

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

Department of Enforcement,

Complainant,

v.

John S. Hudnall (CRD No. 4200298),

Respondent.

DISCIPLINARY PROCEEDING  
No. 2013036412601

**COMPLAINT**

The Department of Enforcement alleges:

**SUMMARY**

1. Between May 2012 and July 2014, while registered with FINRA member firms BancWest Investment Services, Inc. ("**BancWest**") and U.S. Bancorp Investments, Inc. ("**U.S. Bancorp**"), Respondent John S. Hudnall (1) participated in an undisclosed and unapproved private securities transaction in violation of NASD Rule 3040 and FINRA Rule 2010; (2) made unapproved and undisclosed financial sales promotions to firm customers, in violation of FINRA Rule 2010; (3) recommended and sold an unsuitable variable annuity product in violation of FINRA Rules 2111 and 2010; and (4) provided false information in response to FINRA information requests in violation of FINRA Rules 8210 and 2010.

2. Hudnall's private securities transaction occurred in May 2012, while he was registered with BancWest. As detailed below, Hudnall artificially split a customer's \$400,000 REIT investment into two parts – one part for \$40,000 and the other for \$360,000. He then disclosed and submitted only the smaller part to his firm for supervisory review and approval, while submitting the far larger part directly to the REIT sponsor in order to circumvent BancWest's supervisory review of the overall transaction, which exceeded the firm's concentration guidelines.
3. Hudnall's unapproved sales promotion occurred between April 2011 and July 2012, also while he was registered with BancWest. As detailed below, Hudnall offered and paid monetary incentives to two customers from his own personal funds to incent them to hold their fixed annuity contracts for at least a year before surrendering them, which enabled Hudnall to retain commissions he would have lost had the customer surrendered before the year was up. Hudnall concealed this sales promotion from BancWest and masked the source of the funds paid to the customers, knowing that BancWest would not have approved the promotion had he disclosed it.
4. Hudnall's unsuitable variable annuity sale occurred in July 2014, while he was registered with U.S. Bancorp. As detailed below, the variable annuity Hudnall recommended and sold provided no material benefit to the customer for its additional cost and instead offered less flexibility, fewer investment options, and additional liquidity risk.
5. Finally, Hudnall provided false information to FINRA staff in May 2013, also while registered with U.S. Bancorp. As detailed below, during FINRA's investigation of

his conduct, Hudnall falsely denied using cashier's checks in connection with his payment of promotional incentives to two customers.

### **RESPONDENT AND JURISDICTION**

6. Hudnall entered the securities industry in 2000 and was associated with four member firms before joining BancWest on September 8, 2010. During the period relevant to this Complaint, Hudnall was associated with two firms: (1) BancWest from September 8, 2010 to November 28, 2012, and (2) U.S. Bancorp from November 28, 2012 to March 26, 2015. Hudnall was discharged from U.S. Bancorp on March 6, 2015, for failing to report that he had been contacted by a regulatory body. Hudnall is not currently registered.
7. Although Hudnall 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:
  - a. the Complaint was filed within two years after the March 26, 2015 termination of Hudnall's registration with U.S. Bancorp; and
  - b. the Complaint charges Hudnall with misconduct committed while he was registered or associated with a FINRA member.

### **FACTS**

#### ***Undisclosed Private Securities Transaction***

8. In May 2012 while registered with BancWest, Hudnall participated in an undisclosed and unapproved private securities transaction.

9. On May 9, 2012, he recommended and sold a \$400,000 Wells Core Office Income REIT investment to an 80-year old BancWest customer "AFJ" which he split into two simultaneous transactions of \$40,000 and \$360,000 (the "REIT Investment").
10. To circumvent BancWest's supervisory review of such a large transaction of this kind, Hudnall executed the \$360,000 portion of the REIT Investment directly with the REIT sponsor while submitting only the \$40,000 portion to BancWest for its supervisory review.
11. At the time of the REIT Investment, BancWest required sales of non-traded REITS – of which the REIT Transaction was one – to follow specific procedures in order to ensure sufficient supervisory scrutiny, including pre-approval of all sales before the investment transmittal forms and payment were forwarded to the REIT sponsor.
12. At the time of the REIT Investment, BancWest's supervisory manual specified that no more than 10% of a client's liquid net worth could be invested with a particular REIT sponsor, and no more than 20% of a client's liquid net worth could be invested in all REIT holdings combined; any exception to these thresholds required pre-approval from a BancWest regional sales manager. The \$400,000 REIT Investment exceeded these thresholds and thus, if fully disclosed to BancWest, would have triggered additional supervisory review and likely would have been disapproved.
13. As part of the supervision of these transactions, BancWest required Hudnall to complete non-traded REIT paperwork with the customers and then submit the paperwork to BancWest for review. If approved, the documentation and payment would be forwarded by BancWest to the product sponsor.

14. Hudnall prepared subscription paperwork for the \$40,000 portion of the REIT Investment and submitted that paperwork to BancWest's back office for review, approval and processing, consistent with BancWest policies.
15. Simultaneously, however, Hudnall prepared separate subscription paperwork for the \$360,000 of the REIT Investment which he submitted directly to the REIT sponsor instead of BancWest.
16. If Hudnall had submitted the \$360,000 of the Wells REIT purchase to BancWest for its required review, it would have triggered an additional level of review and approval as the \$400,000 cumulative investment far exceeded the firm's 10% of liquid net worth guideline for one sponsor.
17. Hudnall generated a gross commission of \$25,200 in connection with the \$360,000 portion of the REIT Investment.

***Undisclosed Promotional Offers***

18. As a registered representative at BancWest, Hudnall sold Jackson National fixed annuities that included a return-of-premium guarantee. The guarantee allowed the owner to surrender the annuity within the first few years of ownership and receive the return of their initial premium payment without incurring a surrender fee.
19. Under this guarantee, however, if an annuity owner surrendered the annuity within the first year of ownership, Jackson National would charge back the commission it had paid the representative for the sale; by contrast, surrenders after the first year did not result in a recapture of the commission from the selling representative.

20. As part of Hudnall's fixed annuity sales efforts in 2011 and 2012, Hudnall made a promotional offer in which he promised to pay certain clients who purchased Jackson National fixed annuities 1% annual interest if they held their annuity for at least a year before surrendering it. This promotional offer was not part of the Jackson National fixed annuity product that Hudnall was selling.
21. Hudnall made this promise to two BancWest clients, BC and FM, and he subsequently made the promised interest payments to these clients using cashier's checks drawn on his personal account.
22. Through Hudnall, and based on Hudnall's recommendation, BancWest customer BC invested a total of \$250,000 in Jackson National Optimax 4 fixed annuities, including a \$100,000 investment in February 2011 and a \$150,000 investment in June 2011.
23. Hudnall generated gross commission of \$13,750 and he received a net payout of approximately \$4,565 associated with BC's investments in these Jackson National fixed annuities.
24. In July 2012, over a year after her investments, BC surrendered her Jackson National fixed annuities.
25. In August 2012, Hudnall obtained two cashier's checks made payable to BC and drawn on his personal account, one for \$3,346.17 and the other for \$30, and he subsequently gave those checks to BC.
26. Hudnall's name and checking account number initially appeared on the face of each check by "NAME OF REMITTER," but Hudnall obscured this information on the checks.

27. Through Hudnall, and based on Hudnall's recommendation, BancWest customer FM invested \$127,000 in Jackson National Optimax 4 fixed annuities, including a \$27,000 investment in May 2011 and a \$100,000 investment in September 2011.
28. Hudnall generated gross commission of \$6,985 and he received a net payout of approximately \$2,474 associated with FM's investments in these Jackson National fixed annuities.
29. In September 2013, over a year after her investment, FM surrendered her Jackson National fixed annuity.
30. On September 28, 2012, Hudnall obtained a cashier's check for \$1,544.27 drawn on funds from his personal account and made payable to FM, obscured his name and his account number on the remitter line of the check and hand-wrote "JNL" which is a reference to "Jackson National Life", and gave the check to FM.
31. Hudnall did not disclose to BC and FM that the interest payments he promised to them would be paid, and ultimately were paid, from his personal funds. In fact, as detailed above, he concealed the source of the funds from the clients by obscuring his name and account number on the cashier's checks he gave them. As a result, at the time each customer received the checks from Hudnall, neither customer was aware that she had been reimbursed directly by Hudnall, and believed the checks were from Jackson National.
32. Hudnall did not disclose to BancWest either his promotional offer or his related payments to BC and FM.

### ***Unsuitable Investment Recommendation***

33. In April 2014, while registered with U.S. Bancorp, Hudnall met customer RD at a U.S. Bancorp branch, where RD expressed to Hudnall his desire to convert his pension with a past employer to a more flexible traditional IRA account without putting these retirement funds at risk.
34. Hudnall's suitability information for RD reflected that RD was age 68 and an investment objective of "balanced" and "moderately conservative."
35. Hudnall recommended and sold RD the Prudential Premier Retirement Variable Annuity B Series ("**Prudential VA**").
36. RD completed paperwork for the purchase of the Prudential VA in July 2014, and Hudnall generated a 5% gross commission from the sale of the Prudential VA to RD.
37. The Prudential VA did not have suitable features and benefits to meet RD's financial needs.
38. The Prudential VA was an overly costly and unsuitable product for RD given that it failed to provide RD with any material benefit, offered less flexibility than a traditional IRA, was inconsistent with RD's investment goal, represented a far smaller selection of investment options than a traditional IRA, incurred additional liquidity risk (associated with surrender fees), provided no tax deferral benefit (as the funds involved were already qualified), and involved no particular death protection benefit (given that RD already had adequate life insurance).

***False Responses to Rule 8210 Requests***

39. On May 16, 2013, FINRA staff sent Hudnall a Rule 8210 request for information including answers to the following questions: “Did you ever provide cashier’s checks to any Firm customers? If so, what was the reason for providing the cashier checks? How much money was provided to the customer(s)?”
40. On May 25, 2013, Hudnall submitted a response in which he answered “no” to the question of whether he had provided cashier’s checks to any Firm customers.
41. Hudnall’s May 25, 2013 response was false because Hudnall had provided cashier’s checks to customers BC and FM in August and September 2012.
42. In a September 25, 2013 letter, through counsel, Hudnall admitted that his prior response to FINRA’s May 16, 2013 requests was false and that he had in fact given cashier’s checks to two customers. Moreover, on February 27, 2015, Hudnall testified before Enforcement and admitted that he had given the customers cashier’s checks not as an accommodation to respond to a misunderstanding but rather in fulfillment of the unapproved Promotional Offer.

**FIRST CAUSE OF ACTION  
SELLING AWAY (NASD RULE 3040)**

43. The Department re-alleges and incorporates by reference paragraphs 1 - 42.
44. NASD Conduct Rule 3040 provides that an associated person may not participate in any securities transaction outside of the regular course of his employment with his member firm without first providing written notice to the member firm describing in

detail the proposed transaction and his proposed role and stating whether he has received or may receive selling compensation for the transaction.

45. Hudnall participated in a private securities transaction by recommending and executing the \$360,000 portion of the REIT Investment for BancWest customer AFJ directly with the REIT product sponsor and without providing the requisite prior written notice to BancWest.
46. Hudnall violated NASD Rule 3040 by participating in the foregoing private securities transaction. By virtue of this violation, Hudnall also violated FINRA Rule 2010.

**SECOND CAUSE OF ACTION  
UNDISCLOSED PROMOTIONAL OFFER (FINRA RULE 2010)**

47. The Department re-alleges and incorporates by reference paragraphs 1 - 42.
48. By making his undisclosed and unapproved promises to pay U.S. Bancorp customers BC and FM 1% annual interest if they held their fixed annuities for more than one year, by misleading BC and FM into believing that the payments were being promised and made by the annuity issuer rather than from Hudnall's own personal funds, and by actively concealing his promises and related payments from his firm, Hudnall failed to adhere to high standards of commercial honor and just and equitable principles of trade and thereby violated FINRA Rule 2010.

**THIRD CAUSE OF ACTION  
UNSUITABLE PRODUCT RECOMMENDATION (FINRA RULES 2111 & 2010)**

49. The Department re-alleges and incorporates by reference paragraphs 1 - 42.
50. FINRA Rule 2111 requires that, in recommending to a customer the purchase, sale or exchange of any security, a member must have reasonable grounds for believing that

the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs and consistent with his customer's best interests.

51. By making an unsuitable recommendation for the sale of the Prudential VA to customer RD, Hudnall violated FINRA Rules 2111 and 2010.

**FOURTH CAUSE OF ACTION  
FALSE RESPONSES TO FINRA REQUESTS FOR INFORMATION (FINRA RULE 8210 & 2010)**

52. The Department re-alleges and incorporates by reference paragraphs 1 - 42.
53. FINRA Rule 8210 requires associated persons to provide accurate information to FINRA in response to requests made during the course of an investigation. An associated person who provides false or misleading information to FINRA violates Rule 8210.
54. Hudnall's May 25, 2013 response to FINRA's Rule 8210 request for information was inaccurate because it falsely denied that he had provided cashier's checks to any Firm customers when in fact, as he later admitted, he had provided cashier's checks to BC and FM in August and September 2012.
55. Hudnall's false responses to FINRA violated FINRA Rules 8210 and 2010.

**RELIEF REQUESTED**

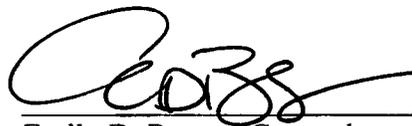
WHEREFORE, the Department respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Hudnall committed the violations charged and alleged herein;

- B. order that one or more of the sanctions provided under FINRA Rule 8310(a) be imposed, including that Respondent be required to disgorge fully any and all ill-gotten gains, with interest; and
- C. order that Hudnall bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.

**FINRA DEPARTMENT OF ENFORCEMENT**

Date: May 2, 2016



\_\_\_\_\_  
Emily D. Barnes, Counsel  
Lane Thurgood, Director  
FINRA Department of Enforcement  
15200 Omega Drive, Ste. 300  
Rockville, Maryland 20850  
Phone: 301-258-8500; Fax: 301-208-8090  
e-mail: emily.barnes@finra.org