

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014040951702**

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

RE: Cetera Advisor Networks LLC, Respondent
Member Firm
CRD No. 13572

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent, Cetera Advisor Networks LLC ("CAN" 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 Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. CAN 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

The Firm has been a member of FINRA since June 1983. The Firm maintains its home office in El Segundo, California. CAN has approximately 3,398 registered individuals and maintains approximately 1,400 branch offices.

RELEVANT DISCIPLINARY HISTORY

In May 2017, CAN entered into an AWC (No. 2016050258801) in which FINRA imposed a censure and restitution of \$1,911,080, for the Firm's failure to establish and maintain a supervisory system and written procedures reasonably designed to ensure that customers who purchased mutual fund shares received the benefit of applicable sales charge waivers.

In November 2016, CAN entered into an AWC (No. 2015045234401) in which FINRA imposed a censure, a fine of \$750,000, and approximately \$4.5 million in restitution (which sum also includes restitution amounts paid by the Firm's affiliates), for the Firm's failure to establish, maintain, and enforce a supervisory

system and written procedures reasonably designed to identify red flags in the sale of multi-share class variable annuities.

In October 2015, the Firm entered into an AWC (No. 2014041838501) in which FINRA imposed a censure, a \$150,000 fine, and restitution of \$151,108.33, for the Firm's failure to establish, maintain, and enforce a supervisory system and written procedures reasonably designed to ensure that customers received sales charge discounts on all eligible unit investment trust purchases.

OVERVIEW

Between January 2009 and January 2015 (the "Relevant Period"), CAN failed to respond reasonably to red flags of unsuitable mutual fund switching, and unsuitable stock trading intended to conceal the switching, by one of its registered representatives, MK. MK's misconduct spanned six years; occurred in the accounts of 14 customers, including seniors; involved hundreds of unsuitable mutual fund switches and related stock trades; and caused nearly \$700,000 in customer losses.¹

Although CAN's supervisory system detected red flags indicative of MK's misconduct as early as 2012, the Firm failed to reasonably respond to three audit reports and hundreds of electronic trading system alerts that flagged the short-term trading patterns as problematic. In particular, even though MK's two Series 24 designated supervisors (the "Designated Supervisors") detected and passed on their findings of potentially unsuitable trading via annual audit reports to the Firm's home office, the Firm failed to take disciplinary action against MK. No one in the home office reviewed or acted upon those findings. In this instance, the Firm did not read, and thus failed to respond reasonably, to the audit reports it received detailing the potential misconduct. During the same period that the audits and trading alerts were flagging MK's trading activity as problematic, the Firm was giving sales awards to MK for his high production.

MK's Designated Supervisors were registered with FINRA through the Firm, but were employed by an outside company that provided back office and compliance support to the Firm's registered representatives (the "Outside Company"). The Firm allowed the Designated Supervisors to be managed by a sales manager (the "Sales Manager"), who was also an employee of the Outside Company and was registered with FINRA only as an Investment Company and Variable Contracts Products Representative, and not as a General Securities Principal.² Although the Designated Supervisors also reported directly to the Cetera Home Office Supervision Department, the Firm did not establish a reasonable system to ensure that the Sales Manager, who lacked a supervisory principal license and had an indirect interest in MK's financial production, did not interfere with the

¹ In 2017, MK was barred by FINRA for his failure to cooperate in its investigation.

² The Designated Supervisors and the Sales Manager each listed their affiliation with the Outside Company as an outside business activity on Uniform Application for Securities Industry Registration or Transfer forms ("Forms U4") filed with FINRA.

Designated Supervisors' supervisory responsibilities. FINRA found that, in one instance, the Sales Manager directed that a Designated Supervisor not send MK a letter of reprimand for problematic trading that the Designated Supervisor had discovered.

Only after FINRA began its investigation did the Firm take action against MK, terminating his registration by a Uniform Termination Notice for Securities Industry Registration ("Form U5") filed in February 2015.

By virtue of the foregoing, the Firm failed to reasonably supervise MK and failed to establish and maintain a supervisory system and procedures reasonably designed to identify and prevent unsuitable mutual fund switching and unsuitable stock trading in customer accounts in violation of NASD Rule 3010(a)³ and FINRA Rules 3110(a) and 2010.

FACTS AND VIOLATIVE CONDUCT

Factual Background

FINRA opened the investigation in 2014 after receiving a tip that MK appeared to have excessively traded a CAN customer's account. FINRA investigated MK's trading activity as well as CAN's supervision of MK and CAN's supervisory system relating to unsuitable trading and mutual fund switching.

MK's Unsuitable Trading

MK worked from his home in Chadds Ford, Pennsylvania and was supervised from a Pennsylvania branch office. During the Relevant Period, MK engaged in hundreds of short-term purchases and sales of Class A mutual funds in the accounts of 14 customers, including senior customers. In these accounts, MK would buy one Class A mutual fund, which was designed to be held for long periods, and sell it, often within a few months. He would then buy another Class A mutual fund from a different fund family, all within the same year. Between the mutual fund sales and purchases, MK would also buy and sell equities in an effort to mask the short-term mutual fund switches. There was no business purpose for this activity, and it was contrary to the risk tolerances and investment objectives of the customers.

This unsuitable trading activity caused MK's customers to be charged unnecessary front-end load fees, which were imposed every time MK purchased a Class A mutual fund. Contrary to the Firm's procedures, MK did not notify his customers of the fees incurred by the short-term switching, or have them execute required disclosure forms providing for their affirmative consent to the mutual fund switches.

MK's excessive trading and switching generated revenue for himself and for the

³ NASD Rule 3010 was superseded by FINRA Rule 3110 effective December 1, 2014.

Firm. He received sales awards in 2013 and 2014 from the Firm, even after his Designated Supervisors flagged his problematic trading, as discussed further below. MK's unsuitable trading caused nearly \$700,000 in customer losses.

The Firm Failed to Reasonably Respond To Three Audit Reports Documenting MK's Unsuitable Trading

The Designated Supervisors detected evidence of MK's unsuitable trading no later than 2012, and they followed CAN's procedures by submitting their findings to the home office. In 2012, 2013 and 2014, two different Designated Supervisors conducted annual audits of MK's activities. The 2012 and 2014 audit reports documented MK's unexplained and unjustified short-term Class A mutual fund switching, while the 2013 audit report raised questions relating to MK's recordkeeping regarding Class A mutual fund transactions. Neither the Firm, nor the Designated Supervisors, who were registered with FINRA through the Firm, but employed by the Outside Company, took any disciplinary action against MK. The Designated Supervisors did not have authority to terminate or take other significant disciplinary action against MK on their own. The Firm's system and procedures required them to alert the home office of any problematic findings. They sent all three audit reports to CAN's home office upon completion.

The Firm failed to act upon the concerns raised in those audits, allowing MK's trading misconduct to continue. At the time, CAN's procedures did not require the Firm to review the results of completed audits. Instead, the Firm, through its Compliance Department, employed a practice of checking only that audits had been conducted, rather than reviewing the substance of the findings. Further, although members of the Firm's Audit Department visited the Designated Supervisors' branch office once a year, and reviewed a sample of audits, they never reviewed the audits flagging MK's misconduct.⁴ Thus, the Firm's system allowed three years of documentation about MK's unsuitable trading, which was sent to the Firm's home office as the supervisory system required, to go unnoticed by the Firm personnel with the authority and responsibility to address it.

The Firm Failed To Have A Reasonable System To Oversee The Supervision of MK's Designated Supervisors

One of the employees of the Outside Company was a Sales Manager who supervised the Designated Supervisors. As discussed above, unlike the Designated Supervisors, who were qualified as supervisory principals, the Sales Manager was not. The Designated Supervisors considered the Sales Manager to

⁴ In 2016, CAN amended its policies and procedures such that the Firm's Audit Department, and not its Designated Supervisors, conduct the annual audits of the Firm's registered representatives. The Audit Department now sends its findings from each audit to the Firm's home office Supervision Department, which is responsible for following up on deficiencies. The Firm also upgraded its electronic trade surveillance system. The Firm now has an independent office conducting pattern-based surveillance of improper trading.

be their boss, and the Sales Manager expected the Designated Supervisors to follow his directions. In February 2013, one of MK's Designated Supervisors drafted a letter of reprimand sharply criticizing MK for his unsuitable mutual fund switching. However, FINRA found that the Sales Manager instructed him not to send the letter, and the Designated Supervisor complied as was expected. Thus, CAN permitted an individual outside of the licensed supervisory chain to direct the Designated Supervisors on matters relating to a registered representative's supervision. Furthermore, as the Sales Manager's compensation was based in part on the profitability of the branch, and thus on MK's commissions, the Sales Manager had a financial incentive to not restrict MK's production.

CAN Failed to Reasonably Address Hundreds of Electronic Trade Review System Alerts About MK's Unsuitable Trading

Beginning no later than 2012, and continuing through 2014, the Firm's electronic Trade Review System repeatedly flagged trades in MK's customer accounts, generating hundreds of exceptions relating to MK's short-term mutual fund switching and excessive stock trading. These alerts went to MK's Designated Supervisors, who in turn incorporated them into their annual audit reports described above. As discussed above, however, the Firm failed to take disciplinary action against MK.

Violations

The Firm Failed to Reasonably Respond to Red Flags of MK's Misconduct and Failed to Establish a Reasonable Supervisory System in Connection with Mutual Fund Switching and Stock Trading

From 2009 through December 1, 2014, NASD Rule 3010(a) required that every member firm establish and maintain a system, including written procedures, to supervise the activities of each registered representative, which was reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. FINRA Rule 3110, which superseded NASD Rule 3010 effective December 1, 2014, contains the same requirements. Failing to reasonably supervise the activities of a registered representative violated NASD Rule 3010(a) and is a violation of FINRA Rule 3110(a). A violation of NASD Rule 3010 and FINRA Rule 3110 is also a violation of FINRA Rule 2010, which requires member firms to "observe high standards of commercial honor and just and equitable principles of trade."

CAN's supervisory obligations under NASD Rule 3010 and FINRA Rule 3110 include obligations to ensure its registered representatives comply with the suitability rule—FINRA Rule 2111 and its predecessor, NASD Rule 2310 and to reasonably respond to red flags of potentially unsuitable transactions. Under the suitability rule, members and associated persons must have a reasonable basis to believe that a recommended transaction involving a security is suitable for the

customer.

Further, NASD Notices to Member 94-16 and 95-80 remind broker-dealers of their obligation to ensure that any recommendation to switch mutual funds be evaluated with regard to the net investment advantage to the investor. Members are obligated "to ensure that their supervisory and compliance procedures are adequate to monitor switching of customers among funds and should be prepared to document their reasons for switching a customer from one fund to another."

As set forth above, during the Relevant Period, CAN failed to reasonably respond to red flags that MK was engaged in unsuitable mutual fund switching and related stock trading. In addition, its supervisory system for the supervision of mutual fund switching and stock trading in order to detect unsuitable switching or trading was not reasonably designed. The Firm lacked a reasonable process for reviewing the red flags raised through audits and electronic trade reports regarding unsuitable mutual fund switching and stock trading. For example, the persons at CAN's home office with authority to terminate or take other significant disciplinary action against MK did not review those reports. No one in the home office reviewed indicia of problematic trading. MK's Designated Supervisors were themselves not empowered to fire or take other significant disciplinary action against MK on their own. Although the home office noted that audits were completed, it did not review the findings or take further steps when misconduct was flagged. Thus, although the Firm tasked MK's Designated Supervisors with conducting audits that detected the unsuitable trading, it did not review the audit findings and supervise the resolution of issues raised. As a result, given the design of the system, no one at the Firm addressed the misconduct raised in those reports, and the misconduct was allowed to continue for several years.

The Firm also failed to have a reasonable system overseeing MK's Designated Supervisors. In particular, the Firm permitted a non-supervisor employed by the Outside Company to exercise control over the Designated Supervisors with respect to supervisory matters.

By virtue of the foregoing, the Firm violated NASD Rule 3010(a) (for the conduct between January 2009 and November 30, 2014), FINRA Rule 3110(a) (for the conduct between December 1, 2014 and January 2015), and FINRA Rule 2010.

- B. Respondent consents to the imposition of the following sanctions:
1. A censure; and
 2. A fine in the amount of \$700,000.
 3. Certification: Within 60 days of Notice of Acceptance of this AWC, CAN shall certify to FINRA in a submission signed by an

officer and registered principal of the Firm that, as of the date of the certification, the Firm has established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues identified in this AWC. The certification shall be addressed to Elissa Meth Kestin, Senior Director, FINRA Department of Enforcement, 200 Liberty Street, New York, NY 10281, elissa.methkestin@finra.org. Upon written request showing good cause, FINRA staff may extend the procedural date set forth above.

Respondent also agrees to comply with the following undertaking:

1. Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of \$691,755.27, 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 January 23, 2015 until the date this AWC is accepted by the NAC.
 - a. A registered principal of CAN shall submit satisfactory proof of payment of restitution, or of reasonable and documented efforts undertaken to effect such restitution. Such proof shall be submitted to Elissa Meth Kestin, Senior Director, FINRA Department of Enforcement, 200 Liberty Street, New York, NY 10281, either by letter that identifies Cetera Advisor Networks LLC, Case No. 2014040951702 and includes a copy of the check, money order, or other method of payment or by e-mail, with pdf copies of the payment documentation, 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.
 - b. If for any reason Respondent cannot locate any customer (and where appropriate, estate of a deceased 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, CAN 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.
 - c. The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, and the acceptance of compensation by the customer shall

not preclude customers from pursuing a separate action to obtain restitution or other remedies.

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

Respondent 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

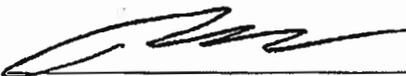
Respondent understands that:

- 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 it; 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 Respondent’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. 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. The 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.

12/5/18
Date

Cetera Advisor Networks LLC – Respondent

By: 

Name: Timothy P. Stone

Title: SVP & Head of Operations

Reviewed by:



Emily P. Gordy
Counsel for Respondent
McGuireWoods LLP
2001 K Street N.W.
Suite 400
Washington, DC 20006-1040
Tel: 202-857-2449

Accepted by FINRA:

12/19/18
Date

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



Samir Ranade
Senior Counsel
FINRA Department of Enforcement
Brookfield Place
200 Liberty Street
New York, NY 10281
Tel: 646-315-7417

ATTACHMENT A
SCHEDULE OF RESTITUTION

Customer #	Account #	Restitution Amount (Exclusive of Interest)
1	---3885	\$1,354.34
2	---2638	\$959.34
3	---6886	\$86,080.92
4	---4154	\$12,010.45
4	---4559	\$1,659.51
4	---6710	\$59.04
4	---6777	\$13.79
4	---6926	\$41.66
5	---8298	\$11,302.11
5	---6806	\$309,232.02
5	---0823	\$38,082.66
6	---3095	\$6,245.65
7	---0960	\$2,386.37
7	---0978	\$998.94
8	---5711	\$46,981.90
9	---6256	\$8,721.74
9	---5831	\$8,575.99
10	---7293	\$599.84
10	---7210	\$15,869.24
10	---6087	\$4,484.16
11	---7643	\$13,610.66
12	---7287	\$477.94
13	---3973	\$121,847.46
14	---4370	\$159.54