Quarterly Disciplinary Review

April 2017

FINRA publishes this quarterly review to provide firms with a sampling of recent disciplinary actions involving misconduct by registered representatives. The sample includes settled matters and decisions in litigated cases (National Adjudicatory Council (NAC) decisions and Securities and Exchange Commission (SEC) decisions in FINRA cases). These summaries call attention to, and remind registered representatives and firms of, specific conduct that violates FINRA rules and may result in disciplinary action. FINRA also provides detailed disciplinary information and decisions and a summary of monthly disciplinary actions on its website.

Failing to Adopt and Implement Supervisory Procedures Related to Research Reports and an Anti-Money Laundering Compliance Program

- FINRA settled a matter involving a registered representative who failed to adopt and implement reasonably designed supervisory procedures related to research reports and did not adopt and implement a reasonably designed anti-money laundering (AML) compliance program. The representative was the firm's chief compliance officer (CCO).

  From November 2011 to June 2012, the representative also served as the firm's director of research, and, during that period, failed to adopt and implement supervisory procedures reasonably designed to ensure that the firm's research reports satisfied certain disclosure requirements detailed in FINRA's rules. For example, the firm's written supervisory procedures (WSPs) relating to research explained that research analysts may not distribute any research report without prior supervisory review and approval. The WSPs also stated that the firm had an automated system that generated the disclosures required by FINRA's rules. The WSPs, however, did not describe a specific process by which the firm would ensure that such required disclosures were actually made. Nor did the firm have any systems in place to track and ensure that certain required disclosures were included in the research reports it disseminated. The WSPs did not contain supervisory procedures to ascertain whether the firm or its research analysts owned the securities of the subject company, whether the firm acted as a manager or co-manager of public offerings of the subject company, whether the firm received or sought compensation for investment banking services, or whether the firm provided non-investment banking products or services to the subject company.

  In addition, the representative failed to review 18 research reports, which the firm had published, to ensure that disclosures required under FINRA's rules were properly included, that the price targets had a reasonable basis, and that the valuation methods used to determine price targets were disclosed in the

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research reports. Although the representative read the 18 research reports, he did not adequately review their content, and he failed to verify that the final versions of the reports included the required disclosures. The 18 research reports that the representative approved contained multiple violations of the research report disclosure requirements set forth in FINRA's rules. The representative's supervisory failures related to the research reports violated NASD Rule 2711(i)* (supervisory procedures related to research analysts and research reports) and FINRA Rule **2010** (ethical standards).

While the representative was the firm's CCO, he also served as the firm's AML compliance officer from August 2012 to September 2013; and, during that period, the representative failed to develop and implement an AML compliance program that was reasonably designed to achieve and monitor the firm's compliance with the requirements of the Bank Secrecy Act (BSA) and the BSA's implementing regulations. Specifically, the representative failed to develop an AML compliance program and related policies and procedures that were tailored to the firm's business lines and the risks of those business lines, particularly as they related to the trading and liquidation of low-priced securities. For example, the representative failed to ensure that the firm reviewed its securities transactions to monitor for, detect and cause the reporting of suspicious activity in accounts at the firm. The firm did not have any reports that monitored the trading of low-priced securities, and the representative failed to develop any internal automated reports, manual reports or other means to monitor for suspicious trading activities.

Indeed, after the customer identification procedures were completed upon the opening of an account, the firm failed to monitor any trading activity in the account, did not identify any suspicious activity in the account, and did not conduct any investigations relating to any customer's trading activity. Consequently, the firm's AML compliance program, for which the representative was responsible, was not reasonably designed to detect and cause the reporting of suspicious transactions related to the short-term trading of low-priced stocks through the firm's accounts.

The representative's failures related to the firm's AML compliance program violated FINRA Rules **3310** (AML compliance program) and **2010** (ethical standards). For the supervisory failures related to the research reports and AML compliance program, FINRA suspended the representative in all principal capacities for three months and fined him $30,000

Using Non-Firm Communication Methods to Communicate With a Customer, and Making Exaggerated and Promissory Claims About Securities

- FINRA settled a matter involving a registered representative who used a non-firm-issued smartphone to exchange business-related text messages with a customer, provided a non-firm-issued email address to the customer for the purpose of receiving business-related emails from the customer, and sent text messages to the customer that included exaggerated and promissory claims about securities the representative had purchased for the customer. From September 2014 to February 2015, the representative used the text-messaging function of a non-firm-issued smartphone to exchange business-related messages with the customer. These messages included, among other things, recommendations of securities and discussions of the customer's account performance. The representative also provided the customer his personal email address and instructed the customer to use that email address in connection with a business-prospecting project the customer was completing as the representative's intern.

  The firm's WSPs required that all electronic business communications to be transmitted only through firm-sponsored systems, and prohibited the use of personal email accounts for business communications. The representative did not provide the firm with his communications with the customer or inform the firm that he was communicating with the customer via text message and personal email. The representative's use of text messages and a non-firm issued email address caused the firm to fail to retain those communications and undermined the firm's ability to supervise the representative's communications with a customer. As a result, the representative violated FINRA Rules **4511** (books and records) and **2010** (ethical standards).

  During this same period, the representative sent the customer five text messages that made inappropriate predictions and exaggerated and promissory claims about securities that the representative had purchased for the customer. For example, the representative sent the customer a text message that stated, "I can make you $1000 in a day if you give me $2000 tomorrow" to invest in a certain security. Later in the month, the representative predicted another security "will go up to $40 in two weeks," and told the customer about a "no loss strategy using covered call." The representative's exaggerated and performance-projecting text messages violated FINRA Rule **2210**(d) (content standards of communications with the public) and FINRA Rule **2010** (ethical standards). For the representative's use of the non-firm-sponsored communication methods, and the representative's exaggerated and promissory claims about the securities, FINRA suspended the representative from associating with any FINRA member firm in any capacity for 60 calendar days and fined him $7,500.

Purchasing Securities While in Possession of Material Nonpublic Information

- FINRA settled a matter involving a registered representative who willfully engaged in securities fraud by purchasing securities while in possession of material nonpublic information. From October 2015 to November 2015, the representative purchased more than 2,000 shares of a company's stock in six accounts under his trading authority, including individual accounts and those of his family members. The representative purchased the shares at various prices between $94.95 and $97.42 per share. But the representative purchased those shares while in possession of material nonpublic information that he had improperly obtained from an employee of that company—specifically, that another company was in the process of acquiring it. In November 2015, after the representative had purchased his shares, the other company publicly announced that it had entered into an agreement to acquire the first company. That day, the first company's closing share price increased from almost 30 percent over the previous day.

  By purchasing the company's shares while in possession of material nonpublic information concerning the company's impending acquisition, the representative willfully violated Section 10(b) of the **Securities Exchange Act of 1934** (Exchange Act) (antifraud rule), **Exchange Act** Rule 10b-5 (antifraud rule), and FINRA Rules **2020** (antifraud rule) and **2010** (ethical standards). For this misconduct, FINRA barred the representative from associating with any FINRA member firm in any capacity. The representative's willful violation of the **Exchange Act** also results in his statutory disqualification.

Improperly Effecting Discretionary Trades in Accounts, Failing to Mark Trades as Discretionary, and Making False Statements on Compliance Questionnaires

- FINRA settled a matter involving a registered representative who improperly effected discretionary trades in customer accounts, failed to mark trade orders as discretionary in his firms' order systems, and made false statements on compliance questionnaires concerning his use of discretion. From January 2008 to January 2015, the representative was registered with two firms.

  Each firm's procedures prohibited registered representatives from exercising discretion in non-advisory customer accounts unless the account was maintained by the financial advisor's family member and certain other conditions were satisfied, including that the family member executed a written discretionary trading agreement and the firm's supervisors executed a discretionary trading approval form. The firms also required that the compliance department review the customer's written discretionary trading agreement and authorize the coding of the account as discretionary before such authority could be exercised.

During the seven-year period at issue, the representative violated these firms' procedures. Specifically, the representative improperly exercised discretionary trading authority in the accounts of 21 customers, some of whom were the representative's family members. In almost all instances, the representative did not have the customers' prior written approval to engage in discretionary trading. In addition, the representative did not obtain the discretionary trading approvals and forms the firms required, and the firms did not accept the accounts as discretionary, in any instance. By exercising discretionary authority in the accounts of 21 customers without the firms' acceptance of the accounts as discretionary, and, in most instances, without the customers' prior written approvals, the representative violated NASD Rule **2510**(b) (discretionary accounts), NASD Rule 2110† (ethical standards) (prior to December 15, 2008), and FINRA Rule **2010** (ethical standards) (on and after December 15, 2008).

Each firm's procedures also required that any discretionary order be marked as discretionary in the firm's order system when that order was entered. When the representative entered the trade orders for the 21 customers discussed above, he failed to mark the orders as discretionary in the firms' order systems as the firms' procedures required. The representative's failure caused the firms to create and maintain inaccurate books and records, in violation of Section 17(a) of the **Exchange Act** (accounts and records, examinations of exchanges, members, and others) and **Exchange Act** Rule 17a-3 (records to be made by certain exchange members, brokers and dealers); and the representative violated NASD Rule 3110‡ (books and records) (prior to December 5, 2011), NASD Rule 2110† (ethical standards) (prior to December 15, 2008), FINRA Rule **4511** (books and records) (on or after December 5, 2011), and FINRA Rule **2010** (ethical standards) (on and after December 15, 2008).

Finally, from April 2009 to December 2014, the representative made false and misleading statements concerning his use of discretion on compliance questionnaires. The firms' compliance questionnaires asked whether the representative had accounts in which he had exercised discretion. In response to this question, on four occasions, the representative answered "no." These responses were false because the representative had exercised discretionary authority in customer accounts throughout that time period. Moreover, the representative attested to the truthfulness of his representations related to his use of discretion in customer accounts on six annual associate certifications.

By making misstatements on the compliance questionnaires and associate certifications, the representative violated FINRA Rule **2010** (ethical standards). For improperly effecting discretionary trades in accounts, failing to mark trades as discretionary, and making false statements on compliance questionnaires, FINRA suspended the representative from associating with any FINRA member firm in any capacity for six months and fined him $15,000.

Exercising Time and Price Discretion in the Purchase of Municipal Bonds, and Failing to Disclose the Use of That Discretion on Compliance Questionnaires

- FINRA settled a matter involving a registered representative who exercised time and price discretion in the purchase of municipal bonds and failed to disclose it on annual compliance questionnaires. On 220 occasions from 2010 to 2013, the representative exercised time and price discretion in 14 customer accounts to purchase municipal bonds. At all relevant times, the firm prohibited its representatives from exercising discretion, including time and price discretion, in commission-based accounts unless prior written authorization had been obtained from both the customer and the firm. Contrary to firm policy, the representative failed to obtain the customers' or the firm's written authorization to exercise time and price discretion to purchase the municipal bonds in the customers' accounts.

  In addition, for a four-year period, the representative failed to disclose his use of time and price discretion to the firm when responding to the firm's annual compliance questionnaires. For each year, the questionnaire asked, "Do you have any accounts in which business is transacted on a discretionary basis?" And for each year, the representative falsely answered "no."

  In exercising time and price discretion to purchase municipal bonds and failing to disclose his use of that discretion on his firm's compliance questionnaires, the representative violated **Municipal Securities Rulemaking Board (MSRB) Rule G-17** (fair dealing in municipal securities or municipal advisory activities). For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any capacity for 30 calendar days and fined him $15,000.

Failing to Timely Disclose an Outside Business Activity and Providing False Information on Compliance Questionnaires

- FINRA settled a matter involving a registered representative who failed to timely disclose an outside business activity, *i.e.,* that he had served as the executor of a customer's estate, and falsely stated on annual compliance questionnaires that he had not been named a beneficiary to any account. From February 2012 to September 2014, the procedures of the representative's firm required registered representatives to disclose all outside business activities to the firm prior to engaging in such activities, and prohibited representatives from acting as the executor for a customer's estate. Despite this prohibition, the representative served as the executor of a customer's estate, received compensation for acting as the executor, and failed to disclose his activities as the customer's executor to the firm. The representative's failure to disclose his outside business activity violated FINRA Rules **3270** (outside business activities or registered persons) and **2010** (ethical standards).

In September 2011, the representative completed the firm's annual compliance questionnaire and falsely answered that he had not been named a beneficiary to any customer account. Despite the attestation, the representative had been designated as the beneficiary of the customer's account in March 2010, even though the firm's procedures prohibited registered representative's from being the beneficiary of customer accounts. In addition, in October 2012 and October 2013, respectively, after the customer had passed away, the representative acted as the executor of the estate, as discussed above, and he completed annual compliance questionnaires on which he falsely answered that he had notified the firm of all outside business activities.

The representative's false statements violated FINRA Rule **2010** (ethical standards). For engaging in an undisclosed outside business activity and providing false statements on his firm's annual compliance questionnaires, FINRA suspended the representative from associating with any FINRA member firm in any capacity for three months and fined him $10,000.

Accessing Study Materials and Personal Notes During a General Securities Representative (Series 7) Examination

- FINRA settled a matter involving a registered representative who accessed his study materials and personal notes during the Series 7 examination. The Series 7 examination is a qualification test that assesses a person's competency to perform his or her job as a general securities representative. It is a closed-book test. Candidates are not permitted to bring, use, or have access to any study materials or personal notes during the test. In addition, before beginning the examination, a candidate must acknowledge that he or she will not use or attempt to use any such materials. All personal items—including study materials and personal notes a candidate may have brought to the testing center—must be stored in a testing center-provided locker prior to entering the test room. If a candidate takes an unscheduled restroom break, the candidate may not access his or her locker.

  In February 2016, while associated with a firm, the representative took the Series 7 examination. The representative took several unscheduled breaks during the examination. After the last unscheduled break, test center personnel found a Series 7 study manual and handwritten notes belonging to the representative in a trash can in the test center restroom. Thus, during unscheduled restroom breaks, the representative had access to study materials and notes related to the subject matter of the Series 7 examination, in violation of FINRA Rule **2010** (ethical standards). For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any capacity for 18 months and fined him $5,000.

Opening a Securities Account at an Outside Firm, Effecting Securities Transactions in the Outside Account, and Signing New Account Documents at the Outside Firm

- FINRA settled a matter involving a registered representative who assisted a customer with opening an account at another firm, placed trades in that account without seeking and obtaining the firm's approval, and electronically signed the customer's name on the new account opening documentation for the outside account. In May 2014, at a customer's request, the representative created an online account for the customer at another firm so the customer could effect trades with lower commissions than those that were available at the firm.

  As part of the account-creation process, the representative completed the new account opening documentation and electronically signed the customer's name on it. The customer also called the representative on several occasions and asked the representative to place trades in the customer's account at the other firm. The representative complied with the customer's request. The representative logged into the customer's online account at the other firm and placed seven trades on the customer's behalf. The total dollar amount involved in the trades was $68,000. The representative did not receive compensation for opening the account or for placing the trades, but the representative also did not seek or receive the firm's authorization to participate in the opening of the outside account or to place the trades in it.

  The representative violated NASD Rule 3040§ (private securities transactions of an associated person) and FINRA Rule 2010 (ethical standards) by opening an account and placing trades for a customer at another firm without seeking or receiving the firm's authorization. And by entering the customer's electronic signature on the new account documentation at another firm, the representative again violated FINRA Rule 2010 (ethical standards). For all of these violations, FINRA suspended the representative from associating with any FINRA member firm in any capacity for two months and fined him $10,000.

* NASD Rule 2711 has been superseded by FINRA Rule 2241, effective September 25, 2015.

† NASD Rule 2110 has been superseded by FINRA Rule 2010, effective December 15, 2008.

‡ NASD Rule 3110 has been superseded by FINRA Rule 4511, effective December 5, 2011.

§ NASD Rule 3040 has been superseded by FINRA Rule 3280, effective September 21, 2015.