Quarterly Disciplinary Review

April 2018

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.

Recommending Unsuitable and Speculative Energy-Sector Securities to Retail Customers

- FINRA settled a matter involving a registered representative who recommended unsuitable and speculative energy-sector securities to retail customers. Between November 2012 and October 2015, the representative recommended that more than 50 of his customers become significantly over-concentrated in a single sector of the overall energy market. In certain instances, the over-concentration exceeded 50 percent of the customer's net worth, exclusive of the customer's personal residence.

  The over-concentration involved four speculative equity securities within the energy sector. Due to the speculative nature of the recommended securities, the volatility of the energy market and the high level of concentration, the representative's recommendations exposed his customers to significant investment risk and potential losses. In many instances, the representative failed to properly consider, and failed to obtain accurate customer investment profile information to determine, the suitability of over-concentrating his customers in the speculative, energy-sector securities. Consequently, the representative recommended the investment to customers without proper consideration of each customer's individual investment experience, risk tolerance, investment time horizon, net worth, liquidity needs and income, and he failed to properly assess the significant potential risks associated with his investment recommendation for each of these customers. In 2015, when the energy market began a downturn, the representative's customers suffered millions of dollars in aggregate losses.

  The representative's over-concentration of his customers in the speculative, energy-sector securities violated FINRA Rules 2111 (suitability) and 2010 (ethical standards). For this misconduct, FINRA barred the representative from association with any FINRA member in any capacity.

FINRA
Financial Industry Regulatory Authority

Impersonating Shareholders for Proxy Voting and Facilitating the Casting of False Proxy Votes

- FINRA settled a matter involving a registered representative who impersonated shareholders for proxy voting, and facilitated another registered representative's submission of false proxy votes. Between May and September 2015, the representative worked as an entry-level internal wholesaler at a FINRA member firm. It was the representative's first job out of college. The representative's job responsibilities included contacting financial advisors to discuss investment opportunities in certain non-traded real estate investment trusts (REITs) and other funds.

  In 2015, an affiliate of the representative's member firm retained the firm to conduct proxy solicitation services for the annual shareholder meetings for several of the affiliate's sponsored funds. As part of the proxy solicitation services, the representative's firm required that its internal wholesalers contact shareholders to encourage them to record their vote with the affiliate's proxy tabulation service. For the various funds to achieve a quorum to hold the meetings, tens of thousands of shareholder votes were required. Accordingly, proxy season was a high-pressure environment, in which the firm encouraged its employees to work long hours and make no less than 200 calls to shareholders per day. At one point, the firm's management began monitoring the progress of the proxy solicitation calls every 30 minutes.

  Between May and September 2015, the representative made thousands of phone calls to shareholders and encouraged them to vote. On three occasions, however, at the direction of his supervisor, he impersonated three shareholders in phone calls with representatives of the affiliate's proxy tabulation service, and he voted the shareholders' shares in favor of board and management proposals.

  In addition, at his supervisor's direction, the representative participated on several telephone calls where he introduced his supervisor as a certain shareholder or the shareholder's financial advisor. During those telephone calls, the supervisor impersonated the shareholder or financial advisor and fabricated shareholder votes in favor of board and management proposals for various funds of the member firm's affiliate. Neither the shareholders nor their financial advisors authorized any of these votes.

  The representative violated FINRA Rule **2010** (ethical standards) when he impersonated three shareholders and voted their shares without their knowledge or consent. The representative violated FINRA Rule **2010** (ethical standards) in a second instance when he participated in telephone calls where he knew that his supervisor was posing as shareholders or financial advisors to cast unauthorized shareholder votes. For this misconduct, FINRA suspended the representative from association with any FINRA member in any capacity for two years.

Participating in Undisclosed Private Securities Transactions, Submitting False Firm Compliance Questionnaires, and Providing False Statements in Response to FINRA Requests for Information

- FINRA settled a matter involving a registered representative who participated in undisclosed private securities transactions, submitted false firm compliance questionnaires, and provided false statements in response to FINRA requests for information. Between January and June 2012, the representative participated in private securities transactions by soliciting at least 30 prospective investors, including several customers of his member firm, to invest in convertible notes being offered by a private company. The representative sent the prospective investors information about the private company from his the firm email account. He arranged meetings where prospective investors could meet with representatives of the private company to obtain additional information. He facilitated the movement of funds for three of the firm customers, so they could make aggregate investments of $175,000 in the convertible notes. He also invested $50,000 of his own money in the convertible notes. The representative did not provide his member firm with prior written notice of his participation in the private securities transactions, and therefore violated NASD Rule 3040* (private securities transactions) and FINRA Rule **2010** (ethical standards) as a result.

  In addition, in May 2012 and November 2012, respectively, the representative completed his member firm's required compliance questionnaires. In his responses to both questionnaires, he falsely denied having participated in any private securities transactions during the months since completing his previous questionnaire. The representative's false responses on the firm's compliance questionnaires violated FINRA Rule **2010** (ethical standards).

  Finally, during FINRA's investigation of this matter, the representative provided false responses to information requests made pursuant to FINRA Rule **8210**. First, the representative denied having participated in any private securities transactions involving the firm customers. Second, he denied having made any personal investment in the private company that was the subject of the private securities transactions. The representative's false statements to FINRA violated FINRA Rule **8210** (provision of information and testimony and inspection and copying of books) and FINRA Rule **2010** (ethical standards). For participating in undisclosed private securities transactions, submitting false firm compliance questionnaires, and providing false statements in response to FINRA's requests for information and documents, FINRA barred the representative from association with any FINRA member in any capacity.

Churning and Excessive Trading

- FINRA settled a matter involving a registered representative who churned and excessively traded four customer accounts, two of whom were senior citizens. The representative's misconduct occurred between April 2014 and October 2016.

  The first customer was a 59-year-old emergency room physician when he opened an account at the representative's member firm in April 2014. He worked extremely long hours and did not take personal calls while at work. The customer's experience with the stock market was limited to selecting mutual funds in an employee retirement account. He relied on the representative's investment advice and followed his recommendations. The customer invested nearly $60,000 with the representative's member firm. The representative churned and excessively traded the customer's account, and, in just over one year, the customer suffered losses of more than $40,000, while the representative generated sales charges of more than $30,000.

  The second customer was a 65-year-old insurance salesperson when he opened an account with the representative in April 2014. This customer's investment experience was limited to owning a few stocks of companies that were his clients. He invested nearly $45,000 with the representative. Over nine months, from April 2014 to December 2014, the representative exercised control over the customer's account and executed 31 transactions in the account. Many of the transactions enriched the representative, but provided no economic benefit to the customer. For example, in December 2014, the representative recommended that the customer purchase 250 shares of a company, marked up the trade to include a sales charge, and, later that same day, sold the shares. Although the representative sold the customer's shares at a higher price than the purchase price, the customer nevertheless suffered a loss due to the representative's marked up sales charge. Because of the representative's actions, over the course of nine months, this second customer suffered losses of more than $25,000, while the representative generated sales charges of nearly $20,000.

  The third customer was retired and 86 years old when he opened the account with the representative in August 2014. The customer's annual income was $50,000. During a nine-month period from August 2014 to April 2015, the representative exercised control over the customer's account, and churned and excessively traded the account. Over the course of nine months, the representative effected 39 transactions in the customer's account. The customer suffered losses of more than $40,000, while the representative generated sales charges of nearly $20,000.

  The fourth customer was a 41-year-old farmer when he opened the account with the representative in December 2014. This customer had limited investment experience, with no more than five years of experience with both stocks and bonds. He had an income of $700,000 and a net worth of $6.5 million, but a liquid net worth of $50,000. During a 10-month period between December 2015 and September 2016, the representative exercised control over the customer's account, effected more than 130 transactions in his account, and engaged in active trading in the account in order to generate sales charges for himself. For example, in September 2016, the representative recommended that the customer purchase 1,500 shares of a company, marked up the trade to include a sales charge, and, one week later, recommended the sale of those shares at a higher price and marked down the trade to include a sales charge. But, similar to the second customer, this customer suffered a loss on an otherwise profitable transaction due to the marked up and marked down sales charges. Because of the representative's actions over the 10 months, the customer had a profit of $300, while the representative generated sales charges of nearly $95,000.

Between April 2014 and October 2016, the representative churned and excessively traded the accounts of all four customers. The representative exercised control over the four accounts because the customers had limited investment experience and all of them relied on the representative to direct the investment decisions in their accounts. In addition, the representative's excessive trading in the four customers' accounts generated sales charges at the expense of his customers. The customers experienced more than $115,000 in cumulative losses, while the representative generated $160,000 in sales charges. Finally, since more than half of the trades were mark ups or mark downs, the customers could not appreciate the extent of the costs.

The representative's churning and excessive trading violated Section 10(b) of the **Securities Exchange Act of 1934** (Exchange Act) (manipulative and deceptive devices), **Exchange Act Rule 10b-5** (employment of manipulative and deceptive devices), and FINRA Rules **2020** (use of manipulative, deceptive or other fraudulent devices), **2111** (suitability) and **2010** (ethical standards). For this misconduct, FINRA barred the representative from association with any FINRA member in any capacity.

Failing to Provide Written Notice of a Financial Interest in Outside Brokerage Accounts

- FINRA settled a matter involving a registered representative who failed to provide her member firm with written notice of her interest in five outside brokerage accounts and failed to provide prompt written notice to the executing firms of her status as a person registered with a FINRA member firm. The representative opened two of the five brokerage accounts prior to the date she became registered with a firm, but she failed to disclose the accounts to the firm in writing when she registered. The representative opened the three remaining accounts after she registered with the firm, but she failed to provide written notification to the firm prior to the opening of the accounts. The representative disclosed three of the five accounts to her firm in writing one to three years after opening them; she closed the other two accounts prior to disclosing them in writing to the firm.

Rather than make the required disclosures to her firm, the representative relied on her spouse, who also was a registered representative with the firm during part of the period, to complete the firm's annual outside brokerage account disclosures on her behalf. The representative reviewed the information on the disclosures and signed the disclosures before submitting them to the firm. The representative's annual disclosures did not include two of her five outside brokerage accounts and failed to promptly report the remaining three accounts. In addition, the representative failed to provide any written notice to the executing firms to inform them of her status as an associated person of a FINRA member firm.

The representative failed to provide written notice to her member firm of a financial interest in outside brokerage accounts, failed to provide prompt written notice to the executing firms of her status as person registered with a FINRA member firm, and therefore violated NASD Rule 3050(c)† (transactions for or by associated persons) and FINRA Rule **2010** (ethical standards). For this misconduct, FINRA suspended the representative from association with any FINRA member firm in any capacity for one month and fined her $5,000.

Borrowing Funds From Customers, Engaging in Undisclosed Outside Business Activities, and Making False Certifications on Firm Compliance Questionnaires

- FINRA settled a matter involving a registered representative who borrowed funds from customers, engaged in undisclosed outside business activities, and made false certifications on firm compliance questionnaires. Between 2008 and 2015, the representative accepted five loans from four customers of his member firm.

While the representative worked at the firm, the firm's policy prohibited registered representatives from accepting loans from firm customers under any circumstances. Nevertheless, in 2008, the representative accepted a loan for $20,000 from a firm customer. In 2009, the representative disregarded the firm's policy once again, in that he borrowed $27,000 in two loans from another customer of the firm. The representative did not disclose these loans to the firm as required. He also falsely certified on two firm compliance questionnaires over two years that he was aware of, understood, and complied with the firm's prohibition on borrowing and lending arrangements between registered representatives and customers.

Later, in 2011 and 2015, while he was associated with another FINRA member firm, the representative borrowed $31,000 and $11,000, respectively, from two customers of his firm. When the representative borrowed the funds from the customers, he did so in contravention of his firm's policies because the representative's firm had a strict prohibition against borrowing and lending arrangements between representatives and customers. While at the second firm, the representative also falsely certified on six firm compliance questionnaires over five years that he was aware of, understood, and complied with the firm's prohibition on borrowing and lending arrangements between registered representatives and customers.

The representative's loans with customers of the firm and false certifications on the firms' compliance questionnaires concerning the loans violated NASD Rules 2370‡ (borrowing from or lending to customers) (for conduct prior to June 14, 2010) and 2110§ (ethical standards) (for conduct prior to December 15, 2008), and FINRA Rules **3240** (borrowing from or lending to customers) (for conduct on or after June 14, 2010) and **2010** (ethical standards) (for conduct on or after December 15, 2008).

The representative also engaged in two outside business activities without disclosing those activities to his firms. In 2010, while at one firm, a customer engaged the representative to provide consulting services. The representative accepted a payment of $1,500 for the services, but he never disclosed the activity or the compensation to the firm. In addition, between 2011 and 2016, while associated with another firm, the representative earned nearly $50,000 in compensation by serving on the board of directors of an entity that had been his customer since 2002. The representative, once again, failed to report the activity to his firm, and he never sought approval for it.

During this same period (2010 to 2016), while associated with two firms, the representative completed compliance questionnaires, upon which he falsely certified that he had complied with the firms' policies concerning outside business activities. In fact, on six occasions over five years, the representative falsely certified to his firms that he had complied with the firms' policies related to outside business activities. The representative's undisclosed outside business activities and false certifications on the firms' compliance questionnaires concerning them violated NASD Rules 3030Đ (outside business activities) (for conduct before December 15, 2010) and 2110§ (ethical standards) (for conduct prior to December 15, 2008), and FINRA Rules **3270** (outside business activities) (for conduct on or after December 15, 2010) and **2010** (ethical standards) (for conduct on or after December 15, 2008). For all of these violations, FINRA suspended the representative from associating with any FINRA member firm in any capacity for 10 months.

Conducting Inadequate Due Diligence for an Offering of Convertible Notes

- FINRA settled a matter involving a registered representative who, in connection with an offering of convertible notes, did not adequately verify the issuer's representations or investigate the background of management. In 2013, the issuer sought financing to develop a digital signage advertising network. The issuer retained the representative's firm to undertake a private placement, a $1 million "best efforts" offering of subordinated convertible notes with no minimum requirement. The issuer claimed that the securities offering was exempt from registration under **Rule 506(b) of Regulation D of the Securities Act of 1933**. The issuer's president signed an investment banking agreement with the representative's firm in August 2013, and the firm's president signed the agreement in September 2013. The representative began his review and investigation of the issuer in preparation for the offering shortly thereafter.

The representative did not adequately investigate representations that the issuer had made, and he failed to investigate discrepancies in materials that the issuer had provided, such as leases, signage sites and background information related to the issuer's officers. For example, the issuer's ability to lease signage space in high-traffic areas was central to the issuer's business model, and the issuer had communicated to potential investors the fact that it had secured prime locations. Despite this fact, when the representative traveled to conduct due diligence on the issuer in June 2014, the representative failed to do anything to confirm that the issuer had secured signage sites. The representative also did not attempt to contact any of the issuer's leasing counterparties about the existence of any leases or commitments to lease space to the issuer.

Finally, the representative failed to adequately investigate the background of the issuer's officers. Among other things, the representative failed to discover prior litigation alleging securities fraud and the existence of liens that could impact the issuer's assets and business. Although the representative did not adequately investigate the issuer's representations or management, he nevertheless recommended and sold $200,000 of the issuer notes to two customers of the firm. For these investments, the representative received more than $13,000 in commissions.

Because the representative did not adequately vet the issuer's representations and management, he did not have a reasonable basis on which to conclude that the issuer's convertible notes were suitable for any customer. The representative therefore violated FINRA Rules **2111**(a) (suitability) and **2010** (ethical standards). For this misconduct, FINRA suspended the representative from association with any member firm in any capacity for 30 days, fined him $10,000, and ordered him to disgorge the commissions that he received on his sales of the convertible notes.

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

† NASD Rule 3050 has been superseded by FINRA Rule 3210, effective April 3, 2017.

‡ NASD Rule 2370 has been superseded by FINRA Rule 3240, effective June 14, 2010.

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

Ð NASD Rule 3030 has been superseded by FINRA Rule 3270, effective December 15, 2010.