



1 of 2 DOCUMENTS

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Department of Enforcement, Complainant, vs. Kevin L. Cohen, Dennis S. Kaminski, Gari C. Sanfilippo, Respondents.

Complaint No. EAF0400630001

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY REGULATORY AUTHORITY:

2010 FINRA Discip. LEXIS 12

August 18, 2010

TEXT:

[*1]

DECISION

Registered representatives created and maintained inaccurate books and records related to variable annuity trades, and registered principal failed reasonably to supervise the timely review of variable annuity trades. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., and Lane A. Thurgood, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Peter J. Anderson, Esq., and Cheryl L. Haas-Goldstein, Esq., for Dennis S. Kaminski; Kevin L. Cohen and Gari C. Sanfilippo appeared pro se

Decision

Pursuant to NASD Rule 9311, Kevin L. Cohen ("Cohen") and Gari C. Sanfilippo ("Sanfilippo") appeal a FINRA Hearing Panel's December 16, 2008 decision, finding that Cohen and Sanfilippo created and maintained inaccurate books and records related to variable annuity trades at member firm Mutual Service Corporation ("MSC"). Pursuant to NASD Rule 9312, the Review Subcommittee of the National Adjudicatory Council called the Hearing Panel decision for review as to Dennis S. Kaminski ("Kaminski") to review the sanctions imposed. The Hearing Panel found that Kaminski failed [*2] to supervise MSC's variable annuity trading. For these violations, the Hearing Panel barred Cohen and Sanfilippo in all capacities and suspended Kaminski as a principal for six months and fined him \$ 50,000. The Hearing Panel also assessed costs. After a thorough review of the record, we affirm the Hearing Panel's findings and costs. We reduce the bars imposed as to Cohen and Sanfilippo to 18-month suspensions in all capacities and require that they requalify before acting in any capacity requiring qualification. We also affirm the \$ 50,000 fine imposed as to

Kaminski, increase the six-month principal suspension of Kaminski to an 18-month suspension in all capacities, and require that he requalify before acting in any capacity requiring qualification.

n1 Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because the complaint in this case was filed before December 15, 2008, the procedural rules that apply are those that existed on December 14, 2008. The conduct rules that apply are those that existed at the time of the conduct at issue.

[*3]

I. Background

MSC became a FINRA member in 1970. At the time of the conduct at issue (2004), MSC was headquartered in West Palm Beach, Florida, but the majority of its more than 1,200 registered representatives operated out of more than 800 branch offices that MSC maintained across the country. All of MSC's registered representatives were independent contractors and the vast majority of them reported to an office of supervisory jurisdiction ("OSJ"). For the approximately 20 to 30 percent of MSC's registered representatives who were not supervised by an OSJ, MSC's home office conducted the primary review of their securities transactions. Kaminski, Sanfilippo, and Cohen worked in MSC's home office.

Kaminski joined MSC in 1986. In 2004, Kaminski was an Executive Vice President at MSC, and he held the position of Chief Administrative Officer. Kaminski was responsible for MSC's day-to-day operations, and he oversaw MSC's compliance department and operations department. In October 2004, Michael Poston ("Poston"), MSC's Chief Compliance Officer and head of the firm's compliance department, left MSC, and Kaminski assumed the position of Chief Compliance Officer for the remainder of 2004. [*4] Senior Vice President Susan Coates ("Coates") ran MSC's operations department and reported directly to Kaminski.

MSC's compliance department contained a working group called the Trade Review Team ("TRT"). n2 The TRT provided heightened oversight of MSC's variable annuity trades. Sanfilippo joined MSC in November 1999. Sanfilippo was registered as a general securities principal at MSC, and he headed the TRT. Cohen joined MSC in February 2002 as a general securities representative and principal. He worked under Sanfilippo's oversight on the TRT. Generally, three people, including Sanfilippo and Cohen, comprised the TRT.

n2 The TRT was formed in response to a prior regulatory action against MSC relating to its sales of variable products. In December 2001, MSC agreed to a FINRA Letter of Acceptance Waiver and Consent ("AWC") in which FINRA found that, between 1996 and 1999, MSC violated NASD Rules 2110, 2310 and 3010, because the firm failed to: (1) establish, maintain and enforce adequate written supervisory procedures with respect to the firm's variable annuity transactions -- particularly with respect to the home office's review of variable products sales in OSJs; (2) establish and maintain a system to supervise registered representatives' exchanges of variable products (1035 exchanges); (3) evidence principals' suitability reviews of variable annuity transactions; and (4) obtain customer information necessary for determining whether variable products transactions are suitable. MSC agreed to a censure and fine of \$ 35,000, and to update the firm's written supervisory procedures.

[*5]

Sanfilippo and Kaminski remain in the securities industry; Cohen is no longer in the industry.

II. Procedural History

In July 2007, FINRA's Department of Enforcement ("Enforcement") filed a complaint alleging, in relevant part, that Kaminski, Sanfilippo, and Cohen had supervisory responsibility for MSC's variable annuity blotters, knew that variable annuity trades were not timely reviewed between March 15 through May 31, 2004, and took no action reasonably to supervise MSC's variable annuity trading (cause one); that Sanfilippo and Cohen created and maintained inaccurate books and records in that, with Sanfilippo's and Cohen's knowledge or at their direction, Graham Taylor ("Taylor"), a registered person from MSC's marketing department, inaccurately entered Cohen as the reviewer of variable annuity trades that Taylor in fact reviewed and backdated the reviews on variable annuity blotters, and with Sanfilippo's knowledge or at his direction, Cohen backdated compliance letters to MSC's registered representatives that he entered into MSC's compliance files to create the appearance that the letters had been mailed when, in fact, they had not (cause two); that Cohen and Sanfilippo [*6] failed reasonably to supervise the creation of accurate books and records as alleged in cause two (cause three).

The Hearing Panel dismissed allegations of supervision failures under causes one and three as to Cohen and Sanfilippo. We affirm the Hearing Panel's dismissals. As to cause one, we find that Cohen and Sanfilippo actually participated in the underlying misconduct (which is alleged under cause two), that they were not responsible as supervisors of others, and that both Cohen and Sanfilippo were low in the chain of command at MSC. As to cause three, Kaminski, not Cohen or Sanfilippo, supervised Taylor.

The only findings under review here are the Hearing Panel's findings as to Kaminski, Cohen, and Sanfilippo under causes one and two. n3 Under cause one, the Hearing Panel found that Kaminski failed to supervise and timely review MSC's variable annuity trades. For this violation, the Hearing Panel suspended Kaminski for six months as a principal and fined him \$ 50,000. Under cause two, the Hearing Panel found that Sanfilippo and Cohen created and maintained inaccurate books and records regarding MSC's variable annuity trades. For this violation, the Hearing Panel barred Sanfilippo [*7] and Cohen.

n3 The complaint also named MSC, Coates, and Poston in cause one, Denise Roth ("Roth"), First Vice President and a principal in MSC's operations department, Poston, and Taylor in cause two, and MSC and Roth in cause three. The complaint alleged, in cause four, that MSC and Poston failed to conduct an annual internal review of MSC for 2002 and conducted the 2003 annual internal review untimely. The complaint alleged in cause five, that MSC provided FINRA staff with false and misleading information in response to requests for information. The Hearing Panel imposed the following sanctions as to MSC, Coates, Poston, Roth, and Taylor: (1) fined MSC \$ 1,535,000 for failing to supervise variable annuity trades (cause one), creating and maintaining inaccurate books and records (cause two), failing to conduct timely internal reviews (cause four), and failing to respond fully to FINRA information requests (cause five); (2) fined Coates \$ 50,000 and suspended her for six months in all principal capacities for failing to supervise MSC's variable annuity business (cause one); (3) barred Roth for creating and maintaining inaccurate books and records with respect to MSC's variable annuity trading (cause two); (4) fined Poston \$ 10,000 and suspended him for six months for failing to supervise MSC's variable annuity business (cause one) and fined Poston an additional \$ 10,000 and suspended him as a principal for 30 days for failing timely to conduct internal reviews (cause four); and (5) issued a letter of caution as to Taylor for his involvement in the creation of inaccurate books and records (cause two). These respondents did not appeal the Hearing Panel decision, and we have not called the decision for review as to these respondents. The findings and sanctions as to MSC, Coates, Roth, Poston, and Taylor therefore are final and are not subject to review.

[*8]

III. Facts

A. MSC's System for Reviewing Variable Annuity Trades

During 2004, MSC's compliance and operations departments were responsible for reviewing the firm's variable annuity transactions. n4 In 2004, variable annuity trading accounted for approximately 30 percent of MSC's business. Yearly, MSC processed variable annuity transactions valued at approximately \$ 900 million, of which approximately 28 percent involved exchanges between variable annuities or "1035 exchanges." n5

n4 Generally, a variable annuity is a contract between an investor and an insurance company, whereby the insurance company promises to make periodic payments to the contract owner or beneficiary starting immediately or at some future time. *FINRA Regulatory Notice 10-05, 2010 FINRA LEXIS 5*, at *3 (Jan. 2010). n5 A "1035 exchange" refers to a tax exempt exchange of one annuity contract for another. *See 26 U.S.C. § 1035*.

In connection with the 2001 AWC, MSC [*9] submitted to FINRA a statement that documented MSC's corrective actions. A central feature of MSC's corrective action statement was the creation of a separate unit within the compliance department, the TRT, to provide heightened supervision of variable annuity transactions. MSC represented that TRT would review variable annuity transactions and 1035 exchanges that triggered certain red flags. MSC also created the New Variable Business Pending Approval Report ("Red Flag Blotter") to capture daily variable products trades and 1035 exchanges that triggered red flags. n6 TRT was tasked with reviewing the details of each trade that appeared on the daily Red Flag Blotter, assessing suitability, approving or rejecting each trade, generally within a three-day window, and forwarding the Red Flag Blotter to the operations department for final firm approval. n7 In 2004, Cohen was the designated principal responsible for reviewing the Red Flag Blotter. Cohen testified that, on an average day, the Red Flag Blotter included 30 to 45 transactions and would take three or more hours to review.

n6 The Red Flag Blotter captured variable trades that triggered the following red flags: missing age or financial information; customer over age 70; trade amount in excess of 15 percent of customer's net worth; customer's annual income less than \$ 25,000; trade amount greater than or equal to 25 percent of customer's annual income; trade amount greater than \$ 150,000; IRA within a qualified account; holding period of less than five years; surrender charges greater than \$ 1,000; and inappropriate sub-account allocations.

[*10]

n7 Sanfilippo testified that the Red Flag Blotter was one of MSC's most important surveillance tools because it enabled MSC to reverse unsuitable variable annuity sales without cost within the "free look" period provided by the issuer.

Cohen documented TRT's review of the Red Flag Blotter on line via MSC's "Trade Review Forms," which included for each trade three screens that contained client information entered into MSC's system by the registered representatives in the field. If Cohen had questions about a trade after reviewing information contained in the Trade Review Forms, he or another member of TRT would contact the registered representative responsible for the trade and request additional information or documentation. n8 Cohen indicated on the Trade Review Forms screens whether TRT approved or denied the trade, the reason for the approval or denial, and the date approved or denied. Cohen, as the TRT principal approving the trade, selected his name from a drop-down menu in the "Approved By" field on the Trade

Review Forms. TRT printed the blotter daily and delivered it to the operations department [*11] for a second review and final approval of each trade. Sanfilippo oversaw Cohen's work on the TRT.

n8 TRT employees never contacted customers directly. They requested additional information or documentation from registered representatives in MSC's branch offices.

In 2004, Roth, First Vice President and an operations department principal, was responsible for final review and approval of trades contained in the daily Red Flag Blotter. Roth's review on behalf of the operations department also occurred online. Roth would verify that no red flags had been missed and that all necessary customer data had been entered into the system, and she would determine if any questions were left unaddressed. If Roth had any concerns about transactions on the Red Flag Blotter, she would discuss them with Coates. If Roth agreed with TRT's conclusions about the trades on a Red Flag Blotter, she would approve, date, and sign the Red Flag Blotter.

B. MSC Halts Its Daily Review of the Red Flag Blotter

In 2004, MSC's compliance department [*12] performed numerous routine daily functions. The compliance department was responsible for: OSJ training and support, reviewing sales material, inspecting approximately 550 branch offices, handling investment advisor issues for approximately 350 affiliated investment advisors, investigating customer complaints, accepting daily calls from registered representatives in the field, interfacing with regulatory bodies, and conducting surveillance (through TRT). TRT reviewed approximately 20 different exception reports and blotters daily and approximately 10 additional reports weekly or monthly. In 2004, MSC also saw a significant increase in the size of the firm with the acquisition as MSC branch offices of smaller independent firms throughout the country.

Poston and other members of MSC's compliance staff testified that, starting in early 2004, MSC's compliance department became significantly understaffed. Poston testified that, as of January 2004, the compliance department's normal staff of approximately 17 was down to 12, and more staff members continued to leave as 2004 progressed. Poston also testified that MSC paid compliance personnel salaries that were not competitive, making it [*13] difficult for MSC to replace people who left. Also in 2004, MSC became the subject of numerous regulatory sweeps and investigations that placed significant time demands on the compliance department. n9

n9 MSC was one of numerous member firms required to notify mutual fund customers who purchased Class A mutual fund shares that they may be eligible for breakpoint discounts. In 2004, MSC sent breakpoint claim forms to approximately 85,000 customers. MSC's compliance department was responsible for sending and tracking the letters and reviewing and responding to customer claims (hereafter "the Breakpoint Project"). During that time, MSC also was the subject of a variable annuity sweep investigation, regulatory investigations related to Class B and Class C mutual fund shares, and other regulatory investigations.

In February 2004, MSC's compliance department fell two or more weeks behind in its daily review of the Red Flag Blotter. n10 In March 2004, Poston and Kaminski decided to halt TRT's daily review of the Red Flag [*14] Blotter, n11 and they instructed Cohen and Sanfilippo to cease TRT's review of all exception blotters, including the Red Flag Blotter, to focus instead on the Breakpoint Project. The compliance department ceased its daily review of the Red Flag Blotter on or around March 15, 2004.

n10 Roth also fell behind on her review and final approval of trades included in the Red Flag Blotter because she was not timely receiving the blotters from TRT. In February 2004, Roth raised the issue of the backlog with Coates, her supervisor, and Jennifer Aracri ("Aracri"), a supervisor in the compliance department to whom Sanfilippo reported until Aracri left MSC in April 2004. In early March 2004, Roth alerted Coates that the backlog had worsened, and Coates reported the issue to both Poston and Kaminski.

n11 The testimony conflicts on the issue of who decided to halt daily review of the Red Flag Blotter. Kaminski testified that Poston unilaterally decided to stop Cohen's review of the Red Flag Blotter so that Cohen could focus all of his time and attention on the Breakpoint Project. Poston, however, testified that he had discussed the matter with Kaminski and that Kaminski concurred in the decision to halt the review. Sanfilippo testified that Poston directed him to halt TRT's daily review of the Red Flag Blotter on March 15, 2004. Sanfilippo did not know if Poston had consulted with Kaminski on the initial decision. Poston's administrative assistant, Julie Hamilton ("Hamilton"), testified that Kaminski had been involved in the decision and that Poston did not possess the authority to make such a decision unilaterally. The Hearing Panel concluded that Poston and Kaminski together determined to halt TRT's review of the Red Flag Blotter. As discussed in more detail below, based on the evidence, we concur with the Hearing Panel's determination in this regard.

[*15]

In May 2004, Kaminski and Poston determined that Cohen should restart his daily review of the Red Flag Blotter on June 1, 2004. Poston directed Cohen to ignore the backlogged blotters and review the Red Flag Blotter daily, going forward, starting June 1, 2004.

C. MSC Commences Review of Backlogged Red Flag Blotters

In August 2004, Kaminski transferred three individuals temporarily from other departments in MSC to the compliance department to help TRT reduce its backlog of surveillance reports, including the Red Flag Blotter. Taylor was assigned to review backlogged Red Flag Blotters. Taylor had worked in MSC's marketing department since 1998, and he had no experience doing compliance work. Kaminski advised Taylor that he (Kaminski) was his direct supervisor, but that Taylor would take his day-to-day instructions from Cohen and Sanfilippo. Cohen and Sanfilippo assigned Taylor to review 597 variable annuity trades on backlogged Red Flag Blotters. They instructed him to handle the backlogged blotters in chronological order.

Cohen trained Taylor on how to conduct a suitability review of each trade and to insert information into MSC's online Trade Review Forms. Cohen advised Taylor [*16] that there likely would be no need for him to contact any registered representatives about any of the transactions, and Taylor never did. n12 Cohen instructed Taylor to choose Cohen's name as the reviewer from the drop-down menu in the Trade Review Forms and to enter the current date in the "Trade Approved" field. Cohen instructed Taylor to deliver a working copy of each blotter to him after Taylor completed his review. Taylor understood from Cohen's instructions that Cohen would review all of his work and provide the compliance department's final principal review of each transaction. n13 Cohen also instructed Taylor to deliver a second copy of the completed blotters to Roth in the operations department.

n12 In fact, Taylor testified that he understood that he did not possess the authority to contact registered representatives.

n13 Taylor testified that he did not believe himself to be qualified to review trade information for suitability determinations. He stated that he considered his role to be that of a data entry person and that Cohen and Sanfilippo conducted the actual reviews. Cohen disagreed with Taylor's assessment on this point. Cohen testified that he understood that Kaminski had placed Taylor in TRT because Taylor was qualified to review the Red Flag Blotter. Cohen did not review all of Taylor's work, but he spot-checked approximately five or six backlogged transactions per week.

[*17]

After Cohen trained Taylor, Taylor worked for TRT largely unsupervised. Although Kaminski was designated as Taylor's supervisor during Taylor's temporary assignment to the compliance department, Kaminski testified that he was largely unaware of Taylor's responsibilities and actions on a day-to-day basis.

D. TRT and Operations Backdate the Red Flag Blotter

Shortly after Taylor commenced his temporary assignment to MSC's compliance department in August 2004, Roth began receiving the Red Flag Blotters that Taylor had reviewed. She noted that Taylor was dating the blotters accurately and that the difference in time between the transaction dates and the recorded review dates demonstrated that MSC's suitability reviews were not occurring within the time frame prescribed by MSC's supervisory procedures. Roth's testimony regarding the events that followed was internally inconsistent. The evidence indicates, however, that Roth discussed the issue with Coates and thereafter instructed Sanfilippo and Cohen to direct Taylor to backdate his reviews of Red Flag Blotters to create the impression that Taylor's reviews had occurred closer in time to the trade dates. n14 Taylor followed these directions [*18] and began backdating his review of Red Flag Blotters. He also went back and backdated reviews he had already completed.

n14 During on-the-record testimony in June 2005, Roth testified that, in a meeting between Sanfilippo or Poston, Coates, and Roth, Coates directed that the Red Flag Blotters be backdated. Coates denied that she directed that backdating occur. During the Hearing Panel hearing in March 2008, Roth reversed her prior testimony and indicated that Coates never directed that backdating occur. Sanfilippo testified that Roth approached TRT and questioned Taylor's using an accurate date to evidence review of backlogged Red Flag Blotters. Sanfilippo testified that he and Roth discussed the issue with Kaminski, and Kaminski responded with "just get it done." Sanfilippo testified that Roth thereafter directed that TRT backdate its reviews of Red Flag Blotters. Sanfilippo stated that he deferred to Roth because she and her department were responsible for final review of Red Flag Blotters and final approval of the firm's variable annuity trades. Kaminski denied that he approved of the backdating of Red Flag Blotters. The Hearing Panel found that Roth, at Coates' direction, ordered Sanfilippo and Cohen to backdate the Red Flag Blotters. We affirm the Hearing Panel's finding.

[*19]

Roth similarly backdated her approval dates on backlogged Red Flag Blotters to correspond to the dates input by Taylor. She dated her approval of backlogged trades to appear as though she had reviewed and approved trades within days of Taylor's review, which had been backdated to correspond to a date one or two days after the trade date.

E. MSC Develops a 1035 Exchange Exception Report

In May 2004, MSC developed a report known as the 1035 Exchange Exception Report ("Exchange Report"), which was a monthly trend report that tracked client accounts that had been subject to two or more 1035 exchanges during the prior 12 months. MSC developed the Exchange Report in response to FINRA staff's concerns about MSC's vigilance in monitoring 1035 exchanges. n15 MSC never implemented the prototype, however, and eventually revised the report instead to track registered representatives who executed five or more 1035 exchanges in client accounts in a one-month period. In October 2004, Kaminski directed TRT to implement the Exchange Report. At that time, MSC was able to generate the Exchange Report for every month in 2004 going back to January 2004.

n15 MSC officials John Dixon ("Dixon"), Chief Executive Officer and Chairman of MSC, John Poff ("Poff"), President and Chief Operating Officer of MSC, Kaminski, and Poston met with FINRA staff in Atlanta on May 18, 2004, to resolve outstanding issues from FINRA's 2003 routine examination of MSC. One outstanding issue was FINRA's concern about MSC's ability to monitor 1035 exchanges. MSC developed the Exchange Report in response to FINRA's concerns.

[*20]

In October 2004, Sanfilippo directed Cohen to review the Exchange Report going back to January 2004. MSC had a template for a letter that should be sent to any registered representative who was responsible for five or more 1035 exchanges in a one-month period. Sanfilippo testified that he expected Cohen to review the reports going back to January and to send letters to the identified registered representatives as needed. Cohen reviewed the reports going back to January 2004, and revised the template letter. He showed proposed revisions to the template to Sanfilippo. Sanfilippo indicated that, if Cohen had backdated the proposed revised template letter, Sanfilippo did not notice.

Cohen's understanding of Sanfilippo's directions to him was quite different from Sanfilippo's purported intentions. Cohen testified that he understood that Sanfilippo had directed him to make MSC's records appear as though the firm had been reviewing the Exchange Report monthly since January 2004. Cohen took it upon himself to draft 49 letters (one to each registered representative flagged in each 2004 monthly report), backdate the letters to correspond to the dates of the 1035 exchanges at issue, sign the [*21] letters, place copies of the original letters in MSC's files, and then destroy the original letters rather than mail them. By placing copies of the original letters in the firm's files and destroying the original letters, Cohen created the appearance that MSC had in fact mailed the letters. Rather than mail the letters, Cohen asked Robert Layton ("Layton"), another registered person at MSC, to contact the representatives identified in the letters to request the information sought in the letters. Layton testified on the record in June 2005 that Cohen provided him with letters generated from the Exchange Report in December 2004. n16 He stated that Cohen asked him to contact the registered representatives identified in the letters and to request the information indicated in the letters. Layton also testified that, when he reported to Cohen and Sanfilippo that the registered representatives claimed not to have received the letters, Sanfilippo seemed perplexed. Layton testified that Sanfilippo appeared to have understood that the letters were in fact mailed and learned after the fact from Cohen that the letters had not been mailed to the identified registered representatives.

n16 Layton was not called as a witness at the Hearing Panel hearing.

[*22]

IV. Discussion

A. Cause One -- Kaminski Failed to Supervise the Timely Review of MSC's Variable Annuity Trades

Under the first cause, the Hearing Panel found that Kaminski failed to supervise the timely review of MSC's variable annuity trades by failing to address the breakdown in TRT's review of MSC's Red Flag Blotters between March 15 and May 31, 2004, in violation of NASD Rules 3010 and 2110. We affirm these findings.

Under NASD Rule 3010, a supervisor is responsible for providing supervision that is reasonably designed to achieve compliance with securities laws, rules, and regulations. "Reasonable supervision" is a standard that is "determined based on the particular circumstances of each case." *Christopher J. Benz*, 52 S.E.C. 1280, 1284 (1997). Here, Kaminski's supervision of the compliance department in general and TRT in particular consisted predominantly of Kaminski's delegating oversight responsibility to Poston. Kaminski argues that his delegation to Poston was reasonable. We disagree. It is "not sufficient for the person with overarching supervisory responsibilities to delegate supervisory

responsibility to a subordinate, even a capable [*23] one, and then simply wash his hands of the matter until a problem is brought to his attention Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised." *Harry Glikzman, 54 S.E.C. 471, 484-85 (1999), aff'd, 24 Fed. Appx. 702 (9th Cir. 2001)*. Kaminski not only failed to follow-up to ensure that Poston properly exercised his delegated authority, he also failed to heed Poston's numerous warnings of staff deficiencies in the compliance department and the many red flags that suggested that irregularities existed.

Poston struggled with his oversight responsibilities. Poston testified that, even before January 2004, MSC's compliance department was understaffed due, in part, to MSC's aggressive business expansion and the acquisition of additional registered representatives and branch offices. As early as the third quarter of 2003, Poston warned Kaminski about the compliance department's staffing shortfalls. In response, Kaminski directed Poston to prepare a written plan to address the problems. Poston prepared a report that he provided to Kaminski in January [*24] 2004, but Kaminski did little to respond to Poston's concerns. n17 Furthermore, the record is replete with memoranda and emails from Poston to Kaminski, dated between January 2004 and October 2004 (when Poston left MSC), in which Poston advises Kaminski of the compliance department's urgent need for additional staff. n18 Coates also copied Kaminski on emails that she sent to Poston expressing concern over TRT's backlog of surveillance work, including a backlog in its review of Red Flag Blotters. n19 Poston also repeatedly reported to Kaminski an inability to hire qualified people at the salary levels approved by MSC management, an increasing number of compliance department staff leaving MSC, and the compliance department's difficulty in managing its surveillance functions and increasing workload. Kaminski did not respond adequately. He ignored staffing shortages, failed diligently to inform senior management of compliance needs, placed individuals from other departments in compliance positions for which they were not qualified, failed effectively to communicate to senior management the need to restrict business expansion to that which could be supervised adequately, and failed to [*25] limit the firm's activities when resources were not made available.

n17 Kaminski attributed his failure to respond to the staffing issue to the fact that his superiors, including Poff and Dixon, did not support adding staff to the compliance department. Although Kaminski approached Poff on the issue of increasing staff, he did little to press the issue. Kaminski took few steps towards securing staffing level increases. Kaminski, as the supervisor of the compliance department, had at least some responsibility for the firm having inadequate resources to supervise the activities in which it engaged. MSC needed either to provide adequate resources to allow for sufficient supervision or reduce its business to a level that it could adequately supervise. In any event, Poff's and Dixon's unwillingness to expand MSC's staff does not excuse Kaminski's indifference to the issue. *Cf. Ronald Pellegrino, Exchange Act Rel. No. 59125, 2008 SEC LEXIS 2843, at *46 (Dec. 19, 2008)* (finding that firm president's refusal to replace wrongdoer does not absolve supervisor of responsibility).

[*26]

n18 Kaminski made one meager attempt to address the compliance department's staffing deficiencies. In late March 2004, Kaminski approved the hiring of temporary workers in the compliance department to assist with the workload. When Poston quickly reported to Kaminski that the temporary workers were not sufficiently knowledgeable to assist the compliance department, Kaminski suggested that Poston try other temporary workers, but directed that Poston get them at a cheaper rate.

n19 Both the compliance and operations departments reported to Kaminski. Red Flag Blotters were reviewed first by TRT in the compliance department and then by Roth in the operations department. When TRT suspended its review, the operations department stopped receiving Red Flag Blotters, and Roth alerted her immediate supervisor, Coates. Coates, in turn, questioned the backlog in the Red Flag Blotters in a March 2004 email on which she copied Kaminski. Kaminski testified that he could not recall reviewing the email, although he also testified that he "may have had a conversation with [Poston] and [Coates]" on the subject. Coates,

Poston, and Kaminski also met on a weekly basis to discuss compliance, operations, and regulatory issues and concerns, including staffing issues. Coates testified that, during the weekly meetings and during her own private meetings with Kaminski, she and Kaminski discussed problems, including inadequate staffing, that she perceived in the compliance department.

[*27]

Kaminski also ignored red flag indications that MSC's compliance department was not functioning well. Adequate supervision includes "the responsibility to investigate 'red flags' . . . and to act upon the results of such investigation." *Michael T Studer, 57 S.E.C. 1011, 1023-34 (2004)*. Once red flags suggest irregularities have occurred, the supervisor has a responsibility to respond appropriately. *See Pellegrino, 2008 SEC LEXIS 2843 at *33*. Kaminski ignored indications of irregularities that should have signaled to him that, under Poston, the compliance department was struggling. In March 2004, Poston warned Kaminski that the compliance department would not be able to meet breakpoint deadlines if Cohen was not excused from performing a daily review of the Red Flag Blotter. In April 2004, Poston advised Kaminski and MSC's management committee of the compliance department's dire need for help with surveillance work. In emails in April, Kaminski advised other departments that they needed to "volunteer" people to work in the compliance department or MSC would have to be prepared to "shut off the lights." The volunteers proved [*28] fruitless, and Kaminski took no further action. In an April 2004 email from Poston to Kaminski, Poston advised Kaminski that morale in the compliance department was low because of the staff's inability to keep up with its workload, and he stated that the compliance department would be "letting go of daily demands on time to adequately handle [break point] reviews." None of these warnings were sufficient to prompt Kaminski to take decisive action in the compliance department.

Other evidence indicates that Kaminski harbored many concerns about Poston's abilities, but Kaminski's concerns did not result in action on his part. Kaminski testified during an on-the-record interview in March 2005 that Poston had encountered performance problems in 2003 and that Kaminski had to talk to Poston about improving Poston's handling of "duties and responsibilities in the way that the rules and regulations were evolving." Kaminski also testified that, in 2003 and 2004, he began receiving complaints about Poston's supervisory performance from Coates. MSC's President, Poff, testified that Kaminski advised him on several occasions that Poston had had "performance problems." Kaminski advised Poff that [*29] Poston had attendance issues, had been unable to meet internal deadlines, and that he once found Poston asleep at his desk. Poff also testified that Kaminski was aware of and reported to Poff that the compliance department had encountered difficulties retaining and recruiting qualified staff.

Kaminski testified that he did not fully appreciate the extent of the problems in the compliance department and that he had no idea that Poston had completely halted the Red Flag Blotter review in March 2004. The Hearing Panel found Kaminski's testimony in this regard not credible when viewed against Poston's consistent testimony that Kaminski ordered the halt and the many emails and memoranda that Kaminski received regarding TRT's inability to manage its surveillance workload. The credibility findings of the initial fact finder are entitled to considerable weight and deference and can be overcome only when there is substantial evidence to support doing so. *Dane S. Faber, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at * 18 (Feb. 10, 2004)*. We find no support for reversing the Hearing Panel's credibility finding. Kaminski's testimony on what (and when) he learned [*30] of the backlog was riddled with inconsistencies. He testified during an August 2005 on-the-record interview that he first learned of the backlog in TRT in a July 2004 memorandum from Sanfilippo. He testified at the Hearing Panel hearing that in fact he had received similar memoranda prior to July, and later in the hearing testified that Poston had advised him of the Red Flag Blotter backlog as early as March and again in May 2004. Furthermore, Poston's testimony that Kaminski authorized Poston to suspend all other work in the compliance department until the Breakpoint Project was completed is supported by evidence that Poston lacked sufficient authority to make that type of decision alone. Poston and Hamilton testified that Poston lacked the authority to suspend daily review of the Red Flag Blotter. n20 Furthermore, Poston did not enjoy a good working relationship with Poff, and he depended on Kaminski to function as an intermediary between him and Poff. Poston took few actions at MSC without Kaminski's approval. Indeed, the evidence suggests that Poston was wary

of acting on his own and that, even if he believed that he possessed the authority to suspend TRT's daily review of the [*31] Red Flag Blotter, he would not have done so without Kaminski's approval.

n20 Poston's administrative assistant, Hamilton, testified that she was in the office on the day that Poston announced to the compliance department staff that they could suspend their Red Flag Blotter reviews. Hamilton testified that Poston emerged from a closed-door meeting with Kaminski and immediately announced that the department had been granted permission to halt the reviews.

Kaminski argues that the Hearing Panel erred because it ignored two critical pieces of evidence: (1) Sanfilippo's testimony that Kaminski was stunned to learn of the backlog in TRT's daily review of the Red Flag Blotter in July 2004; and (2) emails from Poston to Kaminski in March and April 2004, in which Poston reassured Kaminski that he had control of the situation in the compliance department. We disagree.

Sanfilippo testified before the Hearing Panel that, in July 2004, he updated Kaminski as to the state of the compliance department. The following exchange followed: [*32]

Q: Did [Kaminski] express concern?

A: Yes.

Q: Did he express surprise?

A: I don't know if he expressed surprise, but it was concern.

Q: Was he upset?

A: If he was he didn't show it to us.

Q: Did he appear stunned?

A: Yeah, I could say that.

When prompted, Sanfilippo testified that he "could say" that Kaminski was stunned to learn of the backlog. This testimony, however, does not prove that Kaminski adequately monitored his delegation of duty to Poston or that he responded appropriately to numerous red flags signaling problems in the compliance department. Indeed, it suggests to us that, even in the face of memoranda, emails, and verbal warnings from Poston, Coates, and Roth, Kaminski turned a blind eye to significant failures in the compliance department. We find that Kaminski's purported surprise is further proof that he failed to heed warnings and comprehend the extent of the problems in MSC's compliance department.

As to Poston's "reassuring" emails to Kaminski, the Hearing Panel held that Kaminski's interpretation of the four emails to which Kaminski cites was a misdirected "attempt to disclaim responsibility for his actions." We agree. For instance, in one of the emails [*33] to which Kaminski cites, a March 11, 2004 email, Poston advised Kaminski that his department had stopped one 1035 exchange that involved an 83-year-old client. Poston stated, "[m]y point is TRT is moving against bad trades wherever they come from, and we are building a nice file of trade rejections and corrections." Although Poston highlights in this email one inappropriate 1035 exchange that TRT halted, he does not indicate that the compliance department's staffing needs have been met or that the department was staying current in its surveillance functions. In another email to which Kaminski refers, an April 21, 2004 email, Poston tells Kaminski that the compliance department has managed to stay current on variable business. Poston also states, however, that unidentified TRT reviews are behind "anywhere from a few days to a few weeks" and that TRT is having difficulty with calling representatives on specific trades. The email also outlines a panoply of other problems and deficiencies in TRT and the compliance department. We do not agree that Kaminski should have found this email reassuring. The other emails to which Kaminski cites are equally unconvincing. We do not believe that [*34] it was reasonable for Kaminski to find comfort in four emails, given that he ignored others and failed to react to numerous other indications of irregularities in the compliance department.

Poston alerted Kaminski to many inadequacies and irregularities in the compliance department, and Kaminski had many reasons to question Poston's abilities as a supervisor. Rather than address these issues, Kaminski instead focused on preventing Poston and other supervisors from providing FINRA with incriminating evidence of MSC's regulatory shortcomings. n21 "Where there are ample indications of irregularities and misconduct . . . it is 'especially imperative' that those in authority 'exercise particular vigilance' . . ." *Bradford John Titus, 52 S.E.C. 1154, 1160 (1996)*. In the face of red flags and other warnings, rather than take an active role in MSC's compliance department, Kaminski let Poston flounder.

n21 The record shows that Kaminski devoted significant MSC resources to preparing for MSC's May 18, 2004 meeting with FINRA in Atlanta. In preparation for the meeting, Kaminski emailed Poston to warn him not to turn over incriminating information to FINRA. After the meeting, Poston emailed Kaminski that MSC was "able to dodge yet again." Kaminski ignored this email from Poston, like so many other emails from Poston, and, at best, failed to comprehend that MSC had a significant compliance problem.

[*35]

In conclusion, we find that Kaminski, by failing to perform his responsibilities as the supervisor of the compliance department, failed to supervise MSC's timely review of variable annuity trades, in violation of NASD Rules 2110 and 3110.

B. Cause Two -- Cohen and Sanfilippo Created and Maintained Inaccurate Books and Records

Under cause two, the Hearing Panel found that Cohen and Sanfilippo created and maintained inaccurate books and records with respect to MSC's 2004 variable annuity trading. We affirm these findings. n22

n22 The complaint alleged, and the Hearing Panel found, that Sanfilippo's and Cohen's actions also violated Section 17(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rules 17a-3 and 17a-4 thereunder. Exchange Act Rules 17a-3 and 17a-4, by their terms, apply to broker-dealers, not associated persons. *See Davrey Fin. Serv., Inc., Exchange Act Rel. No. 51780, 2005 SEC LEXIS 1288*, at *12 (June 2, 2005). Individuals may violate NASD Rules 2110 (just and equitable principles of trade) and 3110 (recordkeeping) when they fail to comply with Exchange Act Rules 17a-3 and 17a-4 or are otherwise responsible for creating and maintaining inaccurate broker-dealer books and records. *See North Woodward Fin. Corp., Exchange Act Rel. No. 60505, 2009 SEC LEXIS 2796*, at *23 (Aug. 19, 2009). Here, we find that the evidence establishes that Sanfilippo and Cohen violated NASD Rules 2110 and 3110 by creating and maintaining inaccurate books and records with respect to MSC's variable annuity trading.

[*36]

Entering inaccurate information into a member firm's books or records violates both NASD Rule 2110's requirement to comply with high standards of commercial honor and just and equitable principles of trade and NASD Rule 3110's requirement to keep accurate books and records. *Fox & Co. Inv., Inc., Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822*, at *30-32 (Oct. 28, 2005) (finding that FINOP who maintained materially inaccurate books and records violated NASD Rules 2110 and 3110); *see also Charles E. Kautz, 52 S.E.C. 730, 733 (1996)* (finding that registered person who caused other registered persons under his supervision falsely to list their names as the selling agent on 10 applications to purchase variable annuities violated Article III, Sections 1 (later NASD Rule 2110) and 21 (later NASD Rule 3110)); *Dep't of Enforcement v. Prout*, Complaint No. C01990014, 2000 NASD Discip. LEXIS 18, at *2 (NASD NAC Dec. 18, 2000) (finding that entry of false dates of birth on three variable annuity applications violated

NASD Rule 2110). Additionally, the Commission has held generally that the requirement that records be kept embodies [*37] the requirement that such records be true and accurate. *See Dillon Sec., Inc., 51 S.E.C. 142, 147 (1992)*. "The entry of accurate information on official firm records is a predicate to [FINRA]'s regulatory oversight of its members. It is critical that associated persons, as well as firms, comply with this basic requirement." *Kautz, 52 S.E.C. at 734; see Edward Mawod & Co., 46 S.E.C. 865, 873 n.39 (1977)* (finding that the maintenance of accurate books and records is key to regulation), *aff'd, 591 F.2d 588 (10th Cir. 1979)*.

With respect to Cohen and Sanfilippo, the complaint alleged, and the Hearing Panel found, three distinct areas of violation: (1) with Sanfilippo's and Cohen's knowledge and at their direction, Taylor inaccurately entered Cohen's name into the Red Flag Blotter as the reviewer of backlogged trades; (2) with Sanfilippo's and Cohen's knowledge and at their direction, Taylor backdated the review dates in the Red Flag Blotter for the same backlogged trades; and (3) at Sanfilippo's direction and with his knowledge, Cohen prepared false and backdated [*38] letters to MSC representatives regarding 1035 exchanges that he never sent to the representatives, but which he inserted into MSC's files so as to appear that the firm had mailed the letters.

1. Taylor Inaccurately Entered Cohen's Name as the Reviewer on the Red Flag Blotter

There is no dispute that in August 2004, Taylor commenced a review of Red Flag Blotters for MSC's backlogged variable annuity trades (for trade dates approximately between March 15 and May 31, 2004). Taylor reviewed Red Flag Blotters electronically and input information and proof of his review on Trade Review Forms. The pull-down menu to identify the principal reviewing each day's variable annuity trades on the Trade Review Forms did not include Taylor's name. Taylor admitted that he chose Cohen's name from the drop-down menu for the 597 backlogged variable annuity trades that he reviewed. He testified that he was directed by Cohen and Sanfilippo to do so. Both Cohen and Sanfilippo admitted that they were aware of Taylor's actions, and Cohen admitted that he directed Taylor to use his (Cohen's) name. Neither Cohen nor Sanfilippo contacted MSC's computer support department to request that Taylor's name be added [*39] to the drop-down menu. In addition, neither directed Taylor to stop inputting inaccurate information.

We find that Cohen and Sanfilippo are responsible for Taylor's inserting an inaccurate name (Cohen) on the 597 Trade Review Forms for Red Flag Blotters that he reviewed between August and October 2004.

2. Taylor Backdated Review Dates on MSC's Red Flag Blotters

Taylor testified that, in August 2004, when he initially began reviewing the backlogged variable annuity trades on the Red Flag Blotter, he inserted as the date of his review the correct date. n23 Taylor testified that, after he had completed several days of reviews, Cohen advised him that Roth had directed that TRT backdate Taylor's reviews so that the reviews would appear to have occurred closer in time to the transaction dates. Sanfilippo also testified that Roth directed that Taylor backdate his reviews of Red Flag Blotters. Sanfilippo stated that he disagreed with backdating, but that he was overruled by Kaminski, so he allowed Taylor to backdate. n24 Cohen testified that Roth directed TRT to backdate Taylor's review of backlogged trades on the Red Flag Blotter and that she claimed to have cleared the issue with Kaminski. [*40] Thereafter, Taylor changed all dates that he had already input to dates closer to the actual trade dates, and he backdated all additional Trade Review Forms that he completed going forward. Neither Cohen nor Sanfilippo directed Taylor to stop or sought assistance from Roth's and Kaminski's superiors at MSC on the issue of backdating.

n23 In 2004, the computer system on which MSC maintained the Red Flag Blotter did not automatically date individual trade reviews. Thus, the reviewer was required to insert a date for his review. Subsequently, MSC corrected this feature so that the computer system automatically dated the principal review on the date that it occurred.

n24 Sanfilippo also testified that, because the Red Flag Blotter was subject to Roth's final approval, he decided

that Roth and the operations department were responsible for determining how the blotter review should be dated, so he relented. The complaint did not allege that Kaminski was responsible for inaccurate books and records, so we need not determine the extent of Kaminski's involvement here.

[*41]

We find Cohen and Sanfilippo responsible for Taylor's backdating of 597 Trade Review Forms.

3. Cohen Inserted False and Backdated 1035 Exchange Letters into Compliance Files

The complaint alleged that both Cohen and Sanfilippo were responsible for the false 1035 exchange letters. The Hearing Panel decision finds a violation only as to Cohen, and does not discuss this allegation as to Sanfilippo. Below, we address the allegation as to both Cohen and Sanfilippo.

Cohen admitted that he falsified MSC's records by creating and signing 49 fictitious letters to MSC registered representatives (dated between January and October 2004). Cohen placed the fictitious letters in MSC's files to create the appearance that the letters were sent and that MSC had been reviewing the Exchange Report since January 2004. We find that, in doing so, Cohen created and maintained inaccurate records at MSC.

Sanfilippo testified that he directed Cohen to review the Exchange Report going back to January 2004. Cohen reviewed the reports and revised a template for a letter to the affected registered representatives. Sanfilippo admits that Cohen showed him the revised template and states that he did not notice [*42] the date on the template. Sanfilippo testified that he expected Cohen to mail the letters. Cohen testified that he understood Sanfilippo's instructions to be to make MSC's records appear as though the firm had been reviewing the Exchange Report monthly since January 2004. Layton testified that he was directed by Cohen and Sanfilippo to contact the registered representatives identified in the letters and to request information from them. He stated that Sanfilippo told him that the 1035 exchange letters had been mailed to the representatives. When Layton talked to the representatives, he heard from many of them that they had not in fact received the letters. Layton testified that when he went back and told Sanfilippo and Cohen that the representatives had not received the letters, Cohen appeared to advise Sanfilippo for the first time that the letters had not been mailed. We find that the evidence is insufficient to prove that Sanfilippo directed or had knowledge of Cohen's creating fictitious 1035 exchange letters.

* * * *

"Falsifying documents is a prime example of misconduct that adversely reflects on a person's ability to comply with regulatory requirements and . . . [is] inconsistent [*43] with just and equitable principles of trade." *Dep't of Enforcement v. Taylor*, Complaint No. C8050027, 2007 NASD Discip. LEXIS 11, at *22-23 (NASD NAC Feb. 27, 2007). As outlined above, we hold Sanfilippo and Cohen responsible for creating and maintaining inaccurate records, in violation of NASD Rules 2110 and 3110.

V. Sanctions

The Hearing Panel suspended Kaminski in all principal capacities for six months and fined him \$ 50,000 for failing reasonably to supervise MSC's timely review of variable annuity trading. We affirm the \$ 50,000 fine. Given the gravity of Kaminski's violation, we impose an 18-month suspension in all capacities in lieu of the six-month principal suspension and require Kaminski to requalify before acting in any capacity requiring qualification. The Hearing Panel barred Sanfilippo and Cohen from associating with any member firm in any capacity. For the reasons discussed below, we eliminate the bars and instead impose 18-month suspensions in all capacities. We also require Sanfilippo and Cohen to requalify before acting in any capacity requiring qualification.

A. Kaminski

The rules that Kaminski violated serve a critical regulatory purpose. "Assuring [*44] proper supervision is a necessary component of broker-dealer operations." *Rita H. Malm*, 52 S.E.C. 64, 68 (1994). Kaminski failed in his supervision of MSC's variable annuity trading and enabled an important surveillance tool, the Red Flag Blotter, to go unchecked for several months. We find that Kaminski's misconduct was egregious. In making this determination, we consider the FINRA Sanction Guidelines ("Guidelines") and find that many of the principal considerations applicable to this case are aggravating.

The Guidelines applicable to supervisory violations direct that we consider whether the respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny. n25 Kaminski ignored many red flags that should have caused him to question Poston's abilities as a supervisor and the head of MSC's compliance department and whether the compliance department had adequate resources to oversee MSC's expanding business. Poston warned Kaminski that the compliance department was severely understaffed, and Poston and Coates expressed their concern that important surveillance work was falling behind. As early as the third quarter of [*45] 2003, Kaminski received the first of a string of alarming emails and memoranda from Poston, and later from Coates, on TRT's inability to complete its work timely. Kaminski took little action in response to these notices, even though he also knew that MSC had commenced an aggressive business strategy of acquiring other broker-dealers and turning them into branch offices of MSC and that MSC had committed significant resources from the compliance department to complete the Breakpoint Project. Kaminski also had concerns that he expressed to Poff regarding Poston's ability to handle his position, and Kaminski testified that Poston's performance problems began in 2003. Kaminski ignored all of these warning signs and took no action to rectify a crumbling compliance department. As a result of Kaminski's inaction, MSC's red-flagged variable annuity trades went unreviewed for more than two months. n26

n25 *FINRA Sanction Guidelines*, at 108 (Supervision -- Failure to Supervise) (2007), <http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf> [hereinafter "*Guidelines*"].

n26 The Guidelines also recommend that we consider whether individuals responsible for the underlying misconduct -- in this case, Poston, Cohen and Sanfilippo -- attempted to conceal the misconduct. As discussed in Part IV.A above, we reject Kaminski's argument that he was misled by reassuring emails from Poston. When viewed together, Poston's many emails, most of which begged for more staff and warned of dire consequences if the compliance department could not acquire more qualified personnel, should not have appeased Kaminski's concerns.

[*46]

The Guidelines applicable to supervisory violations also recommend that we consider the nature, extent, size, and character of the underlying misconduct. n27 Kaminski was involved in MSC's settlement of an earlier FINRA disciplinary action involving MSC's failure to supervise variable annuity trading, and he knew that MSC had formed TRT, in part, as a response to the prior action. n28 Kaminski acknowledged the importance of the Red Flag Blotter, and he knew that the blotter served the key function of enabling MSC to reverse variable annuity trades that the compliance or operations departments deemed unsuitable. Because of Kaminski's failure to supervise, the Red Flag Blotter, a surveillance tool designed to protect MSC's variable annuity customers, lay dormant for two and one-half months and 597 variable annuity trades that had already triggered one or more red flags were not reviewed timely. The result of Kaminski's failure to supervise could have been devastating to the firm or its customers. We find this factor aggravating. n29

n27 *Id.*

n28 As recommended by the Guidelines, we also find it aggravating that Kaminski was lax in supervising MSC's

variable annuity trading notwithstanding that he knew that MSC had received prior warnings from regulators in this area. *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 15).

[*47]

n29 Kaminski also argues that his misconduct did not result in pecuniary gain to himself or harm to MSC's customers and that these facts should mitigate sanctions. We disagree that these factors should be considered mitigating. Although the evidence does not demonstrate that Kaminski's supervisory failures resulted in his pecuniary gain or customer loss, they potentially could have, which militates against considering lack of customer harm and pecuniary gain as mitigating. *See PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1175 (D.C. Cir. 2009) (holding that the lack of direct harm to a customer or benefit to a violator is not mitigating).

The applicable Guidelines further recommend that we consider the quality and degree of Kaminski's implementation of the firm's supervisory procedures. n30 Kaminski was Poston's direct-line supervisor. Yet, he paid little attention to Poston's numerous requests for salary increases for the compliance department and for additional staff. He also ignored the fact that compliance professionals were fleeing MSC while the department's workload [*48] was increasing due to the firm's acquisition of other broker-dealers and the Breakpoint Project. Kaminski's feeble response, which did not occur until August 2004, was to transfer three individuals who were not compliance professionals to work temporarily in the compliance department. We view Kaminski's response as too little too late, and find it aggravating. *Cf. Michael E. Tennenbaum*, 47 S.E.C. 703, 711 (1982) (finding that, in response to indications of irregularities, supervisor engaged in "foot-dragging" and therefore failed reasonably to supervise).

n30 *Guidelines*, at 108 (Supervision - Failure to Supervise).

We also find that, given the numerous and conspicuous red flags to which Kaminski could have reacted, his failure to act was reckless. n31 *See Dep't of Enforcement v. VMR Capital Mkts. US*, Complaint No. C02020055, 2004 NASD Discip. LEXIS 18, at *36 (NASD NAC Dec. 2, 2004) (finding failure to supervise reckless due to the numerous and conspicuous red flags to which [*49] respondent failed to react). Kaminski questioned Poston's abilities as a supervisor in 2003, but he allowed Poston to remain as the head of the compliance department until Poston resigned in August 2004. Kaminski heard pleas from Poston and others for additional help in the compliance department. He was inundated with memoranda, emails, and charts indicating that the compliance department in general and TRT in particular were falling behind in their surveillance work. He was aware that the number of registered representatives for which the compliance department was responsible was growing exponentially with MSC's acquisitions and that MSC was subject to numerous regulatory inquiries and the Breakpoint Project, yet he did little to react until August 2004, at which point two and one-half months of Red Flag Blotters had not been reviewed. Kaminski's failures are nothing short of reckless.

n31 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 13).

The Principal Considerations in the Guidelines [*50] further suggest that we consider whether Kaminski attempted to mislead regulators or conceal misconduct. n32 We find that Kaminski attempted to conceal MSC's supervisory problems from FINRA investigators. FINRA staff conducted an on-the-record interview of Kaminski on January 12, 2005, as part of its investigation of MSC's variable annuity trading. At the time, FINRA did not know that MSC had halted its daily review of the Red Flag Blotter, and Kaminski did not disclose it during his on-the-record testimony. Additionally, Kaminski was part of a group of MSC officials who met with FINRA staff in Atlanta in May 2004 to

resolve issues related to the firm's variable annuity trading. MSC was intent on demonstrating to FINRA staff that MSC had developed adequate procedures to supervise 1035 exchanges. At the May 2004 meeting, Kaminski never mentioned that the firm's review of the Red Flag Blotter had stalled. Additionally, MSC officials, including Kaminski, misrepresented to FINRA staff that MSC had already implemented the Exchange Report (a report that was not generated until the fall of 2004). We consider these efforts by Kaminski to conceal MSC's supervisory failures to be aggravating. [*51] n33

n32 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 10).

n33 Kaminski argues on appeal that the Hearing Panel improperly considered against him uncharged misconduct. (Cause five of the complaint alleged only as to MSC, not as to Kaminski or any other MSC officials, that MSC provided FINRA staff with inaccurate and misleading information.) We reject Kaminski's claim. The Hearing Panel did not find that Kaminski violated FINRA's rules by misleading FINRA and neither do we. Rather, as instructed by the Guidelines, we consider with respect to sanctions only that Kaminski attempted to conceal his and MSC's misconduct. *See, e.g., Gateway Int'l Holdings, Inc., Exchange Act Rel. No. 53907, 2006 SEC LEXIS 1288*, at *24 (May 31, 2006) (finding it appropriate to consider reporting deficiencies not as violations but as to sanctions); *Joseph J. Barbato, 53 S.E.C. 1259, 1282 (1999)* (finding it appropriate to consider contacting witnesses not as a rule violation but in analysis of sanctions).

[*52]

We next consider Kaminski's claims that several mitigating factors exist. First, Kaminski contends that he has had a clean disciplinary history during his many years in the securities industry, which should mitigate sanctions. We disagree. While the existence of a disciplinary history is an aggravating factor when determining appropriate sanctions, its absence is not mitigating. *See, e.g., Dep't of Enforcement v. Fergus*, Complaint No. C8A990025, 2001 NASD Discip. LEXIS 3, at *58-59 (NASD NAC May 17, 2001) (holding that the absence of disciplinary history is not considered part of "relevant disciplinary history" under the Guidelines for purposes of reducing sanctions). A respondent should not be rewarded because he may have previously acted appropriately as a registered person. *See Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006)* (holding that lack of disciplinary history is not a mitigating factor); *Manoff, 55 S.E.C. at 1165-66 n.15; Ronald H. V. Justiss, 52 S.E.C. 746, 750 (1996)*.

Kaminski also argues that the fact that his supervisory failure involved only one out of MSC's many blotters [*53] should be mitigating. We do not agree. Although the Red Flag Blotter was only one blotter, it was MSC's primary tool for supervising MSC's variable annuity trading, which was a significant part of the firm's business. The Red Flag Blotter was particularly important given that FINRA had already expressed concern to MSC about its ability to supervise its variable annuity trading and that the Exchange Report was not yet up and running. Kaminski also contends that he took swift action to address TRT's backlog once he realized the significance and size of the problem and that this should be mitigating. We do not find that Kaminski took swift action or that he adequately addressed the problems in TRT. He fell short on fighting for increased salaries for the compliance department, he neglected the staffing shortages, and he temporarily placed individuals from other departments who had no compliance background in positions for which they were not qualified. In addition, when limited and unqualified resources became available, Kaminski deployed them to enable MSC to continue with new business rather than use the resources to perform the required but overlooked reviews of prior business. We [*54] do not find that Kaminski mitigated his failures with the half-hearted actions that he took.

Kaminski also argues that his misconduct should be mitigated by the fact that his supervisory failures were confined to a few months when the compliance department at MSC was facing many challenges. A supervisor, however, must ensure appropriate supervision of registered persons despite constraints on the supervisor's power or lack of funding. *See Pellegrino, 2008 SEC LEXIS 2843*, at *55 (rejecting respondent's attempt to blame FINRA, new regulations, and insufficient funding for his failure to supervise). Indeed, Kaminski's awareness of the added challenges that the compliance department faced should have caused him to step up his supervision of the department, not neglect

the department's needs.

Finally, Kaminski argues that the sanctions imposed on him are disproportionate to the sanctions imposed on other parties for similar misconduct. The Commission consistently has held that "the appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other [*55] cases." *Scott Epstein, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217*, at *74 (Jan. 30, 2009); *see also Michael F. Flannigan, Exchange Act Rel. No. 47142, 2003 SEC LEXIS 40*, at *21 n.23 (Jan. 8, 2003) (rejecting applicant's attempt to demonstrate that purportedly more severe facts in another disciplinary matter resulted in lesser sanctions). Comparison therefore is an invalid means of determining the appropriateness of the sanctions imposed here.

Kaminski's violations were egregious and demonstrated Kaminski's lack of knowledge or familiarity with the rules and laws governing the securities industry. He enabled MSC, a firm with a history of shortcomings in its supervision of variable annuity trading, to function for two and one-half months without a reliable system for reviewing variable annuity trades that already had triggered red flags. Kaminski demonstrated an overall attitude towards regulation and supervision that was lax at best. Kaminski recklessly ignored indications of irregularities and requests for help from an overworked and understaffed compliance department. He also ignored his own concerns about Poston [*56] and did too little too late to protect MSC's variable annuity customers. For his failure to supervise, we fine Kaminski \$ 50,000, suspend him in all capacities for 18 months, and require that he requalify before acting in any capacity requiring qualification.

B. Sanfilippo and Cohen

The Hearing Panel barred Sanfilippo and Cohen. The Hearing Panel found that no mitigating and several aggravating factors exist. Among the aggravating factors discussed in the Hearing Panel's decision is MSC's "culture of gamesmanship when it came to regulatory compliance," which the Hearing Panel found was best evidenced by an email that Poston sent to Kaminski in May 2004 after Kaminski's, Poston's, Dixon's, and Poff's May 18, 2004 meeting with FINRA staff. Cohen and Sanfilippo, however, did not attend the meeting and were not recipients of the email. More importantly, Cohen and Sanfilippo, although registered principals, were not part of the supervisory structure of MSC and did not contribute to establishing the gamesmanship culture at MSC. n34 We find that Cohen and Sanfilippo were too easily caught in MSC's lax regulatory culture and their violations resulted from their following the orders of [*57] their superiors. Although we do not find that this excuses their misconduct, lessens the significance of their actions, or mitigates sanctions, we also do not agree with the Hearing Panel's determination to consider the culture at MSC as an aggravating factor against Cohen and Sanfilippo.

n34 Cohen and Sanfilippo were fairly low in the compliance department chain of command. Cohen was a compliance examiner who did not possess supervisory authority. Sanfilippo oversaw the TRT (which included Cohen, Sanfilippo, and one other person), but he was not part of the firm's management structure. In fact, there were levels of management and supervision between Sanfilippo and Poston and Kaminski. Some of these supervisors left MSC in 2004 (such as, for example, Aracri), and Kaminski and Poston never filled the positions.

Turning to the Guidelines, we note that both the Guidelines for recordkeeping violations and the Guidelines for falsification of records recommend that we consider the nature of the documents and inaccuracies. [*58] n35 The Red Flag Blotter was a pivotal surveillance tool at MSC. Variable annuity trading accounted for a significant portion of the trading that occurred at MSC. The Red Flag Blotter enabled the compliance and operations departments to review variable annuity trades for suitability, ideally within the window for the firm to reverse the trade. The Red Flag Blotter served a key role also in enabling regulators to oversee MSC's variable annuity trading. This was particularly so given that MSC had faltered in its supervision of variable annuity trading in the past. We find that the inaccurate records for

which Cohen and Sanfilippo are responsible, namely daily Red Flag Blotters, were imperative to MSC's supervisory structure and that this aggravates their misconduct. Furthermore, the number of variable annuity trades at issue (597) and the time span (two and one-half months) are significant, particularly given that these trades already had triggered red flags, thereby necessitating close scrutiny of the trades. These factors also aggravate Sanfilippo's and Cohen's misconduct. n36

n35 The Guidelines for recordkeeping violations recommend a 30-day suspension and, in egregious cases, a suspension of up to two years or a bar and a fine of \$ 1,000 to \$ 10,000 or, in egregious cases, \$ 10,000 to \$ 100,000. *See Guidelines*, at 30 (Recordkeeping Violations). The Guidelines for forgery or falsification of records recommend a suspension of up to two years if mitigation exists and a bar in egregious cases. They also recommend a fine of \$ 5,000 to \$ 100,000. *See Guidelines*, at 39 (Forgery and/or Falsification of Records). General Principle No. 7 recommends requiring a respondent to requalify when the respondent's actions have demonstrated a lack of knowledge or familiarity with the rules and laws governing the securities industry. *See Guidelines*, at 5.

[*59]

n36 *Id.* at 6 (Principal Considerations in Determining Sanctions, Nos. 8 & 9).

Cohen also falsified firm records by inserting into firm files copies of 49 backdated letters to registered representatives that Cohen never actually mailed. Cohen's actions created the false impression that MSC had utilized the Exchange Report as a surveillance tool as far back as January 2004 when in reality, the firm did not implement the Exchange Report until October 2004. This misconduct is particularly significant given that FINRA staff had questioned whether MSC adequately supervised its variable annuity trading in the course of FINRA's 2003 examination of MSC and at MSC's May 2004 meeting with FINRA staff. We find these facts to be aggravating as to Cohen.

We also find aggravating as to Cohen and Sanfilippo the fact that their conduct was intentional. n37 Although both followed directives from their superiors, as securities professionals, they had independent obligations to ensure the accuracy of MSC's records that they participated in creating and maintaining. The Commission consistently has rejected similar [*60] arguments regarding reliance on one's supervisor as a defense to underlying misconduct and as a basis for mitigating sanctions. *Cf. Faber, 2004 SEC LEXIS 277*, at *21 (holding that applicant's reliance on his employer firm for regulatory compliance does not defeat a finding of scienter); *Richard H. Morrow, 53 S.E.C. 772, 779 (1998)* (rejecting argument that applicant acted in good faith because of reliance on member firm for due diligence); *Larry Ira Klein, 52 S.E.C. 1030, 1034 (1996)* (holding applicant responsible for inadequate disclosures that were approved by his supervisors and rejecting his reliance on his supervisors as a mitigating factor for sanctions); *Thomas E. Warren, III, 51 S.E.C. 1015, 1019 (1994)* (rejecting applicant's attempts to shift blame to his supervisor for inaccurate and incomplete account information).

n37 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

[*61]

The Principal Considerations also recommend that we consider whether the respondents attempted to conceal their misconduct. n38 We find that, during the initial phases of FINRA's investigation, Cohen and Sanfilippo in fact concealed their misconduct. Both were aware that TRT had halted all reviews of the Red Flag Blotter from March 15 through June 1, 2004, and both knew that Taylor had misrepresented that Cohen was the reviewer of the Red Flag

Blotter and had backdated the Trade Review Forms for 597 trades. Yet, during initial on-the-record interviews that were part of FINRA's investigation of this matter, Cohen and Sanfilippo failed to reveal the backlog, inaccuracies, and backdating related to Red Flag Blotters. n39 We find Cohen's and Sanfilippo's initial inclinations to conceal their misconduct aggravating.

n38 *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 10).

n39 Cohen testified on the record on December 1 and 2, 2004. He did not disclose any irregularities with the Red Flag Blotter, although he discussed in detail MSC's use of the Red Flag Blotter and his review of it. Cohen also misrepresented during this testimony that MSC had been utilizing the Exchange Report (which the firm began using in October 2004) since January 2004. Sanfilippo testified on the record on December 28, 2004. Sanfilippo similarly did not disclose irregularities with the Red Flag Blotter, although he too discussed TRT's surveillance of MSC's variable annuity trading during his testimony. Additionally, Sanfilippo also misrepresented that the Exchange Report had been used by MSC since January 2004.

[*62]

As to Cohen, however, he ultimately was the first witness to disclose to FINRA staff that MSC employees had backdated reviews of the Red Flag Blotter. Cohen testified on the record for the third time on April 25, 2005 and disclosed the backdating at that time. Additionally, Cohen testified on the record on June 21, 2005, and disclosed additional compliance issues at MSC (unrelated to the allegations against Cohen, Sanfilippo, and Kaminski) at that time. Enforcement stipulated that Cohen's disclosures furthered its investigation. We find this mitigating as to Cohen.

We also have considered Cohen's and Sanfilippo's contention that several mitigating factors exist. They argue that they have clean disciplinary histories and their misconduct did not result in their pecuniary gain or harm to MSC's customers. Like Kaminski, they argue that these factors should mitigate sanctions. We disagree. As we stated above, while the existence of a disciplinary history is an aggravating factor when determining appropriate sanctions, its absence is not mitigating because a registered person should not be rewarded for acting, as he should, in accordance with FINRA rules. *See, e.g., Dep't of Enforcement* [*63] *v. Balbirer*, Complaint No. C07980011, 1999 NASD Discip. LEXIS 29, at *10-11 (NASD NAC Oct. 18, 1999) ("We are not compelled to reward a respondent because he has acted in the manner in which he agreed (and was required) to act when entering this industry. . ."). Furthermore, although the evidence does not demonstrate that Cohen's and Sanfilippo's failures with respect to MSC's surveillance of variable annuity trading resulted in their pecuniary gain or customer loss, they potentially could have, and this militates against considering lack of customer harm and pecuniary gain as mitigating. *See PAZ Sec., 566 F.3d at 1175* (holding that the lack of direct harm to a customer or benefit to a violator is not mitigating). Like Kaminski, Cohen and Sanfilippo also argue that the sanctions imposed on them are disproportionate to the sanctions imposed on other parties for similar misconduct. The Commission consistently has rejected similar arguments, and so do we. *See Flannigan, 2003 SEC LEXIS 40*, at *21 n.23 (rejecting applicant's attempt to demonstrate that purportedly more severe facts in another disciplinary matter resulted in [*64] lesser sanctions).

Cohen and Sanfilippo also argue that their failures occurred during relatively few months, when the compliance department was facing many challenges. We do not see this as mitigating. First, the Red Flag Blotter was not reviewed for two and one-half months, leaving nearly 600 variable annuity trades that had already been flagged as troubling without anyone timely to review them. Then, Cohen and Sanfilippo participated in creating and maintaining inaccurate records that would camouflage MSC's supervisory failures and prevent regulators from gaining an accurate picture of the firm's surveillance of variable annuity trading. MSC's compliance department may have been overworked, but that does not excuse Cohen's and Sanfilippo's intentional falsification of firm records. We reject Cohen's and Sanfilippo's mitigation argument.

Cohen and Sanfilippo intentionally falsified MSC's records. Falsifying documents is dishonest and suggests that

Cohen and Sanfilippo are willing to bend the rules where regulation is concerned to suit their own needs or to follow a superior's misguided directions. Their actions also demonstrate a lack of knowledge or familiarity with the rules and [*65] laws governing the securities industry. Their actions assisted MSC in avoiding regulatory detection of irregularities and ran counter to the very surveillance that the recordkeeping requirements are designed to promote. We find their violations to be egregious, and suspend them both in all capacities for 18 months and require that they requalify before acting in any capacity requiring qualification. n40

n40 We have reduced the bar imposed by the Hearing Panel to an 18-month suspension and requirement to requalify, which we believe is sufficiently remedial and commensurate with the significance of Cohen's and Sanfilippo's misconduct. We have determined that no additional remedial benefit will be gained from adding a fine to the 18-month suspension and requirement to requalify.

VI. Conclusion

We affirm the Hearing Panel's findings that Kaminski violated NASD Rules 2110 and 3010 by failing to supervise MSC's timely review of the firm's variable annuity trading. We also affirm the Hearing Panel's findings that [*66] Sanfilippo and Cohen violated NASD Rules 2110 and 3110 by creating and maintaining inaccurate books and records relating to MSC's variable annuity trades. n41 For these violations, we suspend Kaminski for 18 months in all capacities, fine him \$ 50,000, and require that he requalify before acting in any capacity requiring qualification. We suspend Sanfilippo and Cohen each for 18 months in all capacities and require that they requalify before acting in any capacity requiring qualification. We also affirm the Hearing Panel's assessment of joint and several hearing costs of \$ 19,857. The suspensions imposed in this decision will become effective on a date to be determined by FINRA. n42

n41 We have considered and reject without discussion all other arguments advanced by the parties.

n42 Pursuant to FINRA Rule 8320, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.

On [*67] Behalf of the National Adjudicatory Council,

Marcia E. Asquith, Senior Vice President and Corporate Secretary

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