FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

THE DRATEL GROUP, INC.
(BD No. 8049),

and

WILLIAM M. DRATEL
(CRD No. 843025),

Respondents.

Disciplinary Proceeding
No. 2009016317701

Hearing Officer – MC

AMENDED[1] HEARING PANEL DECISION

September 19, 2013

For violations of FINRA and NASD rules, and the Securities Exchange Act of 1934, as described below, Respondent William M. Dratel is suspended for 25 business days. He and The Dratel Group, Inc. are fined $31,000 jointly and severally, and are assessed costs. Dratel is fined an additional $5,000, and the firm is fined an additional $2,500. Respondents' willful rule violations subject them to statutory disqualifications.

Respondent William M. Dratel violated FINRA Rules 1122 and 2010 when he willfully failed to make timely amendments to his Form U4 to disclose material judgments and liens that had been filed against him. Dratel and The Dratel Group, Inc. violated Rules 1122 and 2010 when they willfully failed to make timely amendments to the firm's Form BD to disclose a material judgment that had been filed against the firm. For these violations, Dratel is suspended from associating with any FINRA member firm in any capacity for 15 business days, and Respondents are fined $5,000 jointly and severally.

Respondents violated NASD Rules 3110(a) and (j), and FINRA Rule 2010, and the firm violated Section 17(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 17a-3 and 17a-4 thereunder, when they willfully failed to create and preserve order memoranda. For these violations, Dratel is suspended from

[1] The Hearing Panel decision has been amended to clarify the allegations for the fine.

associating with any FINRA member firm in any capacity for five business days, and Respondents are fined $10,000 jointly and severally.

Respondents violated Exchange Act Section 17(a) and Rule 17a-4(b)(2), NASD Rule 3110(a), and FINRA Rule 2010 when they failed to preserve e-mail communications. For these violations, Respondents are fined $1,000 jointly and severally.

Respondents violated NASD Rules 2330 and 2110, and FINRA Rules 2150 and 2010 when they compensated customers for losses. For these violations, Respondents are fined $10,000 jointly and severally.

Respondents violated MSRB Rules G-2 and G-3 when they executed 23 municipal securities transactions without (i) being registered with the MSRB, and (ii) having a registered municipal securities principal to supervise municipal securities activities. The firm violated MSRB Rule G-14 when it failed to report transactions in municipal securities to MSRB. For these violations, Respondents are fined $2,500 jointly and severally.

The firm violated FINRA Rules 6720, 6730, and 2010 when it executed 38 customer transactions in corporate debt securities without completing a TRACE participation agreement and failed to report the transactions to TRACE. For these violations, the firm is fined $2,500.

Respondents violated Exchange Act Section 17(a) and Rule 17a-3, NASD Rule 3110, and FINRA Rule 2010 when they maintained inaccurate ledger and trial balances. For these violations, they are fined $2,500 jointly and severally.

Dratel violated FINRA Rules 3012 and 2010 when he failed to establish and enforce supervisory control systems, and violated FINRA Rules 3130 and 2010 when he failed to certify compliance and supervisor processes. For these violations, he is suspended from associating with any FINRA member firm in any supervisory capacity for five business days and fined $5,000.

Appearances

Samuel Barkin, Esq., Andrew Beirne, Esq., and Jon S. Batterman, Esq., for the Department of Enforcement.

Irwin Weltz, Esq., Ellenoff Grossman & Schole LLP, for Respondents.

I. INTRODUCTION

This is a case of numerous rule violations by a FINRA registered broker-dealer and its owner. Some of the alleged violations viewed singly appear minor. When viewed together,

however, they depict a pattern of non-compliance with requirements imposed by securities laws and regulations governing some of the most basic aspects of operating a brokerage firm. The allegations relate to disclosure of liens and judgments, creation and preservation of order memoranda, maintenance of books and records, and other fundamental requirements.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Background

Respondent William M. Dratel ("Dratel") began working in the securities industry in 1977 after graduating from the University of Rochester. Then, attending night classes, Dratel obtained a law degree and passed the New York bar examination. He, his father, and a friend of his father founded and began operating The Dratel Group, Inc. ("DGI") in March, 1980.[2] DGI maintained one office in East Hampton, New York, until October 2009, when it relocated to Southold, New York,[3] and a second office on Broad Street in New York City until early February 2012.[4] The firm has approximately 100 customers with assets totaling $20 million.[5]

After his father's death in 1998, Dratel became the sole owner of DGI and has since then operated the firm under an exception to the "two principal rule."[6] Although DGI had two clerical employees working in the Broad Street office through 2010,[7] Dratel characterizes the firm as a

[2] Hearing Transcript ("Tr.") 86-87, 289-92.

[3] Tr. 57-58.

[4] Tr. 299.

[5] Tr. 236-37, 297.

[6] Tr. 193-94. NASD Rule 1021(e), still in effect, requires each member firm to have a minimum of two officers or partners registered as principals with respect to each aspect of the firm's investment banking and securities business, unless the requirement is waived pursuant to NASD Rule 9610, which was superseded in substantially the same form by current FINRA Rule 9610 on December 15, 2008. *See* NASD to FINRA Conversion Chart Spreadsheet, *available at* www.finra.org. NASD consolidated with the regulatory arm of the New York Stock Exchange in July 2008. A new Consolidated Rulebook was adopted on December 15, 2008. S*ee* FINRA Regulatory Notice 08-57 (Oct. 2008). FINRA's Rules (including NASD Rules) are available at www.finra.org/Rules.

[7] Tr. 299. One employee held a Series 24 General Principal's license from 2007, and a Series 53 Municipal Securities Principal's license from June, 2009, until she left when Dratel closed the Broad Street office in October 2011. Tr. 108, 183.

"one-man shop" where he does "everything," "all the trading … all the research … all the talking to clients … all the dealing with vendors …all the mail."[8]

Dratel holds a number of FINRA licenses: General Securities Representative (Series 7), Branch Office Manager (Series 8), General Securities Principal (Series 24), Financial and Operations Principal (Series 27), and Equity Trader Limited Representative (Series 55). He buys and sells stocks primarily, only occasionally dealing in corporate and municipal bonds.[9]

The Complaint contains 11 causes of action. Some are directed against Dratel, some against DGI, and some against both. The charges emanated from annual FINRA examinations of DGI in 2009 and 2010. Following the examinations, FINRA examiners issued reports listing the violations they found. Dratel's responses to the reports did not dispute many of the underlying facts alleged in the Complaint.

B. Willful Failure to Disclose and Statutory Disqualification

The first and second causes of action contain the most serious charges. The first alleges that Dratel willfully failed to make timely amendments to his Uniform Application for Securities Industry Registration or Transfer ("Form U4") to disclose judgments and liens filed against him, and that the judgments and liens were material facts he was required to disclose. The second alleges that Respondents willfully failed to make timely disclosure of a judgment against DGI, also a material fact, and one which they were required to disclose on the firm's Uniform Application for Broker-Dealer Registration ("Form BD").

Respondents strenuously object to the characterization of their conduct as willful, arguing that the consequences of a finding of willfulness are unduly harsh because it subjects them to

[8] Tr. 293, 298.

[9] Tr. 294-95.

statutory disqualification from the securities industry,[10] which has been characterized as "potentially a more severe sanction than a monetary penalty or temporary suspension."[11] FINRA's By-Laws provide that a person subject to statutory disqualification cannot be associated with any FINRA member firm, and a firm subject to disqualification cannot be a member, until the firm obtains permission from FINRA.[12]

A person or firm is subject to statutory disqualification for willfully making any false or misleading statement, or failing "to state … any material fact which is required to be stated" in a Form U4.[13] As the facts set forth below make clear, Dratel did not make timely amendments to his Form U4 and Respondents did not make timely amendments to DGI's Form BD. The central issues before the Hearing Panel, therefore, are (i) whether FINRA rules required disclosure of the liens and judgments; (ii) if so, whether the liens and judgments were material; and (iii) whether the failures to file timely amendments were willful. Because of the centrality of these issues, we turn first to the legal standards we must apply to decide them.

1. The Obligation to Amend The Forms

It is well established that FINRA, in fulfilling its self-regulatory responsibilities, relies upon the diligence of applicants to complete Forms U4 accurately, and upon members and associated persons to keep them updated and accurate. This is "critical to the effectiveness of [FINRA]'s, and other self-regulatory organizations', ability to determine the applicants' fitness for registration" as securities professionals.[14] Consistent with this principle, Article V, Section 2

[10] *See Mathis v. SEC*, 671 F.3d 210, 211 (2d Cir. 2012).

[11] *Id.* at 215-16.

[12] FINRA By-Laws, Art. III, Sections 3(b) & (d).

[13] *Scott Mathis*, Exchange Act Rel. No. 61120, 2009 SEC LEXIS 4376, at *18 (Dec. 7, 2009)(*quoting* Sections 3(a)(39) and 15(b)(4)(A) of the Securities Exchange Act of 1934), *aff'd*, 671 F.3d 210 (2d Cir. 2012).

[14] *Mathis*, 2009 SEC LEXIS 4376, at *32.

of FINRA's By-Laws imposes a continuing obligation on associated persons to update their Forms U4, stating that applications for registration "shall be kept current at all times by supplementary amendments … filed … not later than 30 days after learning of the facts or circumstances giving rise to the amendment."

Similarly, Article IV, Section 1(c) of the By-Laws imposes upon members a continuing obligation to amend their membership applications within 30 days of learning of changes required to be disclosed on the Form BD. And FINRA Rule 1122 mandates: "No member or person associated with a member shall file with FINRA information with respect to membership or registration which is incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or fail to correct such filing after notice thereof." Thus, a failure to disclose reportable facts on a form BD violates Rule 1122.

2. Materiality

Materiality is established when there is a "substantial likelihood that the disclosure" of a fact or event would be "viewed by the reasonable investor" as significantly altering "the 'total mix' of information" available.[15] The existence of financial problems leading to the filing against an associated person of judgments or liens in large dollar amounts is something that "'significantly' alter[s] the total mix of information made available to [FINRA], other regulators, employers, and investors" because it could be an indication that the broker is under "financial pressures."[16]

Accordingly, the Form U4 and Form BD contain questions specifically designed to elicit information about judgments and liens. Question 14M of Form U4 asks: "Do you have any unsatisfied judgments or liens against you?" And Question 11K of Form BD asks: "Does the

[15] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[16] *Mathis*, 2009 SEC LEXIS 4376, at *29-30.

applicant have any unsatisfied judgments or liens against it?" Because of the importance of full and accurate disclosure, it has been held that "essentially all the information that is reportable on the Form U4 is material."[17] Therefore, tax liens and judgments filed against an associated person or a member firm are material for the purposes of Form U4 filing requirements.[18]

3. Willfulness

The Securities and Exchange Commission has long held that an act is willful if it is volitional; that is, if a person performs the act intentionally, aware of what he is doing. The person need not know or intend that his action violates any regulation or law.[19] It is enough if a person knows or reasonably should know "under the particular facts and circumstances" that his conduct is improper.[20] As one court succinctly stated, '"willfully' simply requires the intentional doing of the wrongful acts--no knowledge of the rule or regulation is required."[21]

Thus, it is not necessary for the Hearing Panel to find that Respondents acted with a culpable state of mind, intending to violate FINRA rules. Rather, we must determine only whether they intentionally failed to make timely amendments to Dratel's Form U4 and DGI's Form BD.[22]

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[17] *Dep't of Enforcement v. Neaton*, No. 2007009082902, 2011 FINRA Discip. LEXIS 13, at *21 (N.A.C. Jan. 7, 2011)(*quoting Dep't of Enforcement v. Knight*, No. C10020060, 2004 NASD Discip. LEXIS 5, at *13 (N.A.C. Apr. 27, 2004)), *aff'd*, Exchange Act Rel. No. 65598, 2011 SEC LEXIS 3719 (Oct. 20, 2011).

[18] *Mathis*, 671 F.3d at 219-20, noting that in assessing the significance of a failure to disclose, it is appropriate to consider the number of judgments and liens, their dollar amount, and how long they were not disclosed.

[19] *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

[20] *Christopher LaPorte*, Exchange Act Rel. No. 39171, 1997 SEC LEXIS 2058, at *8 n.2 (Sep. 30, 1997).

[21] *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)(*quoting United States v. O'Hagan*, 139 F.3d 641, 647 (8th Cir. 1998)).

[22] *Scott Mathis*, Exchange Act Rel. No. 61120, 2009 SEC LEXIS 4376, at *18 (Dec. 7, 2009), *aff'd*, 671 F.3d 210 (2d Cir. 2012); *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

4. The Federal Tax Liens

On March 23, 2010, the Internal Revenue Service sent Dratel a letter notifying him that it had filed a lien against him for an unpaid balance of $291,342.41 owed for income taxes for 2007 and 2008.[23] The IRS sent the notice by certified mail to Dratel and his wife at their correct mailing address. Dratel is unsure when he received it, but admits that he did.[24] He identified a notation he made on the envelope, "4/5/10," which, according to him, "could be April or May" of 2010.[25] Dratel stated that he is certain that he "opened the envelope and looked at it" but "didn't pay attention to it" because he "was working with someone who was talking to the IRS and they did not mention anything about a lien."[26]

On September 13, 2010, the IRS sent Dratel a "Final Notice of Intent to Levy and Notice of Your Right to Hearing."[27] As with the March 23 letter, Dratel testified that he is unsure when he received this notice. Even though the notice expressly states that the IRS "may file a notice of federal tax lien at any time," Dratel claimed that he does not recall reading that language.[28]

A little more than a week later, on September 21, 2010, the IRS filed a second tax lien against Dratel, this one for $123,368.59. Dratel admitted he received notice of it by "at least late September."[29] Nonetheless, he claimed that he did not realize that the federal tax lien had been

[23] JX-17; Tr. 385-86.

[24] Tr. 45. In an on-the-record interview, Dratel testified he "probably" received it sometime around March 12, 2010, but he was not sure. Tr. 47.

[25] Tr. 50. The IRS filed the lien on March 12, 2010.

[26] Tr. 386-87.

[27] JX-21.

[28] Tr. 390-01.

[29] Tr. 53.

filed.[30] Dratel contends that he first became aware of the liens and judgments when FINRA informed him of their existence in late September 2010.[31]

Dratel testified that when he consulted an attorney who counseled him that it would be a "horrendous idea" to meet with the IRS by himself, he hired an accountant to accompany him. Dratel claimed that in the discussions with the IRS, the accountant made no mention of tax liens or judgments. [32] He began making payments in June 2010, and thereafter heeded the accountant's advice to keep them current or risk that his negotiated repayment plan would be "blown up."[33]

5. The New York State Tax Judgments

On September 10, 2009, New York state tax authorities issued a tax warrant for $42,487.84, reflecting a judgment against Dratel for his 2006 and 2007 state taxes.[34] They sent the warrant to the office address Dratel maintained until October 2009. Dratel testified that he does not recall when he received it,[35] but that he first saw it in October 2010 when a FINRA information request prompted him to search through his records.[36] By that time, he was already negotiating an installment payment plan with the state. Because the people with whom he negotiated the installment plan "never mentioned anything" about a judgment, he claims that he was excusably unaware of it.[37]

[30] Tr. 392.

[31] Tr. 403-04.

[32] Tr. 387-88.

[33] Tr. 389.

[34] JX-9.

[35] Tr. 56.

[36] Tr. 366.

[37] Tr. 368.

On April 19, 2010, New York state tax authorities issued a notice to Dratel of a second state tax warrant, which had been issued on February 22, 2010, in the amount of $31,061.38, for his 2008 taxes.[38] They sent the notice and warrant to Dratel's East Hampton mailing and business address, but it was several months after he had moved. Dratel acknowledged that he eventually received the notice and the warrant, but cannot recall when. The warrant explicitly stated that it was a money judgment against him that would be in effect for 20 years, unless Dratel paid it in full. He claims he is "not sure" that he "carefully" read it.[39]

6. The Bank Judgment

On March 13, 2009, American Express Centurion Bank filed a civil complaint against Dratel and DGI for failing to pay credit card debts. An affidavit of service certifies that the complaint was served on a "John Smith," described as Dratel's "co-worker," at DGI's East Hampton address on April 3, 2009.[40] Dratel testified that he was not served, and that he had no co-worker named John Smith.[41] The unanswered complaint resulted in a default judgment against Respondents jointly in the amount of $85,333.83 on December 14, 2009. Another affidavit of service attests to the mailing of a copy of the judgment to the East Hampton address on January 6, 2010, but this was several months after DGI had moved from East Hampton to Southold.[42] Dratel knew that he had not been paying what he owed on his American Express credit cards, and testified that he "may have gotten calls" from the bank seeking to negotiate, but "they were being unreasonable."[43]

[38] JX-19; Tr. 64.

[39] Tr. 66-67.

[40] JX-12.

[41] Tr. 399.

[42] JX-13; Tr. 397, 403-04.

[43] Tr. 396-98, 403-04.

However, the evidence does not establish that Dratel received actual notice of the bank's complaint. Dratel had no "John Smith" co-worker, and the complaint's affidavit of service is not credible evidence of service having been effected. There is also no evidence that the mailing of the notice of the subsequent judgment reached Dratel. The only evidence available is Dratel's uncontradicted testimony that he learned of the bank judgment from FINRA examiners in September 2010.

7. The 2010 FINRA Examination

Dratel testified that it was probably on September 22 or 23, 2010, that FINRA examiners gave him a copy of the bank judgment and informed him orally of the existence of other liens and judgments. According to Dratel, this was his first notice of the outstanding liens and judgments.[44] He stated that he spoke to his accountant and "started looking into it."[45] He claimed that he then "put it right on" his Form U4 and the firm's Form BD.[46] Because he had been unaware of the liens and judgments, he believes he did not willfully fail to disclose them. He claimed that as soon as he realized FINRA wanted him to disclose them, he did so.[47]

However, Dratel did not amend his Form U4 and DGI's Form BD until January 25, 2011, four months later.[48]

8. Dratel Knew of The Judgments and Liens

Dratel obtained advice from an attorney and an accountant on how best to deal with his substantial federal tax arrearages. They helped him negotiate with federal tax authorities, and on

[44] Tr. 404-06.

[45] Tr. 407.

[46] *Id.*

[47] Tr. 409.

[48] JX-26-27. The Complaint charges that Dratel failed to amend his Form U4 until January 11, 2011, but Enforcement states this was a typographical error. Dratel testified that at the time of the hearing, he was in the process of paying off the state and federal tax liens, and had paid in full the judgment against DGI that he disclosed on the Form BD. Tr. 411-12.

his own he negotiated with state authorities, to arrange terms for him to pay off the several hundred thousands of dollars he owed. These circumstances undermine the credibility of Dratel's claims that he did not know that he was subject to the filed liens and judgments. Although it is unclear when he received each federal and state notice, in part because he moved his office location to Southold in the time frame when the authorities sent notices to the East Hampton address, Dratel concedes he received at least some of the notices. Indeed, he provided notices he had received to FINRA examiners in late September or early October 2010. His handwriting on the envelope of the March 23, 2010, notice of the federal tax lien for almost $300,000 indicates he received it on "4/5/10," more than nine months before he amended his Form U4.[49]

Given these facts, the Hearing Panel rejects Dratel's assertions that he was oblivious to the existence of the tax judgments and liens until after FINRA examiners provided evidence to him during the September 2010 examination. Dratel is an astute businessman with many years of experience in the securities industry, and he is a lawyer. Dratel's repeated claims of ignorance of the outstanding judgments and liens, and his inability to recall when he received various notices, are conveniently self-serving. We do not credit his claim that when he received the notice of the second state tax warrant, he looked at but failed to "carefully" read it. It is unreasonable that he would ignore a document so important to him and his firm, relating to the substantial debts of which he was clearly aware.

At the hearing, Dratel claimed that his inattention to the notices, and disregard of the judgments and liens, should be excused by the fact that he was arranging to make installment payments to the tax authorities. In his words, if he "had a payment plan set up, there was no

[49] JX-17.

lien."[50] In his view, being engaged in negotiating terms of payment for his tax arrearages allowed him to ignore the liens and judgments. In his words, again: "I didn't know I had the liens because I had payment plans … in discussion through an accountant with the IRS."[51]

We find these contentions without merit. Discussing a payment plan with the IRS and state tax authorities did not permit Dratel to shrug off the existence of the liens and judgments and did not relieve him of the obligation to disclose them on his Form U4.[52]

9. The Judgments and Liens Were Material

When asked if he believed the liens and judgments were material events, Dratel replied, "It depends what you mean by material event." He questions their materiality because, after he disclosed the judgments and liens, no businesses called him to inquire about them, none of his customers called to ask about them, and no customers withdrew their accounts.[53] Therefore, he contends, the liens and judgments did not affect the "total mix" of information in his customers' possession, and they must have been immaterial to his customers. He concedes, however, that they were not immaterial to FINRA.[54]

The Hearing Panel is not persuaded by Dratel's belittling of the materiality of the liens and judgments. Their number (two federal liens, two state judgments), the large dollar amounts owed (totaling almost half a million dollars), and the length of time during which Dratel chose

[50] Tr. 77-78.

[51] Tr. 79.

[52] *Mathis*, 2009 SEC LEXIS 4376, at *20 (Rejecting Respondent's contentions that his "understanding that a person was subject to a lien [only] when they are denied access to their assets, *i.e.*, an asset attachment" and that "having worked out a payment schedule with the IRS, it was quite reasonable for him" to conclude that he need not amend his Form U4).

[53] Tr. 410-11.

[54] Tr. 485-88.

not to amend his Form U4, are more than sufficient to establish the materiality of the judgments and liens.[55]

10. Respondents Willfully Failed to Make Timely Disclosures

The Hearing Panel finds that Dratel was on notice of the federal tax lien described in the March 23, 2010, letter from the IRS, from at least April 5, 2010, the date he wrote on the envelope. This was over nine months before he disclosed it on his Form U4. We further find that Dratel was aware of the second federal tax lien, the two state judgments, and the American Express Centurion Bank judgment against DGI at least by September 23, 2010, when Dratel admits FINRA examiners brought them to his attention. This was four months before he disclosed them on January 25, 2011.

In each instance, Dratel failed to amend his Form U4, and Respondents failed to amend DGI's Form BD, within 30 days of learning of changes of facts and circumstances that required the amendments. Because Respondents intentionally failed to act as required by Article V, Section 2(c) of FINRA's By-Laws, they willfully violated FINRA Rules 1122 and 2010.[56] By operation of Exchange Act Sections 3(a)(39) and 15(b)(4)(A), Respondents are therefore subject to statutory disqualification.[57]

C. Respondents Willfully Failed to Create and Maintain Order Memoranda

[55] *Mathis*, 2009 SEC LEXIS 4376, at *29-30.

[56] *Wonsover*, 205 F.3d at 414.

[57] "A person who willfully makes a false or misleading statement or a material omission in a Form U-4 is subject to the penalty of statutory disqualification. Exchange Act § 3(a)(39)(F), 15 U.S.C. § 78c(a)(39)(F)." *Mathis*, 671 F.3d at 212.

The Exchange Act requires members and associated persons to create and maintain records of business operations in conformity with SEC rules.[58] In turn, SEC rules mandate that members create and maintain a memorandum of each customer order for a minimum of three years.[59] NASD Conduct Rule 3110(a) makes members responsible for complying with these SEC rules. NASD Rule 3110(j) provides that before a customer order is executed, the account name or designation must be placed upon the memorandum for each transaction, and that any change to an order memorandum, including designating the order to an error account, must be documented and preserved for a minimum of three years. The documentation must explain the essential facts relied upon by the person approving the change.

The Complaint's third cause of action concerns trades that Dratel executed in DGI's riskless principal accounts for customers or for his own account, and subsequently cancelled and rebilled to DGI's error account. DGI's trade blotter reflects that between January 2009 and December 2010, there were approximately 300 trades with errors.[60] The charge is that Respondents willfully failed to create and preserve the required documentation for the cancellations and rebills to the error account.

When FINRA examiners asked Dratel to produce all records relating to error account transactions from January 2009 to September 7, 2010, he was unable to do so. Dratel had thrown

[58] Exchange Act § 17(a)(1).

[59] SEC Rule 17-3(a)(6) and (7).

[60] Tr. 121-23. The Complaint originally alleged there were 75 trades. In its Pre-Hearing Memorandum and at the hearing, Enforcement represented that this was a mistake. With no objection from Respondents, Enforcement amended the third cause of action to read that there were approximately 300 trades. Enforcement's Pre-Hearing Mem. 9 n.3; Tr. 441-42.

away the tickets reflecting the erroneous trades.[61] Respondents had not maintained any other record of the details of trades placed in the error account.[62]

Dratel testified that, relying on customer account statements, he could reconstruct the various reasons the trades were erroneous. He demonstrated familiarity with the details of many of the trades, some occurring as long as four years ago, and offered explanations for the errors.[63] Most involved day trades in which he testified that he exceeded his "buying power," buying when he had insufficient funds to pay for the orders.[64] On other occasions, misunderstandings with customers about their instructions caused him to journal purchases from customer accounts into the error account.[65]

Respondents argue that the absence of order documentation is inconsequential because "between the account statements and Mr. Dratel's P&L you have a record of what the original trade was or an explanation of it. So that these documents together would reflect the record of the error."[66] But even if Dratel can now explain what occurred, the ability to give a post-trade explanation of "the record of the error" does not satisfy the requirements of NASD Rules 3110(a) and (j).

The record establishes that Respondents executed approximately 300 trades and then cancelled and rebilled them to DGI's error account without preparing and preserving order memoranda designating the customer accounts for which the trades were originally intended.

[61] Tr. 145-46.

[62] Tr. 153-54.

[63] Tr. 307-61.

[64] Tr. 307-08, 311.

[65] Tr. 312-13.

[66] Tr. 341.

Respondents failed to document the essential facts Dratel relied upon to cancel and rebill. Respondents therefore willfully violated the SEC, NASD, and FINRA rules cited above.

D. Respondents Failed to Preserve E-mail Communications

SEC Rule 17a-4(b)(2) requires members to preserve originals of all business-related communications they receive, and copies of all communications they send. NASD Rule 3110(a) requires members to preserve their correspondence in accord with SEC Rule 17a-4.

The fourth cause of action alleges that Respondents willfully failed to preserve messages sent from and received by DGI's e-mail domain for nine months, from December 2008 through August 2009.

In November 2008, Respondents contracted with a third-party provider, Smarsh, Inc., to "manage" DGI's e-mail services, and to archive the firm's e-mail as required by SEC Rule 17a-4.[67] Unfortunately, because of a malfunction, the system did not archive most of DGI's e-mails.

Smarsh notified Dratel of the malfunction on December 22, 2008, by e-mail. The subject line of the e-mail reads: "Archiving issue – invalid MX records detected." The message describes "an issue with your domain," requests DGI to remove certain "invalid records," and closes with the warning: "Failure to do so will result in a compliance issue, as not all mail sent or received for your domain will be archived."[68]

Dratel testified that when he received this message, he instructed an employee to contact Smarsh and solve the problem. The employee reported back to Dratel that the problem had been corrected.[69] Because Dratel was able to send and receive e-mails as before, because he continued

[67] JX-32, at 4-5.

[68] JX-35, at 2.

[69] Tr. 95.

to be billed for the services, and because he heard nothing further about the issue from Smarsh, he assumed the issue had been resolved. He did not seek confirmation that the system was properly archiving e-mails.

Each month, Smarsh sent him disks of archived e-mails. When asked if he checked the Smarsh disks to ascertain whether DGI's business e-mails were being archived, Dratel answered that he looked "at some of them." He noticed that they contained few e-mails, but thought nothing of it because at the time he was not a heavy user of e-mail.[70]

Months later, on July 27, 2009, Dratel received another message from Smarsh about the problem, with the subject line "e-mails not being archived for dratelgroup.com." At about that time, in response to a FINRA request for his e-mails, Dratel asked Smarsh to provide him a disk containing all of his e-mails from February 1, 2009, through April 30, 2009.[71] When he reviewed the disk and saw how few e-mails it contained,[72] he realized there was a continuing malfunction. He had it resolved by August 8, 2009.[73]

The Hearing Panel finds that Respondents failed to preserve e-mail correspondence related to DGI's business, as they were required to do. Having been put on notice of the malfunction in late December 2008, Dratel was negligent in not following up to ensure that it was corrected. The Hearing Panel therefore finds that DGI violated SEC Rule 17a-4 and FINRA Rule 2010, and Respondents violated NASD Rule 3110(a) and FINRA Rule 2010. However, there is no evidence to contradict Dratel's testimony that he directed an employee to have the problem remedied, and believed, mistakenly, that it had been. Thus,

[70] Tr. 99-100.

[71] JX-36; Tr. 90.

[72] Tr. 91.

[73] Tr. 92.

although Respondents were negligent, they did not intentionally fail to preserve e-mail. And they took action, albeit unsuccessfully, to rectify the malfunction. The violations were inadvertent, minor, and not willful.

E. Respondents Compensated Customers for Losses

NASD Rule 2330(f) and FINRA Rule 2150 prohibit members from sharing "directly or indirectly in the profits or losses in any account of a customer" except under certain defined circumstances.

The fifth cause of action charges that Respondents, from January 2008 through February 2011, paid a total of $156,575 to a select group of customers. Dratel admits making the payments, but denies he did so to compensate the customers for losses.[74]

A common denominator of the payments was that Dratel made them to long-term, elderly clients who had known his father. According to Dratel, many were accustomed to making monthly withdrawals from their accounts. All of them had lost money in their accounts starting in December 2007.[75] He paid some when their accounts shrank to a level that would not permit them to make their regular monthly withdrawals;[76] he paid others to cover margin calls.[77] Dratel testified that he did not pay the customers to retain their business because most of their accounts were inactive.[78]

While denying that the payments were compensation for his customers' losses, Dratel admitted that, as their money manager, he felt responsible for the losses inflicted upon them by

[74] JX-42; Tr. 195, 237.

[75] Tr. 159.

[76] Tr. 196-98, 200.

[77] Tr. 211-20.

[78] Tr. 199.

adverse market conditions.[79] He insisted that he paid them "because of the relationship and because of my father,"[80] and because it was "the right thing to do under the circumstances."[81]

Although other customers suffered similar or greater losses during the same period, Dratel testified he did not feel obliged to pay them because he did not manage their money, or they were not accustomed to taking monthly withdrawals, or they had not been close friends of his father.[82]

In the beginning, from January 2008 until June 30, 2009, Dratel paid 15 customers from DGI's account, with some customers receiving as little as $25 and others receiving as much as $1,000 monthly. All told, the 15 customers received DGI funds totaling $31,075.[83]

In 2009, according to Dratel, a FINRA examiner informed him that he should not be paying customers through the firm. He then started paying them from his personal checking account. From June 2009 until February 2011, Dratel made monthly payments to six customers in amounts ranging from $1,000 to $3,000, for a total of $125,500.[84]

Despite Dratel's denial that he shared customer losses, Respondents paid select, favored customers because of losses they suffered in their DGI accounts, for which Dratel felt responsible as their money manager. NASD Rule 2330(f) and FINRA Rule 2150 explicitly forbid, except under certain circumstances inapplicable here, directly or indirectly sharing in profits or losses in any customer account. As the National Adjudicatory Council found when confronted with a roughly comparable situation, the rules impose "a flat ban … on sharing losses

[79] Tr. 160.

[80] Tr. 224.

[81] Tr. 162.

[82] Tr. 228.

[83] JX-42, at 5-7.

[84] JX-42, at 1-4.

in a customer's account" and a "broker who contributes his own assets" to a customer's account "because he wants to 'put something back in' to offset trading losses is 'sharing' those losses in any sense of the word."[85] Thus Respondents clearly ran afoul of NASD Rules 2330(f) and 2110, for the payments they made to customers from January to December 15, 2008, and FINRA Rules 2150 and 2010, for the payments they made from December 15, 2008, through February 2011, for a total of $156,575.

F. Respondents Executed Municipal Securities Transactions Without Being Registered With MSRB, and Without A Registered Municipal Securities Principal

MSRB Rule G-2 forbids any broker or dealer from engaging in any municipal securities transaction without being qualified pursuant to the requirements of the MSRB. MSRB Rule G-3 requires firms with fewer than 11 associated persons to have at least one qualified municipal securities principal.

The Complaint's sixth cause of action charges that Respondents executed at least 23 municipal securities transactions from February through May 2009, when DGI was not registered with the MSRB, and had no registered municipal securities principal.

Dratel testified that DGI had been registered with MSRB from March 1980 to 2000, but he let the registration lapse because he stopped trading municipal bonds.[86] In February 2009, "a great time to be buying bonds," he resumed purchasing municipal bonds. The fact that DGI's MSRB registration had lapsed slipped his mind and "didn't hit" him at first.[87] He was unable to

[85] *Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *56-57 (N.A.C. June 25, 2001). The respondent in *Reynolds* offered an explanation in defense of the charge of compensating customer losses that is similar to Dratel's. The respondent stated: "I had lost some money in my grandad's account, and I felt bad and I wanted to put something back in." *Id.* at *56. Here, Dratel testified, "I felt that [the customer] shouldn't suffer for my mistakes," and "they gave their trust to me and my father and that is the most important thing." Tr. 197, 203.

[86] Tr. 107-08.

[87] Tr. 112-13.

recall exactly when, but stated that he "woke up one night," realized that because he was doing municipal bond trading DGI should be registered,[88] and the firm needed to acquire a qualified Series 53 Registered Municipal Securities Principal.[89]

Dratel testified that he immediately acted to rectify these deficiencies.[90] In April he arranged for an employee to take the Series 53 test, which she passed in June, 2009.[91] DGI registered with MSRB on May 18, 2009, before the annual FINRA examination occurred.[92]

These facts establish that Respondents engaged in municipal securities transaction while DGI was not registered with MSRB, and while the firm lacked a Registered Municipal Securities Principal, in violation of MSRB Rules G-2 and G-3.

G. DGI Failed to Report Municipal Securities Transactions to MSRB

MSRB Rule G-14 requires municipal securities dealers to report to MSRB "information about each purchase and sale transaction effected in municipal securities to the Real-time Transaction Reporting System ("RTRS") in the manner prescribed by Rule G-14 RTRS Procedures and the RTRS Users Manual." The manual, in turn, requires municipal securities dealers to report transactions to RTRS, in most instances within 15 minutes of each transaction.

The Complaint's seventh cause of action charges, and the evidence establishes, that DGI failed to report the 23 municipal bond trades described above to MSRB, failed to file a required form with RTRS, and failed to test its ability to interface with RTRS, in violation of MSRB Rule

[88] Tr. 108-09.

[89] Tr. 107.

[90] Tr. 112-13.

[91] Tr. 108.

[92] Tr. 257.

G-14.[93] After FINRA's 2009 annual examination of DGI, FINRA staff informed Dratel of this reporting failure,[94] and DGI then reported the trades.[95]

While admitting that DGI failed to report these municipal securities transactions,[96] Dratel disagrees as to the number of trades, insisting that there were only five.[97] The disagreement between the parties about the number of trades results from Dratel's incorrect assumption that he needed to report only the block purchases of bonds, not the sales to individual customers immediately thereafter.[98]

As for the firm's failure to comply with the RTRS requirements, Dratel testified that prior to 2000, when DGI had been registered with MSRB, RTRS did not yet exist. He learned of the necessity of acquiring an interface and filing a form with RTRS when he contacted the MSRB to register DGI anew in May 2009. In July 2009, he satisfied these requirements.[99]

H. DGI Failed to Report Corporate Bond Trades to TRACE

FINRA Rule 6720 requires members to execute a TRACE participation agreement, and Rule 6730 requires them to report to TRACE each transaction in TRACE-eligible securities, such as corporate debt securities, within 15 minutes of execution.

The Complaint's eighth cause of action charges that, from March 3 through May 5, 2009, DGI executed 38 customer transactions in corporate bonds that should have been reported to

[93] JX-45.

[94] JX-1.

[95] JX-2, at 9, 14-15; Enforcement's Pre-Hearing Mem. 25 n.33.

[96] Tr. 268.

[97] Tr. 107.

[98] Tr. 112.

[99] RX-6; Tr. 263-65.

TRACE.[100] They were not reported because DGI had not completed a TRACE participation agreement.

Dratel testified that prior to the transactions in March 2009, DGI's last previous corporate bond trade took place "probably around 2002,"[101] which was, he believed, before TRACE existed. He testified that he was therefore unaware that DGI needed to be a TRACE participant and to report corporate bond transactions to TRACE.[102] He engaged in corporate bond trades through a number of firms before his clearing firm informed him that DGI needed to execute a TRACE participation agreement. He executed an agreement shortly thereafter, in June 2009.[103]

DGI's failure to report the 38 executions thus violated FINRA Rules 6720, 6730, and 2010.

I. Respondents Maintained Inaccurate Trial Balances and Ledgers

Exchange Act Section 17a, and SEC Rule 17a-3 thereunder, require firms to maintain and keep current books and records reflecting their assets and liabilities. It is well established that such books and records must be accurate.[104]

Dratel acknowledges that, as DGI's General Securities Principal, it is one of his responsibilities to ensure that all entries in DGI's books and records are posted timely, including the firm's general ledger and trial balances. The firm's trial balance and general ledgers for April and May 2009 purport to reflect credits and accrued expenses.[105] The ninth cause of action

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[100] JX-48.

[101] Tr. 103, 279-80.

[102] Dratel maintained he was unaware of TRACE even though DGI's written supervisory procedures describe TRACE reporting requirements. Tr. 104.

[103] Tr. 280-83; JX-50, at 24. Once again, Dratel takes issue with the number of transactions DGI is alleged to have failed to report to TRACE. Tr. 277. As with the municipal bond transactions, Dratel incorrectly assumes that after the purchase of a block of bonds, it is unnecessary for DGI to report each sale to a customer. Tr. 277-78.

[104] *Voss & Co.*, 47 S.E.C. 626, 632 (1981).

[105] JX-62, 66; Tr. 165-68.

charges that Respondents failed to include three then-current liabilities totaling approximately $40,392, consisting of (i) overdue rent for an apartment; (ii) moving and storage expenses; and (iii) a security deposit the firm owed for its Broad Street branch office.[106]

1. Apartment Rent Arrearage

In 1983, DGI rented an apartment in New York. DGI remained the sole tenant on the lease until 2003, when DGI sublet the apartment to a friend of Dratel.[107] According to Dratel, the subtenant was responsible for paying the rent, but had withheld payment because of a dispute with the landlord over maintenance issues.[108] In early 2009, the apartment management obtained a default judgment and warrant of eviction against DGI for non-payment of rent.[109] In April 2009, Respondents filed an emergency show cause petition to stay the eviction and vacate the judgment. Dratel signed an affidavit in support of the emergency petition in which, among other things, he represented that he was willing to make a substantial payment to reduce the arrearage.[110] DGI and the apartment management company settled the matter, recording the settlement in a stipulation in which the firm acknowledged owing $24,376.84 in unpaid rent through April 2009.[111]

[106] Compl. ¶¶ 50-51; Tr. 169.

[107] Tr. 173.

[108] Tr. 175.

[109] Tr. 176.

[110] JX-51, at 4-7.

[111] JX-51, at 1. Dratel denied authorizing the attorney representing him in the rent dispute to sign the stipulation on his behalf. Tr. 415.

When FINRA inquired about the judgment, Respondents claimed they were "unaware of any judgment or lien" against DGI from the apartment management company.[112] Because the rent was payable by his friend, pursuant to the terms of the sublease, Dratel insists that the arrearage was his friend's responsibility and was not a liability of DGI.[113]

The facts belie Dratel's denial that Respondents were unaware of the judgment. Indeed, at the hearing, Dratel conceded that he saw the judgment before signing the affidavit in support of the show cause petition,[114] and that he knew if his friend failed to pay the rent, DGI would have to pay it.[115] Dratel's argument that DGI was relieved of the obligation to accrue the overdue rent because its sublessee was responsible for the rent is unavailing. Respondents remained ultimately responsible for the unpaid rent, and the judgment represented a liability that they were required to include on DGI's trial balance and general ledger; however, no portion of the arrearage appeared on either the trial balance or ledger for April and May 2009.[116]

2. Moving and Storage Expenses

In its December 2009 examination report, FINRA informed Respondents that they had failed to include a bill for $3,580 for moving and storage expenses owed by DGI as a liability on their trial balance and general ledger in April 2009.[117] In their response, Respondents did not contest this assertion, and at the hearing, Dratel acknowledged that Respondents had not

[112] JX-2, at 4-5; Tr. 169-70.

[113] Tr. 179.

[114] Tr. 176-77.

[115] Tr. 174. In addition, the terms of the sublease between Dratel and his tenant provide that the tenant must notify Dratel of any management failure to fulfill its responsibilities as landlord, so that Dratel could demand management do so as required by the original lease terms. RX-7, at 44-45.

[116] JX-62, JX-66.

[117] JX-1, at 6-7.

included it as an accrued liability as required in their April trial balance and general ledger, but did so in May 2009.[118]

3. Broad Street Office Security Deposit

On February 3, 2009, DGI entered into a lease for office space on Broad Street in New York City.[119] The lease agreement required a security deposit of $9,362.49 in the form of an irrevocable letter of credit.[120] On March 12, 2009, the landlord notified Dratel that the letter of credit had not been provided.[121]

Dratel claims that Respondents were negotiating with the landlord to reduce the amount of the security deposit. He argues that, in any event, the letter of credit was not a liability, but a receivable.[122] However, Respondents did not provide the security deposit to the landlord and did not list it as an accrued expense in April or May.[123]

FINRA informed Dratel that it disagreed with his characterization of the security deposit as a receivable and, after May 2009, Dratel listed the security deposit as a liability on DGI's trial balance and ledgers. He testified that he did so only because FINRA insisted, and he "didn't want to fight any more."[124] He argues that because he "gave [FINRA] exact reasons" for not accruing this as a liability, failing to accrue it "couldn't have been willful."[125]

Whether or not Dratel reasonably believed the letter of credit, when delivered, would be a receivable, Respondents did not deliver it to the landlord for months, during which time the

[118] Tr. 170-71.

[119] JX-58, at 2.

[120] JX-58, at 7.

[121] JX-58, at 1.

[122] JX-2, at 5; Tr. 413.

[123] Tr. 180-81.

[124] Tr. 419.

[125] Tr. 420.

security deposit was due and payable. The Hearing Panel finds that in April and May 2009, it constituted a liability and Respondents should have posted it as such on their books. They elected not to do so.

Based upon these facts, the Panel finds that Respondents willfully violated Exchange Act §17(a), SEC Rule 17a-3, NASD Rule 3110, and FINRA Rule 2010 by failing to record the apartment rent arrearage and security deposit as accrued liabilities on their April and May 2009 trial balance and general ledger, and the moving and storage expenses as a liability on their April trial balance and general ledger.

J. Dratel Failed to Establish, Maintain and Enforce Supervisory Control Systems

NASD Rule 3012 requires each member firm to establish, maintain and enforce supervisory control policies and procedures to test and verify that the member's supervisory procedures are reasonably designed to achieve compliance with applicable securities laws and regulations, and to adjust the procedures when testing indicates the need to do so. The Rule requires each member to file an annual report which details the member's supervisory control system, summarizes test results, and describes changes made in response to the results. The requirement applies to sole proprietorships like DGI, as well as to large firms.[126]

Rule 3012 also requires each member to have a person senior to a producing manager conduct supervisory reviews of the producing manager's account activity. Dratel relied on the "limited size and resources exception" under Rule 3012 that applies to small firms with such limited personnel and resources that there is nobody senior to or independent of the producing

[126] *NASD Notice to Members 05-29*, at n.5.

manager to conduct the required supervisory reviews.[127] But the small firm exception did not allow Dratel to supervise his own sales activity, as explained below.

The Complaint's tenth cause of action charges Dratel with violations relating to the "Annual Compliance Report Regarding NASD Rule 3012 and FINRA Rule 3013" that Dratel submitted for the year ending on December 31, 2009 (the "2009 report"). The Complaint alleges that the report was inadequate because it did not summarize the results of testing DGI's supervisory procedures, and did not describe any changes to the firm's supervisory procedures in response to test findings. The 2009 report appears to consist in large part of sections copied and pasted from annual compliance reports from 2007 and 2008,[128] which FINRA had previously informed Dratel were deficient.[129] The Complaint also charges Dratel with failing to establish procedures and policies to provide heightened supervision over his own sales activities, necessitated by the fact that he is solely responsible for all of the firm's securities sales and purchases.

Regulatory Support Services, a third-party vendor, prepared the 2009 report using information Dratel provided.[130] As Dratel admitted in testimony, the 2009 report contains no description of supervisory controls and procedures designed to test and verify DGI's procedures relevant to the violations discussed above, including procedures for: reporting judgments and liens; creating and preserving memoranda of orders and order tickets; documenting trade errors; and performing proper trade reporting. In addition, the report has no summary of the results of tests conducted to verify the adequacy of the firm's supervisory policies and procedures, and

[127] JX-72, at 3; Tr. 183.

[128] *See* JX-68, JX-69, JX-72.

[129] JX-3, at 1, 13-14.

[130] Tr. 182.

consequently identifies no deficiencies or changes made to correct them.[131] But Dratel insists nonetheless that the report is adequate because he is "testing all the time … keeping up with all the rules and all the changes" and if "something is not … proper … I get it taken care of."[132]

The report acknowledges that Dratel is a producing manager, and that DGI should establish and maintain procedures for day-to-day supervision of his customer account activity.[133] Dratel admitted that he supervises himself, and that DGI has no procedure for reviewing his activity as a producing manager, even though in 2009 one of his two employees was a registered principal.[134] Dratel claimed not to understand how he could have his customer account activity supervised as required, implying that because DGI is a "one-man shop" it is impossible for anyone to supervise him.[135] He pointed out that an addendum to DGI's written supervisory procedures specifically states that "Dratel does not have associated persons who can conduct supervisions and are senior or 'otherwise independent' from himself."[136]

However, it is well established that in the securities industry, particularly with regard to sales activity, one cannot supervise oneself.[137] The small-firm exception does not excuse a "one-man shop" from complying with Rule 3012; rather, it allows the small firm the flexibility of

[131] Tr. 185-87.

[132] Tr. 422-23.

[133] JX-72, at 3.

[134] Tr. 183, 422.

[135] Tr. 425.

[136] JX-67, at 4.

[137] *Hans N. Beerbaum*, Exchange Act Rel. No. 55731, 2007 SEC LEXIS 971, at *7 n.8 (May 9, 2007)(*citing Kirk Montgomery*, 55 S.E.C. 485, 504 & n.43 (2001)("[i]t is unreasonable to expect a salesperson to supervise himself")); *Bradford John Titus*, 52 S.E.C. 1154, 1158 (1996)(salesperson could not supervise himself); *Stuart K. Patrick*, 51 S.E.C. 419, 422 (1993)("[s]upervision, by its very nature, cannot be performed by the employee himself"), *aff'd*, 19 F.3d 66 (2d Cir. 1994).

designating "a principal who is sufficiently knowledgeable" of the firm's supervisory control procedures to conduct the necessary supervisory reviews of the producing manager.[138]

The Panel finds that throughout 2009 Dratel failed to provide for supervision over his sales activities as the sole producing manager responsible for all of DGI's revenues, failed to establish and enforce supervisory control systems, failed to detail DGI's system of supervisory controls, and failed to test and verify DGI's supervisory procedures. As a consequence, the 2009 Rule report failed to summarize test findings and changes made to respond to test results, because there were no test findings. In these ways, Dratel violated NASD Rule 3012 and FINRA Rule 2010.

K. Dratel Failed to Certify Compliance and Supervisor Processes

FINRA Rule 3130 requires each member firm's chief executive officer to certify annually that the firm has processes to establish, maintain, and review policies and procedures reasonably designed for the firm to comply with applicable rules, laws and regulations, modify the policies and procedures as needed, and test them periodically. All of this is to be documented in a report reviewed by the chief executive officer.

The Complaint's eleventh cause of action charges Dratel with failing to provide proper certification of DGI's compliance and supervisory processes for 2009.[139]

On February 23, 2010, Dratel submitted an Annual Compliance and Supervision Certification for 2009.[140] It is a rote recitation of the requirements of Rule 3130(b). It refers to

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[138] *See* www.finra.org/Industry/Issues/SupervisoryControl/P037999.

[139] The eleventh cause of action alleges that the Rule 3130 report was for the year ending December 2010, but this is clearly a typographical error, as the report, submitted on February 23, 2010, expressly states that it relates to the year ending December 31, 2009, and testimony makes this clear as well. Tr. 188.

[140] JX-72, at 5.

the Rule 3012 report stating "Dratel's processes … are evidenced in a report reviewed by the Chief Executive Officer, Chief Compliance Officer, and such other officers as Dratel may deem necessary … and the final report has been submitted to Dratel's board of directors and audit committee."[141] When asked if DGI has a board of directors and audit committee, Dratel responded, "Me."[142] When asked where the "processes" were evidenced, Dratel responded, "It is an ongoing thing every day." When pressed further to identify where they are described in the report, Dratel said, "I don't know."[143]

These facts establish that Dratel's certification did not, as Rule 3130 requires, document DGI's processes for establishing, maintaining, reviewing, testing and modifying compliance policies reasonably designed to achieve compliance with the applicable securities laws, regulations, and rules, and therefore Dratel violated FINRA Rules 3130 and 2010.

III. SANCTIONS

A. Failure to Amend Form U4 and Form BD: Causes One and Two

For failing to make timely amendments to a Form U4, FINRA's Sanction Guidelines recommend a fine of $2,500 to $50,000, and consideration of a suspension for five to 30 business days for individuals. In egregious cases, the Guidelines recommend a longer suspension in any or all capacities for up to two years or a bar.[144] The Guidelines do not address failure to make timely amendments to a Form BD.

Estimating that Dratel failed to disclose the liens and judgments over a period of 16 months, Enforcement characterizes Dratel's failures to disclose the liens and judgments as

[141] *Id.*

[142] Tr. 189.

[143] Tr. 190.

[144] *FINRA Sanction Guidelines* 69-70 (2011).

egregious.[145] Enforcement cites Respondents' relevant disciplinary history, which consists of a Letter of Acceptance, Waiver and Consent filed in July 2006, containing findings, among others, that DGI through Dratel failed to report information about a settlement with a public customer, and failed to amend Dratel's Form U4 to disclose a customer complaint.[146] Although the settlement occurred approximately eight years ago, Enforcement contends that it should have sharpened Dratel's awareness of the need to make timely amendments to his Form U4, and it is a factor in the Panel's sanction analysis.[147]

In its Pre-Hearing Memorandum, Enforcement recommended a suspension of not less than nine months for Dratel, and a fine of not less than $100,000, with $85,000 payable by Respondents jointly and severally, and $15,000 payable by DGI.[148] At the conclusion of the hearing, Enforcement tempered its recommendation significantly, now recommending a suspension of three to six months.[149] For his part, Dratel minimizes the failure to make timely amendments to his Form U4 and the firm's Form BD, pointing out that after FINRA first informed him of the reportable events in late September 2010, he made the amendments in January 2011.[150]

The Hearing Panel concludes that Dratel's failures to amend his Form U4 in a timely manner, and Respondents' failure to amend the firm's Form BD, were serious, but not egregious. As we have found, Dratel neglected to disclose the first federal tax lien, which he received on

[145] Enforcement's Pre-Hearing Mem. 30-31. Because the evidence of when Dratel received notice is unclear, Enforcement's estimate is necessarily speculative.

[146] *Id.* at 5.

[147] Tr. 81.

[148] Enforcement's Pre-Hearing Mem. 29. Enforcement did not specify in what capacities Dratel should be suspended.

[149] Tr. 456-57.

[150] Tr. 489.

April 5, 2010, in the amount of close to $300,000, for approximately nine months, and he neglected to disclose the others, amounting to over $200,000, for a period of approximately four months. These are not minor lapses; the judgments and liens are for significant sums. Their large dollar amount, their number, and the length of time they were undisclosed, are all factors underscoring the materiality and importance of the judgments and liens to regulators, and to investors as well.[151] Our finding that the violations were willful is also a factor in our sanctions analysis, because it triggers the additional consequences of statutory disqualification, as discussed above.

For these reasons, the Hearing Panel concludes that suspending Dratel from associating with any FINRA member firm in any capacity for 15 business days, and imposing a fine of $5,000 upon Respondents jointly and severally will sufficiently promote the remedial purposes of FINRA's disciplinary sanctions, to deter Dratel and others from similar future misconduct.[152]

B. Recordkeeping Violations: Causes Three and Four

1. Failure to Create and Preserve Order Memoranda: Cause Three

For books and records violations of NASD Rule 3110, FINRA Rule 2010, and SEC Rules 17a-3 and 17a-4, the Guidelines recommend a fine of $1,000 to $10,000, and consideration of a suspension in any or all capacities or functions for up to 30 business days. In egregious cases, the Guidelines recommend considering a suspension for up to two years in any or all capacities or functions, or expulsion of the firm and a bar of the responsible individual, and a fine of $10,000 to $100,000.[153]

[151] *Mathis*, 2009 SEC LEXIS 4376, at *29-30.

[152] *Guidelines* at 2 (General Principle No. 1).

[153] *Id.* at 29; Tr. 462.

Enforcement characterizes Respondents' failure to preserve order memoranda and document trade errors properly as egregious. Enforcement argues that Dratel's claimed ability to reconstruct the reasons for the errors from the available records is irrelevant. Enforcement further points out that the lack of accurate contemporaneous records prevented FINRA and other regulators from being able to see the nature of the errors, and recommends a fine of $20,000 to deter Dratel and others from similar misconduct.[154]

Dratel argues that he thought he was documenting the trade errors in the appropriate way, and the impact was minimal because most of the errors resulted in losses in his own account.[155]

The Hearing Panel notes that Dratel testified that he threw away the trade tickets for the erroneous trades. The consequence is, as Enforcement stresses, that regulators are incapable of determining the reasons for errors in approximately 300 trades over a period of two years. There is no reason to dispute Dratel's explanations as to the reasons for the errors, but the result is not a de minimis frustration of the purpose of the recordkeeping rules.

Taking these factors into consideration, the Panel concludes that for these violations, to deter Respondents and others from similar willful disregard of the recordkeeping rules, it is appropriate to suspend Dratel from associating with any FINRA member firm in any capacity for five business days and to impose a fine of $10,000 upon Respondents jointly and severally.

2. Failure to Preserve E-mail Communications: Cause Four

The Hearing Panel finds mitigating circumstances that make Respondents' inadvertent failure to preserve e-mails far less serious than the above violations. After being notified of the issue, Dratel appropriately directed an employee to contact Smarsh, and the employee reported to him that the problem had been remedied. Although Dratel did not follow up to confirm the

[154] Enforcement's Pre-Hearing Mem. 31; Tr. 461-62.

[155] Tr. 495-96.

resolution of the issue, he reasonably concluded that the system had been repaired because he continued to be able to send and receive e-mails, and Smarsh continued to provide reports and bill him for the service. Because Dratel did not send or receive large numbers of e-mails, he was unconcerned that the disks of archived e-mails contained only a few. After FINRA requested a copy of archived e-mails for a three-month period, Dratel realized there was an archiving failure, and he resolved it shortly thereafter. For these reasons, the Hearing Panel concludes that a fine of $1,000 imposed upon Respondents jointly and severally will suffice to deter Respondents and others from similar negligence.

C. Sharing Customer Losses: Cause Five

The Guidelines do not address the precise misconduct involved in Respondents' violations of NASD Rules 2330 and 2110, and FINRA Rules 2150 and 2010. The NAC has found the Guideline for guaranteeing a customer against loss to be the most applicable one.[156] This Guideline recommends imposing a fine of $2,500 to $25,000, and considering a suspension of up to 30 business days, or, in egregious cases, a suspension of up to two years or expulsion of a firm or a bar of an individual.[157]

Enforcement argues that "a substantial sanction is warranted to deter Respondents and others from knowingly disregarding" the rules prohibiting sharing customer losses.[158] Taking into consideration that Dratel did not make the payments to conceal misconduct, or to induce customers to remain with DGI, Enforcement recommends suspending Dratel for ten business days in all capacities and imposing a $10,000 fine jointly and severally upon Respondents.[159]

[156] *Reynolds*, 2001 NASD Discip. LEXIS 17, at *67.

[157] *Guidelines* at 86.

[158] Enforcement's Pre-Hearing Mem. 32.

[159] Tr. 467-68.

Respondents argue that there was no "loss sharing agreement," therefore they did not share in losses.[160] They stress that Dratel's motivation was care and concern for his customers.[161] They insist that they are guilty only of doing a "good deed" that should "go unpunished."[162]

Based on Dratel's uncontradicted testimony, the Hearing Panel can find no motive for the payments other than his professed concern for the welfare of elderly, long-time former customers of his father to whom he felt a special obligation. It also appears that the payments reflected some degree of selflessness because Dratel made them when he had personal financial problems, as evidenced by the judgments and liens filed for unpaid taxes, and his own testimony that making the payments was "[v]ery, very hard" for him to do.[163]

Dratel testified that FINRA told him the *firm* should not make the payments, but never told him *he* could not do so. He testified that if he had been told to stop, even though he thinks it is ridiculous to forbid him from the practice, he would have ceased the payments.[164]

By finding him in violation of NASD and FINRA rules, this Decision makes clear what Dratel claimed had been unclear to him — such payments to customers are impermissible. The Hearing Panel believes that a joint and several fine of $10,000 will suffice to reinforce the message that, however compassionately motivated, FINRA rules forbid Respondents from sharing in customer losses.

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[160] Tr. 498-500.

[161] Tr. 497-98. Respondents cited the Commentary to FINRA Rule 2150, which provides: "Nothing in this Rule shall preclude a member, but not an associated person of the member, from determining on an after-the-fact basis, to reimburse a customer for transaction losses; provided, however, that the member shall comply with all reporting requirements that may be applicable to such payment." Respondents did not, however, comply with the reporting requirements. The ad hoc nature of the payments, in some instances to cover margin calls, in others to replenish accounts to allow for customers' customary withdrawals, do not reflect the sort of reimbursement for transaction losses referenced in the Commentary. Indeed, Dratel implied that some of the customers he paid had not engaged in transactions for the past four years. Tr. 199.

[162] Tr. 501-02.

[163] Tr. 221.

[164] Tr. 493-94.

D. MSRB Violations: Causes Six and Seven

Enforcement recommends aggregating, or batching, the MSRB violations in the sixth and seventh causes of action for the purpose of imposing sanctions. The Guidelines approve of batching when fashioning sanctions for similar violations, particularly when they are unintentional or negligent and do not result in injury to the public.[165] We agree that batching is appropriate for these violations.

The sixth and seventh causes of action both allege violations of MSRB registration and reporting requirements. The sixth cause of action charges Respondents with executing municipal securities transactions without being registered with the MSRB and without a registered Municipal Securities Principal, in violation of MSRB Rules G-2 and G-3. The seventh cause of action charges DGI alone with failing to report municipal securities trades in violation of MSRB Rule G-14, and executing municipal securities without testing its ability to interface with RTRS and without filing a Form RTRS.

The Guidelines for Registration Violations are expressly applicable to violations of MSRB Rules G-2 and G-3. They call for a fine of $2,500 to $50,000 and consideration, in cases involving individuals, of suspension in any or all capacities for six months. For a firm, in egregious cases, they recommend consideration of suspension with respect to any or all activities or functions for up to 30 business days.[166] The Guidelines for Trade Reporting Violations are expressly applicable to violations of MSRB Rule G-14, and call for a fine of $5,000 to $10,000, and a greater fine in egregious cases.[167]

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[165] *Guidelines* at 4 (General Principle No. 4).

[166] *Guidelines* at 45.

[167] *Guidelines* at 64-65.

Enforcement contends Respondents had to have known that DGI was not registered with MSRB and did not have a registered Municipal Securities Principal when they executed municipal securities transactions over a period of several months.[168] Enforcement argues that DGI's failures to report its municipal securities trades to MSRB were "serious, but not egregious"[169] and recommends imposition of a fine of $7,500 to $10,000. Respondents characterize these violations as "minor."[170]

Dratel's testimony that he had resumed executing some municipal securities transactions after a hiatus and simply forgot for a time that DGI was not registered was uncontroverted. Dratel's account is consistent with the fact that, once it occurred to him that he needed to register DGI, he did so before FINRA was aware of the violations.[171] Considering these factors, as well as the absence of evidence of injury to the investing public, and that the number of trades, 23 in all, is relatively small, the Hearing Panel deems these violations inadvertent and minor. For these reasons, we believe imposition of a fine of $2,500 jointly and severally upon Respondents is sufficiently remedial.

E. Failure to Report Trades to TRACE: Cause Eight

The eighth cause of action charges DGI with TRACE reporting violations of FINRA Rules 6720, 6730 and 2010 from March through May 2009. The applicable Guidelines recommend a fine of $5,000 to $10,000.[172]

Enforcement describes these violations as serious, but not egregious.[173] Because the evidence suggests that in this instance, as with the MSRB reporting violations discussed above,

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[168] Tr. 469.

[169] Enforcement's Pre-Hearing Mem. 32-33.

[170] Tr. 502.

[171] *Guidelines* at 6 (Principal Consideration No. 2).

[172] *Id.* at 64.

Dratel was unaware of the existence of TRACE when he resumed trading in debt securities, and that once he learned from his clearing firm of the need to do so, he took appropriate steps to complete a TRACE participation agreement so that he could report corporate debt security transactions properly, Enforcement recommends a fine of $5,000.[174]

The Hearing Panel agrees that here, too, Dratel's omissions were inadvertent, and that it is mitigating that he took remedial steps before FINRA learned of the violations. Considering that the duration of the problem was brief, that there were only 38 unreported transactions, and that no customer harm resulted, the Hearing Panel concludes that imposing a fine of $2,500 on DGI will suffice to deter DGI and others from such violations.

F. Inaccurate Trial Balances and Ledgers: Cause Nine

The ninth cause of action describes Respondents' failure to accrue liabilities on DGI's trial balance and ledgers, in violation of SEC Rule 17a-3 and FINRA Rules 3110 and 2010. As noted previously, the Guidelines recommend a fine of $1,000 to $10,000 and consideration of a suspension for up to 30 business days.[175] Enforcement recommends a fine of $2,500.[176]

As discussed above, Dratel claims he believed that the apartment rent judgment did not need to be accrued because, by the terms of his sublease, his subtenant was responsible for paying it, and that the Broad Street office security deposit should have been considered a receivable, once paid, rather than a liability. If Dratel in fact held these beliefs, he was mistaken.

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[173] Enforcement's Pre-Hearing Memorandum 33.

[174] Tr. 471-72.

[175] *Guidelines* at 29.

[176] Tr. 472.

The Hearing Panel agrees with Enforcement's recommendation. We impose a fine of $2,500 jointly and severally upon Respondents to deter them and others from similar negligent omissions to accurately record accruals of liabilities on their trial balances and ledgers.

G. Supervisory Control Violations: Causes Ten and Eleven

The Hearing Panel finds, and the Guidelines reflect, that the final two causes of action, both directed only at Dratel, involve more serious violations. The applicable Guidelines relating to failures to supervise generally suggest a fine of $5,000 to $50,000 and consideration of suspension of a responsible individual in all supervisory capacities for up to 30 business days.[177]

Enforcement, characterizing the supervisory control violations as "substantial" but not egregious, argues that Respondents' 2009 Rule 3012 report was "so conclusory that it was meaningless," and notes that FINRA examiners had brought two similarly deficient prior annual reports to Dratel's attention. Enforcement proposes a fine of $7,500 for the violations, implicitly recommending aggregating the sanctions for the two causes of action.[178]

Dratel insists that being a "one-man shop" excuses his inattention to the supervisory control issues raised here.[179] Dratel appears satisfied to supervise himself in all capacities and believes the annual supervisory control report sufficiently summarized his firm's testing procedures, because he is "testing all the time."[180] He testified that he does not understand how DGI could institute procedures designed to provide supervision over his activities, because he is the sole person responsible for generating the firm's revenues.[181]

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[177] *Guidelines* at 103.

[178] Tr. 474-75. Enforcement recommends imposing the fine jointly upon DGI and Dratel, but the Complaint's tenth and eleventh causes of action charge only Dratel for the supervisory violations.

[179] Tr. 502-03.

[180] Tr. 422-23.

[181] Tr. 425.

But, as noted above, one may not supervise oneself.[182] Dratel must recognize the necessity of ensuring that there is supervisory oversight of his sales activities. Had he implemented a mechanism for proper supervision over his sales activity, some of the rule violations found here may have been averted. Therefore, for violating FINRA Rules 3012, 3130, and 2010, as charged in the tenth and eleventh causes of action, by failing to establish and enforce supervisory control systems and failing properly to document and certify DGI's compliance and supervisory processes, the Hearing Panel suspends Dratel from associating with any FINRA member firm in any supervisory capacity for five business days, and imposes a fine of $5,000.[183]

IV. CONCLUSION

For willfully failing to make timely amendments to his Form U4 to disclose material judgments and liens that had been filed against him, violating FINRA Rules 1122 and 2010, Respondent William M. Dratel is suspended in all capacities for 15 business days.

For willfully failing to make timely amendments to The Dratel Group, Inc.'s Form BD to disclose a material judgment that had been filed against the firm, violating FINRA Rules 1122 and 2010, Respondents are jointly and severally fined $5,000.

For willfully failing to create and preserve order memoranda, whereby Respondents violated NASD Rules 3110(a) and (j), and FINRA Rule 2010, and DGI violated Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder, Dratel is suspended in all capacities for five business days, and Respondents are jointly and severally fined $10,000.

[182] *Beerbaum*, 2007 SEC LEXIS 971, at *7 n.8.

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

Because these violations were willful, they subject Respondents to statutory disqualification.

For failing to preserve e-mail communications, whereby Respondents violated NASD Rule 3110(a) and FINRA Rule 2010, and DGI violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(2) thereunder, Respondents are jointly and severally fined $1,000.

For compensating customers for losses, violating NASD Rules 2330 and 2110, and FINRA Rules 2150 and 2010, Respondents are jointly and severally fined $10,000.

For executing 23 municipal securities transactions without being registered with MSRB, and for failing to have a registered municipal securities principal to supervise municipal securities, violating MSRB Rules G-2 and G-3, and for failing to report municipal securities transactions to MSRB, violating MSRB Rule G-14, Respondents are jointly and severally fined $2,500.

For executing 38 corporate debt transactions without completing a TRACE participation agreement, and failing to report the transactions to TRACE, violating FINRA Rules 6720, 6730, and 2010, DGI is fined $2,500.

For maintaining inaccurate trial balances and ledgers, violating Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, NASD Rule 3110, and FINRA Rule 2010, Respondents are jointly and severally fined $2,500.

For failing to establish and enforce supervisory control systems, violating NASD Rule 3012 and FINRA Rule 2010, and for failing to certify compliance and supervisory processes, violating FINRA Rules 3130 and 2010, Dratel is suspended from associating with any FINRA member firm in any supervisory capacity for five business days, fined $5,000.

The suspensions are to be served consecutively to each other. In sum, for the violations described above, Respondent William M. Dratel is suspended for a total of 25 business days, and he and Respondent The Dratel Group, Inc., are fined jointly and severally a total of $31,000. Dratel is fined an additional $5,000, and the firm is fined an additional $2,500. Respondents are also ordered to pay the costs of the hearing in the amount of $4,672, including an administrative fee of $750 and the cost of the transcript.

If this decision becomes FINRA's final disciplinary action, Dratel's suspension shall become effective on the opening of business on November 18, 2013, and shall end at the close of business on December 23, 2013. The fine and costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.

HEARING PANEL.

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By: Matthew Campbell
Hearing Officer

Copies to:

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