# Quarterly Disciplinary Review

July 2014

**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.**

## Making Unsuitable Securities Recommendations, Causing False Books and Records, and Improperly Exercising Discretion in Customer Accounts

- FINRA settled a matter involving a registered representative who recommended that customers purchase unsuitable securities. The representative recommended that customers purchase inverse exchange-traded funds (ETFs), or short ETFs, as a long-term hedge against potential downturns in the securities markets. The representative, however, lacked a sufficient understanding of the short ETFs' attributes and risks to form a reasonable basis to recommend them to his customers. In addition, the representative's short ETF recommendations lacked customer-specific suitability because the short ETFs were not a suitable solution to the long-term hedge his customers sought. As a result of the unsuitable recommendations, the representative violated NASD Rule 2310* (suitability), NASD IM-2310-2† (fair dealing with customers) and FINRA Rule 2010 (ethical standards).

  The representative also mismarked the orders for each of his customers' purchases of the short ETFs as "unsolicited," when the representative had actually solicited the purchases. By mismarking the orders, the representative caused his firm to create and maintain false books and records. The representative's mismarking of the orders violated FINRA Rule 2010 (ethical standards).

  In addition, the representative entered 668 transactions in 24 customers' accounts after the business day in which each customer authorized the representative to make the trade. By entering customer orders after the business day on which the customer authorized him to make the trade, the representative improperly exercised time and price discretion in non-discretionary customer accounts, which violated NASD Rule 2510 (discretionary accounts) and FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative in all capacities for five months and fined him $20,000.

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## Engaging in Undisclosed Outside Business Activities

- FINRA settled a matter involving a registered representative who engaged in outside business activities without providing his firm with prompt written notice. While he was associated with a firm, the representative received $8,200 for advice that he gave two customers about the allocation of their variable annuity subaccounts.

  The representative, who had a longstanding professional relationship with the customers, spent a great deal of time with the customers addressing their subaccount allocations. He met them at their residence at least twice a year and frequently spoke with them by telephone. In exchange for his ongoing investment advice, the customers agreed to pay the representative a fee, which consisted of 1.75 percent of their assets under his management. The representative did not disclose this arrangement to his firm and did not seek its permission to enter into the agreement.

  Because these investment-advisory services were outside the scope of the representative's relationship with his firm and were accomplished without notification to, or approval from, his firm, the representative violated FINRA Rules 3270 (outside business activities) and 2010 (ethical standards). For this misconduct, FINRA suspended the representative in all capacities for one month and fined him $5,000.

## Executing Unauthorized Transactions in Customer Accounts

- FINRA settled a matter involving a registered representative who made unauthorized trades in customer accounts. During a one-month period, the representative effected 28 transactions in 13 customer accounts without the customers' knowledge, authorization or consent. The unauthorized trades included purchases of equity securities, investment company securities and certificates of deposit totaling nearly $60,000, and sales of equity and investment company securities totaling $13,000.

  The representative admitted that the trades were unauthorized, but claimed that he effected the transactions to benefit the customers and "properly allocate" their portfolios. The representative's execution of the transactions without the customers' knowledge, consent or authorization violated FINRA Rule 2010 (ethical standards) and NASD IM-2310-2† (fair dealing with customers). For this misconduct, FINRA suspended the representative in all capacities for 18 months and fined him $5,000.

## Providing False Attestation and Causing Inaccurate Books and Records

- FINRA settled a matter involving a registered sales assistant who falsely attested that she received verbal confirmation of a customer's requests for check disbursements. At the time the sales assistant effected the disbursement requests, the firm's policies and procedures prohibited branch personnel from acting on a letter of authorization received via fax, mail, or email without first speaking with the customer and verbally confirming the transaction. The policies and procedures permitted wire transfers upon verbal authorization from the customer if the disbursement was for $50,000 or less. Once the verbal authorization was received, the sales assistant was to attest to the verbal authorization in the firm's internal system.

In 2012, the sales assistant received an email from what appeared to be a customer's email account on file. In fact, the email was sent by an imposter who hacked the customer's email account and was fraudulently transferring money to accounts the imposter controlled. Upon receiving the fraudulent email, the sales assistant initiated a third-party check disbursement for the imposter. The imposter requested that the check for $19,800 be sent to an unrelated third party. The sales assistant did not speak to the customer, but processed the transaction and indicated in the firm's internal system that she had spoken to the customer.

Two weeks later, the imposter emailed the sales assistant again to request the disbursement of a second check for $15,200 from the customer's account to an unrelated third party. The sales assistant processed the disbursement that same day. A short time thereafter, the imposter emailed the sales assistant to disburse a third check for $9,600 to another unrelated third party. As she had done on the two prior occasions, the sales assistant falsely attested in the firm's internal system that she spoke to the customer.

Soon after the third disbursement, another firm sales assistant contacted the customer and learned that he never requested any check disbursement from the account. The firm restored the $44,600 in funds that were improperly disbursed from the customer's account.

The sales assistant violated FINRA Rule 2010 (ethical standards) because she falsely attested in the firm's internal system that she spoke with the customer before processing the check disbursements. The sales assistant also violated FINRA Rules 4511 (books and records) and 2010 (ethical standards) because her false attestations caused her firm to maintain inaccurate books and records concerning the check-disbursement requests. For this misconduct, FINRA suspended the sales assistant in all capacities for 30 days and fined her $7,500.

## Participating in Undisclosed Private Securities Transactions and Refusing to Appear for On-the-Record Testimony

- FINRA settled a matter involving a registered representative who participated in undisclosed private securities transactions and refused to appear for on-the-record testimony. Between 2009 and 2010, the representative referred four customers to individuals who were selling interests in an investment fund. By doing so, the representative solicited the customers to invest in securities that were outside the regular course and scope of her employment with her firm. The representative did not provide her firm with prior written notice detailing the proposed transactions, did not describe her proposed role in the transactions, and failed to disclose whether she would receive any selling compensation in connection with the transactions. The representative's participation in the private securities transactions violated NASD Rule 3040 (private securities transactions) and FINRA Rule 2010 (ethical standards).

As part of FINRA's investigation into the representative's private securities transactions, FINRA requested that the representative appear to provide on-the-record testimony. The representative, however, informed FINRA that she would not appear for an interview. By refusing to appear for on-the-record testimony, the representative violated FINRA Rules 8210 (information and testimony) and 2010 (ethical standards). For this misconduct, FINRA barred the representative in all capacities.

## Failing to Timely Disclose Two Judgments on a Form U4

- FINRA settled a matter involving a registered representative who failed to timely disclose two outstanding judgments on his Form U4. During a routine examination of a firm, FINRA reviewed, among other matters, whether associated persons at the firm had disclosed certain events, such as liens, judgments, arrests, criminal charges or convictions. FINRA staff generated LexisNexis reports to assist in this review.

  The LexisNexis report generated for the review disclosed that a representative at the firm had two outstanding judgments filed against him in state small claims court in mid-2012. The representative should have updated his Form U4 within 30 days of receiving notice that the judgments had been filed against him. The representative, however, did not report the judgments on his Form U4 until six months later, and did so only when prompted by the FINRA staff's inquiries.

  The representative's failure to timely disclose the two judgments violated Article V, Section 2(c) of the FINRA By-Laws (current applications for registration), and FINRA Rules 1122 (filing of misleading registration information) and 2010 (ethical standards). For this misconduct, FINRA suspended the representative in all capacities for one month and fined him $2,500.

## Failing to Provide On-the-Record Testimony

- FINRA settled a matter with a registered representative who failed to appear and provide on-the-record testimony in response to a request made pursuant to FINRA Rule 8210. In 2013, FINRA received a regulatory tip alleging that the representative misappropriated customer funds. During the course of FINRA's investigation, FINRA requested that the representative appear and provide on-the-record testimony. Counsel for the representative informed FINRA that the representative would not appear. The representative's failure to appear for on-the-record testimony violated FINRA Rule 8210 (information and testimony). For this misconduct, FINRA barred the representative in all capacities.

## Misappropriating Firm Funds and Causing Inaccurate Books and Records

- FINRA settled a matter with a registered representative who misappropriated firm funds and caused her firm to maintain inaccurate books and records. The representative and the firm had an agreement in which the representative and the firm shared equally in certain advertising and marketing costs, subject to the firm's approval. The representative was to place advertising in local radio and print media and engage in marketing activities, subject to the firm's approval.

  In 2012, the representative asked her sales assistant to prepare expense-reimbursement requests and provided the assistant with a thumb drive of electronic files to use to prepare the reports. The assistant discovered additional files on the thumb drive that suggested that the representative had been creating false reports for advertising expenses. The assistant also found materials in a reimbursement file in the representative's office that supported the assistant's suspicions that the representative had been submitting false expense reports for advertisements. The assistant alerted the firm's management, which reviewed the evidence and terminated the representative's employment.

  FINRA's investigation of the matter revealed that the representative altered invoices and program materials to mischaracterize ineligible expense items or events as eligible advertising or marketing expenses. In several instances, the representative altered invoices and similar supporting documents to increase the amount of eligible expenses. The representative also created or altered invoices and similar supporting documents to reflect eligible expenses that she actually had not incurred, and on two occasions, she submitted duplicate requests for reimbursement for an expense the firm had already paid. The representative requested reimbursement for false expenses for at least four years and obtained approximately $6,000 from the firm in false reimbursements for advertising and marketing.

  By obtaining reimbursement for the expenses by submitting falsified requests and documentation, she misappropriated the firm's funds and violated NASD Rule 2110‡ (ethical standards) for conduct occurring before December 15, 2008, and FINRA Rule 2010 (ethical standards) for conduct occurring thereafter. In addition, by submitting false expense reports and supporting expense documentation, the representative caused the firm to maintain inaccurate books and records, and consequently, the representative violated NASD Rule 3110§ (books and records) and NASD Rule 2110‡ (ethical standards) for conduct occurring before December 15, 2008, and FINRA Rule 2010 (ethical standards) for conduct occurring thereafter. For this misconduct, FINRA barred the representative in all capacities.

* NASD Rule 2310 has been superseded by FINRA Rule 2111, effective July 9, 2012.

† NASD IM-2310-2 has been superseded by FINRA Rule 2111, effective July 9, 2012.

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

§ NASD Rule 3110 has been superseded by the FINRA Rule 4510 Series, effective December 5, 2011.