FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014039071101

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

RE: Cadaret Grant & Co., Inc., Respondent
CRD No. 10641

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Cadaret Grant & Co., Inc. ("Cadaret Grant" 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 Cadaret Grant alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. Cadaret Grant 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

Cadaret Grant has been a member of FINRA since 1982. The Firm is headquartered in Syracuse, New York. It has approximately 676 registered representatives and 456 branch offices.

RELEVANT DISCIPLINARY HISTORY

In December 2016, Cadaret Grant consented to an AWC (2013038424401) that found that the Firm failed to enforce its written supervisory procedures by failing to adequately address the suitability of a registered representative's recommendation to exchange the entire account balance of a customer's variable annuity to a higher risk subaccount. Cadaret Grant agreed to a censure and a fine of $10,000.

In May 2015, Cadaret Grant consented to an AWC (2014039684601) that found that the Firm, among other deficiencies, failed to establish a supervisory system reasonably designed to supervise the surrender of variable annuities that were not part of an exchange or replacement or processed by its sales force. Cadaret Grant agreed to a censure, a fine of $75,000, payment of restitution of $236,242 plus interest, and an undertaking to review the adequacy of its procedures concerning non-exchange variable annuity surrenders.

In December 2011, Cadaret Grant consented to an AWC (2008015475201) that found that the Firm, among other things, failed to establish and maintain a system reasonably designed to supervise variable annuity transactions. Cadaret Grant agreed to a censure, a fine of $200,000, rescission to certain variable annuity contract owners, and an undertaking to review its procedures concerning the suitability of its variable annuity transactions.

OVERVIEW

FINRA Rule 3110 requires that FINRA member firms establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with securities laws, regulations and pertinent rules. From August 2012 through May 2017 (the "Relevant Period"), Cadaret Grant failed to establish such a reasonably-designed supervisory system with respect to numerous areas of its business. In large part, the Firm's supervisory deficiencies stemmed from its failure to devote sufficient resources to the supervision of the Firm's personnel. For example, during the Relevant Period, the Firm employed just three individuals to review for suitability the securities transactions of more than 676 representatives working from more than 450 branch locations.

As set forth below, as a result of these, and other, deficiencies, Cadaret Grant violated Section 17(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and Exchange Act Rule 17a-4, NASD Rule 3010, and FINRA Rules 2330, 3110, 4511 and 2010.

FACTS AND VIOLATIVE CONDUCT

A. Failure to Implement a System Reasonably Designed to Detect Unsuitable Securities Recommendations

During the Relevant Period, Cadaret Grant failed to establish and maintain a supervisory system reasonably designed to ensure that its representatives' securities recommendations were suitable and in compliance with applicable securities laws, regulations and rules.

According to the Firm's procedures, each representative's supervising principal was responsible for reviewing the suitability of "each customer transaction." In practice, however, supervising principals could not effectively accomplish this task.

As an initial matter, the Firm did not employ enough supervising principals. For example, one Firm principal employed in the home office was the designated supervising principal for more than 320 representatives. Also, the Firm did not provide supervising principals with sufficient tools or exception reports designed to identify patterns of potentially unsuitable trading. Rather, supervising principals were expected to conduct suitability reviews through a manual review of the daily trade blotter. The Firm's procedures, however, did not provide any guidance to supervisors on how they should conduct this manual review. In any event, it was not possible for the Firm's supervising principals to manually review hundreds or thousands of trades on a daily basis to detect potentially unsuitable transactions.

The Firm's procedures also provided that the Firm's compliance personnel would conduct a "weekly blotter review" to identify potential sales practice concerns such as "over-concentration" and "churning." However, the Firm employed only three compliance personnel who were responsible for manually reviewing the weekly blotters for all of the Firm's 676 registered representatives. Also, Cadaret Grant's procedures failed to provide guidance to compliance personnel concerning how to review blotter transactions to detect potential suitability violations or what steps should be taken when issues were identified. And the weekly blotter itself was deficient because the Firm used review filters that unreasonably reduced the number of trades subject to review. For example, the Firm excluded transactions under $10,000 from the weekly blotter. Because of these parameters, compliance personnel did not review the majority of the Firm's transactions. Rather, on a weekly basis, the Firm's compliance department reviewed on average less than 3% of the Firm's 9,000 trades.

Finally, the Firm's supervisory procedures required examiners in the compliance department to conduct periodic inspections of branch offices to detect and prevent violations by registered representatives in those locations. However, the Firm employed an insufficient number of compliance examiners for this purpose. For instance, in 2014, the Firm tasked three compliance examiners with inspecting over 400 geographically-disperse branches. As a result, these inspections were conducted in a manner not reasonably designed to identify violative activity.

By virtue of the foregoing, Cadaret Grant violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

B. Failure to Implement a System Reasonably Designed to Supervise Variable Annuity Recommendations

From August 2012 through August 2016, Cadaret Grant sold 9,293 individual variable annuity contracts ("VAs") to its customers. Despite the significant role that VA sales played in Cadaret Grant's overall business, the Firm failed to implement a supervisory system and procedures reasonably designed to ensure the suitability of its VA sales, including its sales of L-share contracts.

In addition, during this period, the Firm failed to implement a supervisory system and procedures reasonably designed to monitor and supervise certain VA exchanges.

1. Variable Annuity Share Class Recommendations

Cadaret Grant sold VA contracts with the option of different share classes. B-share contracts are the most common share class sold in the industry and typically have a seven-year surrender period. L-share contracts typically provide a shorter surrender period of three to four years. Insurance companies design L-share contracts so that customers pay a higher fee in exchange for the increased liquidity provided by the shorter surrender period. The fees associated with an L-share contract are typically between 35 and 50 basis points higher annually than most B-share contracts. Pursuant to the terms established by the insurance company issuers, if a purchaser chooses not to surrender an L-share contract during the surrender period, the purchaser continues to pay a higher annual fee for the life of the contract, unless the contract provides for a "persistency credit."[1]

The Firm's written supervisory procedures and training materials failed to provide guidance to registered representatives on the features of various VA share classes and the associated fees and surrender charges, and did not provide them with adequate information to compare share classes to make suitability determinations. Because of this lack of guidance, registered representatives were not provided the tools to present potential purchasers with a side-by-side comparison of the fees and surrender charges of the various share classes of the annuity being purchased.

Additionally, Cadaret Grant failed to provide sufficient guidance or training to registered representatives and principals regarding the sale of long-term income riders with multi-share class VAs, particularly the combination of long-term income riders and L-share contracts, which have conflicting time horizons.

[1] Some L-Share contracts have a specific provision, commonly called a "persistency credit," which reduces the annual fees so that the contract is comparable to a B-share contract after the product is held for a certain period of time, generally seven to ten years.

2. Failure to Implement a System Reasonably Designed to Supervise Variable Annuity Exchanges

FINRA Rule 2330(d) requires firms to:

(1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws ("inappropriate exchanges"); and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

Cadaret Grant did not have surveillance procedures to identify possible inappropriate rates of VA exchanges. Instead, the Firm relied on individual reviews of VA transactions by Firm principals as the sole means to identify trends concerning high volumes of VA exchange transactions. The Firm failed to provide those principals with guidance or tools, such as exception reports, trend analysis or historical rates of exchange, to assist in evaluating whether exchange rates were excessive. Because of these deficiencies, it was unreasonable for Cadaret Grant to expect its principals to detect trends of potentially inappropriate VA exchanges.

By virtue of the foregoing, Cadaret Grant violated NASD Rule 3010 and FINRA Rules 2330(d) and (e), 3110 and 2010.

C. Failure to Implement a System Reasonably Designed to Supervise Consolidated Reports

A "consolidated report" is a document provided by a broker to a customer that combines account information regarding most or all of a customer's assets. On April 8, 2010, FINRA issued Regulatory Notice 10-19, which reminded member firms that consolidated reports are communications with the public by the firm and must be clear, accurate, and compliant with federal securities laws and FINRA Rules. The Notice cautioned that consolidated reports, "[i]f not rigorously supervised . . . can raise a number of regulatory concerns, including the potential for communicating inaccurate, confusing or misleading information to customers, lapses in supervisory controls, and the use of these reports for fraudulent or unethical purposes."

During the Relevant Period, Cadaret Grant permitted registered representatives to prepare and disseminate consolidated reports using a Firm-approved software program. Additionally, until July 2016, the Firm allowed representatives to prepare and issue consolidated reports using programs and applications of their own choosing.

In either case, representatives could manually enter a customer's securities positions and values on the reports. Throughout this period, at least 325 representatives issued consolidated reports to Firm customers on a regular basis.

Cadaret Grant failed to implement a supervisory system or procedures for the review of consolidated reports. The Firm had no adequate system to detect the use of consolidated reports, or to review their contents to ensure customers were receiving accurate information concerning the value of their holdings. Additionally, the Firm had no procedures requiring registered representatives to retain copies of the consolidated reports sent to customers or the supporting documentation that could be used to verify the accuracy of the manually-entered asset values in those reports.

By virtue of the foregoing, Cadaret Grant violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

D. Failure to Retain Emails

Section 17(a) of the Exchange Act and Rule 17a-4 thereunder require members to preserve for a period of not less than three years, the first two years in an easily accessible place, certain communications (including electronic communications) relating to the firm's business as a broker-dealer. FINRA Rule 4511 requires, among other things, that members comply with the recordkeeping requirements set forth within Rule 17a-4.

From August 2012 through August 2016, Cadaret Grant provided representatives with a Firm email address to use for Firm-related email communications. Cadaret Grant's procedures also permitted representatives to utilize their own email addresses for Firm business, but required them to identify those addresses—at the time they began employment at the Firm and through annual compliance questionnaires—so those emails could be preserved and reviewed through the Firm's email system.

During the above period, at least 70 registered representatives disclosed to the Firm personal email addresses that they used for Firm business. Nevertheless, the Firm failed to take any steps to retain and review those emails. As a result, the Firm failed to retain and review business-related emails for these representatives.

By virtue of the foregoing, Cadaret Grant violated Section 17(a) of the Exchange Act and Rule 17a-4 thereunder, and FINRA Rules 4511 and 2010.

B. Respondent consents to the imposition of the following sanctions:

- a censure;
- a fine of $800,000; and
- the following undertaking:

a. Cadaret Grant shall:

(1) Retain, within 30 days of the date of the Notice of Acceptance of this AWC, an Independent Consultant, not unacceptable to FINRA staff, to conduct a comprehensive review of the adequacy of the Firm's policies, systems and procedures (written and otherwise), staffing and training relating to the violations identified in this AWC, including:

a) The review of transactions in retail brokerage accounts to detect and address potential suitability violations and the adequacy of the firm's branch office inspections to detect and prevent violations by registered representatives in branch locations;

b) Variable annuity sales and exchanges;

c) Consolidated reports; and

d) Retention and review of electronic communications.

(2) The Independent Consultant, any firm with which the Independent Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties, shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the date of the Notice of Acceptance of this AWC;

(3) Exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant;

(4) Cooperate with the Independent Consultant in all respects, including by providing staff support. Cadaret Grant shall place no restrictions on the Independent Consultant's communications with FINRA staff and, upon request, shall make available to FINRA staff any and all communications between the Independent Consultant and the Firm and documents reviewed by the Independent Consultant in connection with his or her engagement.

Once retained, Cadaret Grant shall not terminate the relationship with the Independent Consultant without FINRA staff's written approval; Cadaret Grant shall not be in and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports or documents to FINRA;

(5) At the conclusion of the review, which shall be no more than 120 days after the date of the Notice of Acceptance of this AWC, require the Independent Consultant to submit to the Firm and FINRA staff a Written Report. The Written Report shall address, at a minimum, (i) the adequacy of the Firm's policies, systems, procedures, staffing and training relating to the violations identified in this AWC; (ii) a description of the review performed and the conclusions reached, and (iii) the Independent Consultant's recommendations for modifications and additions to the Firm's policies, systems, procedures and training; and

(6) Require the Independent Consultant to enter into a written agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any other employment, consultant, attorney-client, auditing or other professional relationship with Cadaret Grant, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any firm with which the Independent Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performing his or her duties pursuant to this AWC, shall not, without prior written consent of FINRA staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Cadaret Grant, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

(7) Within 90 days after delivery of the Written Report, Cadaret Grant shall adopt and implement the recommendations of the Independent Consultant; provided, however, that within thirty (30) days of Cadaret Grant's receipt of the Written Report, Cadaret Grant shall, in writing, advise the Independent Consultant and FINRA staff of any recommendations that it considers unnecessary, unduly burdensome or impractical. With respect to any such recommendations, Cadaret Grant need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose. As to any recommendations on which Cadaret Grant and the Independent Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 30 days after Cadaret Grant provides the written notice described above.

In the event that Cadaret Grant and the Independent Consultant are unable to agree on an alternative proposal, Cadaret Grant and the Independent Consultant shall jointly confer with FINRA staff to resolve this matter. In the event that, after conferring with FINRA staff, Cadaret Grant and the Independent Consultant are unable to agree on an alternative proposal, Cadaret Grant must adopt and implement all recommendations deemed appropriate by the Independent Consultant.

(8) Within 30 days of Cadaret Grant's adoption of all the recommendations in the Independent Consultant's Written Report as determined pursuant to the procedures set forth herein, Cadaret Grant shall provide FINRA staff with a written report, certified by an officer of Cadaret Grant, attesting that it has adopted and implemented all of the Independent Consultant's recommendations.

(9) Upon written request showing good cause, FINRA staff may extend any of the procedural dates set forth above.

Cadaret Grant agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Cadaret Grant has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Cadaret Grant specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent 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, Respondent 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.

Respondent 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

Respondent 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 Respondent; and

C. If accepted:

1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;

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. Respondent 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.

Respondent 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 its: (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; and

D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent 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.

Cadaret Grant & Co. Inc.

06/12/18
Date (mm/dd/yyyy)

By: _____
BJ Johnson
Sr. Vice President & Chief Compliance Officer

Reviewed by:

Samuel E. Cohen, Esq.
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Accepted by FINRA:

09/11/18
Date

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

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