FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2019061652404

TO: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)

RE: National Securities Corporation (Respondent)
Member Firm
CRD No. 7569

Pursuant to FINRA Rule 9216, Respondent National Securities Corporation submits this Letter of Acceptance, Waiver, and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described in this AWC.

I.

ACCEPTANCE AND CONSENT

A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

National Securities Corporation (NSC) has been a FINRA member since 1947. The firm conducts a general securities business and is headquartered in Boca Raton, Florida. The firm has approximately 574 registered representatives and 119 branch offices.

In April 2022, NSC was censured, fined $300,000, and ordered to pay $363,447.67 in disgorgement (AWC No. 2019064508801). NSC contravened Section 17(a)(3) of the Securities Act of 1933 and violated FINRA Rules 2010 and 3110 by deceiving investors in connection with its sales of a “pre-IPO” private placement offering, failing to reasonably enforce its written supervisory procedures (WSPs), and failing to reasonably supervise the head of its “pre-IPO” offering business.

In May 2011, NSC was censured and ordered to pay $175,000 in partial restitution to investors in a private offering (AWC No. 2009019068201). NSC violated NASD Rules 2310, 3010, and 2110 and FINRA Rule 2010 when it failed to conduct reasonable due diligence and have a reasonable basis to recommend two private offerings.[1]

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[1] For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

OVERVIEW

NSC has violated various rules promulgated under the Securities Exchange Act of 1934 (Exchange Act) as well as NASD and FINRA rules.

***Regulation M violations and attempts to artificially support underwritten securities*—** Between June 2016 and December 2018, NSC engaged in misconduct intended to influence artificially the market for securities offered by the firm's corporate affiliates and investment banking clients. First, during restricted periods associated with ten offerings underwritten by NSC, NSC attempted to, and did, induce customers to bid for and purchase shares of the offered security in the aftermarket, prior to the completion of the distribution, in willful violation of Rule 101 of Regulation M under the Exchange Act, and in violation of FINRA Rule 2010. Second, NSC violated FINRA Rules 5131(c) and 2010 by attempting to recoup selling concessions from representatives whose customers sold shares of three new issues in the 30 days following each offering. Third, NSC failed to provide written notice to customers of potential conflicts of interest in connection with the customers' purchases and sales of securities that were issued by three firm affiliates, in violation of FINRA Rules 2262 and 2010 and Exchange Act Rule 15c1-5. Fourth, NSC failed to establish, maintain, and enforce a reasonable supervisory system, including WSPs, related to these issues and also failed to reasonably supervise cross trades to detect potential market manipulation, in violation of FINRA Rules 3110 and 2010.

***Negligent omissions of material fact*—**Between April 2018 and July 2018, NSC negligently omitted to tell investors in two offerings related to GPB Capital Holdings, LLC (GPB Capital) that the issuers failed to timely make required filings with the Securities and Exchange Commission (SEC), including filing audited financial statements. By virtue of the foregoing, NSC violated FINRA Rule 2010.

***Inaccurate representations to FINRA*—**In October 2019, NSC acted as a lead underwriter of a public offering, and in connection with that offering received common stock warrants. Although NSC represented to FINRA that certain of these warrants would not be sold for a period of 360 days, NSC permitted certain warrants to be sold within the 360-day period. By virtue of the foregoing, NSC violated FINRA Rule 2010.

***Failure to supervise*—**Between September 2013 and May 2017, NSC failed to reasonably supervise one of its registered representatives (Representative A) by failing to reasonably respond to red flags that he was causing NSC to record false and significant increases in the value of customer assets, as well as false suitability information on record with the firm, in order to avoid the firm's limits on concentration levels of his non-traded real estate investment trust (REIT)[2] recommendations and to make his non-traded REIT

[2] A REIT is a corporation, trust, or association that owns or manages income-producing real estate. There are two types of public REITs: those that trade on a national securities exchange and those that do not trade on a national securities exchange. REITs in this latter category are generally referred to as publicly registered non-exchange traded REITs or non-traded REITs.

recommendations appear to be suitable. As a result, NSC violated FINRA Rules 3110, 4511, and 2010, and NASD Rule 3010.

Regulation SHO violations—Between January 2005 and April 2020, Respondent failed to obtain locates in connection with at least 33,241 short sale transactions, in violation of Rule 203(b)(1) of Regulation SHO under the Exchange Act, NASD Rule 2110, and FINRA Rule 2010. The firm further failed to establish, maintain, and enforce a supervisory system, including WSPs, reasonably designed to achieve compliance with the locate requirements of Regulation SHO, in violation of NASD Rules 3010 and 2110 and FINRA Rules 3110 and 2010.

FACTS AND VIOLATIVE CONDUCT

A. NSC engaged in misconduct intended to influence artificially the market for securities offered by the firm's corporate affiliates and investment banking clients.

1. NSC attempted to induce aftermarket purchases during the restricted periods of ten offerings underwritten by the firm.

Regulation M is an anti-manipulation provision of the federal securities laws and applies to distributions of securities. Rule 101 of Regulation M makes it unlawful for any participant in a distribution of securities "directly or indirectly, to bid for, purchase, or attempt to induce any person to bid for or purchase, a covered security" during the distribution's restricted period.[3] Thus, attempts by underwriters to solicit or otherwise induce customers to make additional purchases of the offered security after trading begins (the aftermarket) are prohibited until the distribution is complete. Such solicitations can undermine the integrity of the market by artificially stimulating demand and supporting the pricing of the offering.

In 2005, the SEC issued an interpretive release concerning Regulation M, in which it stated that Rule 101 applies to any activity by underwriters during an offering that "causes or is likely to cause another person to bid for or purchase covered securities"—irrespective of the underwriter's intent and regardless of whether such conduct results in aftermarket activity by others.[4] The release identified certain conduct during the restricted period that could violate Regulation M, including: (1) inducements to purchase in the form of tie-in agreements or other solicitations of aftermarket bids; (2) soliciting customers as to what price and in what quantity they intend to purchase in the aftermarket; (3) proposing aftermarket prices to customers; and (4) accepting or seeking expressions of interest from customers that they intend to purchase an amount of shares in the aftermarket equal to the size of their allocation (e.g., "1 for 1"). The release also

[3] As defined in Rule 100(b) of Regulation M, the restricted period generally begins one or five business days prior to the determination of an offering price and ends upon the completion of the distribution. *See* 17 CFR § 242.101(a).

[4] *Commission Guidance Regarding Prohibited Conduct in Connection with IPO Allocations,* Release Nos. 33-8565; 34-51500; IC-26828 (April 7, 2005).

stated that conduct occurring *after* the restricted period, including follow-up solicitations for immediate aftermarket orders for customers who had earlier expressed interest, and the tracking of customers' aftermarket purchases, while not illegal itself, could evidence a violation of Rule 101.

A violation of Regulation M also constitutes a violation of FINRA Rule 2010, which requires member firms and associated persons to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.

Between August 2016 and March 2018, NSC acted as an underwriter for three IPOs and seven follow-on offerings. The ten offerings collectively raised over $200 million for the issuers, who were mainly small-cap biopharma or technology companies, and generated net profits of approximately $4.77 million for NSC.[5]

NSC's Investment Banking Department (IBD) had primary responsibility for underwriting offerings and shared responsibility with the firm's Syndicate Department (Syndicate) for the book-building process, including the process for allocating shares to customers. Syndicate communicated the details of a particular offering to the firm's sales representatives, who reached out to their customers and then input their customers' demand—referred to as indications of interest (IOIs)—in the firm's internal computer system. Syndicate and IBD allocated shares at the branch level or occasionally at the individual sales representative level in the case of a branch with only one or two representatives. Once a branch received its final allocation, the branch's manager allocated shares amongst the branch's sales representatives, who booked the shares to customer accounts.

Pursuant to NSC's WSPs, Syndicate would determine "who [was] allocated securities and the amounts of the allocation." However, in practice, Syndicate and IBD shared responsibility for such decisions. The WSPs recited the language of Rule 101 of Regulation M and stated that allocations were to be "based upon [IOI] forms, as well as any other factors [Syndicate] consider[ed] appropriate to facilitate a distribution of the offering." In addition to IOIs, Syndicate and IBD considered a customer's long-term interest in the issuer and, for follow-on offerings, whether the customer was an existing shareholder. They also understood that they were prohibited from basing allocations on whether and in what quantity firm customers would buy additional shares in the aftermarket.

In connection with each of the ten offerings, however, during the restricted periods, NSC directly and indirectly attempted to, and did, induce customers to make aftermarket purchases of the offered securities. Syndicate and IBD, in the context of making allocation decisions, solicited and considered branch managers' and sales representatives' feedback concerning whether their customers would be participating in the immediate aftermarket. This feedback routinely reflected that branch managers and sales representatives understood that in order to receive a "decent" allocation for their

[5] As described below, the firm will be required to disgorge $4.77 million in unlawful profits from its Regulation M violations.

customers, their customers would be expected to buy additional shares in the aftermarket. Conversely, Syndicate and IBD reduced or threatened to reduce allocations to representatives who refused to solicit their customers to participate in the aftermarket.

In other instances, Syndicate and IBD expressly conditioned allocations on a branch manager's agreement to buy a specific number of shares in the aftermarket for the branch's customers, often tied to a percentage of the branch's overall allocation, without reference to its customers' desired overall position. The branch manager would then work with the branch's sales representatives and attempt to solicit that amount of aftermarket shares from the branch's customers.

Syndicate and IBD memorialized the aftermarket feedback in spreadsheets created and emails sent during the restricted periods in the context of determining allocations. For example, a spreadsheet created in connection with one of the offerings reflected that a sales representative "w[ould] participate in the aftermkt – if he gets 50-60% of his interest he will likely buy remainder in the aftermarket."[6]

Syndicate and IBD would also convey their discussions with representatives and branch managers concerning the aftermarket to NSC's Director of Trading,[7] who would track aftermarket bids and purchases in real-time and e-mail, message, or call representatives to ensure that they were following through on their aftermarket commitments.

The firm's conduct was aimed at artificially stimulating demand and supporting the price of the offered securities, which tended to be thinly traded, in the immediate aftermarket. The aftermarket performance of NSC's underwritten offerings was important to the firm's reputation and ability to generate future investment banking revenue.

The two examples set forth below—NSC's actions with respect to Offering A and Offering B—typify the firm's misconduct.

a. Example #1 – NSC's misconduct with respect to Offering A

NSC served as an underwriter for Offering A, a $13.8 million public follow-on offering. The offering had a five-day restricted period from September 22, 2016, at 9:00 am through September 27, 2016, at 8:10 am. On September 22, the Head of the IBD wrote to a Syndicate manager: "[w]ant to please confirm with [Branch Manager 1] and [his] team that if we get them the stock they need, close to it or more than expected, they will also be in the aftermarket for the balance of the orders or something that represents 10% or more of their allocation, meaning if they get 1.25 million shares they are buying 125,000 in the aftermarket as an example, same with other [NSC] office(s)."

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[6] Syndicate or IBD circulated similar spreadsheets and/or emails tracking aftermarket feedback in connection with each of the other nine offerings.

[7] This individual has been barred from the securities industry for failing to provide testimony in response to a FINRA Rule 8210 request issued in connection with this matter.

On September 24, the Syndicate manager emailed the Head of the IBD concerning Branch Manager 1's allocation and said that she "[j]ust got off the phone with [Branch Manager 1]" and "he said aftermarket 10% plus." On September 27 at 8:02 am, a Syndicate manager wrote to Sales Representative 1 and stated, "$54,200 of [Offering A] for your office we are expecting aftermarket activity can you call me on this." Sales Representative 1 responded, "I'll take 5000 shares, spoke with client and they understood." At 8:06 am, a Syndicate manager emailed Sales Representative 2, and said "we have 8000 [shares of Offering A] for you – if you can buy the additional 2k in the [sic] we appreciate." Sales Representative 2 responded, "I will enter the 8,000 in the system and then will support it in the aftermarket with the difference as suggested."[8]

On September 27, the stock opened at $7.09, approximately 9% above its offering price of $6.50 and stayed above that price all day, reaching a high of $7.74. NSC's trading that day—which consisted of all solicited buy orders—made up over 26% of the stock's daily trading volume and approximately half of those orders were from customers who had received allocations. Despite the stock opening above the offering price, shortly after the open, a Syndicate manager emailed Branch Managers 2 and 3 expressing disappointment that their customers had not participated in the immediate aftermarket, stating that "it is paramount that our lead managed deals trade well for reputation and future business. Every office has . . . guys who want stock don't want to do aftermarket, if all of those guys got stock we wouldn't have an up deal."

b. Example #2 – NSC's misconduct with respect to Offering B

NSC served as the underwriter for Offering B, a $28.7 million offering, which had a restricted period from August 11, 2017, at 8:00 am to August 18, 2017, at 8:00 am. On August 15, a Syndicate manager sent the Head of the IBD a spreadsheet listing branch level IOIs and feedback, which included, next to Sales Representative 3, "[w]ill try to match that in aftermarket. Ex. 10k shares for 10k shar[e]s"—i.e., a 1 for 1 relationship. On August 16, an IBD employee wrote the firm's Director of Trading to remind him that the offering "will be launching [Thursday] after the close" and that "some offices are expected to buy in the aftermarket so there will be trading going on on Friday and early next week." The same day, the Head of the IBD wrote to a Syndicate manager and stated, "our expectations are that [Branch 1] will have 300k shares to buy and [Branch 2] 100k shares to buy at the open of trading on Friday, not at some point after or later."

On August 17, the day before the offering, the Head of the IBD emailed a Syndicate manager, asking whether, if they gave Branch 1 a larger allocation, "would the other 425k shares be on the desk to buy at the open at the deal price?" The Syndicate manager replied, "[Branch Manager 1] says yes[.]" In the same email, the Syndicate manager stated that she "just spoke with [Sales Representative 3], [he] understood and agrees that aftermarket orders are to be on our desk" and that "a realistic expectation would be that

[8] Sales Representative 2 allocated 8,000 shares to a single customer and the customer purchased an additional 2,000 shares shortly after the open of trading on a solicited basis.

he would buy up to 50% of his allocation in the aftermarket on our desk for those 4 family accounts."

Later that evening, a Syndicate manager emailed the Head of the IBD stating that Branch Manager 1 wanted a larger allocation. The Head of the IBD responded, "[d]efer to you all for that allocation discussion as all I care about is aftermarket every day and how it trades for our clients." An hour later, the Head of the IBD emailed a Syndicate manager, the Director of Trading, and others, stating, "make sure [the Director of Trading] gets final order book by 8 am to start calling guys, let him know your discussions on after market so he can use that."

On August 18, 2017, the stock opened at $2.38, approximately 10% above its offering price of $2.15, and stayed above that price all day, reaching a high of $2.88. NSC's buy orders that day—over 75% of which were solicited—made up over 18% of the stock's daily trading volume and approximately 92% of those purchases were from customers who had received allocations.

Therefore, NSC willfully violated Rule 101 of Regulation M and FINRA Rule 2010.

2. NSC attempted to recoup selling concessions awarded in connection with new issues from representatives whose customers "flipped" shares.

FINRA Rule 5131 addresses potential misconduct in the allocation and distribution of new issues. FINRA Rule 5131(c) states that no person associated with a member "may directly or indirectly recoup, or attempt to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares of a new issue that are subsequently flipped by a customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate." A violation of FINRA Rule 5131(c) is also a violation of FINRA Rule 2010.

A "penalty bid" is an arrangement, typically contained in the syndicate selling agreement, that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are sold by the syndicate member's customers in the 30-day aftermarket (a practice known as "flipping"). Flipping creates downward pressure on the secondary market trading price, and therefore underwriters and selling group members may seek to discourage such sales by imposing a penalty bid.

FINRA Regulatory Notice 10-60 explains that pursuant to FINRA Rule 5131(c), member firms are prohibited from attempting to recoup a sales representative's selling concession absent a uniform penalty bid because flipper policies—unlike penalty bids—do not require a firm to forfeit its compensation to the managing underwriter when a customer flips shares.

Between August 2016 and October 2017, in connection with the three IPOs discussed above, NSC or another co-manager filed a trading notification form with FINRA,

disclosing that it did not intend to apply a penalty bid to the syndicate.[9] Nevertheless, in connection with each of the three IPOs, NSC included a flipper policy in the launch email sent to the firm's sales force. Each launch email stated that the firm would track sales of the new issue for 30 days following the offering and recoup selling concessions from representatives whose customers flipped shares during that time frame. The flipper policies also were communicated orally to branch managers by the firm's sales manager and members of Syndicate.

Therefore, NSC violated FINRA Rules 5131(c) and 2010.

3. NSC failed to disclose in writing to customers buying and selling shares of affiliated issuers that NSC was under common control with those issuers.

FINRA Rule 2262 requires that "[a] member . . . under common control with, the issuer of any security . . . before entering into any contract with or for a customer for the purchase or sale of such security, disclose to such customer the existence of such control." Additionally, where the initial disclosure is not made in writing, the firm must supplement it with a written disclosure "at or before the completion of the transaction." Exchange Act Rule 15c1-5 imposes these same obligations on member firms. A violation of FINRA Rule 2262 and Exchange Act Rule 15c1-5 also constitutes a violation of FINRA Rule 2010.

Between December 2016 and February 13, 2018, NSC failed to disclose in writing to its customers who purchased or sold securities issued by three firm affiliates—at any point prior to completing the transaction—that NSC was under common control with these issuers. These issuers, who were also investment banking clients of the firm, were each controlled by an entity that was at the time a majority shareholder of NSC's parent company. NSC failed to disclose this affiliate relationship in connection with approximately 17,000 customer transactions in these three securities.

Therefore, NSC violated FINRA Rules 2262 and 2010 and Exchange Act Rule 15c1-5.

4. NSC failed to establish, maintain, and enforce a reasonable supervisory system and procedures.

FINRA Rule 3110 requires that firms establish and maintain a supervisory system, and establish, maintain, and enforce WSPs, that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. The duty to supervise imposed by Rule 3110 also includes the responsibility to reasonably investigate red flags that suggest that misconduct may be occurring and act upon the results of such investigation. A violation of FINRA Rule 3110 also constitutes a violation of FINRA Rule 2010.

[9] FINRA Rule 5190 sets forth the notice requirements applicable to all members participating in securities offerings.

Between June 2016 and December 2018, NSC's supervisory systems and procedures were not reasonably designed in a number of areas.

a. Supervision failures relating to Regulation M and FINRA Rule 5131(c)

With respect to Rule 101 of Regulation M and FINRA Rule 5131(c), NSC's WSPs simply recited the requirements of these rules—*i.e.*, that representatives were prohibited from attempting to induce aftermarket purchases during the restricted period, and from attempting to recoup a representative's selling concession when his or her customer flipped shares of a new issue, in the absence of a penalty bid. However, the firm's WSPs did not explain how representatives were to be supervised with a view to preventing and detecting improper activities under Regulation M or Rule 5131, when such supervision would occur, or how it would be documented. The firm also lacked any surveillance designed to monitor for compliance with Rule 101 of Regulation M and FINRA Rule 5131(c). Additionally, the firm did not provide any training on activities prohibited during restricted periods or explain the difference between permissible penalty bids and impermissible flipper policies.

b. Supervision failures relating to FINRA Rule 2262 and Exchange Act Rule 15c1-5

With respect to supervision for compliance with FINRA Rule 2262 and Exchange Act Rule 15c1-5, NSC failed to enforce its WSPs requiring disclosure of affiliate relationships to customers both before and after recommending such transactions. Specifically, the WSPs required that representatives, "prior to [] recommending a transaction in the securities of . . . an affiliated issuer," among other things, "[d]isclose to the client that [NSC] is a wholly owned subsidiary of the parent, or an affiliate of the issuer, as the case may be." Nevertheless, NSC did not maintain a list of firm affiliates for representatives to consult when making sales recommendations or otherwise provide guidance as to how representatives were supposed to determine which issuers were affiliates. The WSPs also required that representatives call trades in affiliate issuers into the equity trading desk (where they could be centrally supervised) but the firm did not follow this procedure and instead allowed representatives to enter the trades directly into the firm's electronic trading system. Finally, the WSPs required that customer trade confirmations for transactions in affiliated issuers disclose that NSC was an affiliate of the issuer, a requirement which was also not followed with respect to approximately 17,000 trade confirmations pertaining to three affiliate issuers.

c. Supervision failures relating to potentially manipulative cross trades

Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and FINRA Rule 2020 prohibit market manipulation and other deceptive techniques intended to convey false information to the market as to a stock's actual price and the demand for it, including through cross trades. A cross trade occurs when a firm facilitates buy and sell transactions between customer orders at the same time and price.

The firm's supervisory system was not reasonably designed to supervise for potentially manipulative cross trades. For example, there were conflicts of interest in the firm's supervision of cross trades. Specifically, the firm supervisor tasked with reviewing daily exception reports for cross trades was supervised by the Director of Trading who implemented many cross trades that appeared on exception reports.

NSC's WSPs stated that pre-arranged trading was prohibited, and that cross trades required written pre-approval. However, these procedures were not followed. Additionally, while the firm's WSPs said that cross trades could not be used to maintain or support the share price of a security, they did not provide guidance on how supervisors were to review cross trades for price support or maintenance or when to request additional information about the trades.

NSC did not reasonably review its representatives' cross-trading activity in securities issued by NSC's corporate affiliates and investment banking clients. The firm solely relied upon a daily exception report to monitor for cross trades between its customers; however, that report's parameters were overly broad through March 2018, resulting in numerous false positives appearing on the report where the buy or sell orders did not internally cross between NSC's customers, thus making it difficult to determine which trades actually were cross trades. The report also lacked sufficient information to enable the supervisor to identify red flags of potential manipulation. Many exceptions that presented red flags of potential manipulation—including cross trades involving the same representative or representatives from the same branch on both sides of the transaction and large transactions in thinly traded securities issued by the firm's investment banking clients and affiliates—were closed out without further investigation or reasonable follow-up.

The firm's exclusive reliance on daily exception reports meant that it did not monitor patterns of cross trades over time. Had it done so, it would have noted an unusually large number of crosses in NSC's affiliate and investment banking client stocks, often where NSC's trading made up a significant percentage of the total market volume of the security.

d. <u>Supervision failures relating to the review of internal correspondence</u>

FINRA Rule 3110(b)(4) requires firm WSPs to include supervisory procedures specific to the review of internal communications relating to the member's investment banking or securities business. While firms may employ a risk-based approach, the procedures for reviewing internal emails must be appropriately tailored for the member's business, size, structure, and customers.

The firm's WSPs provided for review of internal emails by the firm's designated principals and stated that the review "must be conducted . . . no later than two weeks from receipt/delivery, unless additional time has been granted by the [chief supervision officer] due to extenuating circumstances." Nevertheless, NSC did not conduct any regular review of internal emails, let alone review the emails within two weeks. Instead,

the firm only reviewed internal emails on an ad hoc basis related to regulatory requests, internal investigations, and customer complaints. NSC thus did not reasonably monitor and follow up on emails containing red flags of misconduct relating to Rule 101 of Regulation M, FINRA Rule 5131(c), and potentially manipulative cross trades.

Therefore, NSC violated FINRA Rules 3110 and 2010.

B. NSC made negligent omissions to investors in connection with GPB Capital securities.

GPB Capital is a New York-based alternative asset management firm founded in 2013. GPB Capital serves as the general partner for limited partnerships formed to acquire income-producing companies. From 2013 through 2018, GPB Capital launched several limited partnerships, each focused on acquiring controlling interests in certain private sector companies. As relevant here, the GPB Capital limited partnerships included GPB Automotive Portfolio, LP (Automotive Portfolio), which was formed in 2013 to acquire and operate automotive dealerships and GPB Holdings II, LP (Holdings II), which was formed in 2015 primarily to acquire and operate companies in the automotive retail and managed IT sectors.

These GPB Capital limited partnerships raised capital by selling limited partnership interests to retail investors. GPB Capital sold the limited partnership interests through, among other channels, broker-dealers. The securities GPB Capital sold, including those issued by Automotive Portfolio and Holdings II, were not registered. Instead, the limited partnership interests were sold pursuant to Regulation D of the Securities Act of 1933. As a condition of the offerings, only accredited investors were permitted to purchase the GPB Capital limited partnership interests.[10]

After conducting due diligence on each offering, NSC approved Holdings II for sale by the firm's registered representatives in December 2015, and then approved Automotive Portfolio in May 2016.

Making a negligent misrepresentation or omission of a material fact to customers violates FINRA Rule 2010, as it is inconsistent with just and equitable principles of trade.

On July 10, 2017, GPB Capital filed a lawsuit in New York against one of its former operating partners who had allegedly failed to acquire certain automotive dealership interests (the New York Litigation). In connection with the New York Litigation, the former partner asserted various counterclaims against GPB Capital and alleged that GPB Capital had falsified financial statements to conceal that GPB Capital was defrauding its investors. GPB Capital denied the former partner's allegations and the litigation remains pending.

[10] *See* 17 CFR § 230.501(a) (defining accredited investor).

On April 27, 2018, GPB Capital released what it characterized as important updates regarding the audited financial statements for certain of its limited partnerships, including Automotive Portfolio and Holdings II. The letters, which were sent to broker-dealers that sold GPB Capital-related investments, including NSC, stated that GPB Capital was in the process of registering certain classes of securities issued by certain of the limited partnerships, including Automotive Portfolio and Holdings II, with the SEC. As part of that process, Automotive Portfolio and Holdings II were required to file audited financial statements. The letters further stated that the delivery of Automotive Portfolio's and Holdings II's audited financial statements (which were due to be filed by April 30, 2018) would be delayed pending the completion of a forensic audit. Specifically, GPB Capital disclosed that it and its auditors "determined that it would be prudent to hire a third-party firm to complete a forensic audit in order to endeavor to put [the former partner's] counterclaims and other allegations to rest." The offering documents for Automotive Portfolio and Holdings II were not timely amended to disclose that the partnerships would be delayed in filing their audited financial statements with the SEC.

While NSC received the letters from GPB Capital notifying it of the delays and GPB Capital's stated intention to complete a forensic audit, it sold 115 limited partnership interests in Automotive Portfolio and eight limited partnership interests in Holdings II after that announcement. The principal value of those sales, which occurred between April 30, 2018 and July 11, 2018, totaled approximately $8.7 million. NSC received a total of $701,480 in commissions from the sales.

In connection with these sales, however, NSC representatives did not inform the customers that Automotive Portfolio and Holdings II had not timely filed their audited financial statements with the SEC or the reasons for the delay. The delay in filing audited financial statements was material information that should have been disclosed.[11]

Therefore, by negligently omitting material facts, NSC violated FINRA Rule 2010.

C. NSC made inaccurate representations to FINRA that common stock warrants for a public offering would not be sold for a period of 360 days.

FINRA Rule 5110(e)(1) prohibits the sale or transfer of any securities deemed to be underwriting compensation for a period of 180 days from the date of the offering. Pursuant to FINRA 5110(c)(4), if a member wishes to reduce the proposed maximum value of any securities received as underwriting compensation, it may do so by voluntarily agreeing to lock-up such securities for successive 180-day periods (in addition to the initial lock-up period). Each additional 180-day period reduces the proposed maximum value attributable to such securities by 10%.

[11] In February 2021, the SEC filed a complaint against GPB Capital and other defendants alleging, among other things, that the defendants engaged in securities fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. (Case No. 1:21-cv-00583, E.D.N.Y.). The United States Department of Justice also brought criminal charges against GPB Capital's founder and CEO and two other executives, charging, among other things, securities fraud, mail fraud, and wire fraud. (Case No. 1:21-cr-54, E.D.N.Y.).

In October 2019, NSC acted as the lead underwriter of a public offering and, in connection with the offering, received common stock warrants from the subject company exercisable at a premium above the offering price (the Warrant Shares). Pursuant to FINRA Rule 5110, the Warrant Shares were underwriting compensation.

During its review of the terms of the offering, FINRA's Corporate Financing Department determined that NSC's overall compensation, including the Warrant Shares, was excessive. In order to have the terms of the offering approved, NSC represented to FINRA that certain of the Warrant Shares would not be sold for a period of 360 days, rather than 180 days, from the offering date of October 24, 2019, thereby reducing NSC's overall compensation. In order to effectuate the extended lock-up period, eight individuals associated with NSC who had been assigned Warrant Shares executed lock-up agreements prohibiting the sale of 141,600 Warrant Shares until October 20, 2020.

Notwithstanding its representations to FINRA regarding the extended lock-up period, in April 2020, after 180 days, NSC included over 79,000 of the restricted Warrant Shares among those it submitted to the transfer agent to remove the restricted legends. These shares were commingled with common shares and sold by the eight affiliated persons during the period April 2020 through October 19, 2020, after 180 days but prior to the close of the 360-day extended lock-up period. The early sale of the restricted Warrant Shares impermissibly accelerated the receipt of over $1 million to the sellers.

Therefore, NSC violated FINRA Rule 2010.

D. NSC failed to reasonably supervise one of its representatives and failed to maintain accurate books and records.

FINRA Rule 4511 requires members to make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, and regulations, including the Exchange Act, and Rule 17a-3, promulgated thereunder. Inherent in the obligation to make and preserve books and records is the requirement that they be accurate. A violation of FINRA Rule 4511 also constitutes a violation of FINRA Rule 2010.

In 2014 and 2015, Representative A recommended purchases of more than $35 million in non-traded REITs to more than 100 customers. NSC's WSPs required Representative A's direct supervisor and the firm's Alternative Investments Department to review these recommendations for suitability and to ensure that the proposed transactions complied with the firm's concentration limits for alternative investments.

During their review, Representative A's direct supervisor and the firm's Alternative Investments Department failed to recognize multiple red flags that Representative A was circumventing the firm's concentration limits by inflating customer financial information on various documents required for non-traded REIT transactions. Representative A routinely submitted updates to new account forms in connection with non-traded REIT recommendations that reflected extraordinary and unsubstantiated increases in the

customer's net worth or liquid net worth. The updated financial information was frequently grossly inflated and false. For example, an update to the new account form for one customer falsely reflected that his net worth and liquid net worth increased from $500,000 in October 2013 to $10 million in June 2014.

The updates Representative A submitted to the firm often occurred within months after the opening of an account or after an earlier update of financial information. These updates also often occurred in response to concerns raised by the firm that the proposed non-traded REIT transactions violated the firm's concentration limits or that there were discrepancies in the recorded financial information for the customers. In many instances, the non-traded REIT recommendations would have exceeded the firm's concentration limits and would have been rejected without the updated and inflated liquid net worth of the customers.

These red flags should have caused the firm to investigate the accuracy of customer financial and suitability information provided by Representative A, but the firm failed to take any reasonable action. The firm never verified the customer's financial and suitability information and never sought documentation substantiating the customer's financial information. Instead, NSC approved Representative A's non-traded REITs recommendations, resulting in many of Representative A's customers having an unsuitably high concentration of their liquid net worth in non-traded REITs.

For example, one retired, senior customer invested more than 90% of his liquid net worth in non-traded REITs. Many other customers had between 60% and more than 80% of their liquid net worth invested in non-traded REITs. One non-traded REIT that Representative A frequently recommended to customers went public in August 2020. Its share price dropped immediately and has fluctuated over the past year between approximately 41% and 77% below the initial offering price, resulting in substantial losses to Representative A's customers.[12]

Therefore, NSC violated FINRA Rules 3110, 4511, and 2010, and NASD Rule 3010.[13]

E. NSC failed to obtain locates for short sales as required by Rule 203(b)(1) of Regulation SHO.

The SEC adopted Regulation SHO in January 2005 to update short sale regulation and to address concerns regarding persistent fails to deliver and potentially abusive "naked" short selling (*i.e.*, the sale of securities that an investor does not own or has not borrowed).

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[12] As of the execution of this AWC, NSC has paid approximately $17.7 million in restitution for losses sought by 59 customers who filed arbitration claims arising out of Representative A's non-traded REIT recommendations.

[13] FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014. Because the supervisory failures occurred before and after this date, both rules apply.

Rule 203(b)(1) of Regulation SHO, generally known as the locate rule, prohibits a broker-dealer from accepting a short sale order in an equity security from another person, or effecting a short sale in an equity security for its own account, unless, in relevant part, the broker-dealer has: (i) borrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due.

Rule 203(b)(2)(iii) provides an exemption from locate requirements for short sales effected by a market maker[14] in connection with bona-fide market making activities in the security for which the exemption is claimed.

In the Adopting Release to the 2008 Amendments to Regulation SHO, the SEC stated that determining whether or not a market maker is engaged in bona-fide market making "would depend on the facts and circumstances of the particular activity," and that clear examples of such activity include: (i) incurring any economic or market risk with respect to securities (e.g., putting a firm's own capital at risk to provide continuous two-sided quotes in the market); (ii) providing liquidity to a security's market; (iii) a pattern of trading that includes both purchase and sales in roughly comparable amounts to provide liquidity to customers or other broker-dealers; and (iv) continuous quotations that are at or near the market on both sides and that are communicated and represented in a way that makes them widely available to investors and other broker-dealers. The SEC also set forth specific examples of types of activities that would not be considered bona-fide market making activities, including where a market maker posts continually at or near the best offer, but does not also post at or near the best bid. [15]

A violation of Rule 203(b) of Regulation SHO also constitutes a violation of FINRA Rule 2010 and its predecessor NASD Rule 2110.[16]

1. NSC was not engaged in bona-fide market making and was required to obtain locates in connection with its principal short sale orders.

From January 2005, when Rule 203 became effective, until April 2020, when it ceased operating as an over-the-counter market maker, NSC failed to obtain locates in connection with principal short sale orders it entered to facilitate the execution of orders received from broker-dealer customers. NSC relied on the bona-fide market maker exemption to the locate requirement, but was not entitled to do so because it was not engaged in bona-fide market making activities. NSC did not incur any economic or market risk when executing the subject transactions, did not engage in a pattern of trading including purchases and sales in roughly comparable amounts to provide liquidity to

[14] Section 3(a)(38) of the Exchange Act defines a market maker as a dealer that holds itself out, by entering quotations in an inter-dealer communications system or otherwise, as being willing to buy and sell a security for its own account on a regular or continuous basis.

[15] Exchange Act Release No. 34-58775, 73 Federal Register 61690, 61699 (Oct. 17, 2008).

[16] FINRA Rule 2010 superseded NASD Rule 2110 on December 15, 2008.

broker-dealers, and did not maintain continuous quotations that were at or near the market on both sides. Instead, the firm routinely maintained quotes that were not in line with the current market.[17] Upon receipt of a customer order to sell, the firm would move only one side of its quote, the offer, to be at or near the national best offer, but would not move its bid to be in line with the market. After executing the customer order, the firm then moved its offer away from the national best offer, where it would remain until another customer order was received or the trading day ended. Because the firm was not engaged in bona-fide market making activities, the firm was required to, but did not, obtain locates.

A review of the firm's trading activity for a sample period of January 2018 through April 2020, revealed that the firm failed to obtain locates for 33,241 short sale transactions, representing approximately 2.8 billion shares, where the firm improperly relied on the bona fide market making exception.

Therefore, NSC violated Exchange Act Rule 203(b) of Regulation SHO, NASD Rule 2110, and FINRA Rule 2010.

2. NSC failed to establish, maintain, and enforce a reasonable supervisory system and procedures.

The firm's supervisory system was not reasonably designed to achieve compliance with the locate requirement in Rule 203(b)(1) of Regulation SHO. NSC had no supervisory reviews to determine whether its trading activity constituted bona-fide market making activity. The firm reviewed its trades each day only to verify that it was registered as a market maker in the subject securities. This review, however, would not reveal to the reviewer whether the firm was engaged in bona-fide market making and, therefore, whether the firm was eligible to rely on the bona-fide market maker exemption of Rule 203(b)(2)(iii).

Therefore, Respondent violated NASD Rules 3010 and 2110 and FINRA Rules 3110 and 2010.

B. Respondent also consents to the imposition of the following sanctions:

- a censure;
- a $3,600,000 fine;

[17] For example, NSC would maintain a quote representing its willingness to buy a security (bid) for $0.0001 and sell the same security (offer) for $2,000 when the national best bid and offer for the security was $6.63 and $6.70, respectively.

- disgorgement of $4,770,000;[18] and
- partial restitution of $625,480 plus interest to certain customers who purchased GPB Capital securities as described below.[19]

Respondent agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payment is due and payable. Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanctions imposed in this matter.

Respondent understands that this settlement includes a finding that it willfully violated Rule 101 of Regulation M under the Securities Exchange Act of 1934 and that under Article III, Section 4 of FINRA's By-Laws, this makes Respondent subject to a statutory disqualification with respect to membership.

Disgorgement of unlawful profits is ordered to be paid to FINRA in the amount of $4.77 million.

Partial restitution is ordered to be paid to the customers listed on Attachment A to this AWC in the total amount of $625,480, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from the respective dates set forth on Attachment A until the date this AWC is accepted by the NAC.

A registered principal on behalf of Respondent shall submit satisfactory proof of payment of restitution and prejudgment interest (separately specifying the date and amount of each paid to each customer listed on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent. The email must identify Respondent and the case number and include a copy of the check, money order, or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 days after the date of the notice of acceptance of the AWC.

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[18] In determining not to impose prejudgment interest on the disgorgement, FINRA considered that the firm will pay a remedial fine in excess of three times the amount of prejudgment interest that would have accrued on the ill-gotten gains, thus achieving the appropriate deterrence value of equitable disgorgement. See *DOE v. Davidofsky*, Complaint No. 2008015934801 (NAC Apr. 26, 2013) at 16.

[19] The amount of partial restitution being paid to customers who made GPB Capital investments is equal to the commissions that NSC received in connection with these customers' investments in Automotive Portfolio and Holdings II. Seventeen customers at issue in this AWC will not receive partial restitution because they previously settled their claims related to GPB Capital with the firm.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days after the date of the notice of acceptance of the AWC, or such additional period agreed to by FINRA in writing, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property, or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to FINRA in the manner described above, within 14 calendar days of forwarding the undistributed restitution and interest to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction in this AWC, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

Restitution payments to customers shall be preceded or accompanied by a letter, not unacceptable to FINRA, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a complaint issued specifying the allegations against it;

B. To be notified of the complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made, and to have a written decision issued; and

D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions

regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and

C. If accepted:

1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;

2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;

3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and

4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.

D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this statement. This statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

6-3-22
Date

National Securities Corporation
Respondent

Print Name: Michael Mullen

Title: Chairman & CEO

Reviewed by:

Leonard J. Amoruso, Esq.
Counsel for Respondent
McGonigle, P.C.
1185 Avenue of the Americas
New York, NY 10036

Accepted by FINRA:

Signed on behalf of the
Director of ODA, by delegated authority

June 23, 2022
Date

Abigail Shechtman
Principal Counsel
FINRA
Department of Enforcement
200 Liberty Street
New York, NY 10281