

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

ALFRED CHI CHEN
(CRD No. 3173732)

Respondent.

Disciplinary Proceeding

No. 2008015651902

Hearing Officer:

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. In March, September and October of 2008, Respondent Alfred Chi Chen, a registered representative at FINRA member firm Wells Fargo Investments, LLC ("WFI"), engaged in unauthorized trading in three customers' accounts. Two of those customers, EM and RS, were dead at the time the trades were placed and executed. The other customer, KK, specifically instructed Chen not to make any purchases from her account because she needed the cash in that account to pay quarterly taxes and for other reasons. Three weeks after that instruction, Chen used all of the cash in KK's account to purchase approximately \$75,000 of reverse convertible notes. Chen violated NASD Rule 2110 by engaging in unauthorized transactions in these customers' accounts.

2. Between late 2006 and July 2008 (the "RCN relevant period"), Chen recommended and effected unsuitable reverse convertible note transactions for twenty-three

customers (the “RCN Customers”). Reverse convertible notes (“RCNs”) are complex, highly volatile structured products, and they are highly volatile. Consequently, they are not suitable for investors who have little or no investment experience, conservative investment objectives or low risk tolerance.

3. Most of the RCN Customers were retired, living on a fixed income and had little or no investing experience. None of the RCN Customers had ever invested in a complex product like a reverse convertible. Many of the RCN Customers described themselves as having a “low” risk tolerance, and listed as their investment goals capital preservation or income at the time their accounts were opened. In some cases, Chen changed the risk tolerance for the “low” risk RCN customers to “medium” so that those customers’ RCN purchases would be approved by WFI. With only one exception, all of the RCN Customers were at least 65 years old, and many of them were in their 80s and 90s. The RCN Customers generally followed Chen’s recommendations. A spreadsheet is attached hereto and incorporated herein as Schedule A to this Complaint. That spreadsheet lists the twenty-three RCN Customers (some of whom had more than one account with Chen), including the RCN Customer’s age at the time of their initial RCN purchase; the RCN Customer’s stated risk tolerance prior to their first RCN purchase; and additional information relevant to the suitability determination.

4. Chen recommended reverse convertibles indiscriminately to the RCN Customers. Chen did not stop with the initial recommendation to his customers to buy RCNs; rather, he steadily built up the concentration of RCNs in those customers’ accounts over time such that most of the RCN Customers had all, or close to all, of the assets in their accounts invested in RCNs.

5. Chen was so relentless in switching his customers, including the RCN Customers, into reverse convertibles that he was WFI's second-highest producer of reverse convertible revenue in 2007, and in 2008 was the firm's highest reverse convertible revenue producer. In or around April 2007, Chen was promoted and given the title of Vice President and Senior Financial Consultant.

6. Chen continued aggressively promoting reverse convertibles until approximately July, 2008, when WFI demanded that he reduce his customers' concentrations in the product. Chen's unsuitable recommendations resulted in significant income for him and losses for many of his customers.

7. By recommending and effecting these unsuitable transactions, Chen violated NASD Rules 2310 and 2110.

RESPONDENT

8. Respondent Alfred Chi Chen entered the securities industry in approximately January, 1999, when he began working in a registered capacity as a financial advisor at a FINRA member firm. Chen passed his series 7 on February 23, 1999 and his Series 66 on April 1, 1999. In approximately September, 2000, Chen left his prior firm to work as a Financial Consultant at Wells Fargo Securities, Inc., a FINRA member. He held that position through the relevant period.

9. Chen worked out of Wells Fargo bank branch offices. He got most of his customers through referrals from Wells Fargo bank personnel.

10. Chen maintained his FINRA registration until he was terminated by WFI on approximately November 26, 2008. Although Respondent is no longer registered or associated with a FINRA member, he remains subject to FINRA's jurisdiction for purposes of this

proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because (1) the Complaint was filed within two years of an amendment to the notice of termination disclosing that he may have engaged in actionable conduct, namely, a May 10, 2010 amendment to Form U5 disclosing a customer complaint against Chen; and (2) the Complaint charges him with misconduct committed while he was registered with a FINRA member.

FIRST CAUSE OF ACTION

Violations of NASD Rule 2110 – Chen Engaged in Unauthorized Transactions in Three Customers' Accounts

11. Paragraph numbers 1 through 10 above are re-alleged and incorporated herein by reference.

12. Customer EM had an IRA account with WFI beginning in approximately December 2005. EM's account was a non-discretionary account. EM died on September 29, 2008. Approximately a week after EM's death, on October 7, 2008, Chen placed eight trades in EM's IRA account, purchasing almost \$29,000 in securities and all but depleting the available cash in the account. Chen did not have authorization to place these trades.

13. Customer RS had an investment account with WFI beginning in approximately January, 2002. RS's account was a non-discretionary account. RS died on February 29, 2008. Several days later, on March 3, 2008, Chen sold 112 shares of Celgene Corp. stock, generating proceeds of \$6,201.91, from RS's account. Chen did not have authorization to place this trade.

14. Customer KK was a self-employed accountant. She had a trust account with WFI beginning in approximately December 2006. KK's account was a non-discretionary account. On or about September 2, 2008, KK's trust account held \$20,521 in reverse convertibles maturing on October 3, 2008, \$35,244 in stocks, and \$74,963 of cash in a money market fund.

On or about that date, KK told Chen that he was not to invest any of the cash in that account, for several reasons. Among other things, KK told Chen she needed the cash to pay quarterly taxes that she owed. KK also told Chen she intended to use cash from the trust account to invest in her Simplified Employee Pension (SEP) IRA account.

15. In direct contravention of KK's explicit instructions, on or about September 24, 2008, Chen used the cash in KK's trust account to purchase a total of approximately \$75,000 in mutual funds. These trades were unauthorized.

16. By reason of the foregoing, Chen violated NASD Rule 2110.

SECOND CAUSE OF ACTION

Violation of NASD Rules 2310 and Rule 2110 – Chen Recommended Unsuitable Reverse Convertible Instruments

17. Paragraph numbers 1 through 16 above are re-alleged and incorporated herein by reference.

18. Reverse convertible notes ("RCNs") are structured products that generally consist of a high-yield, short-term note of the issuer that is linked to the performance of an unrelated reference asset. The reference asset is often a single stock but sometimes a basket of equities, an index, or some other asset. In this case, the RCNs were typically linked to single equities.

19. The RCNs Chen recommended and sold were typically issued by financial institutions such as Barclays, ABN Amro, and Wells Fargo Bank. An RCN works like a package of financial instruments, and typically has two components. First, there is a debt instrument, usually in the form of a note that pays an above-market coupon on a monthly or quarterly basis. The second component is a derivative in the form of a put option, which gives the issuer the right

to repay principal to the investor in the form of a set amount of the underlying “reference asset” (often, but not always, shares of stock), rather than cash. One of the reasons RCNs are so complicated is that an investor may receive stock, rather than cash, at the end of an RCN’s term under a number of different scenarios, depending on the nature of the RCN. For example, for certain RCNs, an investor may receive stock at the end of an RCN’s term if (1) during the life of the instrument, the stock’s share price goes below a predetermined price (commonly referred to as the “knock-in” level); and (2) at maturity, the share price is below its price on the date the RCN was issued. For other RCNs, stock may be put to the investor if the share price drops below the “knock-in” level at the end of the RCN term. For still others, stock may be put to the investor if the share price drops below the “knock in” level at any time during the term of the RCN. There are myriad variations in the conditions under which the reference asset may be put to the investor. In such scenarios, an investor can lose some, or even all, of their principal, offset only by any interest payments the investor has received and the value of the devalued asset.

20. When investors purchase an RCN, they do not own, and do not get to participate in the upside appreciation of, the underlying asset. Instead, in exchange for higher coupon payments during the life of the note, the investor gives the issuer a put option on the underlying asset. Thus, the investor is betting that the price of the underlying asset will remain stable or go up, while the issuer is betting that the price will fall.

21. Therefore, in purchasing a reverse convertible, an investor receives the opportunity to obtain a higher income stream than available from other bonds or bank products, but gives up any appreciation in the value of the underlying asset. In exchange for those higher yields, the investor takes on significantly greater risks, including the risk of receiving the underlying asset at the end of the term of the RCN at a reduced price.

22. Because reverse convertibles are complex investments, WFI required all of its sales professionals, including Chen, to take an in-house “Reverse Convertibles course” before the representatives could offer reverse convertibles to “suitable clients.” Having completed the course, Chen would understand that, as stated in the course materials, reverse convertibles are “suitable for sophisticated investors.”

23. WFI’s sales brochure on “Reverse Convertible Securities,” which Chen reviewed and provided to some of his customers, stated that investors “who might consider a reverse convertible” should be “knowledgeable and comfortable investing in options.”

24. RCNs were a lucrative product for Chen. As noted, Chen was WFI’s second-highest producer of RCN revenue in 2007; that year, his gross dealer concessions on RCNs were approximately \$595,000. Chen was paid approximately 36 to 37% of the gross. RCN revenue constituted approximately 78% of Chen’s total gross of \$767,110 for the year. In 2008, Chen was the firm’s highest producer of reverse convertible revenue; his gross dealer concessions of approximately \$573,000 in RCN revenue were almost \$250,000 higher than the next largest producer’s. The revenue generated from his RCN transactions accounted for approximately 69% of Chen’s total gross of approximately \$826,121 for the year. Over the RCN relevant period, Chen received approximately \$69,000 in income on the RCN Customers’ RCN transactions.

25. As noted, when the reference asset (typically a stock) for a particular RCN declined a certain amount in value, Chen’s customers were put the stock. The market value of the stock on such occasions was always, and sometimes significantly, less than the value of the RCN Customer’s initial principal investment. On some occasions, when RCN Customers were put the stock, Chen recommended that they sell the stock and use the proceeds to buy more RCNs. The RCN Customers usually followed Chen’s recommendations. In those transactions,

the RCN Customers paid commissions to sell the stock put to them, and Chen also got paid when the new reverse convertibles were purchased with the proceeds from the stock sale.

26. During the RCN relevant period, Chen recommended RCNs to each of the RCN Customers listed on Schedule A; overall, he recommended hundreds of unsuitable RCN transactions to those Customers. For example, Chen's customer BS opened an account at WFI in May 2002. At the time, she was 83 years old and had no prior investment experience. She also indicated on her new account forms that she had a "low" risk tolerance and an investment objective of "conservative income/preservation of capital." Chen recommended that she purchase a fixed annuity in the account. Nearly all of BS's liquid assets were invested in her accounts with Chen. In June 2007, BS established a trust account. Chen recommended that BS surrender the fixed annuity that she owned and use the proceeds to purchase reverse convertibles in the new trust account. BS was 88 at the time. Over the next 13 months, based on Chen's recommendations, BS purchased 46 RCNs. Chen made the recommendations despite BS's specific instruction that she did not want to invest in equity securities. Chen knew that one of the primary risks of owning an RCN was that the reference security would be put to the investor. As a result of Chen's recommendations, throughout the RCN relevant period BS's account was heavily concentrated in RCNs or the equity securities positions that were put to her account when the value of the reverse convertible reference equity fell below the knock-in price. On five occasions, based on Chen's recommendation, BS sold the put equities at a loss and used the proceeds to purchase more RCNs. Investments in RCNs were inconsistent with BS's low risk tolerance and her stated investment objective to preserve capital. Chen's recommendations were also inconsistent with BS's lack of investment experience and sophistication, and were further

inappropriate given her need to be conservative in light of her age and her lack of other investible assets.

27. Chen also recommended reverse convertibles during the RCN relevant period to EM. In 2006, EM was an 85-year-old client with no prior investing experience. EM indicated in her new account forms that she had a “low” risk tolerance and that her investment objective was “Conservative Income/Preservation of Capital.” Consistent with her stated investment preferences, in 2006 and early 2007, EM’s holdings were invested entirely in CDs and money market funds. In February 2007, following Chen’s recommendations, EM begin investing in RCNs. At the same time, and without EM’s knowledge or permission, Chen changed EM’s risk tolerance from “low” to “medium” and her investment objectives from “conservative income/preservation of capital” to “income,” knowing that approval of the reverse convertible trade required a more aggressive investment objective. Between February 2007 and September 2008, EM purchased 58 RCNs. By May 2007, EM’s account was 99% invested in RCNs. Chen knew as early as September 2006 that EM had limited assets totaling approximately \$328,000, including the WFI brokerage account, a checking account balance of approximately \$31,000, and a \$50,000 Certificate of Deposit. By causing EM to have 100% of her assets concentrated in RCNs or securities put to her from RCNs, Chen exposed EM to a risk of loss that was inconsistent with EM’s low risk tolerance, conservative investment objectives, lack of additional investible assets, lack of investment experience and sophistication, and age.

28. As a third example, Chen also recommended RCNs to RB, a retired painter, and his wife, CB, an interior designer. Both RB and CB had been Chen’s clients since 2001. According to RB and CB’s new account forms, they had an annual income of under \$50,000 and a liquid net worth of less than \$500,000. In 2007, RB was 71 and CB was 70. In April 2007, RB

and CB's joint account at WFI was entirely in Unit Investment Trusts and a fixed annuity. In May 2007, on Chen's recommendation, RB and CB sold their Unit Investment Trusts at WFI and used the proceeds to purchase RCNs. RB passed away in August 2007. That month, Chen recommended that CB surrender the fixed annuity in the amount of approximately \$99,200 to purchase more RCNs. The assets were transferred to an account in CB's name, and by September 2007 over 99% of the account, totaling approximately \$270,989, was concentrated in RCNs. The account remained concentrated in RCNs or the equity put from the RCN. CB also maintained an IRA account with WFI. In May 2007, Chen recommended that she liquidate the UITs in that account and that she purchase RCNs in the IRA account in order to "preserve the gains accumulated in the portfolio with a flexible short-term high coupon investment." In June 2008, Chen further recommended that CB surrender her fixed annuity to purchase additional RCNs. By the end of the month, 93.48% of CB's IRA account, which was valued at \$194,646.73, was invested in RCNs. Also in June 2008, the trust account was nearly 100% concentrated in RCNs or equities put as a result of RCNs. Between May 2007 and September 2008, CB's accounts purchased 102 RCNs based on Chen's recommendations.

29. In another example, on or about January 15, 2008 Chen recommended that DH pay a surrender charge of over \$2,000 in order to exit a variable annuity and invest approximately \$57,000 in annuity proceeds in RCNs. At the time, DH was 91 years old, and had indicated investment goals of "conservative income with preservation of capital" (the most conservative option on the WFI Brokerage Account Form ("BORA")) and a "low" risk tolerance (also the most conservative option on the BORA). DH was an unsophisticated investor and had no experience investing in mutual funds, stocks, bonds or options prior to 1999 when she first opened her brokerage account at WFI. Despite her very limited experience,

Chen recommended RCNs to DH. Chen recommended that several other RCN customers exit comparably conservative annuities, even in cases where they would pay surrender charges to do so, in order to purchase unsuitable RCNs.

30. Customer RS maintained a margin account with Chen. In March of 2008, based on Chen's recommendations, RS began purchasing reverse convertibles in the account using margin, in part, to facilitate the purchases. By mid June 2008, the equity in RS' account declined and WFI began issuing margin calls. Chen requested transfers of funds from RS's bank account to meet the margin calls. Between June 15 and July 3, 2008, there were at least nine transfers ranging from \$100 to \$500 each from RS's bank account in order to meet margin calls, one of which resulted in a \$33 overdraft charge. Soon thereafter, RS canceled her margin account.

31. All of Chen's RCN recommendations to the RCN Customers were unsolicited. None of the RCN Customers had experience with or knowledge of RCNs at the time Chen made the recommendation. None of the RCN Customers had invested in options prior to the investment being recommended by Chen. Chen's recommendations were unsuitable for each of the RCN customers.

32. Among the twenty-three RCN Customers listed in Schedule A, five were over 90 years old at the time they first invested in RCNs on Chen's recommendation; ten were over 80 at the time they first invested in RCNs on Chen's recommendation; three were over 70; four were over sixty; and one was 50 years old.

33. Ten of the twenty-three RCN Customers described themselves on the new account documentation as having a low or conservative risk tolerance when they initially established their accounts at WFI. Thirteen of the twenty-three RCN Customers initially listed

their investment objective on the new account form as either “conservative income and preservation of capital” or “income.”

34. Most of the RCN Customers’ accounts became highly concentrated in RCNs during the RCN relevant period. Eighteen of the twenty-three RCN Customers had accounts in which their concentrations of RCNs peaked at over 90%. Five RCN Customers had accounts with peak concentrations between 75% and 90%. For many of the RCN Customers, moreover, all of the securities other than RCNs in their accounts were the underlying equities that had been put to the customers when their RCNs matured.

35. Chen was highly paid for his unsuitable recommendations. Chen’s recommendations to purchase RCNs resulted in the RCN Customers generating approximately \$192,945.25 in gross dealer commissions. Based on his approximately 36% to 37% share of the grid, Chen received approximately \$69,000 for these transactions.

36. Many of the RCN Customers lost money as a result of the RCN trades recommended by Chen.

37. By reason of the foregoing, Chen violated NASD Rules 2310 and 2110.

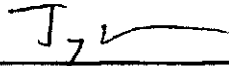
RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. order that one or more of the sanctions provided under FINRA Rule 8310(a) be imposed, including that the Respondent be required to disgorge fully any and all ill-gotten gains, and/or make full and complete restitution (to the extent any customers have not yet received compensation for the losses they suffered due to Chen’s unsuitable recommendations), together with interest; and

B. order that the Respondent bear such costs of this proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.

FINRA DEPARTMENT OF ENFORCEMENT



Jeffrey Parisier, Senior Litigation Counsel
Justin L. Chretien, Senior Litigation Counsel
Department of Enforcement
FINRA
1801 K Street, N.W.
Suite 800
Washington, DC 20006
Tel: 202.974.2807
Fax: 202.721.1348
Email: jeffrey.pariser@finra.org

November 23, 2011

SCHEDULE A

	Age at RCN	Date of Birth	Account Opening Date	First RCN Trade	Initial Investment Objective	Investment Objective Updates	Initial Risk Tolerance	Risk Tolerance Updates	Income	Estimated Net Worth	Liquid Net Worth	Occupation	Investment prior to RCN Purchases
HA	83		2/14/2006	11/27/2007	Growth & Income		Medium		< 50 K	100-499 K	100-499 K	Retired RN	UIT
HA #2	83		2/14/2006	11/27/2007	Growth & Income		Medium		< 50 K	100-499K Update 11/08 by Chen: 100-120 K	100-499 K	Retired RN	
CB	69		8/20/2007	5/27/2008	Growth & Income		Medium		< 50 K	100-499 K	500-999 K	Retired J C Penney	RCN Transfer Annuity
R8 & CB	71		5/9/2001	5/24/2007	Growth & Income		Medium		< 50 K	100-499 K	500-999 K 3-20-08	Retired Painter	UIT/Annuity
RB	71		3/9/2001	5/24/2007	Capital Appreciation		Moderate		33 K	500 K	330 K	Retired Painter	Fixed Annuities
CB #2	70		3/9/2001	5/24/2007	Capital Appreciation	5/22/03 Gr & Inc	Moderate		33 K	500 K	330K 3-20-08 500-999 K	Retired J C Penney	UIT/Annuity
VC	83		2/23/2001	5/24/2007	Capital Appreciation	7/17/03 Gr & Inc	Moderate		18 K	400 K	200K 8-23-06 100-499K	Retired	UIT/Annuity
WD	69		1/13/2005	3/25/2008	Income	3/18/05 Gr & Inc	Low	3/18/05 Medium	< 50 K	100-499 K	100-499 K	Retired	Variable Annuity
JD	80		3/19/2002	5/24/2007	Income	3/20/08 Gr & Inc	Medium		50-99 K	100-499 K	Unknown	Homemaker	Fixed Annuity
DH	91		10/11/2002	2/23/2007	Cons Inc Pres Cap	3/20/08 Gr & Inc	Low		<50 K	100-499 K	100-499 K	Homemaker	Fixed and Variable
KK	50		12/20/2006	12/21/2006	Growth & Income		Medium		100-249 K	100-499 K	100-499 K	CPA	CDs/Savings
KK #2	51		12/22/2002	11/27/2007	Growth & Income		Medium		50-99 K	100-499 K	100-499 K	CPA	UIT
TL	92		2/3/2003	2/22/2008	Cons Inc Pres Cap	3/17/06 Income 3/21/06 Gr & Inc 3/20/08 Gr & Inc	Low	3/17/06 Medium	<50 K	100-499 K	100-499 K	Homemaker	UIT
JM & RM	80		5/16/2003	5/27/2008	Cons Inc Pres Cap	5/20/08 Gr & Inc	Low	5/20/08 Medium	50-99 K	100-499 K	100-499 K 5/20/08 100-200 K	Retired	Fixed
WM & DM	88		8/5/1998	4/20/2007	Capital Appreciation	5/1/2003 Gr & Inc	Moderate		35 K	1 M	900 K	Retired USAF	Annuity UIT
DM	86		3/22/2002	7/25/2007	Growth & Income		Medium		50-99 K	500-999 K		Retired	Fixed Annuity
EM	86		9/19/2006	2/23/2007	Cons Inc Pres Cap	2/22/07 Income 3/20/08 Gr & Inc	Low	2/22/07 Medium	50-99 K	500-999 K	100-499 K	Retired CPA	CD and Money Market
ERM	80		12/1/2005	6/26/2007	Growth		Medium		<50 K	500-999 K	500-999 K	Flooring Company	UITs
ERM & MM			8/18/2001	11/27/2007	Growth & Income		Medium		<50 K	500-999 K	150-499 K 3-20-08	Flooring Company	Fixed Annuities
MM	69		4/10/2003	5/27/2008	Cons Inc Pres Cap		Low		<50 K	150-499 K	150-499 K 3-20-08	Flooring Company	Fixed Annuities
MM #2			10/27/2008	None	Growth & Income		Medium		25-49 K	150-499 K	150-499 K 3-20-08	Retired	Journal
RS	69		7/2/2002	8/28/2007	Conservative	8/29/2007 Gr & Inc	Low	8/29/2007 Medium	<50 K	100-499 K	100-499 K	VP Consumr Lending	Fixed Annuity
RS #2			7/2/2002	3/25/2008	Growth		Medium		<50 K	100-499 K	100-499 K	VP Consumr Lending	UIT

SCHEDULE A

	Age at RCN	Date of Birth	Account Opening Date	First RCN Trade	Initial Investment Objective	Investment Objective Updates	Initial Risk Tolerance	Risk Tolerance Updates	Income	Estimated Net Worth	Liquid Net Worth	Occupation	Investment prior to RCN Purchases
LSJ	90	████████	11/18/2003	3/27/2007	Cons Inc & Pres Capital	3/26/07 Income 3/20/08 Gr & Inc	Low	3/26/07 Medium	< 50 K	500-999 K	500-999 K	Retired Clerk	CDs Annuity
BS	88	████████	6/6/2007	6/26/2007	Income	3/20/08 Gr & Inc	Medium	No	< 50 K	100-499 K	100-499 K	Retired	Annuity
RLS	94	████████	1/9/2002	2/23/2007	Income	3/20/08 Gr & Inc	Medium		<50 K	100-499 K	Unknown	Nurses Aid	Fixed Annuities
TS & PS		████████	11/11/1999	3/25/2008	Income	11/17/03 Gr & Inc	Consv	11/17/03 Medium	35 K	350 K	185 K	Retired Bartender	UIT/Annuity
TS	70	████████	11/11/1999	4/20/2007	Income	3/28/03 Gr & Inc	Consv	3/28/03 Medium	35 K	350 K	185 K	Retired Bartender	UIT/Annuity
PS	65	████████	11/11/1999	3/25/2008	Income	3/28/03 Gr & Inc	Consv	3/28/03 Medium	35 K	350 K	185 K	Receptionist	UIT/Annuity
AW & EC	92	████████	6/20/2007	6/28/2007	Growth & Income		Medium		50-99 K	100-499 K	100-499 K	Retired Homemaker	
MY	82	████████	New Trust 5/10/2007	12/15/2006	Growth & Income		Medium		50-99 K	100-499K Update 11/08 by Chen: 100-120 K	100-120 K	Retired	Annuity UIT