FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. HANK M. WERNER (CRD No. 1615495), and LEGEND SECURITIES, INC. (BD No. 44952), Respondents.	Disciplinary Proceeding No. 2015048048801 Hearing Officer—MJD **EXTENDED HEARING PANEL DECISION** November 6, 2017

Respondent Hank M. Werner fraudulently churned the accounts of a customer and made unsuitable recommendations. For this misconduct, he is barred from associating with any FINRA member firm in any capacity, fined $80,000, and ordered to pay restitution of $155,393.61 to the customer and disgorge $10,030.

Appearances

For the Complainant: Samuel Barkin, Esq., and Michael Perkins, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondent Hank M. Werner: *Pro se.*

DECISION

I. Introduction

Between October 2012 and December 2015, while working at Liberty Partners Financial Services, LLC ("Liberty Partners") and Legend Securities, Inc. ("Legend"), Respondent Hank M. Werner ("Werner" or "Respondent") churned and excessively traded three accounts belonging to his customer, DC. Werner's trading caused DC to lose more than $175,000. DC was 77 years old when Werner began churning her accounts. She is blind and in poor health.

DC's husband, TC, who was also blind, died one month before Respondent began churning DC's accounts.

Cause one of the Complaint[1] charges Werner with churning DC's accounts, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 and in violation of FINRA Rules 2020 and 2010. Cause two charges him with making quantitatively unsuitable recommendations to DC that resulted in excessive trading, in violation of FINRA Rules 2111 and 2010. Cause three charges Werner with making an unsuitable recommendation to DC in 2015 to exchange a deferred variable annuity ("VA") she had purchased in 2008 for another VA, in violation of FINRA Rules 2111, 2330(b), and 2010.

The Extended Hearing Panel finds that Werner committed each of the violations alleged in the Complaint.[2] For this misconduct, the Panel bars Werner from associating with any FINRA member firm in any capacity, imposes an $80,000 fine, and orders him to pay restitution in the amount of $155,393.61[3] and disgorge $10,030, together with prejudgment interest.

II. Respondent and Jurisdiction

Werner was first associated with a FINRA member firm in 1989. From July 12, 2012, to December 11, 2012, he was registered with Liberty Partners as a General Securities Representative and General Securities Principal.[4] He was registered with Respondent Legend

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[1] On August 1, 2016, Enforcement filed a three-cause Complaint ("Compl.") against Werner. Werner timely filed an Answer ("Ans."). On November 30, 2016, Enforcement filed an Amended Complaint ("Am. Compl."), adding Legend Securities, Inc., and Werner's designated supervisor as Respondents. The Amended Complaint contained two new causes of action alleging supervision-related violations of NASD Rules 3010(a) and (b) and FINRA Rules 3110(a) and (b) and 2010. Cause four alleges that Legend failed to implement a plan of heightened supervision concerning Werner. Cause five alleges that Legend and Werner's supervisor failed to supervise Werner's sales practices and securities recommendations concerning customer DC. The Amended Complaint contained the same factual and legal allegations against Werner as the original Complaint. Werner timely filed an Amended Answer ("Am. Ans.") to the Amended Complaint, which is identical to his Answer to the Complaint.

Legend did not file an Answer to the Amended Complaint and accordingly was held in default. Enforcement filed a Motion for Entry of Default Decision. A Default Decision is being issued at the same time as this Extended Hearing Panel Decision. The Default Decision finds that Legend committed the violations alleged in causes four and five of the Amended Complaint and censures and fines the firm $200,000.

Werner's supervisor timely filed an Answer to the Amended Complaint. In May 2017, Enforcement accepted the supervisor's Offer of Settlement, in which he, without admitting or denying the allegations, consented to the entry of findings by Enforcement that he failed to reasonably supervise Werner with respect to his trading in DC's accounts and the recommendations he made to her.

[2] A two-day hearing was held on June 5 and 6, 2017, in New York, New York, involving only the allegations against Werner. In addition to Werner, Enforcement called three witnesses to testify at the hearing: an Enforcement senior investigator, a representative of Hartford Financial Services Group (the issuer of the VA that Werner recommended that DC sell in 2015), and customer DC. Werner testified on his own behalf and called no other witnesses.

[3] According to Enforcement, Werner's former employer, Legend, voluntarily made partial restitution of $20,000 to DC before it went out of business. The Panel accordingly reduces the restitution amount to $155,393.61. Tr. 614.

[4] Complainant's Exhibit ("CX-_") 1, at 1-3, 6.

from December 11, 2012, to March 9, 2016. Werner has not been registered since his association with Legend ended.[5]

Although Werner is no longer associated with a FINRA member firm, he remains subject to FINRA's jurisdiction for purposes of this proceeding pursuant to Article V, Section 4, of FINRA's By-Laws because (1) the Complaint was filed within two years after the effective date of termination of his registration with Legend in March 2016, and (2) the Complaint charges him with misconduct committed while he was associated with a FINRA member firm.[6]

III. Statement of Facts

A. Werner's Financial Situation

Werner was in a dire financial condition when he started churning DC's accounts. According to disclosures in FINRA's Central Registration Depository, by October 2012, Werner had multiple state and IRS tax liens totaling over $750,000.[7] He had agreed to a re-payment plan with New York State tax authorities but was having trouble making payments, and at one point fell behind. He also had trouble paying the mortgage on his home and the rent on his office.

During the period he was trading DC's accounts, Werner frequently asked his employer for advances on commission payouts so that he could meet his financial obligations. In early February 2013, promptly after DC's accounts were transferred to Legend, he emailed Legend's Chief Compliance Officer that he could lose his home.[8] On April 2, 2013, he emailed the Chief Operating Officer asking Legend to advance him $10,000 that day because he "desperately" needed it to pay his mortgage and other expenses.[9] On July 29, 2013, he emailed Legend asking for an advance of $11,500 because he missed a quarterly payment to the New York tax authorities that was due by June 30, 2013. He had been given an extension to August 1, 2013, to make a catch-up payment.[10] On December 4, 2013, he asked Legend to deposit the money it owed him that day because his office landlord and other creditors were pressuring him. He said that he "need[ed] these funds yesterday."[11] On October 1, 2014, Werner emailed Legend asking that it pay his commissions "early" which would "greatly reduce [his] stress level" because he

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[5] Comp. ¶ 9; Am. Compl. ¶ 12; CX-1, at 1, 6. In his Answer and Amended Answer, Werner does not contest the allegation in the Complaint that he was registered with Legend from December 11, 2012, to March 9, 2016. Werner testified that he was registered with Legend until March 2016. Tr. 25. At Legend, Werner worked out of a non-Office of Supervisory Jurisdiction branch in Northport, New York.

[6] This matter originated from an investigation by the Department of Member Regulation into Werner's sales practices in connection with customer DC. Compl. ¶ 10; Am. Compl. ¶ 13.

[7] CX-1, at 14-20.

[8] CX-9.

[9] Tr. 145; CX-11.

[10] Tr. 152-53, 589-90; CX-13. Werner noted in his email that he had made $24,000 in commissions that month.

[11] Tr. 161; CX-14.

had a large bill due the next day.[12] Two weeks later, he asked the Firm not to deduct $293 from his current commission payment for brokerage license expenses. He said this was "a must" because the check for his mortgage payment would otherwise bounce.[13]

On July 21, 2015, Legend informed Werner that it had received two tax levies from New York State tax authorities, totaling $249,466.60.[14] Legend withheld 10 percent of the compensation it owed Werner as a result of the state's garnishment.[15]

Werner had few customers—only 26 when he was with Liberty Partners and Legend.[16] Trading in DC's three accounts generated $210,586.81 in commissions while Werner was registered at Legend, the second highest of all his customers.[17] This amount accounted for 32 percent of all commissions that Werner earned at Legend. Werner generated the highest commissions ($261,688) from the accounts of another customer, which amounted to nearly 40 percent of Werner's commissions during this period.[18]

B. Customer DC's Background and Financial Condition

DC has been blind most of her life.[19] She attended high school at the New York Institute for the Education of the Blind in the Bronx, New York. She did not attend college. After high school, DC worked for 27 years as a typist for the New York Department of Social Services.[20]

DC married her husband TC in 1971. For about 20 years, DC and TC together owned and operated a concession stand located in a government office building. DC retired when she was 62 years old.[21]

Werner was introduced to DC and TC in 1993 or 1994 through another broker at the firm where he worked. The couple became Werner's customers in 1995 after the other broker

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[12] Tr. 189-90; CX-16

[13] Tr. 191-92; CX-17. Werner's mortgage was $4,000 per month and the rent on his office ranged from $900 to $1,400 during the relevant period. Tr. 570-71.

[14] CX-21, at 1, 3, 8.

[15] Tr. 212-13.

[16] Tr. 32-33.

[17] CX-201.

[18] Tr. 33. Accordingly, just two customers—DC and the other customer—accounted for nearly 72 percent of Werner's commissions at Legend. CX-201. Werner testified that he used the same trading strategy and commission rates for the other customer as for DC. The other customer died in approximately 2015 at the age of 96. Tr. 33, 562, 582.

[19] Tr. 475; CX-41, at 3; CX-79, at 3.

[20] Tr. 475-76.

[21] Tr. 476-77.

retired.[22] DC and TC followed Werner as he moved from one broker-dealer to the next. Werner often visited the couple at their home in Long Island. Werner testified that he was "[v]ery close" to the couple.[23] He testified that DC and TC placed their confidence in him and trusted him to handle their investments.[24]

TC died in early September 2012.[25] Since then, DC has required the assistance of full- and part-time home health aides. She suffers from acute scoliosis that causes her pain and she uses a wheelchair. She also has difficulty hearing. After her husband died, DC suffered from depression and anxiety, according to Werner.[26]

Werner described his relationship with DC as "way beyond a casual adviser-client relationship."[27] Werner said DC was "more to me than a client and I felt a strong bond with her." He stated that he and DC became friends and he "treated her like a family member."[28] He says that he never declined to do favors for DC when she asked him to help her.[29] Werner further testified that he believed that DC considered him a "good friend,"[30] and he in turn "was nothing but kind to her and did everything she asked."[31] DC testified at the hearing that she "absolutely" trusted Werner.[32]

According to Werner, DC's annual income was between $93,000 and $96,000. She received Social Security benefits, a pension, and financial support from the Association for the Blind.[33] In addition to the assets held in her brokerage accounts at Liberty Partners and then Legend, DC had invested in annuities and certificates of deposit. She also had a checking

[22] Ans. at 1; Am. Ans. at 1.

[23] Tr. 27-28.

[24] Tr. 30. Werner testified, "Obviously, I had their trust." Tr. 513.

[25] Tr. 27, 60, 63.

[26] Tr. 54-56, 63-64, 479. DC had no relatives nearby. Tr. 66.

[27] Ans. at 5; Am. Ans. at 5.

[28] Ans. at 2-3; Am. Ans. at 2-3.

[29] Ans. at 2; Am. Ans. at 2.

[30] Tr. 67.

[31] Tr. 523.

[32] Tr. 479.

[33] Tr. 49-50. On DC's account application at Liberty Partners, dated July 2012, Werner selected the income range of $100,000 to $199,999. Werner testified that he selected this range, even though he believed her income was not more than $96,000, because her income amount was at the high end of the next lower range provided on the form. Tr. 567.

account.[34] Werner testified that DC's net worth in 2012 was approximately $1.2 million, excluding her home.[35]

C. Customer DC's Accounts

The Complaint charges Werner with churning three accounts belonging to DC—two Individual Retirement Accounts ("IRA") and a third account she opened in 2015 at Legend. While he was registered with Liberty Partners, Werner churned the two IRA accounts from October to November 2012. In December 2012, Werner left Liberty Partners and registered with Legend. He started churning DC's accounts at Legend in February 2013, after her securities were transferred from Liberty Partners. The churning continued until December 2015. Werner testified that the "only reason" he stopped trading DC's accounts in December 2015 was because FINRA began investigating him.[36]

Werner testified that he filled in himself or provided the information contained in the new account documents to Liberty Partners and Legend based on information he acquired from DC.[37] The speculative trading strategy Werner pursued with DC's accounts was inconsistent with her financial situation and investment objectives set forth in the applications for each of her accounts. Werner tried to hide from his employers that he intended to engage in speculative trading in DC's accounts. He testified that he "always thought if you let your bosses know this account is going to be speculative, that falls into a different review."[38] Werner marked many transactions "unsolicited" even though, as he acknowledged, he solicited all of the trades for DC.[39]

1. DC's Two Accounts at Liberty Partners (July 2012 to December 2012)

During the five months that Werner was registered with Liberty Partners—from July 2012 to December 2012—DC had two IRA accounts. DC opened her first IRA account at Liberty Partners ("IRA Account No. 1") in July 2012, when she transferred the account from another broker-dealer where Werner had been registered. At the time it was opened, the account held $158,700.28 in cash and securities.[40]

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[34] Tr. 46-47.

[35] Tr. at 519; CX-28, at 2. DC's residence was worth approximately $387,000 in 2017, according to a current commercial estimate. Tr. 519; Respondent's Exhibit ("RX-_") 10.

[36] Tr. 232-33.

[37] Tr. 49, 122-23, 565-67.

[38] Tr. 521.

[39] Tr. 86-87, 95, 572-73. Werner did not explain why many transactions were marked unsolicited when he in fact solicited them. Falsely marking orders unsolicited suggests to the Panel that Werner wanted to mislead his Firm into believing that DC had a hand in picking stocks.

[40] CX-29, at 8.

According to the account application, DC's income was between $100,000 and $199,999, her net worth (excluding her home) was between $1 million and $2,999,999, and her liquid net worth was between $500,000 and $999,999. DC's investment objective was "Growth – Focus is on generating long-term capital growth." This option was in the middle of the range provided on the form to describe investment objective—from "speculation" to "preservation of principal/income." As for her tolerance for risk, the selected box on the form stated, "I am willing to accept moderate risk, including some volatility, to seek higher returns and understand that I could lose a portion of my investment." This was the middle selection for risk tolerance, which ranged from "minimal risk" to "maximum risk."[41]

For the answer to the question, "How involved are you in making your investment decision?," the option selected was, "I rely on the guidance of my Financial Advisor most of the time." This answer, too, was in the middle of the range provided on the form. According to the application, DC had an investment horizon of 9 to 11 years and she estimated that she would need to withdraw between $10,000 and $49,999 from this account each year. The account application also indicated that DC had investment experience in stocks, bonds, mutual funds, annuities, exchange traded funds, and alternative investments.[42]

After DC's husband died in September 2012, Werner opened a second IRA account for DC at Liberty Partners ("IRA Account No. 2"). A balance of $34,287.28 was transferred into this account from proceeds of an account that had belonged to TC.[43] According to the account application, DC's income was between $50,000 and $99,999. Her net worth (excluding her residence) was between $1 million and $2,999,999 and her liquid net worth was between $1 million and $2,999,999.[44]

The application form for IRA Account No. 2 described DC's investment objective as "Balanced Growth – Focus is on generating current income and/or long-term capital growth." This was a more conservative investment objective than indicated on the new account form for IRA Account No. 1 in July 2012. The selected risk tolerance remained unchanged from July 2012: "Moderate."[45] The investment time horizon selected for this account was seven to eight years. For DC's "typical investment holding period," the option chosen on the form was one to three years. In response to the question, "How involved are you in making your investment decisions?" the account application indicated, "I discuss investment decisions with my Financial Advisor, but I also consult other sources of financial information and/or discuss with other parties."[46]

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[41] CX-28, at 2.

[42] CX-28, at 3.

[43] Tr. 93; CX-36, at 1, 7; CX-187.

[44] CX-35, at 3.

[45] CX-35, at 3.

[46] CX-35, at 2.

2. DC's Three Accounts at Legend (February 2013 to December 2015)

In December 2012, Werner moved from Liberty Partners to Legend.[47] On February 15, 2013, shortly after New York State securities regulators approved Werner's registration with Legend, the holdings in DC's two IRA accounts were transferred from Liberty Partners to Legend.[48] Securities and cash valued at $148,927.86 were transferred into IRA Account No. 1 and $34,151 into IRA Account No. 2 at Legend.[49]

The application forms for both IRA accounts at Legend stated that DC had annual income between $100,001 and $200,000 and her estimated net worth (exclusive of residence) and liquid net worth were both between $1 million and $5 million. According to the application form, DC had "Extensive" investment experience, her risk tolerance was "Medium," and her investment objective was "Growth." DC's investment time horizon—defined on the form as the "number of years planned to invest to achieve a particular financial goal"—was "Average (4 to 7 years)." DC's liquidity needs, according to the form, were "Not Important."[50]

By October 2014, as a result of Werner's trading and high commissions, the balances in DC's two IRA accounts were low. To replenish the balance, Werner had DC make a partial surrender of a VA she owned. The net surrender amount, after deducting surrender and rider charges, was $59,927.75. This amount was deposited in IRA Account No. 2 on October 28, 2014.[51] Werner promptly began trading IRA Account No. 2. He bought seven different securities from October 29 to 31, 2014, for over $60,000, and charged DC $2,388.50 in commissions for the purchases.[52]

In July 2015, after the balances in DC's two IRA accounts had declined further,[53] Werner had DC open a third account at Legend (the "Investment Account"). Werner had DC fund the Investment Account by withdrawing $45,000 from an existing annuity with Jackson National Life Insurance Company.[54] The money could not be deposited into one of DC's existing IRA

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[47] Werner testified that he left Liberty Partners because it was having trouble paying its brokers and he expected that the firm was going to shut down. Tr. 104.

[48] Tr. 109-10, 115, 125-28, 390; CX-8; CX-9; CX-10. Werner could not trade on behalf of New York resident customers during the time his license was being reviewed by state securities regulators. As a result, Werner did not trade DC's two IRA accounts between November 27, 2012, and February 15, 2013. Tr. 125, 390, 394; CX-194; CX-195; CX-196; CX-197.

[49] Tr. 111-12, 137-38; CX-34, at 1; CX-40, at 1.

[50] CX-41, at 1; CX-79, at 1.

[51] Tr. 192-97; CX-18; CX-102, at 5; CX-187.

[52] Tr. 198-200; CX-102, at 5; CX-197, at 3.

[53] DC's IRA Account No. 1 held assets valued at $3,943.98 as of June 30, 2015, and IRA Account No. 2 held assets valued at $34,467.11. CX-73, at 1; CX-110, at 1.

[54] Tr. 219; CX-119; CX-120, at 4-5. The $45,000 was deposited in the Investment Account on July 15, 2015.

accounts because DC was over 70 years old and the funds came from a non-qualified annuity.[55] Werner knew that he had lost a significant amount of money in DC's two IRA accounts, but he testified that the "whole plan" of opening the Investment Account with $45,000 was to "speculate" in order to make up for some of the money lost.[56]

The application form for the Investment Account at Legend, dated June 15, 2015, represented that DC had income of between $100,001 and $200,000 and her net worth (exclusive of residence) was between $1 million and $3 million and her liquid net worth was between $500,001 and $1 million. DC's investment horizon was "Intermediate – 1-10 yr." Her investment objective was "Maximum Growth," which was defined on the form as "Maximum capital appreciation with higher risk and little to no income." Her risk exposure was "Aggressive" and, according to the application form, DC had "Excellent" investment knowledge. The form stated that the money to fund the account came from "business revenue," not from a withdrawal from one of DC's annuities.[57]

3. Werner's Excessive Trading in DC's Accounts

Werner engaged in such an active trading strategy that, when the high commissions he charged were taken into account, it was impossible for DC to make money. In his Answer, Werner claimed that he pursued an aggressive trading strategy to make enough money for DC to afford the high costs of her home health care aides, which he estimated were between $11,000 and $18,000 per month. According to Werner, one aide told him that DC had agreed to buy her a new automobile. Another aide, Werner said in his Answer, was "very confrontational" with him when he visited DC at her home because Werner was concerned that DC was spending too much money on health aides.[58]

Werner said that it "was [his] idea to try to offset the unusual amount of spending that was occurring" by trading DC's accounts. He said he limited the amount of DC's money he invested to 15 percent of her liquid net worth. Werner also said in his Answer that, "We have been friends for the better part of two decades and I would never put her in a position that would risk her well being or standard of life."[59] Werner blamed the high losses he generated in DC's accounts on "picking the wrong stocks."[60] He testified that his strategy was to engage in "speculative" trading, even though the account opening documents indicated that DC's investment objective was growth and not speculation.[61] Werner recommended all of the

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[55] Tr. 216.

[56] Tr. 217. Werner testified that he had DC withdraw the $45,000 so that he could continue to trade her money. Tr. 214.

[57] CX-118, at 2.

[58] Ans. at 2-3; Am. Ans. at 2-3.

[59] Ans. at 4; Am. Ans. at 4.

[60] Ans. at 4; Am. Ans. at 4.

[61] Tr. 521, 549-51

transactions in DC's accounts, including what to purchase and when to sell securities. He testified that DC relied on his judgment and that he would update DC to let her know how her accounts were doing,[62] but Werner did not give her a "running total" of the money he lost.[63]

DC contradicted Werner's testimony on key points. She testified that Werner did not review statements with her. When asked how she knew what Werner was doing with her accounts, DC said, "We trusted him." She never had discussions with Werner about whether the accounts were doing well or not.[64] Werner did not tell her which stocks he was buying and selling.[65] According to DC, when FINRA staff contacted her to discuss her accounts, Werner told her not to talk to anyone from FINRA.[66]

Werner engaged in 716 trades in DC's three accounts from October 2012 to December 2015.[67] Werner charged DC excessive commissions on both the purchase and sale of the same security. While at Liberty Partners, all but one of Werner's 44 trades in DC's two IRA accounts resulted in commissions that ranged from 2.02 percent to 4.41 percent.[68] At Legend, with few exceptions, Werner charged DC commissions in her two IRA accounts that exceeded 2 percent and frequently were more than 4 percent.[69] In all but two of the 56 transactions in DC's Investment Account, Werner charged commissions that exceed 3 percent; for one trade, he charged a 5 percent commission.[70]

The commissions Werner charged DC at Liberty Partners during the two months he churned her account (October and November 2012) averaged 2.81 percent. Werner raised his commissions when he joined Legend. Including all three of DC's accounts, they averaged 3.57 percent from February 2013 to December 2015.[71] Werner testified that he decided to charge DC higher commissions by the time he got to Legend because she was so demanding of his time and he ran so many errands for her. Werner said that he would "think about how I would have to go out in the middle of my day to take care of her problem," which led him to charge at least "a

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[62] Tr. 81. Werner also testified that DC told him to do "whatever you want to do" with her accounts. Tr. 80.

[63] Tr. 217.

[64] Tr. 482-83.

[65] Tr. 484-85.

[66] Tr. 486.

[67] Each purchase and each sale is counted as a separate transaction.

[68] CX-194; CX-196. One commission, for $25.00, was 0.34 percent. CX-196.

[69] CX-195; CX-197. In a handful of instances, DC was not charged a commission or was charged less than 1 percent.

[70] Tr. 394-95; CX-198.

[71] Tr. 397-98; CX-199.

little bit more" in commissions. Werner did not have a "set formula" when he charged a commission—"It was more of a gut feeling than anything else."[72]

Werner frequently bought and sold a security within a week or two, rarely holding a security for longer than a few months, and he charged her exorbitant commissions.[73] For example, on February 20, 2013, in IRA Account No. 1, Werner purchased 240 shares of Automated Data Processing, Inc. (ADP) for a net cost of $15,401.37. He sold all of the shares on March 15, 2013, for net proceeds of $14,799.45, resulting in a $601.92 loss to DC. Werner charged DC a total of $1,236 in commissions on the purchase ($636) and sale ($600).[74]

Even when DC made a profit on a purchase and sale of a security, Werner's high commissions usually wiped out the gain. For example, on March 18, 2013, in IRA Account No. 1, Werner purchased 280 shares of WageWorks, Inc. (WAG) for $12,461.12, and on April 11, 2013, sold all the shares for $12,993.10, resulting in a profit of $531.98. Werner charged DC $1,078 in commissions on the purchase ($490) and sale ($588) of WAG, erasing the gain on the investment.[75]

Werner engaged in the same pattern of "in-and-out trading"[76] in DC's IRA Account No. 2 and the Investment Account.[77]

Enforcement calculated the turnover ratio, the cost-to-equity ratio, and the commission-to-equity ratio for each of DC's accounts. Turnover ratio is a measure of the number of times in a given period that securities are sold in an account and replaced by purchases of other securities. Enforcement used the modified Looper formula to calculate the turnover rate, which is derived

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[72] Tr. 576-77.

[73] Werner was paid 85 percent of the commissions he generated for Liberty Partners. Tr. 32. According to the agreement he signed with Legend, Werner received 90 percent of the commissions he generated during the first six months he was registered. After six months, Legend could reduce the payout to 85 percent for months during which Werner generated less than $20,000 in commissions. Tr. 118; CX-3, at 3.

[74] Tr. 359; CX-195, at 1; CX-208, at 1.

[75] Tr. 360-61; CX-208, at 15. The $490 and $588 commissions on the purchase and sale constituted, respectively, 4.11 percent and 4.31 percent commissions. *See* CX-195, at 1.

[76] "In-and-out trading" is the sale of all or part of the securities in an account and re-investing the proceeds in other securities, followed by the sale of the newly acquired securities. *See Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *47 n.39 (May 27, 2011), *aff'd*, 2012 U.S. App. LEXIS 18914, at *1 (1st Cir. 2012).

[77] For example, in IRA Account No. 2, on November 11, 2014, Werner purchased 560 shares of American Eagle Outfitters (AEO) for a total cost of $7,312.14 and sold the shares three days later for total proceeds of $7,236.49, generating a loss of $75.65. Three days later, on November 17, 2014, he purchased 250 shares of Blackstone Group (BX) for $8,321.48, all of which he sold eight days later for proceeds of $7,958.31, for a loss of $363.17. CX-197, at 3; CX-209, at 1, 3.

by dividing the total cost of purchases by the account's average monthly equity, and annualizing the result.[78]

The cost-to-equity ratio is a calculation of the percentage return on a customer's average net equity needed to pay the broker-dealer its commissions and other expenses. Stated differently, it is the percentage appreciation needed on an annualized basis for a customer to break even.[79] Enforcement's calculation of the cost-to-equity ratios in DC's accounts included transactional costs, such as ticket charges and Securities and Exchange Commission fees. Legend charged customers $49 per transaction.[80]

a. DC's IRA Account No. 1 (July 2012 to December 2015)

Werner traded DC's IRA Account No. 1 from October 2012 through December 2015 while he was at Liberty Partners and Legend. During the three-year period, DC paid a total of $16,637.48 in ticket and service charges for the transactions Werner recommended.[81] Werner engaged in 357 transactions in IRA Account No. 1 in just over three years, for which DC paid $118,519.76 in commissions. The account lost $85,072.01.[82]

The annualized turnover rate was 8.01 for IRA Account No. 1. The annualized cost-to-equity ratio for this account was 64.92 percent.

b. DC's IRA Account No. 2 (October 2012 to December 2015)

Werner traded DC's IRA Account No. 2 from October 2012 to December 2015 while he was registered with Liberty Partners and Legend. Werner engaged in 303 transactions in this account and generated $75,034.85 in commissions. DC paid service and ticket charges totaling $14,551.77. The account lost $66,671.16.[83]

The annualized turnover ratio for DC's IRA Account No. 2 was 12.13. The annualized cost-to-equity ratio was 97.73 percent and annualized commission-to-equity rate was 81.85 percent.[84]

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[78] Tr. 330. *See Jack H. Stein*, 56 S.E.C. 108, 119 (2003).

[79] Tr. 330-31. *See also Rafael Pinchas*, 54 S.E.C. 331, 340 (1999).

[80] According to Werner, Legend's charge was a fee for postage and handling. Tr. 378-79, 508, 537-38.

[81] Tr. 378-81; CX-185.

[82] Tr. 340; CX-185. Enforcement calculated the loss of $85,072.01 by subtracting the equity position at the beginning of the time period from the equity at the end of the period, then adding back cash and securities withdrawals from the account and subtracting cash and securities deposits made to the account. DC withdrew a total of $69,600 from IRA Account No. 1. The account earned $7,140.30 in interest and dividends. Tr. 332; CX-185.

[83] Tr. 347-48; CX-187. The calculation of the $66,671.16 loss in the account took into account two deposits totaling $61,671.29 and six withdrawals totaling $12,000. Tr. 346; CX-187.

[84] Tr. 347; CX-188.

c. DC's Investment Account (July 2015 to December 2015)

Werner had DC open the Investment Account at Legend in July 2015, funded by a $45,000 withdrawal from one of her VAs. During the six months that he traded the Investment Account, Werner engaged in 56 transactions. Werner charged DC $17,115.75 in commissions and generated losses of $23,650.44.[85]

The annualized turnover ratio for the six months that Werner traded the account was 18.05. The annualized cost-to-equity ratio was 141.09 percent and the annualized commission-to-equity ratio was 122.17 percent.[86]

D. Werner Recommends an Unsuitable Variable Annuity Switch to DC

In January 2008, DC invested $157,724.87 in a non-qualified VA sold by Hartford (the "Hartford VA") known as "Director M," through the FINRA member firm with whom Werner was then registered.[87] DC also purchased Hartford's lifetime income rider, which provided guaranteed lifetime benefit payments.[88] The total mortality and expense charge for the Hartford VA was 1.15 percent per year, and the fee for the income rider was 0.75 percent per year. The Hartford VA had a surrender period of seven years that expired in January 2015.[89]

In July 2015, Werner recommended to DC that she exchange the Hartford VA for a VA sold by Nationwide called "Destination B 2.0" (the "Nationwide VA").[90] In August 2015, DC completed the exchange. She invested $162,755.82 in the Nationwide VA, which was the total current value of the Hartford VA.[91] DC also purchased from Nationwide a lifetime income rider that provided guaranteed lifetime benefit payments. The total mortality and expense charge for the Nationwide VA was 1.3 percent per year, and the fee for the rider was 1.2 percent per year.[92] In addition, the Nationwide VA had a surrender period of seven years, during which DC would be charged on annual withdrawals in excess of 10 percent of the total purchase amount.

Nationwide paid Legend a commission of 7.25 percent, or $11,799.81, on the sale of the VA; Legend paid Werner 85 percent of this amount, or approximately $10,030.[93]

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[85] Tr. 354; CX-189.

[86] Tr. 353-54; CX-189.

[87] CX-128.

[88] CX-128, at 20-27.

[89] CX-128, at 8.

[90] Werner testified that he recommended the VA switch to DC. Tr. 233.

[91] CX-136, at 2; CX-141, at 4; CX-143, at 2-3.

[92] CX-141, at 4-5.

[93] Tr. 225-28; CX-140; CX-142.

Werner offered different and changing explanations for why DC switched from one VA to another, which the Hearing Panel does not find credible. Instead, we find that Werner's proffered reasons for the switch were pretexts and that the actual purpose for the switch was to generate a commission for Werner on the sale of a new VA.[94]

1. The Hartford Variable Annuity Was Not an Inferior Investment to the Nationwide Variable Annuity

At the time Werner recommended that DC switch her VA, he claimed that the Hartford VA did not perform as well as other VAs. The disclosure statement supporting the VA exchange asked Werner to provide the "primary reason(s) for recommending the new annuity contract." He answered, "low returns." In response to the question asking why the existing annuity contract "cannot meet applicant's objectives," Werner answer that the Hartford VA "has had low returns for years below market returns [*sic*]."

In fact, when Werner recommended the VA switch it was apparent, based on information available to him, that the Hartford VA was a better investment for DC than the Nationwide VA. The Nationwide VA provided no benefit to DC that outweighed the increased fees and expenses and the new surrender periods she incurred as a result of the exchange. Moreover, as of June 30, 2015, a month before Werner recommended the switch, the historical one-year, three-year, five-year, and ten-year returns on DC's mutual fund portfolio under the Hartford VA were higher than the returns for the same periods for the mutual fund portfolio Werner selected under the Nationwide VA.[95]

Werner also acknowledged that the Hartford VA surrender period had expired.[96] He also understood that the Nationwide VA imposed a new seven-year surrender period, expiring in 2022. Accordingly, DC would be subject to a new surrender period that would run until she reached the age of 87. This meant she would incur penalties ranging from 2 percent to 7 percent until August 2022 if she withdrew more than 13 percent of the contract value annually.[97]

Furthermore, DC would incur increased mortality and expense charges under the Nationwide VA. The Hartford VA's annual mortality and expense charge was 0.95 percent and the administrative charge was 0.2 percent, or a total of 1.15 percent.[98] The Nationwide VA's

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[94] Werner submitted the application for the Nationwide VA on August 4, 2015, less than two weeks after he learned that New York state tax authorities had garnished his compensation at Legend a total of nearly $250,000. CX-21; CX-139, at 8-9.

[95] CX-181. The returns for Hartford VA for one-, three-, five-, and ten-year historical periods were 2.86, 11.31, 10.45, 4.33 percent, respectively, and the returns for the Nationwide VA for the same periods were 1.26, 8.64, 8.82, and 3.84 percent.

[96] Tr. 257; CX-139, at 24.

[97] CX-141, at 4, 18-19.

[98] CX-184, at 8.

annual base contract variable account charge (equivalent to a mortality and expense charge) was 1.1 percent and the administrative charge was 0.2, or a total of 1.3 percent.[99]

DC also paid just 0.75 percent for her lifetime income rider under the Hartford VA.[100] As of June 30, 2015, she could withdraw up to $11,089.46 per year under this benefit without penalty.[101] After purchasing the Nationwide VA, DC paid 1.2 percent per year for its lifetime income rider.[102] As of September 30, 2015, under the Nationwide VA, DC could withdraw only $9,195.71 per year without penalty.[103] Accordingly, the Hartford VA provided DC $1,893.75 more in annual income than the Nationwide VA for 45 fewer basis points.

2. The Hartford Did Not Cease Servicing Its Variable Annuity Contracts

Werner claims in his Answer that DC—not he—initiated the VA switch because she received a letter from Hartford in which the company supposedly notified policy holders that Hartford intended to terminate its VA business by selling it to Forethought Financial Group, Inc. ("Forethought"). Werner claimed he investigated the situation and learned that Hartford "needed to eliminate that annuity business due to the cost factors" and "the only way [for it] to survive was to eliminate funds that had successful returns" or "exit the annuity business entirely."[104]

Although Hartford sold its annuity business to Forethought in 2012, Werner's claim that the sale affected DC's investment is false. In April 2012, Hartford announced it had agreed to sell its annuity business to Forethought. In the announcement, Hartford stated that the sale would not affect Hartford's existing annuity contracts.[105] In December 2012, Hartford completed the sale to Forethought.[106] Hartford never announced that it would cease servicing or honoring its existing annuity contracts with customers.[107] Hartford continued to service DC's VA until Werner decided to replace it with the Nationwide VA two and a half years later, in July 2015.

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[99] Tr. 276; CX-141, at 4.

[100] In November 2012, Hartford increased the charge for its income rider to 0.75 percent per year. Tr. 281-82; CX-129.

[101] Tr. 281; CX-134, at 2.

[102] CX-141, at 5.

[103] Tr. 278-79; CX-143, at 2.

[104] Ans. at 6-7; Am. Ans at 6-7.

[105] CX-130, at 1-3.

[106] CX-130, at 4.

[107] A Hartford in-house counsel who also served as the Chief Compliance Officer of its broker-dealer affiliate testified that Hartford had announced in 2012 that it would no longer issue new VA contracts and was selling its VA sales force and related support services to Forethought. It never told customers that it would no longer service its existing VA contracts. Tr. 441-44, 447, 461. He further explained that Hartford would not unilaterally breach contractual commitments made to customers contained in VA policies. Tr. 460-61. *See also* CX-130, at 5-6; CX-131; CX-132; RX-2.

Werner knew, or reasonably should have known, that Hartford's sale of its annuity business to Forethought would have no effect on DC.

IV. Conclusions of Law

A. Werner Excessively Traded and Churned DC's Accounts

Cause one charges Werner with churning DC's accounts, in violation of Section 10(b) of the Securities Act and Exchange Act Rule 10b-5 and FINRA Rules 2020 and 2010. Cause two charges Werner with excessively trading DC's accounts, in violation of FINRA Rules 2111 and 2010. We discuss first Werner's excessive trading, in violation of Rule 2111, and then his churning of DC's accounts, which violated Federal and FINRA anti-fraud provisions.

1. FINRA Rule 2111

FINRA Rule 2111 provides that an associated person "must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for a customer" based on the customer's investment profile. A customer's investment profile includes the customer's age, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the associated person.[108]

Supplementary material to Rule 2111 describes the suitability rule as "fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct."[109] "Implicit in all member and associated person relationships with customers and others is the fundamental responsibility of fair dealing."[110]

A broker's recommendations of investments and an investment strategy must be suitable. Rule 2111 identifies three suitability obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.[111] Enforcement alleges that Werner engaged in quantitatively unsuitable trading in DC's account, focusing on whether the number of transactions within a given period of time is suitable given a customer's financial circumstances and investment objectives rather than the characteristics of the securities recommended.[112] Supplementary Material to Rule 2111 defines "quantitative suitability."

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[108] FINRA Rule 2111(a). *See also* Supplementary Material 2111.04 (Customer's Investment Profile).

[109] Supplementary Material 2111.01 (General Principles).

[110] Supplementary Material 2111.01 (General Principles).

[111] Supplementary Material 2111.05 (Components of Suitability Obligations).

[112] *See O'Conner v. R.F. Lafferty & Co., Inc.*, 965 F.2d 893, 898 (10th Cir. 1992) (noting that "churning deals with the quantity of securities purchased for an account, while [the typical] unsuitability concerns the quality of the purchased securities").

> Quantitative suitability requires an associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity but factors such as the turnover rate, the cost-equity rate, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or an associated person has violated the quantitative suitability obligation.[113]

To prove quantitative unsuitability, or excessive trading, Enforcement must show that (i) Werner had control over DC's accounts, and (ii) the excessive trading was inconsistent with DC's financial circumstances and investment objectives.[114] The record shows that Werner controlled DC's accounts and that the excessive trading was inconsistent with her financial situation and investment objectives.

a. Werner Controlled DC's Accounts

A broker controls an account if he "has either discretionary authority or *de facto* control over the account."[115] DC did not give Werner discretion to trade her accounts. Werner, however, exercised *de facto* control over them. He engaged in excessive trading in her accounts and charged her extremely high commissions. The Hearing Panel finds that DC would never have agreed to the heavy trading Werner engaged in, combined with the egregiously high commissions, had Werner fully disclosed what he was doing. These circumstances amply demonstrate to the Hearing Panel that Werner controlled DC's accounts.

b. Werner's Excessive Trading

The record in this case establishes that DC's financial circumstances required that Werner invest her assets with a minimum amount of risk. DC is blind and dependent on others for her care. She was 77 years old and in ill health when Werner began churning her accounts. Although he claimed his strategy was designed to make profits sufficient to cover the expenses, it was inappropriate for Werner to implement an aggressive and speculative trading strategy. The quantity of Werner's trading in DC's accounts was completely inconsistent with her financial circumstances and investment objectives. Werner engaged in over 700 trades in the three accounts over a three-year period. It is apparent to the Hearing Panel that Werner took advantage of DC's vulnerability after her husband died in September 2012. Werner's sole motivation was

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[113] Supplementary Material 2111.05(c) (Components of Suitability Obligations).

[114] *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *27 (NAC Apr. 26, 2013) (citing *Dep't of Enforcement v. Medeck*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *34 (NAC July 30, 2009)).

[115] *Medeck*, 2009 FINRA Discip. LEXIS 7, at *34.

to use DC's accounts to generate commissions to cover his financial liabilities, not to make money for his client.

Werner's trading generated annualized turnover ratios of 8.01 (IRA Account No. 1), 12.13 (IRA Account No. 2), and 18.05 (Investment Account) in DC's accounts, and annualized cost-to-equity rates of 64.92, 97.73, and 141.09 percent, respectively. These are far above levels that have supported findings of excessive trading in other cases.[116]

Accordingly, the Hearing Panel finds that Werner excessively traded DC's accounts and violated FINRA Rules 2111 and 2010.[117]

2. Werner Fraudulently Churned DC's Accounts

To find that Werner's excessive trading, established above, constituted churning, in violation of Section 10(b) of the Exchange Act, Rule 10b-5, and FINRA Rule 2020 requires a finding that he acted with scienter.[118] Scienter "is established either by evidence of intent to defraud or by evidence of willful and reckless disregard of the customer's interests."[119] Proof of scienter may be "a matter of inference from circumstantial evidence."[120] FINRA Rule 2020 prohibits associated persons from using "manipulative, deceptive, or other fraudulent devices or contrivances" in connection with the purchase or sale of any security.

Werner knew that his trading was costing DC a large amount of money yet he persisted in excessively trading her accounts and charging her unreasonable commissions. Indeed, Werner

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[116] *See Stein*, 56 S.E.C. at 118 ("Turnover rates between three and five have triggered liability for excessive trading, and it has been generally recognized than an annual turnover rate of greater than six evidences excessive trading."); *Pinchas*, 54 S.E.C. at 340 (finding that a cost-to-equity ratio of 20 percent constitutes excessive trading).

[117] Excessively trading a customer's account also violates FINRA Rule 2010, which requires that FINRA members "observe high standards of commercial honor and just and equitable principles of trade." *See Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *30 (finding that excessive trading also violated NASD Rule 2110, the predecessor to FINRA Rule 2010).

[118] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *31 (citing *Dep't of Enforcement v. Murphy*, No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *54-58 (NAC Oct. 20, 2011), *aff'd*, *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933 (July 2, 2013)). A finding of a violation of Section 10(b) of the Exchange Act and Rule 10b-5 also requires proof that Werner "used any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." This element is satisfied because Werner communicated with DC by telephone, Tr. 87, and the trades were effected through various means of interstate commerce and national securities exchanges.

[119] *Murphy*, 2013 SEC LEXIS 1933, at *64 (quoting *Al Rizek*, Exchange Act Release No. 41725, 54 S.E.C. 261, 268 (1999)). *See also Medeck*, 2009 FINRA Discip. LEXIS 7, at *34 ("Scienter requires proof that a respondent intended to deceive, manipulate, or defraud or 'acted with severe recklessness involving an extreme departure from the standards of ordinary care.'") (citing *Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *44 & n.27 (NAC June 25, 2001)).

[120] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983). *See also Lawrence H. Ripp*, 46 S.E.C. 771, 773 (1977) ("Since it is impossible to probe into the depths of a man's mind, a finding of fraudulent intent, absent an admission, must be based on inferences drawn from the evidence.").

testified that he charged high commissions because DC was asking him to help her and run errands for her.[121] Within three years, even after taking into account DC's withdrawals, Werner depleted DC's two IRA accounts. This led him to have DC open a third brokerage account, the Investment Account, funded with a VA withdrawal, so that he could continue to trade.

The amount of commissions that Werner generated further demonstrates that he acted with scienter. The $210,586 in commissions over three years was an important source of income for Werner that helped him pay his substantial tax liabilities and living expenses. The level of trading he engaged in, combined with the inappropriate commissions he charged, made it unreasonable for Werner to expect that he could earn a profit in DC's accounts, as he claimed.[122] The NAC has held in a churning case that "the amount of commissions that [respondent] generated from trading [the customer's] account demonstrates that he acted with scienter."[123] Based on the outrageously high turnover rates and cost-to-equity ratios for DC's accounts, Werner had to have known he was not acting in DC's interests.

The Hearing Panel finds that Werner churned DC's accounts and that he willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder[124] and he violated FINRA Rules 2020 and 2010.

B. Werner Made an Unsuitable Recommendation that DC Surrender an Existing Variable Annuity to Purchase Another Variable Annuity

Cause three alleges that Werner's recommendation to DC that she sell one VA in order to purchase another was unsuitable. Enforcement alleges that, in addition to violating FINRA Rule 2111, Werner also violated FINRA variable annuity rule, FINRA Rule 2330(b). Rule 2330(b) prohibits a representative from recommending the purchase or exchange of a deferred VA unless the representative has a reasonable basis to believe that the purchase or exchange meets the suitability requirements of FINRA Rule 2111 and there is a reasonable basis to believe that the

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[121] Tr. 181-82.

[122] *See Michael T. Studer*, Exchange Act Release No. 50543, 2004 SEC LEXIS 2347, at *16-17 (Oct. 14, 2004) (churning exists when a broker "manages a client's account for the purposes of generating commissions"), *aff'd*, 148 F.App'x 58 (2d. Cir. 2005).

[123] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *33.

[124] Werner's willful violation of Section 10(b) of the Exchange Act and Rule 10b-5 results in his statutory disqualification. *Dep't of Enforcement v. Escarcega*, No. 2012034936005, 2017 FINRA Discip. LEXIS 32, at *44-45 (NAC July 20, 2017) (respondent statutorily disqualified as a result of willfully violating Section 10(b) of the Exchange Act and Rule 10b-5); *see also Dep't of Enforcement v. Ahmed*, No. 2012034211301, 2015 FINRA Discip. LEXIS 45, at *90 n.84 (NAC Sept. 25, 2015) (citing *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) ("'[W]illfully' in [the Exchange Act] means intentionally committing the act which constitutes the violation," not that "the actor [must] also be aware that he is violating one of the Rules or Acts.")); *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *3 n.2 (Feb. 13, 2015) (stating that applicants were statutorily disqualified because they willfully violated Section 10(b) of the Exchange Act and Rule 10b-5); *see also* Sections 3(a)(39)(F) (15 U.S.C. § 78c(a)(39)(F)) and 15(b)(4)(D) (15 U.S.C. § 78o(b)(4)(D)) of the Exchange Act; Article III, Section 4 of FINRA's By-Laws.

purchase or exchange is consistent with the suitability determination required by Rule 2330(b)(1)(A).

With respect to an exchange of a VA, FINRA Rule 2330(b)(1)(B) also requires the representative to consider whether (i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements); and (ii) the customer would benefit from product enhancements and improvements.

A registered representative is permitted to recommend an annuity exchange "only if it is in the investor's best interest and only after evaluating the investor's personal and financial situation and needs, tolerance for risk, and the financial ability to pay for the proposed contract."[125] For years, FINRA has advised members that "the sales and distribution of variable contracts are fully subject to [FINRA's] sales practice rules," including the suitability rule.[126] In a Notice to Members, FINRA stated that when considering a VA replacement, a registered representative "should determine, based on information provided by the customer and their own knowledge of the product features, that replacing the existing contract with a new contract is suitable for the customer."[127] A broker should consider "such matters as product enhancements and improvements, lower costs structures, and surrender charges."[128] FINRA stated that in determining the suitability of a VA, a broker should have "a thorough knowledge of the specification of each variable annuity that is recommended, including the death benefit, fees and expenses, subaccount choices, special features, withdrawal privileges, and tax treatment."[129] Suitability determinations for VAs, FINRA advised, also must take into account the customer's age, financial and tax status, investment objectives, current need for income and liquidity, investment sophistication, risk tolerance, and previous investment experience.[130]

In DC's case, replacing the Hartford VA with the Nationwide VA caused her to incur additional expenses and fees and a new surrender period. The new product offered her no features that were better than the Hartford VA that she owned. The Nationwide VA imposed on DC higher annual mortality and expenses charges and higher administrative costs. She also paid more for the annual lifetime income rider for which she received a lower annual benefit. The Nationwide VA also triggered a new seven-year surrender period just six months after the Hartford VA surrender period had expired. This VA exchange was unsuitable for DC because of

[125] *Dep't of Enforcement v. Pierce*, No. 2007010902501, 2013 FINRA Discip. LEXIS 25, at *80 (NAC Oct. 1, 2013).

[126] NASD Notice to Members 96-86, 1996 NASD LEXIS 108, at *3-4.

[127] NASD Notice to Members 99-35, 1999 NASD LEXIS 10, at *12.

[128] NASD Notice to Members 99-35, 1999 NASD LEXIS 10, at *12.

[129] NASD Notice to Members 99-35, 1999 NASD LEXIS 10, at *8.

[130] NASD Notice to Members 99-35, 1999 NASD LEXIS 10, at *7-8.

her age, financial needs, and likely medical expenses. Furthermore, as an experienced securities professional, Werner knew, or should have known, that Hartford could not unilaterally breach its contractual commitments to customers like DC, which was one of his purported reasons for recommending the switch.

The Panel finds that Werner recommended a VA exchange to DC without having a reasonable basis to believe that the transaction was suitable for her. By engaging in this misconduct, Werner violated FINRA Rules 2111, 2330(b), and 2010.

V. Sanctions

Werner plundered DC's accounts. The appropriate sanction for his depredations is a bar from associating with any FINRA member firm in any capacity. He is also fined $80,000 and ordered to pay restitution to DC in the amount of $155,393.61. For Werner's unsuitable VA switch, the Panel assesses, but does not impose in light of the bar and $80,000 fine, a six-month suspension in all capacities and a $25,000 fine. However, the Panel orders Werner to disgorge $10,030, the commission he was paid for recommending DC's unsuitable VA purchase.

A. Churning and Excessive Trading (Causes One and Two)

In determining the appropriate sanctions for Werner's misconduct, the Hearing Panel considered FINRA's Sanction Guidelines ("Guidelines"),[131] including the General Principles Applicable to All Sanction Determinations and the Principal Considerations in Determining Sanctions. The Hearing Panel finds that it is appropriate to assess a unitary sanction for the misconduct alleged against Werner, all of which relates to his churning and unsuitable recommendations.[132]

The Guideline for churning or excessive trading, in violation of FINRA Rules 2111 and 2010, provides for a fine between $5,000 and $110,000. Adjudicators should consider suspending an individual in any or all capacities for a period of one month to two years. In cases where aggravating factors predominate, adjudicators should consider a suspension of two years or a bar. For intentional or reckless misconduct involving churning, adjudicators should strongly consider a bar.[133]

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[131] *See* FINRA Sanction Guidelines (2017), http://www.finra.org/industry/sanction_guidelines.

[132] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *37-40 (applying a single sanction for respondent's churning and excessive trading); *see also Escarcega*, 2017 FINRA Discip. LEXIS 32, at *67 (applying a single sanction for fraudulent misrepresentations and unsuitable recommendations based on same facts) (citing *Blair C. Mielke*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927, at *59 (Sept. 24, 2015) (affirming FINRA's imposition of a single sanction for violations that are based on the same facts)).

[133] Guidelines at 78. For unsuitable recommendations that do not rise to the level of churning, the Guidelines also provide that where aggravating factors predominate, adjudicators should strongly consider barring a respondent. Guidelines at 95.

After considering multiple aggravating factors, the Panel bars Werner and fines him $80,000 for churning DC's accounts and for making quantitatively unsuitable recommendations. The fine is approximately half of the amount of restitution the Panel orders Werner to pay DC.[134] There are no mitigating circumstances. Werner's misconduct caused considerable harm to DC. She lost over $175,000 as a result of his reckless trading. His excessive trading, combined with steep commission rates, generated over $210,000 in commissions, at least 85 percent of which he received as compensation from Liberty Partners and Legend.[135] He engaged in the misconduct for over three years.[136] DC was not a sophisticated or experienced investor.[137] Given DC's overall poor health and the recent death of her husband, Werner was easily able to take advantage of her.[138] Werner acted intentionally, thinking only of his own financial well-being and not the interests of DC.[139] Finally, Werner never accepted responsibility for his actions. During the hearing, he claimed that DC's losses were the result of his picking the wrong investments, and not the result of the volume of his trading and high commissions.[140] Simply put, Werner engaged in egregious misconduct and is unfit to work in the securities industry.

Additionally, the Guidelines provide that where appropriate, adjudicators should order restitution. Restitution is a traditional remedy used to restore the *status quo ante* where a victim otherwise would unjustly suffer loss. It may be ordered when an identifiable person has suffered a quantifiable loss proximately caused by a respondent's misconduct. In addition, "Adjudicators should calculate orders of restitution based on the actual amount of the loss sustained by a person, ... as demonstrated by the evidence."[141] DC lost $175,393.61 as a result of Werner's reckless trading. The Panel orders that Werner pay restitution to DC that amount, less $20,000, the amount that Legend paid to DC as partial restitution.[142] Accordingly, Werner is ordered to

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[134] The Guidelines provide that adjudicators generally should impose a fine in all sales practice cases even if a respondent is barred if the case "involves widespread, significant and identifiable customer harm" or the respondent has retained substantial ill-gotten gains. Guidelines at 10. The Panel finds that both conditions are met.

[135] Guidelines at 7-8 (Principal Considerations in Determining Sanctions, Nos. 11 and 16) (whether respondent's misconduct resulted in injury to the investing public and the potential for the respondent's monetary or other gain).

[136] Guidelines at 7-8 (Principal Considerations in Determining Sanctions, Nos. 8, 9, and 17) (whether the respondent engaged in numerous acts and/or a pattern of misconduct; whether the respondent engaged in the misconduct over an extended period of time; and the number, size, and character of the transactions at issue).

[137] Guidelines at 8 (Principal Considerations in Determining Sanctions, No. 18) (the level of sophistication of the injured or affected customer).

[138] Guidelines at 8 (Principal Considerations in Determining Sanctions, No. 19) (whether the respondent exercised undue influence over the customer).

[139] Guidelines at 8 (Principal Considerations in Determining Sanctions, No. 13) (whether the respondent's misconduct was the result of an intentional act, recklessness, or negligence).

[140] Guidelines at 7 (Principal Considerations in Determining Sanctions, No. 2) (whether the respondent accepted responsibility for and acknowledged his misconduct).

[141] Guidelines at 4 (General Principle No. 5).

[142] Enforcement calculated DC's losses of $175,393.61 from information contained in account statements and trade blotters provided by Liberty Partners and Legend, which the Panel finds sufficiently reliable to support the

pay restitution of $155,393.61. Werner shall also pay prejudgment interest on this amount from December 31, 2015, which is the date of the last transaction he made in one of DC's accounts.[143]

B. Unsuitable Recommendation to Switch Variable Annuity (Cause Three)

The Guideline for making unsuitable recommendations in violation of FINRA Rule 2111 provides for a fine of $2,500 to $110,000. Adjudicators should consider suspending a respondent in any or all capacities for 10 business days to two years. Where aggravating factors predominate, adjudicators should strongly consider a bar for an individual respondent. The Guideline directs adjudicators to apply the principal considerations applicable to all violations.[144] The Panel finds that the considerations discussed above are applicable to Werner's unsuitable recommendation to DC that she switch from one VA to another. The Panel finds that Werner was motivated primarily, if not solely, by the prospect of making a quick commission from the transaction.

Given DC's financial circumstances, Werner's recommendation to make the VA switch—even when viewed in isolation from the churning he engaged in—constituted serious misconduct. Accordingly, the Panel assesses (but does not impose in light of the bar and the $80,000 fine for churning and excessive trading) a six-month suspension in all capacities from associating with any member firm and a $25,000 fine. However, we determine that disgorgement is appropriate in this case and therefore order Werner to disgorge $10,030 to FINRA, which is his share of the commission Nationwide paid Legend for DC's purchase of the new VA. Disgorgement of Werner's commission will remediate his misconduct in light of his ill-gotten gain.[145] Werner shall also pay prejudgment interest on $10,030 from August 21, 2015, which is the date that Nationwide paid its commission.[146]

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restitution amount. *See* Guidelines at 4 (General Principle No. 5) (requiring adjudicators to include a description of the method of calculation of restitution). *See also* Tr. 614.

[143] CX-116, at 4; CX-197, at 6.

[144] Guidelines at 95. There is no Guideline for violations of FINRA Rule 2330 involving a registered representative's duties with respect to sales of variable annuities. Because cause three charges violations of FINRA Rules 2111 and 2330, the Panel applied the Guideline for making unsuitable recommendations, in violation of Rule 2111.

[145] *See* Guidelines at 95 (instructing adjudicators to order disgorgement in cases involving unsuitable recommendations) (citing General Principle No. 6) (adjudicators may require disgorgement of ill-gotten gain when determining sanctions); Guidelines at 10 (disgorgement is appropriate even if an individual is barred); *see also Dep't of Enforcement v. Akindemowo*, No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *50-51 (NAC Dec. 29, 2015) (ordering respondent to disgorge ill-gotten gains from converting investor funds), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016).

[146] CX-142, at 2. *See also Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *43 (applying prejudgment interest to order of disgorgement).

VI. Order

Hank M. Werner made quantitatively unsuitable recommendations resulting in excessive trading in DC's accounts and fraudulently churned her accounts, in willful violation of Section 10(b) of the Securities Act, Exchange Act Rule 10b-5, and in violation of FINRA Rules 2010, 2020, and 2111, as alleged in causes one and two of the Amended Complaint.

Werner made an unsuitable recommendation to DC to switch her VA investment, in violation of FINRA Rules 2111, 2330(b), and 2010, as alleged in cause three of the Amended Complaint.

The Extended Hearing Panel bars Werner from associating with any FINRA member firm in any capacity, and fines him $80,000 for churning and making quantitatively unsuitable recommendations. He is also ordered to pay restitution of $155,393.61, plus prejudgment interest, to customer DC.[147] Werner shall provide Enforcement with proof of payment of restitution, with interest.[148]

For the unsuitable VA switch, the Hearing Panel assesses, but does not impose in light of the bar and $80,000 fine above, a six-month suspension in all capacities and a $25,000 fine. However, the Panel orders Werner to disgorge $10,030 to FINRA, plus prejudgment interest, representing his compensation for selling the replacement VA.[149]

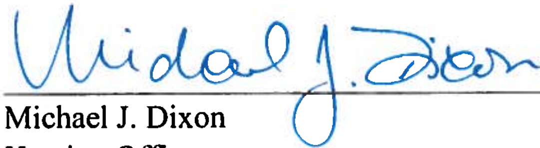
Werner is ordered to pay the costs of the hearing in the amount of $5,237.66, consisting of a $750 administrative fee and $4,487.66 for the cost of the transcript.

[147] Interest shall accrue from December 31, 2015, until paid. The prejudgment interest rate shall be the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a). *See* Guidelines at 11.

[148] Proof of payment of restitution shall be submitted to FINRA, Department of Enforcement, 200 Liberty Street, Brookfield Place, New York, NY 10281, either by letter that identifies the case name and number and includes a copy of the check, money order, or other method of payment or by email, with PDF copies of the payment documentation, to enforcementnotice@finra.org no later than 60 days after the date this Decision becomes FINRA's final disciplinary action in this proceeding.

[149] Prejudgment interest on the $10,030 disgorgement amount shall accrue from August 21, 2015, until paid. The prejudgment interest rate shall be the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a). *See* Guidelines at 11.

If this Decision becomes FINRA's final disciplinary action, the bar will take immediate effect. Restitution (including prejudgment interest) shall be due 60 days after this Decision becomes FINRA's final action. The $80,000 fine, disgorgement (including prejudgment interest), and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this Decision becomes FINRA's final action.[150]



Michael J. Dixon
Hearing Officer
For the Extended Hearing Panel

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Jeffrey D. Pariser, Esq. (via electronic mail)

[150] The Extended Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this Decision.