Quarterly Disciplinary Review

July 2012

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

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

Exercising Discretion Without Approval

- FINRA settled a matter involving a registered representative who exercised discretion in a customer account without customer or firm approval. During a three-month period, the representative effected 38 discretionary trades in a customer's securities account without obtaining the customer's prior written authorization and without his employer firm's acceptance of the account as discretionary. FINRA found that the representative's conduct violated NASD Rules 2110* (ethical standards) and 2510 (discretionary accounts). FINRA suspended the representative in all capacities for two months and fined him $14,432, which included disgorgement of $6,932 in commissions.

Engaging in Private Securities Transactions and Failing to Respond to Information Requests

- FINRA settled a matter involving a registered representative who engaged in a private securities transaction without his firm's prior approval and refused to provide information to FINRA during its investigation of his activities. The private securities transaction involved a "participation agreement" offered by a limited liability corporation (LLC). The agreement provided that, in return for investments, participants would receive a potential return of up to 4 percent per month and principal would be available for return upon request. The agreement also provided that the LLC would use the investors' funds to provide advances to merchants who met certain sales history and operations parameters. The merchants were expected to repay the advances, which would be limited to $50,000, within six months at an annual interest rate of 76 percent. Individuals who referred potential participants to the LLC for investment received commissions of 1 percent to 2 percent per month. FINRA concluded that the participation agreement constituted an investment contract and therefore a security under Section 3(a)(10) of the Securities Exchange Act of 1934.

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The registered representative obtained a check in the amount of $202,673 from an individual that the individual made out to herself and then endorsed to the registered representative. Days later, the registered representative deposited the check into his personal checking account. Weeks later, he withdrew $200,000 of the funds by causing the bank to issue a cashier's check to the LLC. The representative gave the check to the LLC and, in return, received four monthly payments equal to 4 percent of principal plus a commission of 2 percent for two months. The LLC thereafter collapsed, and the representative did not receive any further payments.

FINRA concluded that the registered representative engaged in a private securities transaction for compensation, without notifying his firm in writing and obtaining the firm's prior approval. FINRA concluded that the representative's conduct violated NASD Rules 2110* (ethical standards) and 3040 (private securities transactions).

After the LLC collapsed, FINRA requested copies of all records for bank accounts and financial accounts in which the representative held an interest during the period related to the misconduct. The representative produced some monthly statements and copies of certain checks drawn from his accounts, but refused, even after a second request, to provide copies of checks deposited into his accounts. FINRA specifically requested information related to the $202,673 check. Through counsel, the registered representative refused to provide the information. FINRA found that the registered representative's conduct violated FINRA Rules 8210 (requests for information) and 2010 (ethical standards). In light of the registered representative's violations, FINRA barred him from associating with any firm in any capacity.

Converting Customer Funds, Failing to Disclose Outside Business Activities, Misrepresenting Facts and Failing to Respond to Information Requests

- FINRA settled a matter involving a registered representative who engaged in outside business activities without obtaining his firm's prior written approval, misrepresented the outside activities to the firm, converted customer funds and failed to respond to several FINRA requests for information. In 2008 and 2009, the registered representative formed a variety of holding companies and partnerships in which he maintained an ownership interest. He also held positions with these entities for which he received compensation. The registered representative failed to obtain his member firm's prior written approval for his employment with these entities and receipt of compensation. Additionally, the representative completed a firm compliance survey in which he incorrectly answered "no" to the questions of whether he participated in any outside business activities and whether he was involved in any outside business relationships with clients; these answers were material misstatements. FINRA concluded that the representative's activities violated NASD Rules 3030** (outside business activities) and 2110* (ethical standards), and FINRA Rule 2010 (ethical standards).

Throughout 2009, the registered representative made three withdrawals totaling $540,000 from a customer's securities account without the customer's knowledge or authorization. The customer's accountant questioned the withdrawals, and the representative stated that the funds had been invested in an outside private business entity. The registered representative stated that he executed the transfers based on his written discretionary authority. The discretionary authority that the customer had granted, however, did not include authority to transfer funds or securities out of the customer's securities account. The registered representative and his firm negotiated a settlement with the customer whereby the customer received a refund of his money plus interest and fees. FINRA concluded that the representative's conduct constituted conversion of customer funds and violated FINRA Rules 2010 (ethical standards) and 2150(a) (improper use of customer funds), and NASD Rules 2330(a)† (improper use of customer funds) and 2110* (ethical standards).

FINRA requested that the registered representative submit a written statement explaining his actions and supporting documents. The registered representative submitted a written statement, but failed to produce any documents. FINRA thereafter requested several times that the registered representative produce the documents and appear for on-the-record testimony. The registered representative refused to appear or produce the documents. FINRA concluded that the representative's conduct violated FINRA Rules 8210 (requests for information) and 2010 (ethical standards).

In light of the registered representative's violations, FINRA barred him from associating with any firm in any capacity.

Selling Unregistered Securities and Communicating With Customers From a Personal Email Account

- FINRA settled a matter involving a registered representative who sold unregistered securities and emailed correspondence from a personal account. In the first half of 2009, three customers opened accounts for three different LLCs. Two of the customers transferred into their LLC accounts billions of shares of two stocks. The third customer transferred into his LLC account 160 million shares of another stock. The registered representative was the representative for each of the three accounts, and each of the accounts liquidated all of the shares of stock and wired the majority of the proceeds out of the accounts. Sales in one account generated proceeds of approximately $100,000. Sales in the second and third accounts generated proceeds of approximately $230,000 and $50,000, respectively. The three securities were neither registered with the SEC nor exempt from registration. FINRA concluded that the representative failed to inquire as to the securities' registration despite the questionable circumstances surrounding the sales, and that the representative violated Section 5 of the Securities Act of 1933 and FINRA Rule 2010 (ethical standards).

The firm's supervisory procedures required representatives to use the firm's email account when communicating about firm business, and specifically prohibited the use of a representative's personal email account for outgoing correspondence. During the first half of 2009, the registered representative communicated with several customers, including the three customers referenced here, regarding activity in their accounts at the firm via his personal email account. FINRA found that the representative's conduct violated FINRA Rule 2010 (ethical standards). In light of the representative's misconduct, FINRA fined him $50,000 and suspended him in all capacities for six months.

Failing to Provide Notice of Outside Brokerage Accounts and Notice of Broker-Dealer Employment, and Misrepresenting Information

- The SEC recently upheld a NAC decision in which the NAC fined a registered representative and suspended him for maintaining outside brokerage accounts without advising the firms holding the accounts that he was employed at another member firm, and without advising his member firm—and, in fact, misrepresenting to his member firm—that he held the outside accounts.

  In the representative's outside brokerage accounts, the representative actively traded in the stock of an issuer that registered representatives he supervised recommended to firm customers. The SEC concluded that this fact underscored the importance of full disclosure. The SEC found that the representative's trading activities threatened the integrity and transparency of the securities industry, and created an environment ripe for customer abuse. The SEC affirmed the NAC's findings that the representative violated NASD Rules 2110* (ethical standards) and 3050 (transactions for or by associated persons). The SEC affirmed the NAC's suspension of the representative for two years in all capacities and a $25,000 fine.

Impersonating Customers

- FINRA settled a matter involving a registered representative who impersonated four customers. During a period of approximately two months, the registered representative placed telephone calls to his former broker-dealer, misidentified himself as a customer, and impersonated four customers to expedite moving the customers' accounts from the former broker-dealer to the new broker-dealer with which he became associated. Sometimes the registered representative used the customers' personal information, such as birth dates or Social Security numbers, to impersonate his customers. Although the registered representative had the customers' authorization to transfer their accounts to the new firm, the customers had not authorized the impersonations. FINRA concluded that the registered representative's actions violated FINRA Rule 2010 (ethical standards). FINRA suspended the registered representative in all capacities for one month and fined him $5,000.

Recommending Unsuitable Transactions

- FINRA settled a matter involving a registered representative who recommended unsuitable trades in a customer's account. The registered representative opened an IRA account for a new customer with approximately $41,000 that the customer had accumulated in an employer-sponsored 401(k) plan with the customer's previous employer. The customer's investment experience was limited to her passive role as an investor in the 401(k) plan. She was a single mother working as a beautician in a hair salon. Over the course of approximately two months, the registered representative recommended and caused the liquidation of the securities held in the account, including mutual funds, and invested the proceeds in the common stock of two companies. Throughout this period, the representative recommended and caused several more purchase and sale transactions involving the common stock of the same two companies. Finally, at the end of the period, the representative recommended and caused the liquidation of all of the assets in the account and used the sales proceeds to purchase warrants one of the two companies issued.

  FINRA concluded that the registered representative did not have reasonable grounds for believing that the recommendations were suitable for the customer because the trading was inconsistent with her financial situation and needs. FINRA found that an over-concentration of the customer's assets in the securities of one or two companies, each of which carried a level of market risk that was not suitable for the customer given the amount invested and her financial resources, violated FINRA's suitability requirements. FINRA concluded that the representative's activities violated NASD Conduct Rules 2110* (ethical standards) and 2310‡ (recommendations to customers) and IM-2310-2‡ (fair dealing with customers). FINRA fined the representative $5,000 and suspended him in all capacities for 20 business days.

* NASD Rule 2110 has been superseded by FINRA Rule 2010, effective December 15, 2008.

** NASD Rule 3030 has been superseded by FINRA Rule 3270, effective December 15, 2010.

† NASD Rule 2330(a), (e) and (f) has been superseded by FINRA Rule 2150, effective December 14, 2009.

‡ NASD Rule 2310 and IM 2310-2 have been superseded by FINRA Rule 2111, effective July 9, 2012.