Quarterly Disciplinary Review

July 2008

FINRA publishes this quarterly review to provide firms with a sampling of recent disciplinary actions involving misconduct by registered representatives. The sample includes settled matters and decisions in litigated cases (National Adjudicatory Council decisions and decisions of the SEC in FINRA cases). These summaries call attention to, and remind registered representatives and firms of, specific conduct that violates FINRA Rules and may result in disciplinary action.

FINRA also provides detailed disciplinary information and decisions and a summary of monthly disciplinary actions on its Web site.

Borrowing Funds from a Customer

- FINRA settled a matter that involved a registered representative who borrowed $10,000 from an elderly customer and agreed to repay the customer in one year at 7-percent interest. The representative failed to inform or obtain permission from his employer firm, even though the member firm's supervisory procedures expressly prohibited representatives from borrowing money from customers.

  FINRA concluded that this conduct violated Rules 2110 (ethical standards) and 2370 (requirements for borrowing from customers). As a result, FINRA suspended the representative for 10 business days and fined him $5,000.

Communicating with the Public

- FINRA settled a matter involving a registered representative who prepared sales literature that a professional association distributed to its members at seminars. The representative failed to obtain written approval of the sales literature from a principal of his member firm before providing it to the professional association. Furthermore, some customer questionnaires and sales literature that the representative prepared for distribution at the seminars were misleading.

  FINRA concluded that the representative violated Rules 2110 (ethical standards) and 2210 (communications with the public). As a result, FINRA fined the representative $5,000 and suspended him in all capacities for 30 days.

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Failure to Amend Form U4

- FINRA settled a matter involving a registered representative who was indicted on two second-degree felony charges of aggravated assault and one first-degree felony charge of aggravated battery. The representative failed to amend his Form U4 to disclose the felony indictments because he believed that he would not be convicted.

  FINRA concluded that the representative's conduct violated Rule 2110 (ethical standards), IM-1000-1 (misleading registration information) and Article V, Section 2 of the FINRA By-Laws (registration applications). As a result, FINRA suspended the representative in all capacities for six months and fined him $5,000. Additionally, since the settlement included a finding that the representative willfully failed to disclose material facts, under the Securities Exchange Act of 1934, the representative is statutorily disqualified from the industry.

False Account Statements, Unsuitable Recommendations and Exercising Discretion without Written Authority

- FINRA's National Adjudicatory Council (NAC) issued a decision in a case involving a registered person who created false account summaries that provided his customer with a misleading picture of the status of the customer's account. The NAC rejected the representative's contention that he did not intend to deceive his customer, who was well educated and knowledgeable, and that he prepared the summaries to gauge his own performance. The NAC also found that the representative recommended unsuitable trades to the customer based on the excessive level of trading in the customer's account, the high turnover ratio in the account, and the high concentration of a single stock or limited number of stocks in the account. Additionally, the NAC found that the representative added substantially to the level of risk in the customer's account by engaging in an excessive level of margin trading. The representative argued in defense that the customer was not a conservative or unsophisticated investor, and that he knew about the trading activity in his account. The NAC rejected the representative's defenses and held that the volatile mix of excessive trading, overly-concentrated equity positions and extended use of margin was unsuitable for the customer. The NAC concluded that the customer was wealthy and sophisticated enough to expose the account to some risk, but that the customer's account was appropriate for only moderate risk, not speculation. Additionally, the representative admitted that he had exercised discretion in customer accounts without obtaining the customers' written authority and the firm's approval.

  FINRA's NAC concluded that the registered person's conduct violated Rules 2110 (ethical standards), 2310 (suitability standards) and 2510 (discretionary accounts). As a result, the NAC imposed two bars in all capacities: one for issuing false and misleading account summaries and one for violating the suitability rule.

Misuse of Customer Funds

➤ FINRA settled a matter that involved a registered representative who accepted $5,000 from a customer to invest on the customer's behalf, but instead transferred the funds to an account the representative's spouse owned, and used the funds to pay personal expenses. One month later, after the customer complained to the member firm, the representative returned the funds to the customer.

FINRA determined that the representative violated Rule 2110 (ethical standards). As a result, FINRA barred the representative in all capacities.

Private Securities Transactions

➤ FINRA settled a matter that involved a registered representative who engaged in private securities transactions without providing prior written notice to, or receiving written approval from, his member firm. The representative referred customers to a third party that sold timeshare interests in the form of universal leases which, FINRA concluded, were securities. The representative did not provide his member firm with written notice prior to his customers' investments in the universal leases, and did not obtain the firm's written approval.

FINRA found that the representative violated Rules 2110 (ethical standards) and 3040 (selling away). FINRA suspended the representative in all capacities for 10 business days and fined him $5,000.

Unethical Conduct – Selling Securities in a State without Blue-Sky Registration and Incorrectly Marking Order Tickets

➤ Another FINRA settlement involved a registered representative who solicited his customers to purchase securities that were not Blue-Sky registered in the state in which the customers resided. Additionally, the representative incorrectly marked 19 customer order tickets as "unsolicited" when the representative had in fact solicited the customers to execute the transactions. The representative also caused Letters of Affirmation of Non-solicitation to be sent incorrectly to the same customers.

FINRA held that the representative's conduct violated Rule 2110 (ethical standards). As a result, FINRA suspended the representative in all capacities for 12 months and fined him $10,000.