**FINANCIAL INDUSTRY REGULATORY AUTHORITY**
**OFFICE OF HEARING OFFICERS**

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| DEPARTMENT OF ENFORCEMENT,<br><br>Complainant,<br><br>v.<br><br>CHARLES EDWIN TAYLOR<br>(CRD No. 443066),<br><br>JODI OYLER PADGETT<br>(CRD No. 1828918),<br><br>and<br><br>JOHN LODGE FARMER<br>(CRD No. 5354041),<br><br>Respondents. | Disciplinary Proceeding<br>No. 2017053382401<br><br>Hearing Officer–DW<br><br>**HEARING PANEL DECISION**<br><br>August 22, 2019 |

**Respondents Charles Taylor, Jodi Padgett and John Farmer engaged in undisclosed outside business activities. Respondents were compensated for referring customers to a company marketing investments in precious metals without advance disclosure to their member firm. Taylor also failed to adequately supervise Padgett and Farmer to ensure that they disclosed their outside business activities. In light of the misconduct, Taylor is suspended for six months in all capacities, six months in a principal capacity, and fined $25,000 for his misconduct. Padgett is fined $15,000 and ordered to requalify as a principal. Farmer is fined $6,000. Respondents are also assessed costs.**

*Appearances*

For the Complainant: Brody W. Weichbrodt, Esq. and Andrew Cattell, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Dochtor Kennedy, Esq. and Frances Menzer, Esq., AdvisorLaw, LLC

## DECISION

## I. Introduction

FINRA Rule 3270, like its predecessor NASD Rule 3030, requires that each associated person provide advance written notice to his or her member firm before engaging in any outside business activity. This notice is necessary "so that the member's objections, if any, to such activities could be raised at a meaningful time and so that appropriate supervision could be exercised as necessary under applicable law."[1]

This case involves alleged violations of this disclosure obligation. According to the first cause of the Department of Enforcement's Complaint, Respondents Charles Taylor, Jodi Padgett, and John Farmer engaged in an undisclosed and unapproved outside business activity involving sales of precious metal coins. Over several years, Taylor, Padgett, and Farmer allegedly received compensation from International Collector's Association ("ICA"), a third-party gold and silver dealer, in exchange for referring customers to ICA to facilitate investments in gold and silver coins. Yet Respondents never disclosed their outside business activity to their FINRA member firm employer, Royal Alliance Associates, Inc. ("Royal Alliance" or the "Firm") in the form required by Royal Alliance or otherwise, as required by FINRA rules. And since at least 1999, the Firm's written policies prohibited offering or selling precious metals.

The Complaint's second cause alleges that Taylor failed to reasonably supervise Padgett and Farmer in the context of their outside business activity, in violation of NASD Rules 3010(b) and 2110, and FINRA Rules 3110(b) and 2010. Taylor allegedly failed to enforce Royal Alliance's policies and procedures about prompt and prior disclosure of the ICA activity, as well as the Firm's prohibition on assisting Firm customers with purchases of gold, silver, or other precious metals. Each Respondent denied liability. This Hearing Panel held a hearing on the claims and defenses in Denver, Colorado.

## II. Findings of Fact

### A. The Respondents

Taylor entered the securities industry in 1969. From 1989 through January 2019, he was registered as a General Securities Representative and as a General Securities Principal with Royal Alliance. Taylor remains registered in similar capacities with another FINRA member firm.[2]

Padgett first associated with Royal Alliance in November 1995. From that time until January 2019, she was registered as a General Securities Representative with the Firm. Beginning in January 2016, she was also registered as a General Securities Principal with Royal Alliance. After departing

[1] *Dep't of Enforcement v. Weinstock,* No. 2010022601501, 2016 FINRA Discip. LEXIS 34, at *27 (NAC July 21, 2016).

[2] Stipulations ("Stip.") ¶ 1.

the Firm in January 2019, Padgett remains registered in similar capacities with another FINRA member firm.[3]

Farmer entered the securities industry in 2007. He joined Royal Alliance in 2011, where he remained registered as a General Securities Representative until January 2019. He is currently registered in the same capacity in a different FINRA member firm, where he continues to work with Taylor and Padgett.[4]

Because each Respondent is currently registered, each is subject to FINRA's jurisdiction.[5]

### B. The Precious Metal Referral Outside Business

Beginning in the early 1980s, while associated with Financial Planners Equity Corporation ("FPEC"), Taylor referred clients interested in investing in gold or silver to ICA.[6] ICA compensated Taylor for his referrals, generally two percent of the amount of the precious metal purchases.[7]

According to Taylor, at the beginning of the relationship his referral compensation was paid through his firm as a result of a selling agreement between ICA and FPEC.[8] After FPEC merged into another firm, Taylor received his referral compensation through the new firm.[9] In late 1989, this successor firm merged with yet another firm, Royal Alliance.[10]

Royal Alliance's written procedures prohibited its representatives from participating in any precious metal sales.[11] Royal Alliance performed no due diligence on precious metal products and was unable to analyze various coins or similar products to determine the composition or degree of purity of the metals being marketed.[12] So the Firm decided not to permit any sales of the products.[13]

Despite the Firm's prohibition, Taylor continued receiving compensation for referring his Royal Alliance customers to ICA for precious metal purchases.[14] Taylor did not disclose his referral activity to Royal Alliance.[15] Royal Alliance firm records showed that Taylor never received any

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[3] Stip. ¶ 3.

[4] Stip. ¶ 4.

[5] Stip. ¶¶ 1, 3, 4; Second Amended Answer ("Ans.") ¶¶ 3, 4, 5.

[6] Stip. ¶ 6; Hearing Transcript ("Tr.") (Taylor) 530-31.

[7] Tr. (Fraunhoffer) 881; Tr. (Taylor) 552-53.

[8] Tr. (Taylor) 530-31.

[9] Tr. (Taylor) 526, 539.

[10] Tr. (Taylor) 534-35.

[11] Complainant's Exhibits ("CX-") 28, at 41; CX-31, at 27-28; CX-33, at 27; CX-36, at 28.

[12] Tr. (Chitwood) 730-31.

[13] Tr. (Chitwood) 731.

[14] Tr. (Taylor) 582.

[15] Tr. (Taylor) 820-21.

referral compensation through the Firm.[16] Instead, Taylor received his referral compensation directly from ICA.[17]

According to Taylor, selling agreements between his two predecessor firms and ICA permitted his selling activity.[18] Because of those prior agreements, Taylor believed that his referral business was "grandfathered" and incorporated into his relationship with Royal Alliance.[19] Taylor even believed that years ago, his selling compensation from ICA was paid through Royal Alliance.[20] Taylor conveyed this belief to Padgett and Farmer as they joined in the referral activity, leading them to believe that Royal Alliance approved the referral business.[21] So none of the Respondents disclosed the activity as an outside business.[22]

But the evidence of such payments or any agreement involving Royal Alliance was insubstantial.[23] And Taylor acknowledged that each of the firms he worked for provided him a list of approved products the Firm permitted for sale.[24] Precious metals from ICA were never on any approved product list from Royal Alliance.[25] Indeed, since at least 1999, Royal Alliance's written supervisory procedures explained that "no [registered representative] may assist a customer in the purchase or sale of gold, silver, or other precious metals or other tangible assets."[26] Under this policy, Respondents' precious metal referrals were prohibited.[27] Royal Alliance consistently reiterated this prohibition in policy manuals and updates disseminated over the years of Respondents' undisclosed referrals.[28]

Over a period of nearly two decades, Taylor never disclosed to Royal Alliance that he was earning referral fees from sales of products prohibited by the Firm.[29] As Taylor enlisted Padgett and Farmer into the undisclosed activity, each Respondent participated in and profited from these referrals for years.[30]

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[16] Tr. (Taylor) 579.

[17] Tr. (Taylor) 579.

[18] Tr. (Taylor) 577.

[19] Tr. (Taylor) 577.

[20] Tr. (Taylor) 777-78.

[21] Tr. (Padgett) 90-93; Tr. (Farmer) 381-83.

[22] Tr. (Taylor) 581.

[23] CX-23; Tr. (Chitwood) 734-35.

[24] Tr. (Taylor) 525, 576-77.

[25] Tr. (Chitwood) 737; Tr. (Taylor) 576-77.

[26] CX-28, at 41; CX-31, at 27-28; CX-33, at 27; CX-36, at 28.

[27] Tr. (Chitwood) 742.

[28] Tr. (Taylor) 780-88.

[29] Stip. ¶ 13; Tr. (Taylor) 581.

[30] Stip. ¶¶ 7, 8, 9, 10.

### C. Royal Alliance's Oversight Did Not Detect the Outside Business

As a result of the firm mergers described above, beginning in 1989 Taylor was the sole principal of a small Royal Alliance branch office in Prescott, Arizona.[31] Thus, he had first-line responsibility for supervision of the branch.[32] Taylor was responsible for implementing Royal Alliance's policies at his branch office.[33] This included first-line approval responsibility for outside business activities.[34] Besides functioning as an office of Royal Alliance, the branch was also a registered investment adviser that provided advisory services to clients. The investment adviser was a disclosed (and approved) outside business activity for Taylor and Padgett.[35]

As part of its oversight of Taylor's branch office, Royal Alliance conducted regular supervisory office visits.[36] One of the key areas of inquiry during these reviews was the outside business activities of the registered representatives in the office.[37] Reviews focused on these activities to identify any potential conflict or risk to the Firm.[38] The Firm required all outside business activities to be disclosed on an online questionnaire.[39] Once the branch manager approved the questionnaire, the Firm's online system electronically forwarded it to the home office for final approval.[40] The Firm required this disclosure and approval before a representative could engage in any outside business activity.[41] Taylor, Padgett, and Farmer never disclosed any referrals from ICA during any of these supervisory reviews.[42] And for years, the Respondents never completed any outside business activity questionnaire for ICA referral activity.[43]

During one supervisory review in 2016, Taylor, Padgett, and Farmer were asked about their recommendations and their investment objectives in advising clients.[44] In response to that inquiry, they did disclose that at times they recommended gold and silver to clients.[45] But Respondents

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[31] Tr. (Taylor) 540-41. The branch was an office of supervisory jurisdiction (OSJ) of Royal Alliance where Taylor was initially the sole principal. Later, Padgett joined Taylor in the branch. Although at one point Padgett obtained a Series 24 supervisory license, Taylor oversaw the office. Tr. (Padgett) 284-85.

[32] Tr. (Taylor) 541.

[33] Tr. (Taylor) 543.

[34] Tr. (Farmer) 472-73; Tr. (Gutierrez) 624; Joint Exhibit ("JX-") 17 at 70.

[35] CX-50, at 3; CX-52, at 13-14.

[36] Tr. (Gutierrez) 622-23.

[37] Tr. (Gutierrez) 623.

[38] Tr. (Gutierrez) 623.

[39] Tr. (Gutierrez) 624.

[40] Tr. (Gutierrez) 624.

[41] Tr. (Gutierrez) 624.

[42] Tr. (Gutierrez) 628-29.

[43] Stip. ¶ 14.

[44] Tr. (Gutierrez) 629.

[45] Tr. (Gutierrez) 629-30.

explained that they made their recommendations through an investment advisor also maintained by Taylor (and an approved outside business activity).[46] Respondents did not mention that they earned any transaction-based fees through referrals.[47]

On top of its regular supervisory visits, Royal Alliance conducted annual practice reviews of its branches.[48] During these reviews, branch managers provided the firm with a detailed description of the branch's business, product mix, production, goals, office staffing, as well as a review of the outside activities by associated persons in the office.[49] As a part of this review, a branch manager must provide a breakdown of all the products marketed to customers.[50] Taylor never disclosed any gold or silver referrals or any dealings involving ICA during these reviews.[51]

Royal Alliance also required its registered representatives to complete a compliance questionnaire annually. The questionnaire requires the representative to attest to their compliance with internal policies significant to the Firm.[52] Each Respondent completed this questionnaire from at least 2011 through 2016.[53] The questionnaire contains an extensive list of Firm policies and procedures and requires representatives to attest to their compliance with each policy.[54] Although in each year the questionnaire identified several products prohibited by the Firm and required representatives to attest that they did not sell, promote or endorse any of those products, the questionnaire never specifically identified precious metals as a prohibited product.[55]

### D. Royal Alliance Discovers the Outside Business

Taylor brought Padgett into the referral business in 1999, a few years after she became a registered representative with Royal Alliance.[56] Taylor communicated to Padgett because of prior selling agreements involving predecessor firms, the branch was "grandfathered" into the referral

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[46] Tr. (Gutierrez) 630-32.

[47] Tr. (Gutierrez) 631-32.

[48] Tr. (Gutierrez) 628.

[49] Tr. (Gutierrez) 628.

[50] Tr. (Gutierrez) 628.

[51] Tr. (Gutierrez) 629. Taylor explained his failure to disclose the referrals during practice reviews as an oversight. He provided the branch's product mix breakdown to Royal Alliance in a written document by checking relevant boxes corresponding to the product types offered at the branch, and the document did not identify precious metals as a potential product. Although one box on the document indicated "other" products, which should have prompted Taylor to make further disclosure, it did not occur to him check that box because the referrals were a small part of his business. Tr. (Taylor) 792-94. And as explained above, Taylor did mention recommending precious metals to customers during a supervisory review in the latter part of the conduct.

[52] JX-17; CX-51; CX-53.

[53] JX-17; CX-51; CX-53.

[54] JX-17; CX-51; CX-53.

[55] Tr. (Padgett) 122-23; CX-50; CX-51; CX-53.

[56] Stip. ¶ 9.

business with Royal Alliance.[57] Taylor also brought Farmer into the referral business in 2012 or 2013.[58] Taylor similarly told Farmer that precious metal referrals were an approved activity and that there was a selling agreement in place with the Firm.[59] None of the Respondents had any written agreement with ICA memorializing the referral arrangement.[60] Neither Taylor, Farmer, nor Padgett conducted any due diligence to ensure the quality of the products purchased by Royal Alliance customers.[61] Respondents at times took possession of customer checks for ICA products, and at times stored precious metals in the branch office until clients picked up their purchases.[62]

Royal Alliance finally found out about the conduct during a branch examination in July 2016. An examiner found a check in the branch's financial records that raised questions about whether Respondents were receiving compensation from ICA.[63] When asked about the check, Farmer told the examiner that he was receiving compensation from ICA for precious metal referrals and that the check might relate to that activity.[64] The examiner told Farmer that this was an outside business activity that he had to disclose.[65] Farmer then completed an outside business activity disclosure form reporting the referral arrangement to Royal Alliance.[66] Taylor gave his approval to the activity shortly thereafter.[67] The Firm's online system electronically forwarded the disclosure form to Royal Alliance's main office. The main office declined approval because precious metal sales are prohibited under firm policy.[68] The firm sent a cease and desist notice to the branch and referred the activity to its compliance office.[69] After receiving the cease and desist notice from Royal Alliance, Taylor, Padgett, and Farmer stopped their ICA referral activity.[70]

From 1999 through August 2016, Taylor made at least 35 referrals to ICA.[71] Most of these referrals involved Royal Alliance customers.[72] Respondents typically received 2 percent of the

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[57] Tr. (Padgett) 90-93.

[58] Tr. (Farmer) 381-84.

[59] Tr. (Farmer) 381-82.

[60] Tr. (Farmer) 384; Tr. (Taylor) 816-17; Tr. (Padgett) 157-58.

[61] Tr. (Farmer) 382-83, 400-01; Tr. (Taylor) 808; Tr. (Padgett) 229-30.

[62] Tr. (Taylor) 390-91.

[63] Tr. (Gutierrez) 633.

[64] Tr. (Farmer) 442-43.

[65] Tr. (Farmer) 443.

[66] CX-55, at 15.

[67] CX-55, at 16.

[68] CX-55, at 16.

[69] CX-55, at 16.

[70] Tr. (Farmer) 305; Tr. (Taylor) 840; Tr. (Padgett) 221.

[71] Stip. ¶ 8.

[72] Stip. ¶ 8.

amount of the customer purchase as a referral fee.[73] From these referrals, Taylor received at least $10,081 in referral fees.[74] Padgett made nine referrals to ICA, including six Royal Alliance customers, between 1999 and August 2016.[75] She received at least $5,676 in commissions.[76] Between 2011 and August 2016, Farmer made at least six referrals to ICA, including four Royal Alliance customers.[77] Farmer earned at least $4,663 from his referrals.[78] These referral fees resulted from about $1.1 million in precious metal sales.[79]

### E. Royal Alliance Disciplines Taylor, Padgett and Farmer

After discovering the referral activity, Royal Alliance conducted an inquiry to determine its magnitude and scope.[80] As part of the inquiry, Royal Alliance contacted all of the branch office's clients with a letter emphasizing that Royal Alliance had no relationship with ICA and had performed no due diligence on any precious metals investments.[81] Royal Alliance also called dozens of clients of the branch.[82] Ultimately, Royal Alliance identified no complaints or other problems with clients of the branch office.[83] And Royal Alliance identified no other undisclosed activities or improprieties involving the branch.[84]

Royal Alliance contemplated firing the Respondents because of their participation in the undisclosed outside precious metals referrals.[85] Instead, the firm imposed lesser sanctions for their failures to disclose their outside business activity. Royal Alliance issued each Respondent a letter of caution.[86] The Firm also subjected Taylor, Padgett, and Farmer to one year of heightened supervision.[87] This supervision included unannounced periodic reviews of the branch and its records.[88] In addition, the Firm fined Taylor and Padgett $10,000 each, and fined Farmer $5,000.[89]

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[73] Tr. (Fraunhoffer) 880-81.

[74] Stip. ¶ 8.

[75] Stip. ¶ 9.

[76] Stip. ¶ 9.

[77] Stip. ¶ 10.

[78] Stip. ¶ 10.

[79] CX-63.

[80] Tr. (Chitwood) 731-32.

[81] Tr. (Taylor) 807-08; CX-24.

[82] Tr. (Chitwood) 759.

[83] Tr. (Chitwood) 759-60.

[84] Tr. (Taylor) 828-29.

[85] Tr. (Padgett) 231; Tr. (Taylor) 587.

[86] CX-1; CX-2; CX-3.

[87] Tr. (Farmer) 465-66.

[88] Tr. (Farmer) 521.

[89] Tr. (Farmer) 460; Tr. (Taylor) 812; Tr. (Padgett) 233.

Each Respondent paid the fine.[90] During its heightened supervision, Royal Alliance identified no issues or irregularities at the branch.[91]

The Prescott, Arizona, branch where Taylor, Padgett, and Farmer continue to work transitioned to a new broker-dealer in January 2019.[92] The branch is a small office in a small town.[93] As a part of the transition, Padgett will assume supervisory responsibilities at the new branch.[94] Respondents have not continued ICA precious metal referrals at the new firm.[95] At the hearing, each Respondent acknowledged their failure to properly disclose their outside business.[96] Despite their suggestions that Royal Alliance should have been aware of their activities, we generally found Respondents credible in acknowledging their own responsibility for failing to recognize and adequately disclose their outside activity. As Taylor explained, "[W]e were guilty and we've admitted that from the start. And we have made no attempt to hide that. No attempt to fight it."[97]

## III. Conclusions of Law

### A. Taylor, Padgett and Farmer Engaged in Outside Business Activities

The first cause alleges that Taylor, Padgett, and Farmer each failed to properly disclose their ICA referral activity as an outside business activity to Royal Alliance, in violation of FINRA Rule 3270 and NASD Rule 3030.[98] FINRA Rule 3270 and its predecessor, NASD Rule 3030, prohibit registered persons from, among other things, being compensated or having a reasonable expectation of receiving compensation from any other person as a result of any business activity outside the scope of the relationship with their member firm, unless they have provided written notice to the firm in whatever form the member specifies.[99]

Member firms are expected to monitor and provide appropriate oversight of their representatives' outside activities.[100] To facilitate this oversight, registered representatives must "disclose outside business activities at the time when steps are taken to commence a business activity

[90] Tr. (Farmer) 460; Tr. (Taylor) 812; Tr. (Padgett) 233.

[91] Tr. (Farmer) 521.

[92] Tr. (Padgett) 233; Tr. (Farmer) 501-02.

[93] Tr. (Taylor) 828.

[94] Tr. (Padgett) 926-27.

[95] Tr. (Padgett) 233.

[96] Stip. ¶¶ 13-14; Tr. (Farmer) 443-45; Tr. (Taylor) 827-29; Tr. (Padgett) 299-301.

[97] Tr. (Taylor) 828.

[98] Farmer is not charged with a violation of NASD Rule 3030, as that rule predates his misconduct.

[99] NASD Rule 3030 required that notice be provided "prompt[ly]," while FINRA Rule 3270 requires notice to be provided "prior" to commencing any outside work.

[100] *Weinstock*, 2016 FINRA Discip. LEXIS 34, at *27-28.

unrelated to his relationship with his firm."[101] The sweep of the notice requirement is intentionally broad, requiring registered persons "to report *any* kind of business activity engaged in away from their firms,"[102] not just business activities related to securities.[103] A violation of FINRA Rule 3270 constitutes conduct inconsistent with just and equitable principles of trade and therefore violates FINRA Rule 2010.[104]

The evidence presented at the hearing established that each Respondent violated FINRA Rule 3270. Taylor, Padgett, and Farmer all acknowledged earning substantial referral commissions from ICA. They also admitted that over several years, they earned those commissions without providing the requisite written notice to Royal Alliance.

FINRA Rule 3270's notification requirement is intended to provide Royal Alliance the opportunity (and responsibility)[105] to oversee the selling activities of its representatives. By failing to disclose their activities, Respondents frustrated this purpose. That is particularly true here, where Royal Alliance's policies in fact *prohibited* the sale of precious metals for the very reason that the products presented supervision challenges that the firm was unwilling to meet.

We reject Respondents' suggestion that Royal Alliance should have been aware of the selling activity as a result of the Firm's review of the branch's financial statements or otherwise. To begin, we do not find persuasive evidence that Royal Alliance knew about Respondents' activities. In addition, precedent is clear that even if Royal Alliance were somehow on notice of the outside conduct, that notice would not relieve a registered person of his or her responsibility to provide written notice to his or her employer in the format the firm required.[106]

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[101] *Dep't of Enforcement v. Schneider*, No. C10030088, 2005 NASD Discip. LEXIS 6, at *13-14 (NAC Dec. 7, 2005) (citing *Dep't of Enforcement v. Abbondante*, No. C10020090, 2005 NASD Discip. LEXIS 43, at *30-31 (NAC Apr. 5, 2005)) (rejecting argument that representative was not required to disclose outside business activity that was formed to conduct future business).

[102] NASD Notice to Members 01-79 (Dec. 2001), http://www.finra.org/industry/notices/01-79 (emphasis in original).

[103] *Dist. Bus. Conduct Comm. v. Cruz*, No. C8A930048, 1997 NASD LEXIS 123, at *101 (NBCC Oct. 31, 1997).

[104] *See Dep't of Enforcement v. Moore*, No. 2008015105601, 2012 FINRA Discip. LEXIS 45, at *24-25 & n.19 (NAC July 26, 2012) (interpreting predecessor rule).

[105] "While FINRA recognizes that a member does not have the same supervisory responsibilities over a registered person's outside *non-securities* activities as it does for his or her outside *securities* activities, a member nevertheless has an important regulatory responsibility to evaluate the potential impact of the outside business activities of its registered persons …." (Emphasis in original). FINRA Response to Comments, File No. SR-FINRA-2009-042, at p.7 (July 30, 2010), http://www.finra.org/industry/rule-filings/sr-finra-2009-042.

[106] *E.g.*, *Dep't of Enforcement v. Connors*, No. 2012033362101, 2017 FINRA Discip. LEXIS 2, at *29 (NAC Jan. 10, 2017) (maintaining evidence of outside activities in client files did not constitute written notice to member firm); *Wanda P. Sears*, Exchange Act Release No. 58075, 2008 SEC LEXIS 1521, at *15 (July 1, 2008) (keeping copies of tax returns in client files and preparing the tax returns on firm's computers did not satisfy respondent's obligation to provide the requisite written notice); *Dep't of Enforcement v. Barrick*, No. C8A030034, 2004 NASD Discip. LEXIS 22, at *7 (OHO Apr. 26, 2004) (NASD Rule 3030 "requires 'prompt written, not oral, notification'" of outside business activity and "[t]here is no exception for verbal statements to supervisors.").

Accordingly, Taylor and Padgett both violated NASD Rule 3030 and FINRA Rule 3270, during the periods applicable to each Rule.[107] Farmer likewise violated FINRA Rule 3270 through his misconduct. Because of their violations, each Respondent also violated FINRA Rule 2010, and Taylor and Padgett also violated NASD Rule 2110.[108]

### B. Taylor Inadequately Supervised Padgett and Farmer

The second cause alleges that Taylor failed to adequately supervise Padgett and Farmer's ICA referral activity to ensure that they properly disclosed the outside business activity, in violation of both NASD Rules 3010 and 2110 as well as FINRA Rules 3110(b) and 2010.

"Assuring proper supervision is a critical component of broker-dealer operations."[109] Indeed, "[p]roper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and [FINRA] rules."[110] To that end, FINRA Rule 3110(a) requires member firms to "establish and maintain" a supervisory system "reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA Rules." Its predecessor, NASD Rule 3010(a), contained a similar requirement.[111]

"Whether supervision is 'reasonable' depends on the particular circumstances of each case."[112] When circumstances present red flags suggesting that misconduct may be occurring, then the duty of supervision includes an obligation to investigate and to "and to act upon the results of such investigation."[113] These obligations extend to supervision of a registered representative's outside business activities.[114]

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[107] FINRA Rule 3270 became effective on December 15, 2010, superseding NASD Rule 3030 with certain modifications not at issue here. FINRA Regulatory Notice 10-49 (Oct. 2014), http://www.finra.org/industry/notices/10-49. Thus, NASD Rule 3030 applies to Taylor and Padgett's conduct before December 14, 2010, and FINRA Rule 3270 applies to their conduct beginning on that date.

[108] FINRA Rule 2010 became effective on December 15, 2008, superseding NASD Rule 2110. FINRA Regulatory Notice 08-57 (Oct. 2008), http://www.finra.org/industry/notices/08-57. Consequently, Taylor and Padgett violated NASD Rule 2110 through their violations of NASD Rule 3030 on or before December 14, 2008. They violated FINRA Rule 2010 through their subsequent violations of NASD Rule 3030 as well as FINRA Rule 3270.

[109] *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007).

[110] *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011).

[111] FINRA Rule 3110 became effective on December 1, 2014, superseding NASD Rule 3010 without substantive change, although with some modifications not at issue here. FINRA Regulatory Notice 14-10 (Mar. 2014), http://www.finra.org/industry/notices/14-10. Thus, NASD Rule 3010 applies to Taylor's conduct before December 1, 2014, and FINRA Rule 3110 applies to his conduct beginning on that date.

[112] *KCD Fin. Inc.*, Exchange Act Release No. 80340, 2017 SEC LEXIS 986, at *35 (Mar. 29, 2017).

[113] *Dep't of Enforcement v. Newport Coast Sec., Inc.*, No. 2012030564701, 2018 FINRA Discip. LEXIS 14, at *167 (NAC May 23, 2018) (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023–24 (2004)), *appeal docketed*, No. 3-18555 (SEC June 22, 2018).

[114] *Dep't of Enforcement v. Merrimac Corp. Sec., Inc.*, No. 2009017195204, 2015 FINRA Discip. LEXIS 4, at *6 (NAC Apr. 29, 2015) ("[W]e affirm … that Merrimac violated NASD Rules 3010 and 2110 by failing to supervise [two

We find that Taylor failed to adequately supervise Padgett and Farmer's ICA activities. Taylor acknowledged that he was the designated supervisor of the Prescott branch. As such, he was responsible for Padgett and Farmer's supervision. Further, Taylor knew that Padgett and Farmer were engaging in ICA coin referrals—indeed, he enlisted their participation in the conduct. And because Taylor had first-level responsibility for approving outside business activities, he necessarily knew that the Firm had not approved Padgett and Farmer's referral business. Yet Taylor never directed or required Padgett and Farmer to disclose their activities. Indeed, Taylor participated in the same misconduct, engaging in undisclosed referrals.

True, the precious metal referrals at the Prescott branch pre-dated its relationship with Royal Alliance and was approved by a prior firm at the time the referrals commenced. But different firms have different policies, and Taylor was not entitled to assume that approval from a different firm somehow carried over to permit his continued outside business when associated with Royal Alliance. He was at least obligated to investigate whether the previously approved practice was still permissible. He did not do so.

Taylor's supervisory failure in this regard was compounded by the fact that Royal Alliance's written policies prohibited precious metal sales. Although the restriction was not specifically referenced in annual compliance certifications, it was communicated in supervisory procedures regularly provided to Taylor such that he should have been aware of the limitation. Yet, Taylor not only overlooked the prohibition, he permitted Padgett and Farmer to ignore Firm policy as they kept engaging in undisclosed and impermissible ICA referral conduct for years.

As a supervisor, Taylor had to understand the requirement that registered representatives under his supervision disclose all of their outside business activities, and take steps to ensure that they did so. And he was required to be aware of Royal Alliance's policies against precious metal sales and to enforce that policy as to the representatives under his charge. His failure to meet his responsibilities in both respects was unreasonable under the circumstances. Taylor's failure to reasonably supervise Padgett and Farmer violated NASD Rules 3010 and 2110, as well as FINRA Rules 3110(b) and 2010.[115]

## IV. Sanctions

We now consider appropriate sanctions. We do so bearing in mind that the purpose of FINRA's disciplinary process is to protect the investing public, support and improve overall business standards in the securities industry, decrease the likelihood of recurrence of misconduct by the disciplined respondent, and deter others from engaging in similar misconduct.[116]

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registered representatives'] outside business activities."), *aff'd*, Exchange Act Release No. 86404, 2019 SEC LEXIS 1771 (July 17, 2019).

[115] Taylor violated NASD Rule 2110 through his violations of NASD Rule 3010(b) from 1999 through December 14, 2008, and FINRA Rule 2010 by virtue of his violations of NASD Rule 3010(b) and FINRA Rule 3110(b) thereafter.

[116] FINRA Sanction Guidelines at 2 (2019) (General Principle No. 1), http://www.finra.org/industry/sanction-guidelines.

### A. Undisclosed Outside Business Activities

FINRA's Sanction Guidelines ("Guidelines") contain General Principles Applicable to All Sanction Determinations, Principal Considerations in Determining Sanctions, and Guidelines applicable to specific violations. The Guideline specific to outside business activities recommends a fine of $2,500 to $77,000 for a violation. It also recommends a suspension in any or all capacities for a period of 10 business days to three months, when the outside business activities do not include aggravating conduct. Where aggravating factors exist, however, the Guidelines suggest a suspension of up to one year. Where aggravating factors predominate the respondent's misconduct, the Guidelines recommend a longer suspension of up to two years or a bar.[117]

To determine an appropriate sanction, the Guidelines direct adjudicators to several principal considerations: the duration and extent of the Respondents' involvement in the activity; whether the Respondent created the impression that his or her firm approved the product or service; whether the activity involved customers of the firm; whether the activity caused customer harm; and whether a Respondent misled his or her firm about the activity.[118]

These considerations point to a number of aggravating factors. Each Respondent's conduct here spanned many years and involved many firm customers.[119] Taylor and Padgett engaged in the conduct for over 16 years, while Farmer joined the conduct for at least four years.[120] In addition, Respondents referred clients to precious metal sales without making clear disclosure to Firm customers that the referrals did not involve Royal Alliance.[121]

The misconduct here was serious. But as Enforcement acknowledges, there are circumstances in mitigation. In particular, Royal Alliance already sanctioned each Respondent before any regulator detected the misconduct. The Guidelines instruct us to "acknowledge firms that address an individual's misconduct by taking corrective action" by according mitigative weight to those sanctions.[122] Royal Alliance fined Taylor and Padgett $10,000 each, and fined Farmer $5,000. And each Respondent underwent a year-long program of heightened supervision by the Firm that included detailed reviews of outside business activity disclosures, compliance disclosures, financial records, as well as supervisory client contacts to ensure that clients had purchased no investments or services other than those approved by the Firm.

Given these prior sanctions, Enforcement recommends that we impose a $15,000 fine and a four-month suspension for Taylor; a $10,000 fine and three-month suspension for Padgett; and a $5,000 fine and a two-month suspension for Farmer.

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[117] Guidelines at 13.

[118] Guidelines at 13.

[119] Guidelines at 13 (Principal Considerations No. 1 and No. 3).

[120] Guidelines at 13 (Principal Consideration No. 3).

[121] Guidelines at 13 (Principal Consideration No. 4).

[122] Guidelines at 5 (General Principle No. 7).

Considering the sanctions already imposed by Royal Alliance, including the fines and a year of heightened supervision that revealed no recurrent or new misconduct, we find that suspensions are unnecessary to remediate the misconduct of Padgett and Farmer here.

In reaching this conclusion, we also consider that Padgett and Farmer were told by Taylor, their supervisor, that a selling agreement between Royal Alliance and ICA allowed them to conduct their business as a firm-approved activity. Under that direction, both engaged in the activity—with Farmer voluntarily disclosing the conduct during a routine Firm exam—until directed to stop. Of course, following a superior's orders generally does not "excuse[] misconduct, lessen the significance of [violative] actions, or mitigate[] sanctions."[123] Nevertheless, given our directive to afford due consideration to whether Padgett and Farmer misled their firm or concealed the activity from their superiors,[124] their lack of concealment or deception is "relevant to assessing an appropriate sanction."[125]

We are also concerned about how suspensions might affect Respondents' new firm and its ability to service its clients, given that the office has only a few associated persons and Padgett and Taylor serve as its only principals.[126] Accordingly, we impose a fine of $15,000 for Padgett and $6,000 for Farmer. But given the duration of Padgett's misconduct in particular, along with her current responsibility as a principal to ensure that others under her supervision comply with their obligations as registered representatives, we will also require her to requalify in a principal capacity.

We regard Taylor's misconduct as the most serious. His conduct spanned the longest time, he reaped the most financial benefit from his conduct, and he led the other Respondents to believe that Royal Alliance had approved or authorized their misconduct. For these reasons, for Taylor's misconduct, we impose a $15,000 fine and six-month suspension.

The sanctions we impose are appropriately remedial under the circumstances and reflect the substantial nature of each of Taylor, Padgett and Farmer's violations that frustrated rules designed to ensure proper supervision of business transactions necessary to protect investors. Moreover, these sanctions will discourage others from engaging in similar misconduct.

### B. Taylor's Failure to Supervise

For failure to supervise, the Guidelines recommend that Adjudicators consider imposing fines of $5,000 to $77,000. It also recommends individual supervisory suspensions for up to 30 business days. In egregious cases, it recommends suspending the responsible individual in any or all capacities for up to two years or a bar.[127]

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[123] *Dep't of Enforcement v. Cohen*, No. EAF0400630001, 2010 FINRA Discip. LEXIS 12, at *57 (NAC Aug. 18, 2010).

[124] Guidelines at 13 (Principal Consideration No. 5).

[125] *Dep't of Enforcement v. Mathieson*, No. 2014040876001, 2018 FINRA Discip. LEXIS 9, at *25 (NAC Mar. 19, 2018).

[126] The Guidelines direct us to consider a firm's small size in determining appropriate sanctions with respect to rule violations involving negligence, such as the violations at issue here. Guidelines at 2, n. 2.

[127] Guidelines at 104.

In fashioning an appropriate sanction, we give principal consideration to whether a respondent ignored "red flag" warnings that should have led to additional scrutiny; the nature and extent of the underlying misconduct; and the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.

We agree with Enforcement that the nature, extent, size, and character of the underlying misconduct is significant. The conduct spanned over 16 years and involved customer investments of over $1.1 million. And not only did Taylor ignore red flags, he facilitated the misconduct by introducing his subordinates to an outside business activity involving a prohibited product while failing to either require disclosure of the activity or enforce Firm policy by not permitting the precious metal referral activity.

In light of these aggravating circumstances surrounding Taylor's supervisory failures, and considering the prior sanctions imposed against him discussed above, we find Enforcement's recommended sanction of a $10,000 fine and six-month suspension in a supervisory capacity to be appropriately remedial. Because his supervisory violation is distinct from his underlying violation, the supervisory suspension we impose will be consecutive to the all-capacities suspension imposed for Taylor's undisclosed outside business.[128]

## V. Order

We find that Respondents committed the violations alleged and impose these remedial sanctions:

Under cause one, Taylor and Padgett violated NASD Rules 3030 and 2110 as well as FINRA Rules 3270 and 2010. Farmer violated FINRA Rules 3270 and 2010. For these violations, Taylor is fined $15,000 and suspended for six months in all capacities; Padgett is fined $15,000; and Farmer is fined $6,000. Padgett is also ordered to requalify as a principal within six months after this decision becomes FINRA's final disciplinary action.

Under cause two, Taylor failed to reasonably supervise Padgett and Farmer, in violation of NASD Rules 3010 and 2110, as well as FINRA Rules 3110(b) and 2010. For these violations, Taylor is fined $10,000 and suspended for six months in a supervisory capacity. This suspension is to run consecutively with Taylor's all-capacities suspension.

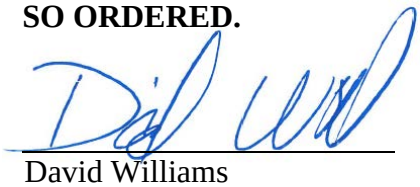
Respondents are also jointly and severally ordered to pay costs of $8,459.81, which includes a $750 administrative fee and $7,709.81 for the cost of the transcript.

If this decision becomes FINRA's final disciplinary action, Respondents' suspensions will begin with the opening of business on Monday, October 21, 2019. The fines and costs shall be due on

[128] *Dep't of Enforcement v. Siegel*, No. C05020055, 2007 NASD Discip. LEXIS 20, at *53 (NAC May 11, 2007) (suspensions should run consecutively where violations were "of fundamentally different natures," such that "consecutive suspensions [will] specifically discourage all types of additional misconduct at issue"), *aff'd*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008).

a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final action.[129]

**SO ORDERED.**



David Williams
Hearing Officer
For the Hearing Panel

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[129] The Hearing Panel considered and rejected without discussion all other arguments of the parties.