE under an SEC approved set of rules." FINRA website, at www.finra.org/industry/compliance/markettransparency/trace/.

cumbersome to execute the trades through TradeRight, so the Firm provided Morrow with direct computer access to its clearing firms to allow Morrow to enter trades directly. Tr. 18, 55.

Morrow kept TradeRight informed by faxing a trade blotter to the firm at the end of each trading day. Tr. 20, 28; CX-7. Although Morrow made all the trades, TradeRight retained the ability to control the account by revoking his access to the clearing firm or restricting the amount of trading he did. Tr. 30, 57.

Morrow made hundreds of trades in the TradeRight account from April 2007 until January 2009, using his strategy of buying and selling bonds while hedging with treasury securities. He bought and sold millions of dollars of securities in the account. Tr. 41-42, 62; CX-7, CX-8. On most days, the amount of trading exceeded one million dollars. It reached as high as \$25 million in bonds, plus \$25 million in treasuries, in a single day. CX-7. TradeRight distributed Morrow's share of the profits to Nassau Capital every month. All told, Morrow received \$479,039 in profits through Nassau Capital. Tr. 21, 27, 47, 59; CX-6. The last transaction was entered on January 26, 2009. Morrow faxed the last trade blotter to TradeRight on January 28, 2009. CX-7 at 263.

The Firm's president described the trading as riskless because the purchase and sale were arranged before a trade "hit the books." Tr. 41, 46. In fact, it was not riskless.⁶ If any of the trades had fallen through or failed to settle, TradeRight, and its capital, were at risk. Tr. 43. The risk in the account is demonstrated by the fact that there were some losses in the account due to

⁶ "[A] riskless principal transaction is the economic equivalent of an agency trade. Like an agent, a firm engaging in such trades has no market making function, buys only to fill orders already in hand, and immediately 'books' the shares it buys to its customers. Essentially, the firm serves as an intermediary for others who have assumed the market risk. The firm in these circumstances provides no liquidity to the interdealer market." *Andrew P. Gonchar*, Exchange Act Rel. No. 60506, 2009 SEC LEXIS 2797, at *9 (Aug. 14, 2009) (citation omitted); *see also, Dennis Todd Lloyd Gordon*, Exchange Act Rel. No. 57655, 2008 SEC LEXIS 819, at *39 n.47 (Apr. 11, 2008) ("We have defined a riskless principal transaction as one in which 'after receiving an order to buy or sell from a customer, the broker-dealer purchases the security from another person to offset a contemporaneous purchase by the customer or sells the security to another person to offset a contemporaneous sale by the customer.'"); Notice to Members 01-85 (Dec. 2001).

changes in interest rates between the times of purchases and sales, and the clearing firms deducted the losses from commission payments owed to TradeRight. Tr. 40-41, 46-47. Furthermore, on the blotter Morrow prepared, it shows that the sell dates were sometimes a day or more after the buy dates, indicating that the Firm bore the risk of market changes while it held the bonds in inventory. CX-7.⁷

Although Morrow claimed in this proceeding that he was a customer, his behavior was inconstant with that assertion. In conference calls with a FINRA examiner, Morrow never said he was customer. He did not disagree when his role was described during the conference calls as a “broker’s broker.” Tr. 96-97. Although Morrow did not have access to the funds in the TradeRight account, and did not receive any of the money that was in the account, he has made no effort to recover the money that would have been his if he had been a customer. The only money he ever received was his share of the trading profits. Morrow has not filed any arbitrations or lawsuits against TradeRight or its former principals, and has not asked for the money that was in the account. Tr. 45-46, 70.

D. FINRA’s Rule 8210 Requests for Testimony

On June 10, 2009, FINRA staff issued a request to Respondent, pursuant to FINRA Rule 8210, to appear and testify at an OTR in Chicago on June 25, 2009. The request was sent to Respondent’s CRD address⁸ and to an alternative address in Florida. CX-9. Respondent received the mailing, and replied by faxed letter on June 23, 2009, showing the alternative address as his return address. In his letter, he asserted that it would be a hardship to come to FINRA’s Chicago office to testify because of the short notice, other obligations, and the expense.

⁷ For most transactions the buy and sell dates are the same on the trading blotter. In some instances the sell date is a day or more after the buy, and in some instances the sell date is earlier than the buy date. CX-7. The only record of the trading in evidence is the trading blotter that Morrow prepared and sent to TradeRight.

⁸ As noted above, Respondent had not been registered since 1999.

Respondent stated that he was not refusing to cooperate, and that he would be willing to submit a sworn written response to written questions, or to appear at a local FINRA office. CX-10; Answer ¶¶ 14, 15.

FINRA staff issued another request to appear and testify at an OTR, pursuant to Rule 8210, on November 9, 2010. The request directed Respondent to appear at FINRA's Chicago office on November 23, 2010. The request was sent to Morrow's CRD address and the alternative address – the same address that appeared on Morrow's June 23 fax, which is the same address that he used for his Answer to the Complaint. The mailings were sent both by first-class and certified mail. CX-11. The certified letter sent to the alternative address was returned marked "Unclaimed." The certified letter sent to the CRD address was returned marked "Not deliverable as addressed." CX-12, CX-13.

Morrow has never come to FINRA's office to testify. Tr. 123-124.

V. Conclusions of Law

A. Respondent Was an Associated Person of TradeRight, a FINRA Member Firm

Article I of FINRA's By-Laws provide that a "person associated with a member," includes "a natural person engaged in the ... securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration with the NASD under these By-Laws or the Rules of the Association...." The definition of the securities business includes "the business, carried on by a broker[or] dealer ... of purchasing securities and offering the same for sale as a dealer...."⁹ A dealer includes a person or entity "engaged in the business of buying and selling securities for such individual's or

⁹ Article I, Sec. (u) FINRA By-Laws.

entity's own account.”¹⁰ The definition of “associated person” should be construed broadly “in order to take regulatory action in circumstances where a person’s connection with a member firm implicates the public interest.”¹¹ It is not necessary to be employed by a firm to be deemed an associated person under FINRA’s By-Laws.¹²

Morrow engaged in the securities business by trading in the TradeRight’s proprietary account on behalf of the Firm, sharing in the profits from his trading. Morrow’s trading had a substantial impact on the Firm’s securities business. As the examiners found, Morrow’s trades caused the Firm’s capital requirement to increase from \$5,000 to \$100,000.¹³ Furthermore, the requirements of Form BD support a finding that trading in a proprietary account constitutes engaging in the securities business. If a firm plans to engage in trading for its own account, Form BD requires that activity to be listed as a type of business in which the firm will be engaged.¹⁴ In addition, Morrow created and maintained an important record of the Firm by preparing the trading blotters for the Firm’s proprietary trading account.

Although Respondent conducted the trading without oversight from TradeRight, Respondent’s activities were controlled by TradeRight. Despite Respondent’s day-to-day control of the Firm’s proprietary account, he could not withdraw the funds in the account, and

¹⁰ Article I, Sec. (k) FINRA By-Laws.

¹¹ *Dep’t Enforcement v. Hedge Fund Capital Partners, LLC*, No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *31 (N.A.C. May 1, 2012), citing *DBBC v. Paramount*, No. C3A940048, 1995 NASD Discip LEXIS 248, at *12 (NBCC Oct. 20, 1995).

¹² *Van Alstyne, Noel & Co.*, Exchange Act Rel. No. 8511, 1969 SEC LEXIS 229, at *14-15 (Jan. 31, 1969); see also *Dep’t of Enforcement v. Harvest Capital Investments, LLC*, No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *32 (N.A.C. Oct. 6, 2008).

¹³ See also SEC Rule 15c3-1(a)(2)(iii)(B) (Net Capital Requirements for Brokers or Dealers) (requiring dealers to maintain net capital of \$100,000, and defining dealers as including any broker or dealer that effects more than ten transactions in any one calendar year for its own investment account. Trading as a riskless principal account is excluded by 15c3-1(a)(2)(vi)(B).

¹⁴ Form BD, Page 5, Item 12.V.

the Firm could terminate his access to the clearing firms and restrict the amount of trading he did.

Based on the foregoing, the Hearing Panel finds that Respondent was an associated person of TradeRight under FINRA's By-Laws through January 28, 2009, the last date on which he faxed a trade blotter to the Firm, reporting transactions of January 26, 2009.

B. Respondent Violated NASD Rules 1031 and 2110, and FINRA Rule 2010, by Failing to Register

NASD Rule 1031 states that a person engaged in the securities business of a member firm who is to function as a representative must be registered with FINRA in the appropriate category of registration. The rule defines a "representative" to include all persons associated with a member firm who engage in the "solicitation or conduct of business in securities."¹⁵ "The requirement that an associated person receive [FINRA] approval of his registration before engaging in any securities business provides an important safeguard in protecting public investors. We have previously emphasized that 'strict adherence' to that requirement is 'essential.'"¹⁶

Anyone who effects securities transactions on behalf of a member firm, and is compensated by the firm for doing so, must be registered with that firm.¹⁷ By trading in the Firm's proprietary account, and preparing a record of the Firm for his trading, Morrow engaged in the conduct of the business of securities for TradeRight.

¹⁵ NASD Rule 1031(b).

¹⁶ *First Capital Funding, Inc.*, Exchange Act Rel. No. 30819, 1992 SEC LEXIS 1369, at *7 (June 17, 1992) (Respondents improperly solicited securities business before the firm was approved as an NASD member by sending certain materials to broker-dealers concerning a private placement of debentures and stock warrants.)

¹⁷ *Gary D. Cohee*, Exchange Act Rel. No. 34-25210, 1987 SEC LEXIS 2985, at *3 (Dec. 17, 1987).

The Hearing Panel finds that Morrow functioned as a representative of TradeRight from April 2, 2007, until January 28, 2009. By failing to register with FINRA, Respondent violated NASD Rules 1031 and 2110, and FINRA Rule 2010.

C. Respondent Violated FINRA Rules 8210 and 2010

FINRA Rule 8210 gives FINRA staff authority to compel a “person associated with a member” to provide information and appear to testify. The authority to compel a person to testify continues for two years after the person ceases to be associated with the firm.¹⁸ A violation of FINRA Rule 8210 is also a violation of FINRA Rule 2010.¹⁹

Respondent had notice of the OTR scheduled for June 2009, yet he did not appear, instead making a counter-offer on the conditions under which he would cooperate. The certified mailings providing notice of the OTR scheduled for November 2009 were returned to FINRA, but the first-class mailings were sent to the address that Respondent was using at the time, and continued to use in this proceeding. Respondent did not deny in his answer that he knew of the second scheduled OTR. The Hearing Panel finds that Respondent had notice of the second OTR, yet he again failed to appear.

By failing to appear and testify at an OTR despite receiving two notices to appear, Respondent violated NASD Rules 8210 and 2110, and FINRA Rule 2010.

VI. Sanctions

A. Sanctions for Failure to Register

FINRA’s Sanction Guidelines (“Guidelines”) provide that for a registration failure in violation of NASD Rule 1031, the adjudicator should consider a fine of \$2,500 to \$50,000 and a

¹⁸ *Dep’t of Enforcement v. Reichman*, No. 200801201960, 2011 FINRA Discip. LEXIS 18, at *15-16 (N.A.C. July 21, 2011), citing Article 5, Section 4(a) of the By-Laws.

¹⁹ *Reichman*, 2011 FINRA Discip. LEXIS 18, at *29.

suspension of up to six months. In egregious cases, the Guidelines recommend a longer suspension or a bar.²⁰ The two principal considerations are whether the respondent has filed a registration application, and the nature and extent of the unregistered person's responsibilities.²¹

Respondent has not filed a registration application, and has denied that he is required to file one. His responsibilities were extensive, trading substantially for the Firm for 21 months. Furthermore, based on his trading, the examiners determined that he exposed the Firm to substantial risk and caused the Firm to have a substantially higher net capital requirement.

In addition, Respondent had engaged in proprietary trading for another firm. When he approached TradeRight to propose bond trading for TradeRight, he told TradeRight that he was doing the same kind of trading but receiving 50% of the profits, and that he had access to Bloomberg services. This arrangement was similar to Morrow's relationship with TradeRight. Respondent would not have shared 50% of the profits in his own account with a broker, and it is unlikely that he would have had the Bloomberg service as a retail customer.

Respondent's violation of NASD Rule 1031 was egregious. His trading for TradeRight created substantial risk for the Firm, and would be risky to any firm for which he engaged in such activities. He put TradeRight at substantial risk and caused its net capital requirement to increase. The dollar amount and financial gain to Respondent were substantial. Respondent's conduct was not an isolated incident, but activity in which he had engaged prior to his relationship with TradeRight. The violation continued for 21 months, and ended only when discovered by a FINRA examiner. A bar is the appropriate sanction.

²⁰ Sanction Guidelines at 43 (2011).

²¹ *Id.*

B. Sanctions for Failure to Appear and Testify at an OTR in Violation of FINRA Rules 8210 and 2010

The Guidelines provide that if a person does not respond in any manner to a request for information made pursuant to Rule 8210, a bar should be the standard sanction.²² Respondent did not appear and testify at two OTRs, and there are no mitigating factors. A bar is the appropriate sanction.²³

VII. Conclusion

Respondent Thomas Homer Morrow II is barred from associating with any member firm in any capacity for failing to register with FINRA despite functioning as a representative for a member firm, in violation of NASD Rules 1031 and 2110, and FINRA Rule 2010. Respondent is also barred for violating FINRA Rules 8210 and 2010 by twice failing to appear and testify at an on-the-record interview. In addition, Morrow is ordered to pay costs in the amount of \$1,724.50, which includes a \$750 administrative fee and the cost of the hearing transcript. The costs shall be payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action in this matter. If this decision becomes FINRA's final disciplinary action, the bars will take effect immediately.²⁴

HEARING PANEL

Lawrence B. Bernard
Hearing Officer

Copies to: Thomas Homer Morrow II (*overnight courier and first-class mail*)
UnBo Chung, Esq. (*via e-mail and first-class mail*)
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²² *FINRA Sanction Guidelines* 33.

²³ *See, Reichman*, 2011 FINRA Discip. LEXIS 18, at *40-48.

²⁴ The Hearing Panel has considered and rejects without discussion all other arguments of the parties.