

Quarterly Disciplinary Review

January 2012

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.

Entering Fictitious Trades and Causing Inaccurate Firm Records

- ▶ FINRA settled a matter involving a registered representative who executed fictitious trades to misrepresent to his member firm the firm's inventory levels in Small Business Administration loan-backed securities (SBA securities). The representative was his firm's head trader on the SBA desk. The firm purchased SBA loans from small regional banks, pooled the loans and securitized them, then ultimately sold them as SBA securities to institutional customers. During a period of approximately one year, the firm's inventory levels of SBA securities exceeded its inventory limit.

The representative knowingly placed four fictitious trades valued at more than \$82 million into the firm's system to create the impression that its inventory levels of SBA securities were lower than they actually were. The four fictitious trades created the false impression that the representative had sold SBA securities to institutional customers, and that the firm's SBA desk had decreased overall inventory levels by \$75 million. The representative also manipulated forward the settlement dates for the four fictitious trades to afford him additional time to try to legitimately sell the SBA securities. Firm employees noticed a discrepancy in the firm's records, and the representative misrepresented to them that he had mistakenly effected the trades and would correct them.

FINRA found that the registered representative entered fictitious trades, engaged in unethical business practices and caused inaccurate books and records. FINRA also found that the representative willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 (federal securities fraud), NASD Rules 2120* (fraud), 2110** (ethical standards) and 3110† (books and records), and FINRA Rule [2010](#) (ethical standards). FINRA fined the registered representative \$10,000 and suspended him in all capacities for six months.

Improper Transfer of Confidential and Proprietary Information

- ▶ FINRA settled a matter involving a registered representative who improperly transferred confidential and proprietary information outside of his firm for purposes other than firm business. When the representative joined the firm, he agreed to comply with firm policies that required him to maintain the confidentiality of all information the firm and its customers supplied. During a period of approximately four months, the registered representative emailed the member firm's proprietary and confidential information outside of the firm. First, he emailed two monthly compliance reports to an individual at another member firm; these reports contained the firm's proprietary information and confidential, non-public information regarding six of the firm's customers. Later, after notifying his member firm of his intent to resign, the registered representative emailed to his personal email account two documents containing proprietary information about the firm and confidential, non-public information regarding approximately 70 of the firm's customers. Several days later, the registered representative emailed to his personal email account three documents containing confidential, non-public information regarding the firm's clients, including driver's license numbers and information regarding customers' residences.

FINRA found that, in each of the referenced instances, the registered person acted for purposes other than his firm's business and in a manner contrary to the firm's established procedures; FINRA found that these actions caused the firm to violate SEC and other federal regulations.

FINRA found that the registered representative's conduct violated NASD Rule 2110** (ethical standards) and FINRA Rule [2010](#) (ethical standards). FINRA fined the representative \$5,000 and suspended him from associating with any member firm in any capacity for 15 business days.

Misrepresenting Information Regarding Prospectus Delivery

FINRA's NAC issued a decision in which a registered representative misrepresented information to his member firm regarding delivery of preliminary prospectuses to nine customers who intended to purchase shares in an initial public offering (IPO) of stock, and caused his firm's books and records to be inaccurate. The representative's firm required its registered representatives to complete a syndicate worksheet for IPO sales to document the representative's compliance with the firm's procedures. The syndicate worksheet included columns for recording, among other things, the date and method of preliminary prospectus delivery to each customer. The registered representative testified that he was not aware that he was responsible for delivering the preliminary prospectuses to customers because he understood that the firm would handle delivery. The representative testified that, when he advised the branch manager that he had not delivered preliminary prospectuses to nine customers for whom he had submitted order tickets to purchase stock in the IPO, the branch manager advised him to nonetheless misrepresent on the syndicate worksheet that he had hand-delivered the prospectuses. Relying on the representative's misrepresentations on the syndicate worksheet, the firm's office administrative manager input into the firm's official records that the prospectuses had been hand-delivered to the customers.

FINRA's NAC found that the representative violated NASD Rules 2110** (ethical standards) and 3110† (books and records). The NAC fined the representative \$5,000.

Willful Failure to Disclose Material Information on a Form U4

- ▶ FINRA's NAC issued a decision in which it found that a registered representative willfully failed to disclose material information on a Form U4. The registered representative failed to disclose a federal tax lien, three civil judgments, two bankruptcies, and a state tax lien on Forms U4 and amendments to Forms U4 that the representative filed while employed with 11 different member firms over the course of seven years. Additionally, the NAC's decision included a finding that the information the representative omitted from his Forms U4 was material, and the representative willfully failed to disclose the information. The NAC therefore found that, under the Securities Exchange Act of 1934, the registered representative is statutorily disqualified from the securities industry.

The NAC found that the representative's conduct violated NASD Rule 2110** (ethical standards) and NASD IM-1000-1‡ (filing of misleading information as to membership). As such, the NAC suspended the representative in all capacities for two years, required the representative to requalify as a corporate securities limited representative and assessed costs.

Misappropriation of Customer Funds and Failure to Respond to FINRA Investigation

- ▶ FINRA settled a matter involving a registered representative who violated FINRA's ethics rules by misappropriating an insurance customer's funds and failing to respond to FINRA's investigation. The registered representative sold securities and insurance products. For insurance products, he was required to immediately remit funds collected from insurance customers to the insurance company or deposit the funds in a segregated account held in trust for customers. Early in the month of December, the registered representative collected two \$500 checks from a customer as payment for the purchase of two insurance policies. The representative deposited the funds into his business checking account, thereby commingling the funds with his own money. By the end of December, the representative had used the funds for his own business expenses, and his business account held a negative balance. In January, the registered representative purchased policies for the customer by making a partial payment with his own funds. Later in the month, the representative paid the remaining balance out of his own funds. Thereafter, during an investigation of the registered person's conduct, FINRA sent two requests for information and documents and one request that the representative appear to testify to the representative's address as listed in the Central Registration Depository (CRD®). The letters were returned, marked "unclaimed" and "undeliverable," and the representative neither responded nor appeared to testify.

FINRA concluded that the registered representative's conduct violated FINRA Rules [2010](#) (ethical standards) and [8210](#) (requests for information). As such, FINRA barred the representative in all capacities.

Improperly Engaging in Outside Business Activities and Failing to Respond to FINRA Information Requests

- ▶ FINRA settled a matter involving a registered representative who improperly engaged in a business enterprise away from his member firm without providing the firm with prior written notice, and failed to respond to FINRA requests for information until FINRA filed a complaint against him.

During a period of nearly three years, the representative was a sales associate for a business that sold services to protect against identity theft. During this time, the representative received compensation from the business for marketing its services. The representative failed to provide prompt written notice to his member firm that he was engaged in such business activities.

In two separate letters, FINRA requested that the registered representative provide information and documentation regarding his outside business enterprise. Both letters were delivered, but the registered person failed to respond to FINRA until FINRA filed a disciplinary complaint against him, at which time he fully responded.

FINRA concluded that the registered representative's conduct violated NASD Rules 3030^s (outside business activities) and 2110** (ethical standards), and FINRA Rules [8210](#) (requests for information) and [2010](#) (ethical standards). FINRA suspended the representative from associating with any member firm in any capacity for two years. The representative filed for bankruptcy protection, so FINRA was precluded from fining him.

Unsuitable Recommendations

- ▶ FINRA settled a matter involving a registered representative who recommended two unsuitable investments to a customer. At the time of the recommendations, the registered representative's customer was contemplating early retirement in the near future, seeking growth and income, and wanting to withdraw a monthly amount without paying the IRS tax penalties. The representative recommended class A shares of three mutual funds and a cash management trust. The customer invested his entire retirement savings of \$530,000 and paid an upfront load of \$9,786 for the mutual fund purchases. The annual expenses for the class A shares was \$2,934, and the representative received \$6,889 in connection with the purchase.

Later that same day, the representative learned from a colleague that a particular deferred variable annuity offered an income protection rider. Despite never having sold a deferred variable annuity before, the representative recommended, on the same day as the mutual fund purchases, that the customer liquidate his mutual fund shares to purchase the variable annuity. The customer agreed, and the representative moved all of the customer's retirement savings into a variable annuity at a total cost to the customer of \$10,513. The representative received \$21,145 in compensation on the variable annuity purchase. Subsequently, the variable annuity company miscalculated the

customer's monthly withdrawal and failed to factor into the calculation the customer's tax limitations, thereby rendering the annuity's income protection rider moot. The representative failed to notice the miscalculation until a later date.

FINRA concluded that the representative's recommendation of these two transactions on a single day was unsuitable for the customer because they resulted in the customer unnecessarily paying an upfront sales charge for the first investment and substantially higher annual fees, and an over-concentration of the customer's investments in an illiquid deferred variable annuity. FINRA found that the representative's conduct violated NASD Rules [2310](#) (recommendations to customers) and 2110** (ethical standards), and NASD [IM-2310-2](#) (fair dealing with customers). As such, FINRA suspended the registered representative from associating with any member firm in any capacity for one month and fined the representative \$5,000.

Improper Exercise of Discretion, Unsuitable Recommendations and Failure to Disclose Risks

- ▶ FINRA settled a matter involving a registered representative who improperly exercised discretion in a husband and wife's joint account, recommended unsuitable transactions and failed to disclose to the husband and wife the risks associated with the trading strategy he recommended.

For more than two years, the registered representative exercised discretionary authority in a husband and wife's joint account without obtaining their prior written authorization and his employer firm's written acceptance of the account as discretionary. FINRA found that this conduct violated NASD Rules [2510](#) (discretionary accounts) and 2110* (ethical standards). During that same period, the representative engaged in excessive and unsuitable trading in the account, which generated substantial losses. The representative's trading strategy involved high transaction costs that resulted over time in an annualized cost-to-equity ratio of 35 percent. The representative also used margin to trade in the account and recommended that the customers use funds borrowed against their primary residence and vacation home to engage in active trading.

FINRA found that the representative's unsuitable and excessive trading violated NASD Rules [2310](#) (recommendations to customers) and 2110** (ethical standards), and NASD [IM-2310-2](#) (fair dealing with customers). In connection with these recommendations, the representative also failed to disclose to the customers the risks associated with trading on margin and engaging in high-frequency trading. FINRA found that the representative's conduct in this regard violated NASD Rule 2110** (ethical standards). As such, FINRA barred the representative from associating with any member firm in any capacity.

Conversion of Customer Funds

FINRA settled a matter involving a registered person who utilized his position as a chief compliance officer at a member firm to convert approximately \$14,000 from two firm customers. First, the registered person arranged for the transfer of securities and cash worth \$4,000 from a customer account to a personal trust account that he had established at his firm using a fictitious letter of authorization that he drafted. He also used the firm's systems to temporarily change the address on the customer's account to his own work address. The customer neither knew about nor authorized the transfer. One month later, the registered person arranged for the transfer of various securities and cash worth approximately \$10,000 from a customer's IRA account to his account. The registered person used a fictitious retirement account distribution form and letter of authorization to effectuate the transfer. The registered person used the converted funds for his own personal benefit.

FINRA concluded that the registered person's conduct violated FINRA Rules [2150\(a\)](#) (improper use of customer funds or securities) and [2010](#) (ethical standards). As such, FINRA barred the registered person from associating with any member firm in any capacity.

* NASD Rule 2120 has been superseded by FINRA Rule [2020](#), effective December 15, 2008.

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

† NASD Rule 3110(a) has been superseded by FINRA Rule [4511](#), effective December 5, 2011. NASD Rule 3110(c) has been superseded by FINRA Rule [4512](#), effective December 5, 2011. NASD Rule 3110(d) and (e) have been superseded by FINRA Rule [4513](#), effective December 5, 2011. NASD Rule 3110(f) has been superseded by FINRA Rule [2268](#), effective December 5, 2011. NASD Rule 3110(g) has been superseded by FINRA Rule [4514](#), effective December 5, 2011. NASD Rule 3110(h) has been superseded by FINRA Rule [7440](#), effective December 5, 2011. NASD Rule 3110(j) has been superseded by FINRA Rule [4515](#), effective December 5, 2011.

‡ NASD IM-1000-1 has been superseded by FINRA Rule [1122](#), effective August 17, 2009.

§ NASD Rule 3030 has been superseded by FINRA Rule [3270](#), effective December 15, 2010.