

Quarterly Disciplinary Review

October 2010

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 decisions and decisions of the SEC in FINRA cases). These summaries call attention to, and remind registered representatives and member 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.

Unregistered Associated Person Acting in Capacity Requiring Registration

- FINRA settled a matter involving an associated person acting at a firm without proper registration. For one year, the unregistered associated person acted as the compliance officer for a member firm. The duties the unregistered person performed required registration as a general securities representative or corporate securities limited representative, and as a general securities principal. He was not, however, qualified by examination in those capacities.

FINRA found that the associated person's conduct violated NASD Rules [1021](#) (principal registration requirements), [1031](#) (representative registration requirements) and 2110* (ethical standards). FINRA censured the individual, fined him \$10,000, and suspended him for 10 business days from associating with any firm in any capacity.

Registered Person Engaging in Conduct for Which He Is Not Properly Licensed

- FINRA settled a matter involving a registered representative who engaged in conduct at his member firm for which he was not properly licensed. The registered representative held a corporate securities limited representative license (Series 62). The parameters of the Series 62 license expressly prohibit proprietary options trading unless separately licensed to do so, via a companion Series 42 registered options representative license. Although the representative held only the Series 62 license, he engaged in proprietary options trading for his firm for more than one year.

FINRA found that the registered representative's failure to register in the registration category appropriate to the function he performed violated NASD Rules 2110* (ethical standards) and [1031](#) (representative registration requirements). As a result, FINRA censured the representative and fined him \$15,000.

Participating in Sales of Equity-Indexed Annuities Without Having Been Appointed as a Selling Agent

- ▶ FINRA settled a matter involving a registered representative who participated in sales of equity-indexed annuities without having been appointed as a selling agent and without firm approval of the sales. The registered representative had formed an informal partnership with another registered person at the firm whereby the two engaged in financial planning for retiring city employees and sold equity-indexed annuities. For nearly two years, the registered representative participated in sales of equity-indexed annuities by discussing with his clients general features and benefits of equity-indexed annuities, facilitating the transactions and introducing the customers to his partner to complete the transactions. The registered representative participated in sales to 15 customers of equity-indexed options issued by three companies for whom the representative was not an appointed agent. With respect to these sales, the customers were unaware that the firm did not have selling agreements with the issuers and did not approve of the sales.

FINRA concluded that the registered representative's conduct violated NASD Rule 2110* (ethical standards) and, as a result, fined the representative \$5,000 and suspended him in all capacities for 10 business days.

Violating Firm Policy Regarding Disclosure of Potentially Market-Sensitive Information

- ▶ FINRA settled a matter involving a registered representative who violated his firm's policy on disclosure of information that is potentially market-sensitive. The registered representative was employed as a research analyst at a member firm. The firm's written policies specifically prohibited disclosure of potentially market-sensitive information prior to the issuance of a research report concerning the same issue. During a two-month period, the registered representative was preparing to issue research on five oil and gas industry stocks. During this period, the representative wrongfully shared earnings estimates, projected price targets and buy recommendations regarding the stocks with institutional clients and firm sales and trading employees. The representative disclosed the information through emails while preparing research reports covering the same securities.

FINRA found that the registered representative's actions violated NASD Rule 2110* (ethical standards). As such, FINRA suspended the representative in all capacities for one month and fined him \$15,000.

Recommending Unsuitable Investments and Misrepresenting Material Facts

- FINRA settled a matter involving a registered representative who recommended unsuitable investments to one customer, negligently misrepresented material facts to another, and failed to ensure that a third customer understood the features and risks of a recommended investment, notwithstanding a language barrier. The registered representative's first customer was an 85 year-old who, two years earlier, had purchased a unit investment trust (UIT). The registered representative recommended that the customer invest the proceeds of the sale of a farm in other UITs, notwithstanding that her risk tolerance was conservative and UITs are not conservative investments. The customer invested \$315,000 in three UITs and sold them three months later at a loss. The representative's firm compensated the customer with a \$36,363 payment. FINRA concluded that the registered representative did not have reasonable grounds to believe that the UIT recommendation was suitable in light of the customer's risk tolerance and the resulting concentration of UITs in the customer's securities portfolio.

The representative's second customer invested \$603,000 in a UIT per the representative's recommendation. The registered representative thereafter sent two letters to the customer, in which he stated that the distribution rate for the UIT would be 5.9 percent for the first year and 6.1 percent for the second. The letters also stated that there would be no penalty for withdrawal at any time. The letters failed to state that the yield rates were estimated as opposed to guaranteed rates of return, and that in fact there was a penalty for selling the UIT within 90 days of purchase. The customer sold his UIT investment before 90 days, and the firm (with a contribution from the registered representative) covered the customer's \$11,848 loss. FINRA concluded that the registered representative made material misrepresentations to the customer.

The representative's third customer followed the registered representative's recommendation to invest \$60,000 in a UIT. The registered representative discovered, before recommending the investment, that there was a language barrier that may have prevented the customer from understanding the information that the registered representative provided about the UIT investment. FINRA found that the representative failed to reasonably ensure that the customer understood the features and risks of investing in the UIT. The customer sold a portion of his UIT investment at a loss. The firm compensated the customer for the fees he incurred in the sale.

FINRA found that the representative's conduct violated NASD Rules 2110* (ethical standards) and [2310](#) (suitability). As a result, FINRA suspended the registered representative in all capacities for 20 business days and fined him \$10,000.

Engaging in Outside Business Activities Without Notifying the Firm

- ▶ FINRA settled a matter involving a registered representative who sold equity-indexed annuities without providing written notice to his employer. The registered representative's firm did not permit its representatives to sell annuities issued by carriers with which the firm did not have selling agreements. During a two-year period, the representative completed firm documentation in which he failed to disclose that he was selling annuities issued by carriers with which the firm did not have selling agreements. During the same two-year period, the representative sold 42 equity-indexed annuities with a face value of \$4,800,000 issued by three carriers that the firm had not approved for sales by its registered representatives.

FINRA found that the representative's conduct violated NASD Rules 2110* (ethical standards) and [3030](#) (outside business activities). FINRA fined the representative \$5,000 and suspended him in all capacities for 90 days.

Engaging in Private Securities Transactions Without Firm Approval

- ▶ FINRA's National Adjudicatory Council (NAC) issued a decision in which it found that a registered representative sold securities away from his firm without providing the firm with prior written notice. The registered representative formed a limited liability company (LLC) to pay the expenses of an office of supervisory jurisdiction that he operated for his firm. Through the LLC, the representative purchased 2.5 million shares of the stock of an issuer that, through a reverse-merger, subsequently became a publicly traded stock. The representative thereafter sold a portion of the stock to three customers without providing his firm with prior written notice. The representative admitted that he incorrectly determined that there was no requirement to provide written notice to his firm because of his mistaken belief that passive investments did not fall under the requirements of NASD Rule [3040](#) (private securities transactions).

FINRA's NAC concluded that the registered representative's conduct violated NASD Rules 2110* (ethical standards) and [3040](#) (private securities transactions). For these violations, the NAC fined the representative \$77,500 and suspended him in all capacities for nine months. The NAC also assessed hearing panel and appeal costs.

Knowingly Submitting Inaccurate Documentation to Member Firm

- FINRA settled a matter involving a registered representative who knowingly submitted false customer documentation to his firm to open 43 customer accounts. The registered representative solicited customers to open banking and investment accounts at his firm and earned commissions based on the number of accounts he opened. The representative's firm required that customers provide photo identification and written verification of residential address to open an account.

The representative's customer base included undocumented, non-U.S. citizens who their employers paid in cash. These individuals rarely maintained established residences in the U.S. and carried their cash holdings on their persons. These individuals often sought to open bank or investment accounts into which they could deposit their money for safekeeping, and many could not comply with the firm's requirement of providing proof of residence before opening an account. The representative approached an unregistered colleague and suggested that the colleague create false address verification letters for the representative's potential customers. The colleague agreed and thereafter drafted and signed address verification letters on his company's letterhead that falsely represented that the customers worked for the colleague and resided at an address indicated in the letter. The registered representative knowingly used these falsified letters to open 43 accounts during a two-month period. The representative earned commissions of \$800 for opening the accounts.

FINRA found that the registered representative's conduct violated NASD Rule 2110* (ethical standards). FINRA suspended the representative in all capacities for six months and fined him \$10,000.

* NASD Rule 2110 has been superseded by FINRA Rule [2010](#), effective December 15, 2008.