

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013035045903**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Alton Securities Group, Inc., Respondent
Registered Broker-Dealer
CRD No. 39639

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Alton Securities Group, Inc. ("Alton" or the "Firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the Firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The Firm hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Alton has been a FINRA-registered Firm since June 1996 and is also a municipal securities dealer. During the period February 2009 through June 2013 (the "Relevant Period"), the Firm employed approximately 27 registered representatives operating from 15 branch offices. The Firm engaged in a general securities business during the Relevant Period, selling equities, government and corporate debt securities, investment company products, and municipal securities.

RELEVANT DISCIPLINARY HISTORY

The Firm does not have any relevant disciplinary history.

OVERVIEW

During the Relevant Period, the Firm failed to establish, implement, and maintain a supervisory system reasonably designed to ensure compliance with the securities laws. In particular, the Firm's supervisory system was not reasonably

designed to ensure that registered representatives made suitable recommendations of complex products such as leveraged, inverse, or inverse-leveraged exchange traded funds (together, "Non-Traditional ETFs") and leveraged, inverse, or inverse-leveraged mutual funds ("Non-Traditional Mutual Funds"). In addition the Firm failed to adopt and implement adequate supervisory procedures relating to markups and markdowns on corporate debt transactions. As a result of these failures, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010 and MSRB Rule G-27.

During the Relevant Period, the Firm, through certain of its registered representatives, also failed to have a reasonable basis to recommend certain purchases of Non-Traditional ETFs and Non-Traditional Mutual Funds, rendering those recommendations unsuitable in violation of NASD Rule 2310 (for the period prior to July 9, 2012), FINRA Rule 2111 (for the period on and after July 9, 2012) and FINRA Rule 2010.

Finally, during the Relevant Period, the Firm charged unreasonable markups or markdowns on certain corporate and municipal debt securities transactions in violation of NASD Rule 2440, MSRB Rule G-30, and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

1. Inadequate Supervisory System

NASD Rule 3010 requires FINRA-registered firms to establish, maintain, and implement a supervisory system reasonably designed to ensure compliance with the securities laws. Similarly, MSRB Rule G-27 requires municipal securities dealers to adopt and implement a supervisory system to ensure compliance with MSRB Rules and the Securities Exchange Act of 1934.

During the Relevant Period, the Firm (both a FINRA-registered firm and a municipal securities dealer) failed to implement a reasonable system to supervise the sales activities of its registered representatives. In general, the Firm's supervision of registered representative sales activity consisted only of a daily review of a trade blotter reflecting sales made by registered representatives on the previous day. The blotter did not contain details relating to the transacting-customer's investment objective, risk tolerance, age, or other information relevant to reviewing transactions for suitability. In addition, the Firm failed to evidence that it conducted ongoing monitoring of customer accounts to detect problematic trends. In fact, the Firm failed to use any exception reports or similar tools in connection with its supervision of registered representative sales activity.

During the Relevant Period, the Firm also failed to reasonably supervise the sale of Non-Traditional ETFs and Non-Traditional Mutual Funds by its registered representatives. As explained in FINRA Regulatory Notice 09-31, Non-Traditional ETFs are complex products that are designed to return the inverse, a

multiple, or the inverse-multiple of an underlying benchmark (such as the Russell 2000 or S&P 500) over the course of one trading session (usually one trading day). Non-Traditional ETFs seek to achieve this result through the use of swaps, futures contracts, and other derivative instruments.

In order to maintain the specified exposure to its benchmark, portfolio managers for most Non-Traditional ETFs must rebalance the underlying portfolios at the end of each trading day. This “daily reset” locks in the gains or losses of the previous trading day, giving rise to a compounding effect over the period that the Non-Traditional ETF is held. As a result of the daily compounding of these locked-in gains and losses, when held beyond one trading day, a Non-Traditional ETF may not meet its specified investment objective. The magnitude of the compounding effect during any set period is primarily a function of the volatility of the Non-Traditional ETF’s underlying benchmark. As benchmark volatility increases, so does the impact of compounding and the resulting deviation of the performance of the Non-Traditional ETF relative to its investment objective. In fact, when a Non-Traditional ETF is held throughout periods of high volatility of its benchmark, the Non-Traditional ETF’s performance may depart so significantly from the performance of the underlying benchmark, that a leveraged ETF might *decrease* in value, even when its benchmark *increased* in value (or, for an inverse ETF, decreased) over the same period. As a result of this daily reset and the accompanying compounding effect, in Regulatory Notice 09-31, FINRA cautioned that Non-Traditional ETFs are typically unsuitable for retail investors who plan to hold them longer than one trading session.

Notwithstanding this guidance, during the Relevant Period, the Firm sold Non-Traditional ETFs (as well as Non-Traditional Mutual Funds, which are subject to similar risks) to its customers, many of whom held these products for far longer than one trading session. Although the Firm sold Non-Traditional ETFs and Mutual Funds, it failed to implement a reasonable system to supervise this sales activity. More specifically, the Firm failed to conduct adequate due diligence on Non-Traditional ETFs and Non-Traditional Mutual Funds and failed to adequately train its registered representatives on the unique risks associated with these products. The Firm also failed to adopt and implement adequate written supervisory procedures relating to these complex products, and further failed to implement any system to monitor Non-Traditional ETF and Mutual Fund holding periods, benchmark volatility, and losses.

Finally, during the Relevant Period, the Firm failed to adopt and implement adequate written supervisory procedures relating to markups and markdowns on corporate debt transactions. Although the Firm’s procedures contained a general discussion of markups and markdowns on corporate bonds, it failed to tailor those procedures to the Firm’s business in corporate debt securities.

As a result of the foregoing, the Firm violated NASD Rule 3010(a) and FINRA Rule 2010 and MSRB Rule G-27.

2. Unsuitable Recommendations of Non-Traditional ETFs and Mutual Funds

FINRA Rule 2111 (like its predecessor, NASD Rule 2310)¹ requires broker-dealers and registered representatives to have a “reasonable basis” to believe that any recommended purchase or sale of a security is suitable for the transacting customer. A broker-dealer cannot have a reasonable basis to recommend a security to any customer unless the broker-dealer fully understands the potential risks and rewards associated with the security. Accordingly, a broker-dealer and its registered representatives must perform sufficient due diligence to fully understand the characteristics of any security that is recommended to customers. With respect to Non-traditional ETFs, “this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETFs’ use of leverage, and the customer’s intended holding period will have on their performance.”²

During the Relevant Period, the Firm failed to conduct sufficient due diligence to understand the foregoing terms and features of Non-Traditional ETFs and Mutual Funds. In addition, the Firm failed to provide adequate training regarding Non-Traditional ETFs and Mutual Funds before permitting its registered representatives to recommend the products to the Firm’s customers. Notwithstanding the inadequate due diligence and training, the Firm, acting through certain of its registered representatives, recommended and sold these funds to the Firm’s customers. During the Relevant Period, the Firm recommended 642 purchases of Non-Traditional ETFs in 225 different accounts. In some instances, the recommendations were made to customers with conservative investment objectives and those customers realized losses on the transactions. As a result of this conduct, the Firm violated NASD Rule 2310 (for the period prior to July 9, 2012), FINRA Rule 2111 (for the period on and after July 9, 2012) and FINRA Rule 2010.

3. Excessive Markups/Markdowns on Corporate Debt Transactions

During the Relevant Period, NASD Rule 2440 prohibited FINRA-registered firms from charging their customers markups or markdowns on corporate debt securities that were not fair, taking into consideration all relevant circumstances.³ Notwithstanding this prohibition, during the Relevant Period, the Firm charged customers markups and markdowns that were not fair, taking into consideration all relevant circumstances, on 54 corporate debt transactions. The markups and markdowns ranged from 3.02-4.73%. As a result of the foregoing conduct, the Firm violated NASD Rule 2440 and FINRA Rule 2010.

¹ FINRA Rule 2111 superseded NASD Rule 2310 effective July 9, 2012.

² FINRA Reg. Notice 09-31.

³ FINRA Rule 2121 superseded NASD Rule 2440 effective May 9, 2014.

4. Excessive Markups/Markdowns on Municipal Debt Transactions

MSRB Rule G-30 prohibits municipal securities dealers from charging their customers markups or markdowns on municipal debt securities that were not fair and reasonable. During the Relevant Period, however, the Firm charged its customers markups or markdowns that were not fair and reasonable in connection with 104 municipal bond transactions. The markups and markdowns ranged from 3.01-4.53%. As a result of this conduct, the Firm violated MSRB Rule G-30.

B. The Firm also consents to the imposition of the following sanctions:

A censure; and
Partial restitution of \$75,000 plus interest as set forth in more detail below.⁴

Partial Restitution is ordered to be paid to the customers listed and in the amounts specified on Attachment A hereto in the total amount of \$75,000, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the date each such customer's purchase of a Non-Traditional ETF and/or purchase or sale of corporate or municipal bond at a markup/markdown that was not fair and reasonable, until the date this AWC is accepted by the NAC.

A registered principal on behalf of the Firm shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Dean M. Jeske, Deputy Regional Chief Counsel, 55 West Monroe, Suite 2700, Chicago, Illinois 60603 either by letter that identifies the Firm and the case number or by e-mail from a work-related account of the registered principal of the Firm to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason the Firm cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, the Firm shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. The Firm shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution and interest to the appropriate state authority.

The Firm has specifically and voluntarily waived any right to claim an inability to pay at any time hereafter the monetary sanction imposed in this matter.

⁴ In the interest of maximizing restitution to customers, FINRA imposed no fine after considering, among other things, the Firm's revenue and financial resources.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Alton specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, the Firm specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

The Firm further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Alton understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule

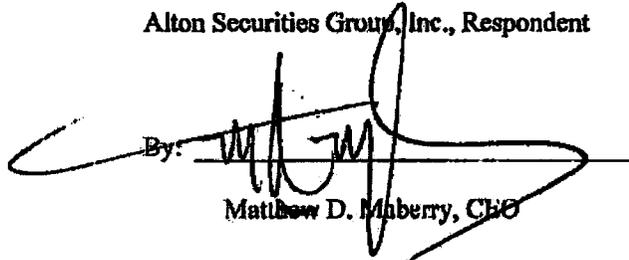
9216;

- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and**
- C. If accepted:**
- 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;**
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;**
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and**
 - 4. The Firm may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. The Firm may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the Firm's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.**
- D. The Firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The Firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.**

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

Alton Securities Group, Inc., Respondent

2/12/16
Date (mm/dd/yyyy)

By: 
Matthew D. Maberry, CEO

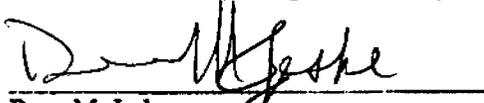
Reviewed by:


R. Craig Zafis, AIC
9201 Spectrum Center Blvd.
Suite 210
San Diego, California 92123
858.384.7380
Counsel for Respondent

Accepted by FINRA:

2/18/16
Date

Signed on behalf of the
Director of ODA, by delegated authority


Dean M. Jeske
Deputy Regional Chief Counsel
FINRA Department of Enforcement
55 West Monroe Street, Suite 2700
Chicago, Illinois 60603
Tel. 312.899.4353

ATTACHMENT A

<u>Customer</u>	<u>Restitution</u>
AB	\$19,705.69
BC	\$4,397.04
DS	\$10,096.39
DS	\$74.56
GS	\$1,197.40
EM	\$29.02
JS	\$755.65
JP	\$221.20
JG	\$101.68
JG	\$7,404.98
JR	\$4.33
JJ	\$29.68
KP	\$164.63
LG	\$81.80
PA	\$106.53
RC	\$89.38
MD	\$1,762.33
PB	\$547.28
RB	\$29.02
RF	\$261.18
AE	\$21.77
WW	\$1,538.99
WR	\$2,970.69
DR	\$4,528.34
RO	\$46.24
AR	\$4,766.45
SB	\$33.35
VT	\$11,202.45
WB	\$33.81
DW	\$485.35
BC	\$2,312.59