

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

**DEPARTMENT OF ENFORCEMENT,

COMPLAINANT,**

v.

**DAVID JOSEPH ESCARCEGA
(CRD No. 4367584),**

RESPONDENT.

**DISCIPLINARY PROCEEDING
No. 2012034936005**

HEARING OFFICER—_____

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Between March 2012 and January 2013 (the “relevant period”), while he was registered with Center Street Securities, Inc. (“Center Street” or “firm”), Respondent David Escarcega violated the antifraud provisions of the federal securities laws as well as numerous FINRA and NASD rules in connection with the sale of more than \$1.8 million of Renewable Secured Debentures of GWG, Inc. (“the Debentures”) to his customers. The Debentures are an illiquid and high-risk alternative investment.

2. Escarcega made false and misleading oral and written statements to seven customers in connection with their purchases of the Debentures. Escarcega falsely told the customers that the Debentures were safe, low-risk, liquid, or guaranteed.

3. Escarcega made unsuitable recommendations to purchase the Debentures to twelve customers. Escarcega’s recommendations to purchase the speculative and risky Debentures were inconsistent with his elderly and retired customers’ investment

objectives and risk tolerances. In each case, the recommendations resulted in either an excessive concentration of the customers' total investable assets or net worth in a speculative and risky investment and/or were otherwise inconsistent with the customers' investment objectives and risk tolerances.

4. Escarcega distributed a misleading sales brochure regarding the Debentures, created by GWG, to numerous customers. The brochure stated that the Debentures are secured by GWG's portfolio of life insurance policies. In fact, as stated in the prospectus for the Debentures, the life insurance policies are pledged as collateral for a line of credit and are not collateral for the Debentures.

5. Escarcega overstated his customers' net worth and asset composition in customer account forms completed in connection with Debenture sales, causing the forms to contain inaccurate information. Escarcega also caused customer forms to contain false information stating that Debenture purchases by certain customers did not involve a product switch from another investment to the Debentures.

6. By making false and misleading statements in connection with Debenture sales, Escarcega violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. By making unsuitable recommendations to purchase the Debentures, Escarcega violated NASD Rule 2310 and FINRA Rules 2111 and 2010.¹ By distributing a false and misleading sales brochure

¹ FINRA Rule 2111 superseded NASD Rule 2310 on July 9, 2012. However, the time period related to Escarcega's recommendations and sales ranges from March 2012 to January 2013.

concerning the Debentures to customers, Escarcega violated NASD Rule 2210² and FINRA Rule 2010. By causing inaccurate information to be placed on customer account forms, Escarcega violated FINRA Rules 4511 and 2010.

RESPONDENT AND JURISDICTION

7. David Joseph Escarcega (CRD # 4367584) has been associated with Center Street as a General Securities Representative since March 2010. Escarcega is an independent contractor, operating his securities business through an entity called Strategic Financial Services located in his home in Chandler, Arizona. Escarcega is currently registered with Center Street.

STATEMENT OF FACTS

GWG RENEWABLE SECURED DEBENTURES

8. GWG Holdings, Inc. purchases life insurance policies on the secondary market at a discount to the face value of the policies. Once GWG purchases a policy, it pays the policy premiums until the insured dies. GWG then collects the face value of the insurance benefit. GWG hopes to profit by collecting more upon the maturity of the policies than it has paid to purchase, finance and service the policies. The company has a limited operating history and is not yet profitable. GWG has purchased almost all of the policies it owns with funds borrowed from financial institutions or raised from investors.

9. In 2012, in an effort to continue funding and operating its business model, GWG began selling what it called Renewable Secured Debentures. GWG's Renewable Secured Debentures are registered debt instruments that offer investors varying maturity

² FINRA Rule 2210 superseded NASD Rule 2210 effective February 4, 2013. Since the violative communications with the public with respect to the sales brochure occurred prior to February 4, 2013, NASD Rule 2210 applies.

terms and interest rates, ranging from six-month Debentures offering an annual interest rate of 4.75%, to seven-year Debentures offering 9.50%. The minimum investment in the Debentures is \$25,000. Additional investments can be made in \$1,000 increments.

10. The prospectus for the Debentures states that the life insurance policies held by GWG are not collateral for obligations under the Debentures. Instead, those policies have been separately pledged as collateral for a line of credit used by GWG to purchase life insurance policies and finance its operations. As stated in the prospectus, the Debentures may be considered speculative investments and involve a high degree of risk, including the risk of loss of the entire investment. The prospectus states that the company's success is dependent upon, among other things, its continued ability to raise funds to pay its obligations, including interest payments under the Debentures.

11. The prospectus further explains that an investment in the Debentures is illiquid. Investors do not have to access their principal prior to maturity unless the request is due to death, bankruptcy or total disability. If GWG decides to prepay the Debentures other than under those circumstances, a prepayment fee of 6% is charged. There is also no trading market for the Debentures. For these reasons, as the prospectus states, an investment in the Debentures is not suitable for investors who need liquidity prior to the Debenture's maturity date.

ESCARCEGA'S FALSE AND MISLEADING STATEMENTS CONCERNING THE DEBENTURES

12. Escarcega knowingly or recklessly made oral misrepresentations to two customers concerning the Debentures.

13. JB and his wife DB maintained an account at Center Street and Escarcega was their registered representative. On or about April 3, 2012, Escarcega told JB that the

principal he and DB invested in the Debentures would be safe. In a joint account, JB and DB purchased \$104,500 of the Debentures on April 3, 2012.

14. RL maintained an account at Center Street and Escarcega was his registered representative. On or about April 9, 2012, Escarcega told RL that the Debentures were a low risk investment. RL purchased \$99,000 of the Debentures on April 9, 2012.

15. Escarcega also made false and misleading written statements about the Debentures on certain account forms he provided to customers.

16. MD maintained an account at Center Street and Escarcega was his registered representative. On February 6, 2013, MD purchased \$111,000 of the Debentures. On a product switch form provided to MD prior to the purchase, Escarcega described the Debentures as having "a guaranteed interest payment" and providing a "guaranteed rate of return."

17. RE maintained an account at Center Street and Escarcega was his registered representative. On December 10, 2012, RE purchased \$67,000 of the Debentures. On a product switch form provided to RE prior to the purchase, Escarcega described the Debentures as providing a "guaranteed income stream" and as a way to "maintain principal."

18. NJ and RJ maintained an account at Center Street and Escarcega was their registered representative. On December 7, 2012, NJ and RJ purchased \$52,875 of the Debentures in a joint account. On a product switch form provided to NJ and RJ prior to the purchase, Escarcega described the Debentures as providing "guaranteed interest."

19. CM maintained an account at Center Street and Escarcega was her registered representative. On June 21, 2012, CM purchased \$117,000 of the Debentures. On a product switch form provided to CM prior to the purchase, Escarcega described the rationale for purchasing the Debentures as “to maximize income and liquidity.”

20. NZ maintained an account at Center Street and Escarcega was her registered representative. On two product switch forms provided to customer NZ prior to the purchases, Escarcega described the Debentures as providing a “guaranteed rate of return.” NZ purchased \$30,000 of the Debentures on November 21, 2012 and an additional \$34,500 of the Debentures on January 30, 2013.

21. These oral and written statements by Escarcega were false and misleading. The Debentures provide no guarantees with respect to market losses, rates of return, income, or maintaining principal. In fact, as the prospectus emphasizes, an investment in the Debentures is speculative, illiquid and involves a high degree of risk, including loss of the entire investment. As such, any description of an investment in the Debentures as one in which the investment was safe, low-risk, guaranteed in any manner, or liquid, is false and misleading.

22. Escarcega knew or was reckless in not knowing that his oral and written misstatements concerning the safety, risk and liquidity of the Debentures were false and misleading.

**ESCARCEGA MADE UNSUITABLE RECOMMENDATIONS
IN THE SALE OF THE DEBENTURES**

23. Escarcega recommended the purchase of the Debentures to his customers during in-person meetings in various states, including Arizona and California. Escarcega

sent account documentation necessary to complete the Debenture purchases to Center Street's headquarter offices in Nashville, Tennessee.

24. During the relevant period, Escarcega made unsuitable recommendations to twelve customers to purchase a total of almost \$1.5 million of the Debentures.

25. Escarcega did not have a reasonable basis to believe that his recommendations to his customers to invest in the Debentures were suitable based on the customers' overall investment profiles.

26. As described above, JB and DB maintained an account at Center Street and Escarcega was their registered representative. JB and DB were a retired married couple, ages 77 and 75 at the time of the purchase of the Debentures. Their account documents listed their investment knowledge as average and their investment objective as balanced/conservative growth.

27. Upon Escarcega's recommendation, JB and DB surrendered a fixed annuity contract and invested the entire proceeds in Debentures. They purchased a seven year Debenture in the principal amount of \$104,500 on April 3, 2012. By surrendering the annuity, JB and DB incurred surrender charges of approximately \$17,000. The purchase represented an investment of approximately one-third of their net worth in the Debentures.

28. PB maintained an account at Center Street and Escarcega was her registered representative. PB was 76 at the time of the Debenture purchases and is retired. On Escarcega's recommendation, PB purchased a seven-year term Debenture for the principal amount of \$148,000 on August 23, 2012. On Escarcega's recommendation, PB also purchased a seven-year term Debenture for the principal amount of \$119,000 on

January 14, 2013, for a total investment of \$267,000 based upon Escarcega's recommendations. Her account documents listed her investment knowledge as average and her investment objective as balanced/conservative growth. Customer PB's combined Debenture purchases represented more than 28% of her net worth.

29. SC maintained an account at Center Street and Escarcega was her registered representative. SC was 73 at the time of the Debenture purchase and is retired. On Escarcega's recommendation, SC purchased a seven-year term Debenture for the principal amount of \$78,000 on March 27, 2012. Her account documents listed her investment knowledge as average and her investment objective as preservation of principal/income. The investment represented 15% of her net worth.

30. NH maintained an account at Center Street and Escarcega was her registered representative. NH was 65 at the time of the Debenture purchase. She purchased a seven-year term Debenture in the principal amount of \$329,500 on March 19, 2012 based on Escarcega's recommendation. Her account documents listed her investment knowledge as average and her investment objective as balanced/conservative growth. The investment represented 28% of her net worth.

31. WJ and SM maintained an account at Center Street and Escarcega was their registered representative. WJ and SM, ages 73 and 81 at the time of the Debenture purchases, are a retired couple. They purchased one-year and five-year term Debentures for a total principal amount of \$156,300 on July 30, 2012 upon Escarcega's recommendation. Their account documents listed their investment knowledge as average and their investment objective as balanced/conservative growth. The investment represented 15% of their net worth.

32. RL maintained an account at Center Street and Escarcega was his registered representative. RL, age 65 at the time of the Debenture purchase, a retiree, purchased a three-year term Debenture in the principal amount of \$99,000 on April 9, 2012 upon Escarcega's recommendation. His account documents listed his investment knowledge as limited for alternative products and his investment objective as preservation of principal/income. The investment represented 16% of his net worth.

33. RS and PM maintained an account at Center Street and Escarcega was his registered representative. RS and PM, ages 81 and 61 at the time of the Debenture purchase, are a retired couple. Upon Escarcega's recommendation, they purchased a one-year term Debenture in the principal amount of \$25,000 on March 29, 2012. Upon Escarcega's recommendation, RS purchased a seven-year term Debenture in the principal amount of \$40,000 on April 3, 2012 in his individual account. Their account documents listed their investment knowledge as limited for alternative products and their investment objective as balanced/conservative growth. The combined investments represented approximately 10% of RS and PM's net worth.

34. Customer JS and MS maintained an account at Center Street and Escarcega was their registered representative. JS and MS, ages 77 and 75 at the time of the Debenture purchases, are a retired couple. They purchased seven-year term Debentures in the principal amount of \$231,014 on August 29, 2012 and seven-year term Debentures in the principal amount of \$152,000 on September 11, 2012, for a total of \$383,014. All of these purchases were made on Escarcega's recommendation. Their account documents listed their investment knowledge as average and their investment

objective as balanced/conservative growth. The combined investments represented more than 32% of their net worth.

35. Escarcega received approximately \$52,270 in commissions from the Debenture sales described in paragraphs 12-34.

**ESCARCEGA DISTRIBUTED A MISLEADING SALES
BROCHURE RELATED TO THE DEBENTURES**

36. GWG provided written materials to Center Street and Escarcega for Escarcega's use in the offer and sale of the Debentures. These materials included a sales brochure that purported to describe the features of the Debentures.

37. Among other things, the brochure stated that the "Renewable Secured Debentures are secured by the corporate assets of GWG, which consist primarily of investments in life insurance policies purchased in the secondary market." The brochure further stated that the Debentures "are secured by all the corporate assets of GWG. GWG's assets consist primarily of the life insurance policies purchased in the secondary market and are summarized in the table below." The table stated that GWG held "Insurance Policy Benefits" of over \$489 million. However, the \$489 million value was the face value of the benefits of the policies and not their current market value, a significantly lower number. Moreover, as stated in the prospectus for the Debentures, those policies were not collateral for the Debentures and instead had been pledged as collateral for a separate line of credit. Thus, the statements in the brochure that GWG held \$489 million of life insurance policies and that those policies served as collateral for the Debentures were incorrect and misleading.

38. The statements in the brochure that the Debentures are secured by the life insurance policies owned by GWG are misleading. As stated in the prospectus for the

Debentures, the policies are not collateral for the Debentures and instead have been pledged as collateral for the separate line of credit.

39. During the relevant period, Escarcega distributed the brochure to 20 customers who purchased the Debentures.

**ESCARCEGA CAUSED FALSE BOOKS AND RECORDS
TO BE MAINTAINED BY CENTER STREET**

40. Escarcega caused customer account forms to contain false information for two accounts.

41. Upon Escarcega's recommendation, customer CM surrendered a fixed annuity contract and invested the proceeds in Debentures. By surrendering the annuity, CM incurred a surrender fee of almost \$2,500.

42. Escarcega falsely indicated that CM's Debenture purchase was not a liquidation, redemption or exchange within the last 30 days to provide the funds for the purchase of the Debentures on Center Street's Alternative Investment (Non-Reg D) Suitability Verification and Investor Acknowledgement form.

43. Upon Escarcega's recommendation, customers JB and DB surrendered a fixed annuity contract and invested the proceeds in Debentures. By surrendering the annuity, JB and DB incurred surrender fees of approximately \$17,000.

44. Escarcega falsely indicated that the Debenture purchase was not a liquidation, redemption or exchange within the last 30 days to provide the funds for the purchase of the Debentures on Center Street's Alternative Investment (Non-Reg D) Suitability Verification and Investor Acknowledgement form. Escarcega also inaccurately represented customers JB and DB's net worth as \$635,000 on the same form. JB's and DB's actual net worth was approximately \$300,000.

**FIRST CAUSE OF ACTION
FALSE AND MISLEADING STATEMENTS IN CONNECTION
WITH THE SALE OF THE DEBENTURES
(SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934, RULE 10B-5
THEREUNDER AND FINRA RULES 2020 AND 2010)**

45. The Department re-alleges and incorporates by reference paragraphs 1 through 44 above.

46. As described above, Escarcega knowingly and/or recklessly communicated false information in oral and written statements about the Debentures when soliciting customers to purchase the Debentures.

47. The false and misleading oral and written misstatements were material to investors. The misstatements concerned the safety, risk, and liquidity of the Debentures.

48. Escarcega utilized the means or instrumentalities of interstate commerce in connection with the sale of the Debentures, including traveling to meet a customer in California outside of his home state of Arizona and mailing account documentation regarding the transactions to Center Street's home office in Tennessee.

49. Escarcega, in connection with the purchase or sale of securities, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, knowingly or recklessly employed manipulative or deceptive devices, schemes or artifices to defraud; made untrue statements of material fact; and engaged in acts, practices, or a course of business which operated or would operate as a fraud or deceit upon any person.

50. As a result of the foregoing conduct, Escarcega willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder and FINRA

Rule 2020. By violating Section 10(b), Rule 10b-5 and FINRA Rule 2020, Escarcega also violated FINRA Rule 2010.

**SECOND CAUSE OF ACTION
(PLED IN THE ALTERNATIVE TO THE FIRST CAUSE OF ACTION)
MISREPRESENTATIONS IN CONNECTION WITH THE SALE OF THE DEBENTURES
(FINRA RULE 2010)**

51. The Department re-alleges and incorporates by reference paragraphs 1 through 50 above.

52. FINRA Rule 2010 requires all FINRA associated persons to “observe high standards of commercial honor and just and equitable principles of trade” in the conduct of their business. As specified above in paragraphs 12-22, Escarcega made material misstatements in connection with the offer and sale of the Debentures to investors. Those misstatements concerned material facts for investors, including the safety, risk and liquidity of the Debentures.

53. By making material misstatements in connection with the sale of the Debentures, Escarcega failed to observe high standards of commercial honor and just and equitable principles of trade.

54. As a result of the foregoing conduct, Escarcega violated FINRA Rule 2010.

**THIRD CAUSE OF ACTION
UNSUITABLE RECOMMENDATIONS TO PURCHASE THE DEBENTURES
(NASD RULE 2310 AND FINRA RULES 2111 AND 2010)**

55. The Department re-alleges and incorporates by reference paragraphs 1 through 54 above.

56. As described above, Escarcega's recommendations that the customers noted above purchase the Debentures—a high-risk, illiquid, alternative investment—were unsuitable based on the complete investment profiles of those customers.

57. Escarcega failed to satisfy his customer-specific suitability obligations by recommending the Debentures to his customers without properly taking into consideration the customers' financial situations and needs, including investment objectives, investment experience and knowledge, risk tolerance, age, liquid net worth, and annual income. As a result, Escarcega did not have a reasonable basis to believe that his recommendations that customers JB, DB, PB, SC, NH, WJ, SM, RL, RS, PM, JS and MS purchase the Debentures were suitable.

58. As a result of the foregoing conduct, Escarcega violated NASD Rule 2310 and FINRA Rule 2111. As a result of that violation, Escarcega also violated FINRA Rule 2010.

**FOURTH CAUSE OF ACTION
DISTRIBUTING MISLEADING SALES LITERATURE
(NASD RULE 2210(d)(1)(A) AND FINRA RULE 2010)**

59. The Department re-alleges and incorporates by reference paragraphs 1 through 58 above.

60. During the relevant period, Escarcega distributed to customers a misleading sales brochure advertising the Debentures. The brochure stated that Debentures were secured by life insurance policies. However, (i) those policies are not collateral for the Debentures and (ii) any "secured" interest the Debentures have in the assets of GWG is subordinate to other creditors of the GWG subsidiaries. The brochure omitted these material facts and thus was misleading.

61. Escarcega thus distributed sales literature that was misleading, omitted material facts, and failed to provide a sound basis for evaluating the securities that were being offered. As a result, Escarcega violated NASD Rule 2210(d)(1)(A). As a result of that violation, Escarcega also violated FINRA Rule 2010.

**FIFTH CAUSE OF ACTION
CAUSING INACCURATE BOOKS AND RECORDS
(FINRA RULES 4511 AND 2010)**

62. The Department re-alleges and incorporates by reference paragraphs 1 through 61 above.

63. FINRA Rule 4511 requires, among other things, that firms “make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations . . . and as prescribed by the Securities Exchange Act of 1934 Rule 17a-3.” In turn, Exchange Act Rule 17a-3(a)(6) and (a)(17) requires member firms to make and keep, among other things “[a] memorandum of each brokerage order” and “[a]n account record including the customer’s . . . net worth”

64. As described above, Escarcega falsely indicated on customer account records as to two accounts created in connection with the purchase of the Debentures by Center Street customers that the transactions were not a liquidation, redemption or exchange within the last 30 days to provide the funds for the purchase of the Debentures. Escarcega also overstated the net worth of JB and DB by approximately \$300,000 on forms supporting their Debenture purchase. Escarcega’s placement of the false information on these documents caused Center Street to maintain false books and records.

65. As a result of the foregoing conduct, Escarcega violated FINRA Rule 4511. As a result of that violation, Escarcega also violated FINRA Rule 2010.

RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that the Respondent committed the violations charged and alleged herein;**
- B. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed, including that Respondent be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;**
- C. order that Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330; and,**
- D. make specific findings that Respondent willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.**

Date: August 25, 2014

FINRA DEPARTMENT OF ENFORCEMENT



Thomas B. Lawson, Vice President and Chief
Counsel

Michael J. Rogal, Senior Counsel

FINRA Department of Enforcement

15200 Omega Drive, 3rd Floor

Rockville, MD 20850-3241

Phone (301) 258-8574 (Rogal)

Facsimile (202) 721-8319 (Rogal)

Email: michael.rogal@finra.org