

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 201605230060Z**

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

RE: Sigma Financial Corporation, Respondent
CRD No. 14303

Pursuant to FINRA Rule 9216 of FINRA’s Code of Procedure, Respondent 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. Respondent 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

Sigma Financial Corporation (“Sigma”) has been a FINRA member since November 1983. As of December 2018, Sigma had 675 registered representatives operating from 394 branch office locations. Sigma’s main office is located in Ann Arbor, Michigan. Sigma conducts a general securities business as an introducing broker-dealer and operates under an independent contractor model.

RELEVANT DISCIPLINARY HISTORY

In October 2014, FINRA accepted an AWC (No. 2012032595501) in which Sigma consented to the imposition of a censure and fine of \$185,000 for various deficiencies in its supervisory systems and procedures. Sigma did not have adequate resources committed to compliance, resulting in systems and procedures not reasonably designed to supervise registered representatives, as well as a failure to conduct due diligence on structured products.

OVERVIEW

From May 22, 2014 through December 31, 2016 (the “Relevant Period”), Sigma failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with securities laws, regulations, and FINRA Rules applicable to the sales of leveraged, inverse, and inverse-leveraged exchange-traded funds (“Non-Traditional ETFs”). As a result, Sigma violated FINRA Rules 3110 and 2010 and NASD Rule 3010. These violations were aggravated by the fact that Sigma represented to FINRA that it would implement specific corrective measures to cure these deficiencies, but failed to implement the measures in the time-frame anticipated by FINRA based on Sigma’s representations.

FACTS AND VIOLATIVE CONDUCT

A. Non-Traditional ETFs

ETFs are typically registered unit investment trusts or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market.

Leveraged ETFs are different from other ETFs in that they seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are “inverse” or “short” funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts, and other derivative instruments.

Most Non-Traditional ETFs reset daily, meaning that they are designed to achieve their stated objectives on only a daily basis. On a particular day, a Non-Traditional ETF may come close to achieving its intended return. However, the correlation between a Non-Traditional ETF and its linked index or benchmark is inexact, and there is typically at least a small difference or “tracking error,” between a fund and its benchmark, which may compound over longer periods of time. This effect becomes more pronounced during periods of volatility in the underlying index or benchmark. The risks, features, and characteristics of Non-Traditional ETFs are typically discussed, in detail, in the prospectuses for these products.

In June 2009, FINRA issued Regulatory Notice 09-31, which dealt specifically with Non-Traditional ETFs. Among other things, Regulatory Notice 09-31 reminded firms and associated persons of their obligation “to fully understand the products and transactions they recommend. With respect to leveraged and inverse 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 ETF’s use of leverage, and the customer’s intended holding period will have on their performance.” The Notice advised that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”¹

The Notice further advised that “[w]hile the customer-specific suitability analysis depends on the investor’s particular circumstances, inverse and leveraged ETFs typically are not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets.”

During the Relevant Period, 110 Sigma registered representatives executed 1,475 transactions involving Non-Traditional ETFs in 304 retail customer accounts. The transactions had a total value exceeding \$26.5 million and generated \$292,000 in commissions reflecting less than 1% of Sigma’s overall revenue during the Relevant Period.

B. Sigma failed to establish, maintain, and enforce a supervisory system reasonably designed for the review of transactions in Non-Traditional ETFs.

FINRA Rule 3110 requires broker-dealers to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable securities laws, regulations, and rules. NASD Rule 3010 imposed similar requirements before December 1, 2014.

During the Relevant Period, Sigma had written supervisory procedures that pertained generally to the approval of ETFs for sale by the firm, including Non-Traditional ETFs. These procedures required a product manager to determine the type of investor for whom a Non-Traditional ETF was suitable, and to include that information in training and marketing materials for representatives. However, Sigma did not enforce these procedures. Prior to receiving an exam report from FINRA, no written materials were created to provide guidance to representatives on determining the suitability of Non-Traditional ETF products. Sigma also failed to train its representatives regarding the unique risks and features of Non-Traditional ETFs.

During the Relevant Period, Sigma failed to have reasonable procedures or a system in place to detect potentially unsuitable transactions involving Non-

¹ See FINRA Regulatory Notice 09-31, *Non-Traditional ETFs* (June 2009).

Traditional ETFs, particularly in light of the product-specific risks described above. For instance, Sigma did not have exception reports or other procedures in place for reviewing the holding periods of Non-Traditional ETFs. There was no review of Non-Traditional ETF transactions beyond the general daily blotter review. As a result, Sigma customers often held Non-Traditional ETF positions in their accounts for extended periods of time (in some cases, longer than two years). These extended holding periods did not raise any alerts in Sigma's internal supervisory system or trigger any additional supervisory review.

On June 21, 2016 at the conclusion of a routine cycle examination of Sigma, FINRA staff issued an examination report in which it expressed concerns about the reasonableness of the firm's supervisory system and WSPs regarding Non-Traditional ETFs. In a July 2016 response, Sigma advised FINRA that it was implementing two corrective actions: (1) it would require its representatives to complete training on Non-Traditional ETFs if they wished to continue selling the products; (2) it would require all current holders and prospective purchasers of Non-Traditional ETFs to read and sign a disclosure statement that advised them of the risks and features of such products.

In January 2017, FINRA requested an update on Sigma's implementation of the corrective measures to its supervisory system. In a February 2017 response, Sigma explained why it elected not to begin implementing any of the corrective measures until February 2017, citing business considerations and the small percentage of firm revenues that Non-Traditional ETFs represented. A month later, in March 2017, Sigma issued a prohibition on the sale of Non-Traditional ETFs that seek to deliver a return of more than two-times the performance of the relevant benchmark or index.

Sigma's July 2016 response to FINRA also represented that it was exploring options for developing exception reports to track holding periods for Non-Traditional ETFs. In August 2017, Sigma's Chief Compliance Officer represented to FINRA that Sigma was still developing a process to monitor these holding periods. On March 20, 2018, FINRA requested an update, and Sigma responded that it had developed a process for contacting representatives (and, in some cases, customers) to ensure that extended holding periods of Non-Traditional ETFs were suitable.

Although Sigma represented to FINRA that this process had been in place since February 2018, the firm did not contact any representatives about Non-Traditional ETF positions until March 21, 2018, the day after FINRA requested the update. Further, by June 2018, Sigma had not yet contacted a number of customers who should have been contacted months earlier, pursuant to its new process.

By virtue of the foregoing, Sigma violated NASD Rule 3010 (for conduct prior to December 1, 2014) and FINRA Rules 3110 and 2010.

B. Sigma also consents to the imposition of the following sanctions:

- a censure; and
- a \$100,000 fine.

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

Sigma 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

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

- A. To have a Complaint issued specifying the allegations against Sigma;
- 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, Sigma 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.

Sigma 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

Sigma 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 Sigma; and**
- C. If accepted:**
 - 1. this AWC will become part of Sigma’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. Sigma 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. Sigma 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 Sigma’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. Sigma may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Sigma 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 Sigma, 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 Sigma 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.

2/27/19
Date (mm/dd/yyyy)

[Signature]
Respondent

Sigma Financial Corporation

By: Brendan Bell

Reviewed by:

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Accepted by FINRA:

3/7/19
Date

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

[Signature]
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