

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

John Joseph Arnold
(CRD No. 2854371),

Respondent.

DISCIPLINARY PROCEEDING
No. 20130383330 01

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. In August 2013, an imposter posing as KDL, a customer of Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch or the Firm), sent two emails to John Joseph Arnold (Arnold), a general securities representative associated with the Firm, requesting that two wire transfers totaling \$127,200 be sent to third-party bank accounts. Despite Merrill Lynch's requirement that Firm personnel verbally confirm all emailed wire instructions, Arnold instructed AL, a Firm sales assistant, to process these two wire requests, falsely representing to her that he had verbally confirmed each of the wire requests with customer KDL. Based on Arnold's representations, AL recorded in the Firm's books and records that both wire requests were verbally confirmed with the customer, when in fact Arnold did not speak with KDL about the wire transfer requests.

2. Arnold also caused the entry of additional fictitious information in the Firm's books and records concerning the purpose of a wire transfer request. In connection with the second wire request, Arnold falsely represented to AL that KDL needed the wire transfer to pay for medical costs. Relying on Arnold's representations, AL recorded in the Firm's books and records that the purpose of the wire transfer was to cover medical expenses.

3. In addition to requiring verbal authentication of emailed wire requests, Merrill Lynch required Firm personnel to obtain a Letter of Authorization (LOA) from a customer for wire requests exceeding \$50,000. The Firm also expressly prohibited its employees from structuring wire transfer requests over consecutive business days to avoid obtaining an LOA.

4. Notwithstanding the Firm's LOA requirements, Arnold structured the impostor's first wire request for \$77,200 by splitting it into two separate transfers executed over two consecutive business days. By structuring the impostor's wire request to send \$50,000 on one day and the remaining \$27,200 the next day, Arnold disguised from the Firm the true amount of the wire request in order to evade Merrill Lynch's requirement that he obtain an LOA from KDL to process the \$77,200 wire request.

5. On August 8, 2013, a Merrill Lynch supervisor explicitly asked Arnold whether he had spoken with customer KDL to verbally confirm the first wire request. Arnold falsely represented to the supervisor that he had spoken with customer KDL.

6. As a result of the foregoing misconduct, Arnold violated FINRA Rule 2010 by making false statements to a Firm sales assistant in order to facilitate wire transfer requests and by making a false statement to a Merrill Lynch supervisor in order to conceal his own misconduct. Arnold also violated FINRA Rule 2010 by structuring a wire transfer request to circumvent Merrill Lynch's LOA requirements, thereby impeding the Firm's ability to supervise

such transactions. Additionally, Arnold violated FINRA Rules 4511 and 2010 by causing the Firm to maintain inaccurate books and records, in contravention of Section 17(a) of the Securities Exchange Act of 1934 (the Exchange Act) and Rule 17a-3 thereunder.

RESPONDENT AND JURISDICTION

7. Arnold entered the securities industry in 1996 and has been associated with five present and former FINRA-member broker-dealers. Arnold obtained the following securities licenses between 1997 and 2003: Series 7 (General Securities Representative), Series 63 (Uniform Securities State Law Examination), Series 66 (NASAA Uniform Combined State Law Examination), and Series 31 (Futures Managed Funds Examination).

8. Since November 2013, Arnold has been associated with ABC, a FINRA-member broker-dealer, as a general securities representative. Arnold remains registered with ABC.

9. FINRA has jurisdiction over Arnold for purposes of this proceeding because Arnold is currently associated with a FINRA member firm and registered with FINRA, and the Complaint charges him with securities and business-related misconduct committed while he was registered with FINRA and associated with a FINRA member firm.

STATEMENT OF FACTS

Firm WSPs Required Verbal Verification & Prohibited Structuring

10. Merrill Lynch's written supervisory procedures (WSPs) in effect during August 2013 (the Relevant Period) required its employees to process wire transfer requests in a Firm web-based system (the ASAP system).

11. The Firm's WSPs prohibited its employees from accepting instructions for account transactions sent by email. In the event emailed instructions were received, Merrill

Lynch's WSPs required its employees to verbally confirm all instructions with the customer or authorized person before effecting the transaction at issue.

12. Additionally, in connection with the receipt of verbal instructions from customers, the Firm's WSPs required its employees to obtain a written LOA for any wire request that exceeded \$50,000. The WSPs also prohibited the structuring of verbal asset transfer requests over consecutive business days in order to avoid obtaining an LOA.

13. Arnold reviewed the Firm's WSPs pertaining to wire transfer instructions and LOAs. In or about May 2013, Arnold completed a Merrill Lynch online annual compliance certification form in which he certified that he was familiar with, understood, and would adhere to such Firm policies.

First Fraudulent Wire Request and Structuring of the Wire Transfers

14. During the Relevant Period, Arnold serviced the KDL "household" of accounts, which held around \$218 million in assets under management.

15. In or about early August 2013, a third-party improperly gained access into the personal email address of Firm customer KDL.

16. On or about August 7, 2013 (August 7th), an imposter posing as KDL sent Arnold an email (the August 7th Email) requesting a wire transfer of \$77,200 to the account of JCAT Inc., held at the Hialeah, Florida branch of DEF bank (the August 7th wire request).

17. According to the August 7th Email sent by the imposter, KDL was starting a board meeting and would be unable to verbally confirm the wire request for the rest of the day.

18. Unaware that he was not in fact communicating with KDL, Arnold sent the following email to the imposter in response:

Our limit for verbal instructions is \$50,000 per transfer per day. If you're okay with it, we can send \$50,000 today and the balance tomorrow. Let me know if that works and we'll send it expeditiously. Our cutoff time is 2:30 PST. If not, we'll require a signed letter of authorization. Sorry for the inconvenience.

Thanks.

19. Arnold did not contact KDL to verbally confirm the August 7th wire request. Instead, in subsequent emails with the imposter, Arnold asked for the last four digits of KDL's social security number, writing "[w]e've had a lot of fraudulent attempts at wire transfers via email lately." The imposter provided Arnold with the last four digits of KDL's social security number and agreed to have the funds wired over a two-day period as Arnold had suggested.

20. Arnold thereafter instructed AL, a Firm sales assistant, to process the August 7th wire request for \$77,200 by splitting the wire transfers over two consecutive days and transferring \$50,000 on August 7th and \$27,200 on August 8th. In order to complete the online wire request form in Merrill Lynch's ASAP system, AL asked Arnold for the date and time that he verbally confirmed the August 7th wire request with KDL. Arnold falsely replied that he had spoken with KDL on August 7th at 12:15 p.m.

21. Based on the false information she received from Arnold, AL recorded in the Firm's ASAP system that in connection with the August 7th wire request, Arnold had positively identified the customer "by voice or in person" on August 7th at 12:15 p.m.

22. The Firm thereafter wired \$50,000 out of customer KDL's account to the third-party account, as instructed by the imposter.

23. On or about August 8, 2013 ("August 8th"), Arnold sent an email to AL, asking if she was prepared to wire the remaining \$27,200 that day. Relying on the false information provided by Arnold on August 7th, AL completed another online ASAP request form to process a

wire for the remaining \$27,200. AL again recorded in the ASAP system that Arnold had positively identified the customer “by voice or in person” on August 7th at 12:15 p.m.

24. On or about August 8th, the Firm wired \$27,200 out of customer KDL’s account to the third-party account, as instructed by the imposter.

Arnold’s Misrepresentation to a Firm Supervisor

25. On or about August 8th, AS, a centralized Firm email reviewer, emailed BH, a Client Relationship Manager for Arnold’s complex. Questioning the nature of the August 7th Email and subsequent email correspondence between Arnold and the imposter, AS asked BH to review the correspondence and to take appropriate action to ensure that the August 7th wire request was properly authenticated.

26. BH called Arnold and asked him whether he had spoken with customer KDL over the telephone concerning the wire request referenced in the August 7th Email. Arnold falsely answered “yes.”

Second Fraudulent Wire Request and Subsequent Transfer

27. On or about August 8th, Arnold received another email from the imposter (the August 8th Email), requesting a wire transfer of \$50,000 from KDL’s account to the account of XYZ Service, held at the Bowie, Maryland branch of MNO bank (the August 8th wire request).

28. Arnold sent an email in response to the imposter, asking him to call so Arnold could speak with him. The imposter replied by email, stating that he was entering another board meeting and would call when he could.

29. After waiting approximately one-half hour for KDL to call, Arnold directed AL to process the August 8th wire request for \$50,000, even though he had not spoken with KDL to verify the wire instructions.

30. In processing the wire request, AL asked Arnold if he had verbally verified the August 8th wire request with KDL. Arnold falsely replied that he had spoken with KDL on August 8th at 10:50 a.m.

31. Additionally, AL asked Arnold for the purpose of the wire transfer. Arnold told AL that the funds to be wired were needed to cover medical expenses.

32. Relying on the false information she received from Arnold, AL recorded in the ASAP system that in connection with the August 8th wire request, Arnold positively identified the customer "by voice or in person" on August 8th at 10:50 a.m. and that the purpose for the wire was to cover medical payments.

33. The Firm thereafter wired \$50,000 out of customer KDL's account to the third-party bank account, as instructed by the imposter.

Discovery of the Fraud

34. On or about August 9, 2013, the imposter sent Arnold another email requesting an additional wire transfer of \$170,000 to JCAT Inc.

35. For the first time, Arnold called KDL to verbally verify the wire request. During Arnold's ensuing telephone conversation with KDL, Arnold learned that KDL's email account had been hacked and that KDL had not requested either the August 7th or the August 8th wire requests.

36. Arnold subsequently called BH and informed him that the wire requests from KDL's account were fraudulent. During the call with BH, Arnold admitted that he had lied to BH when he told BH that he had verbally verified the August 7th wire request with KDL.

37. The Firm reimbursed KDL \$127,200 for the fraudulent wire transfers that it had processed from his account.

FIRST CAUSE OF ACTION
Misrepresentations
(FINRA Rule 2010)

38. The Department realleges and incorporates by reference paragraphs 1 through 37 above.

39. FINRA Rule 2010 requires FINRA members and associated persons "in the conduct of its business ...[to] observe high standards of commercial honor and just and equitable principals of trade."

40. In order to facilitate the processing of wire transfer requests he had received by email, Arnold made verbal misrepresentations to AL as follows:

- a. In connection with the August 7th wire request, Arnold falsely represented that he had verbally confirmed the wire transfer instructions with customer KDL on or about August 7th at 12:15 p.m.
- b. In connection with the August 8th wire request, Arnold falsely represented that he had verbally confirmed the wire transfer instructions with customer KDL on or about August 8th at 10:15 a.m.
- c. In connection with the August 8th wire request, Arnold also falsely represented that the purpose for the wire transfer was to cover medical payments.

41. Arnold's misrepresentations to AL were inconsistent with high standards of commercial honor and just and equitable principles of trade.

42. As a result of the foregoing, Arnold violated FINRA Rule 2010.

SECOND CAUSE OF ACTION
Misrepresentations
(FINRA Rule 2010)

43. The Department realleges and incorporates by reference paragraphs 1 through 42 above.

44. Arnold verbally misrepresented to BH, a Firm supervisor, that he had verbally verified the August 7th wire request with customer KDL, when in fact he had not.

45. Arnold's misrepresentation to BH was inconsistent with high standards of commercial honor and just and equitable principles of trade.

46. As a result of the foregoing, Arnold violated FINRA Rule 2010.

THIRD CAUSE OF ACTION
Structuring a Wire Transaction
(FINRA Rule 2010)

47. The Department realleges and incorporates by reference paragraphs 1 through 46 above.

48. Notwithstanding the Firm's LOA requirements, and without prompting from the imposter, Arnold structured the August 7th wire request for \$77,200 by splitting it into two separate transfers executed over two consecutive business days. By structuring the imposter's wire request to send \$50,000 on August 7th and the remaining \$27,200 on August 8th, Arnold circumvented Merrill Lynch's requirement that he obtain an LOA from KDL.

49. In so doing, Arnold: (a) prevented Merrill Lynch from detecting the true dollar amount of the August 7th wire request; (b) thwarted the Firm's ability to ensure the authenticity of the wire request through an LOA from KDL; and (c) impeded the Firm's ability to supervise such transactions.

50. Respondent's structuring of the August 7th wire request was inconsistent with high standards of commercial honor and just and equitable principles of trade.

51. As a result of the foregoing, Arnold violated FINRA Rule 2010.

FOURTH CAUSE OF ACTION
False Books and Records
(FINRA Rules 4511 and 2010)

52. The Department realleges and incorporates by reference paragraphs 1 through 51 above.

53. Rule 17a-3(a)(1) under the Exchange Act requires broker-dealers to "make and keep current . . . [b]lotters (or other records of original entry) containing an itemized daily record of . . . all receipts and disbursements of cash and all other debits and credits." FINRA Rule 4511 requires each FINRA member to, among other things, comply with the record keeping and retention requirements of Rule 17a-3.

54. Merrill Lynch required its employees to process wire transfer requests through the online ASAP system.

55. Merrill Lynch's ASAP wire request forms were an integral part of the Firm's wire transfer documentation and constitute inter-office memoranda relating to the Firm's business.

56. Relying on Arnold's misrepresentations, and at his direction, AL recorded false entries in the Firm's ASAP system concerning Arnold's purported verbal verification of the August 7th and August 8th wire requests, causing Merrill Lynch to preserve and maintain false

books and records, in contravention of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

57. Moreover, relying on Arnold's misrepresentations, and at his direction, AL recorded in the ASAP system a fictitious purpose for the April 8th wire request, causing the Firm to preserve and maintain false books and records in further contravention of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

58. As a result of the foregoing, Arnold caused the Firm to maintain inaccurate books and records, in violation of FINRA Rules 4511 and 2010.

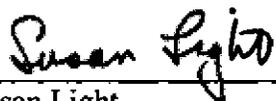
RELIEF REQUESTED

WHEREFORE, the Department of Enforcement respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that 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; and
- C. order that Respondent 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: October 8, 2015



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