FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. JAMES E. ROONEY, JR. (CRD No. 1857754), Respondent.	Disciplinary Proceeding No. 2009019042402 Hearing Officer–MAD **EXTENDED HEARING PANEL DECISION** August 11, 2014

Respondent James E. Rooney, Jr. (1) engaged in a private securities transaction, in violation of NASD Rules 3040 and 2110; (2) recommended a security to a customer without a reasonable basis for believing the investment to be suitable, in violation of NASD Rules 2310 and 2110; (3) misrepresented material information when recommending a security to his customer, in violation of NASD Rule 2110; (4) presented misleading sales materials to his customer in connection with the sale of a security, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110; and (5) failed to supervise a registered representative and his sales of private securities, in violation of NASD Rules 3010 and 2110.

- **For engaging in a private securities transaction, in violation of NASD Rules 3040 and 2110, Rooney is: (1) fined $10,000; (2) suspended for three months from associating with any member firm in any capacity; and (3) required to requalify as a General Securities Representative.**
- **For recommending a security to a customer without a reasonable basis for believing the investment to be suitable, in violation of NASD Rules 2310 and 2110, Rooney is: (1) fined $25,000; (2) suspended for 18 months from associating with any member firm in any capacity; and (3) required to requalify as a General Securities Representative.**
- **For misrepresenting material information when recommending a security to his customer, in violation of NASD Rule 2110, Rooney is fined $10,000 and**

suspended for one month from associating with any member firm in any capacity.

- **For presenting misleading sales materials to his customer in connection with the sale of a security, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110, Rooney is: (1) fined $5,000; (2) suspended for two months from associating with any member firm in any capacity; and (3) required to requalify as a General Securities Representative.**
- **For failing to supervise a registered representative and his sales of private securities, in violation of NASD Rules 3010 and 2110, Rooney is: (1) fined $25,000; (2) suspended for 18 months from associating with any member firm in any supervisory capacity; and (3) required to requalify as a General Securities Principal.**

The above suspensions in all capacities, totaling two years, shall run consecutively. The 18-month suspension in all supervisory capacities shall run concurrently with the all-capacities suspensions.

Rooney is also ordered to pay the costs of this proceeding.

Appearances

For Complainant: Susan Light, Esq., Kevin E. Pogue, Esq., Josefina Martinez, Esq., Tiffany A. Buxton, Esq., FINRA, DEPARTMENT OF ENFORCEMENT, New York, NY.

For Respondent James E. Rooney, Jr.: Daniel E. Tapia, Esq., Tapia Law Firm PLLC, Carrollton, TX.

DECISION

I. INTRODUCTION

This disciplinary proceeding arose from FINRA's investigation into sales of National Foundation of America ("NFOA") installment plan contracts ("NFOA Contracts") by FINRA members. NFOA was a Tennessee non-profit corporation, founded in 2006, that represented itself to the public as a tax-exempt charitable organization under §501(c)(3) of the U.S. Internal Revenue Code ("IRC"). The U.S.

Internal Revenue Service ("IRS") never approved NFOA for tax-exempt status; however, NFOA marketed itself as a tax-exempt organization. Pursuant to the NFOA Contracts, investors transferred their assets (typically annuities) to NFOA in exchange for fixed annual or monthly payments over a term chosen by the investor. NFOA also promised investors a tax deduction in connection with the purchase of an NFOA Contract. After an investor purchased an NFOA Contract, NFOA converted the asset to cash and used the proceeds from its contract sales for the personal expenses of its president. NFOA's president was found guilty of fraud in connection with his sales of NFOA Contracts.

As a result of FINRA's investigation, the Department of Enforcement filed a complaint against Respondent James E. Rooney, Jr., the president of Fox Financial Management Corp. ("Fox"), a former FINRA member. The complaint alleges that Rooney violated several NASD Rules in connection with his sale of an NFOA Contract, and his supervision of sales of NFOA Contracts at Fox. Specifically, the complaint alleges that Rooney: (1) participated in the solicitation and sale of an NFOA Contract to his customer without providing prior written notice to Fox, in violation of NASD Rules 3040 and 2110; (2) recommended the NFOA Contract to his customer without a reasonable basis for believing it to be a suitable investment, in violation of NASD Rules 2310 and 2110; (3) misrepresented to his customer that NFOA was a tax-exempt charitable organization when soliciting the sale of the NFOA Contract to his customer, in violation of NASD Rule 2110; (4) presented his customer with misleading sales materials when soliciting his customer to purchase the NFOA Contract, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110; and (5) failed to supervise the sales of

NFOA Contracts by Harry Winters, a registered representative at Fox, in violation of NASD Rules 3010 and 2110.[1]

Rooney denied the charges. He also asserted two specific defenses: (1) the NFOA Contracts were not securities; and (2) the charges against him were time-barred. The Extended Hearing Panel[2] rejected Rooney's defenses. The Panel determined that the NFOA Contracts were securities, and that Rooney did not establish his time-barred defense. The Panel found Rooney liable for each of the charges and sanctioned him.

II. FINDINGS OF FACT

A. Respondent James E. Rooney, Jr. Was a Supervisor at Fox

1. Registrations

Rooney entered the securities industry in 1988.[3] From May 2004 through December 24, 2013, Rooney was employed at Fox, a small broker-dealer located in Carrollton, Texas.[4] At Fox, Rooney was registered with FINRA as a General Securities Representative and a General Securities Principal.[5] Throughout 2007, the relevant period

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[1] The FINRA Rules, which include NASD Procedural and Conduct Rules, are available at www.finra.org/Rules. 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 after December 15, 2008, the FINRA procedural rules apply. The conduct rules that apply, all NASD Rules, are those that existed at the time of the conduct at issue.

[2] The Hearing Panel conducted a hearing in Dallas, Texas, from February 25 through 27, 2014. The hearing transcript is cited as "Tr." Enforcement's exhibits are cited as "CX-," and Rooney's exhibits are cited as "RX-." The parties filed joint stipulations, which are cited as "Stip."

[3] Stip. ¶ 3.

[4] *Id.* ¶ 4; CX-40, at 3-4.

[5] Stip. ¶¶ 3, 4. Rooney is not currently in the industry. Although he is not currently registered with FINRA or associated with a FINRA member firm, FINRA has jurisdiction over this disciplinary proceeding, pursuant to Article V, Section 4(a) of FINRA's By-Laws, because (1) Enforcement filed the complaint within two years of FINRA's termination of Rooney's registration on December 23, 2013; and (2) the complaint alleges that Rooney engaged in misconduct while associated with a FINRA member firm, Fox.

for the events described in the complaint, Rooney was the assigned registered representative for approximately 20 customer accounts at Fox.[6]

2. Supervisory Roles

Rooney also held significant supervisory roles at Fox. Rooney was Fox's president and branch manager of the only branch.[7] He was responsible for supervising the firm's registered representatives.[8] During 2007, there were approximately eight registered representatives, including Winters.[9]

Rooney was also Fox's Chief Compliance Officer ("CCO").[10] Fox's written supervisory procedures ("WSPs") had specific requirements for private securities transactions and sales materials. Regarding private securities transactions, the WSPs required its associated persons to provide written notice to the firm before participating in any private securities transactions.[11] The WSPs required that the notice include: (1) a detailed description of the proposed transaction; (2) the person's proposed role therein; and (3) whether the person had received or may receive selling compensation in connection with the transaction.[12] The WSPs required a designated supervisory principal to approve in writing any associated person's request to engage in the private sale of

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[6] *Id.* ¶ 11. Rooney's activities with respect to his own customer accounts were supervised by Scott Brantley, Fox's Operations Manager and Chief Financial Officer. *Id.* ¶ 12. Brantley was authorized to raise any compliance-related issues pertaining to Rooney's accounts to the Chief Compliance Officer of Southwest Securities, Fox's clearing firm. *Id*. ¶ 13.

[7] *Id*. ¶ 4.

[8] *Id*. ¶ 5.

[9] Tr. 429. Winters was employed by Fox from April 2006 until December 23, 2013. Stip. ¶ 6. Apart from his employment at Fox, he also was affiliated with a company that engaged in insurance and estate planning. Tr. 40.

[10] Stip. ¶ 4.

[11] *Id*. ¶ 7.

[12] *Id*.

securities outside of their normal association with Fox.[13] Rooney was one of two supervisory principals designated to approve written requests by Fox's registered representatives to engage in private securities transactions.[14]

The WSPs prohibited the use of advertising or sales materials that contained: (1) omissions of material fact; (2) false, exaggerated, or misleading statements; or (3) claims or promises of specific results.[15] Rooney was also the designated supervisory principal responsible for the review and approval of all advertising, sales literature, and other similar materials used by Fox's registered representatives.[16]

B. Winters, a Registered Representative at Fox, Learns About NFOA Contracts

NFOA sold its contracts throughout the United States.[17] To do so, it recruited agents to solicit those sales by sending them mailings that promised large commissions for each NFOA Contract sold.[18] In early 2007, Winters received such a mailing: a postcard mailed to his home from NFOA introducing its installment contracts and promising a 9% commission.[19] The NFOA postcard intrigued Winters, prompting him to call NFOA to learn more about the NFOA Contracts.[20]

During Winters' telephone call with NFOA, an NFOA representative told him that NFOA was a tax-exempt charitable organization under §501(c)(3) of the IRC, which

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[13] *Id*.

[14] *Id*. ¶ 8.

[15] *Id*. ¶ 9.

[16] *Id*. ¶ 10.

[17] Tr. 203.

[18] Tr. 40, 245. If a selling agent requested a greater commission, NFOA's president would comply with his request. Tr. 246.

[19] Tr. 40, 245.

[20] Tr. 42-43.

Winters understood to mean that investors could claim a tax deduction in connection with their investment.[21] Winters had a superficial understanding of the NFOA Contracts as demonstrated by his testimony that, "you donate the annuity, I don't know what they do with it. And they in turn – you pick a time frame in which you want to get your money back . . . ."[22] When speaking with the NFOA representative, Winters did not ask how NFOA would use the investor's assets or whether any penalties might be associated with NFOA's asset exchange program.[23] He did learn that, when an investor exchanged an annuity for the NFOA Contract, NFOA valued the annuity at its accumulated value, not the lesser surrender value.[24] According to Winters, using the accumulated value benefited investors because annuities have high surrender fees.[25]

C. NFOA Sends Winters Misleading Sales Materials

When marketing the NFOA Contracts, NFOA provided selling agents with both general and individualized sales materials to enable them to solicit potential investors. Pursuant to its custom, after Winters received the postcard and contacted NFOA, NFOA mailed him its general sales materials.[26] After Winters identified a potential investor, he received individualized sales materials.[27]

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[21] Tr. 46-47.

[22] Tr. 44.

[23] Tr. 45, 48.

[24] Tr. 45, 48. Typically, when an annuity is liquidated or exchanged, there is a penalty (also known as a surrender fee) assessed. The surrender value is the accumulated value minus the penalty. Tr. 72.

[25] Tr. 45, 49.

[26] Tr. 40, 45.

[27] Tr. 50-53.

1. General NFOA Sales Materials

NFOA's general sales materials consisted of an NFOA Brochure and an NFOA Flyer.[28] The Brochure and Flyer described the NFOA Contracts as asset exchange programs, explaining that investors could exchange their cash, securities, real estate, or annuities for NFOA Contracts.[29] Both documents promised investors a profit in the form of an increased value of their exchanged asset and a tax savings.[30] However, both the Brochure and the Flyer provided exaggerated, misleading, and false information to potential investors.

The NFOA Brochure represented that NFOA was a "Tennessee 501(c)(3) public charity," helping "millions of needy men, women and children around the world" and providing a "generous income tax deduction."[31] This was false. In January 2006, NFOA applied to the IRS for §501(c)(3) tax-exempt status.[32] It claimed to be a charitable entity organized "exclusively" for charitable, religious, educational, and scientific purposes and ". . . to promote the sponsorship and support of a world-wide missionary effort . . . ."[33] NFOA's application remained pending with the IRS throughout 2007, when the IRS concluded that NFOA did not qualify under §501(c)(3).[34] The IRS noted that: (1) the amounts NFOA reported for charitable programs during the last four quarterly periods was less than one-half of one percent of NFOA's reported total revenues; and (2) the funds for charitable programs were approximately three percent of the total operating

[28] CX-1, CX-2.

[29] CX-1, CX-2.

[30] CX-1, CX-2.

[31] Stip. ¶ 16; CX-1, at 2.

[32] CX-50.

[33] *Id*. at 2, 35.

[34] CX-51, at 11.

expenses reported by NFOA during the same time period.[35] The IRS denied NFOA's application and concluded that "the sale of these securities constitute[s] common commercial activities, rather than activities that further a charitable purpose."[36]

The Brochure stressed that the "safety and security" of investor funds was "paramount" to NFOA.[37] It touted NFOA's choice of the institution where NFOA held its funds and indicated that the institution kept investors' funds segregated.[38] Contrary to NFOA's sales materials, investor funds were not segregated. Instead, all funds received by NFOA from the sales of its contracts were held in three custodial accounts, all of which were in NFOA's name and control.[39] NFOA engaged an investment advisor and provided that advisor with discretion to trade in the accounts.[40] None of the NFOA investors was consulted or had any input into the investment decisions.[41]

The Brochure also stated that the NFOA Contracts provided "guaranteed income that grows each year."[42] However, all of the NFOA investor funds were subject to market risk, which NFOA failed to disclose in its Brochure.[43] Once NFOA received investor

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[35] *Id*. at 8.

[36] *Id.* at 10.

[37] Stip. ¶ 20.

[38] *Id.* ¶ 17.

[39] CX-67, CX-70, CX-71, CX-72.

[40] Tr. 378; CX-63. NFOA's president hired an investment advisor to develop an Investment Policy Statement. NFOA approved the Investment Policy Statement, which governed the investment of the funds it obtained from purchasers of its contracts, and tasked the investment advisor with implementing the investment strategies detailed therein. CX-60, CX-61.

[41] Tr. 382.

[42] Stip. ¶ 16.

[43] *Id.* ¶ 20; Tr. 370, 376, 379; *see, e.g.*, CX-90 (reflecting losses in NFOA's accounts).

assets, it liquidated them, and placed the proceeds in NFOA accounts. NFOA invested investor funds as follows: 1% in cash; 59% in fixed income; and 40% in equities.[44]

The Flyer also made representations about the purported advantages of the NFOA Contracts.[45] Similar to the Brochure, the Flyer falsely stated that the NFOA Contracts provided "guaranteed fixed income that grows each year" and an "immediate tax deduction."[46] The Flyer also noted that when investors exchanged annuities for NFOA Contracts, they would receive "the accumulated value [of the exchanged annuity], not the surrender value."[47] However, it provided no explanation regarding how NFOA could absorb the surrender fee.

NFOA used illustrations to demonstrate the purported advantages of the NFOA Contracts.[48] In one illustration, an investor who transferred an annuity with a $113,000 accumulated value and a 10% surrender penalty fee would be: (1) credited for a transfer of the full accumulated value; and (2) guaranteed annual payments of $9,867 for 30 years after a 10-year deferral period.[49] NFOA represented that the total payout for the $113,000 investment would equal $296,010, and the investor would receive an immediate tax deduction of $63,934.[50]

2. Individualized Sales Materials

For each proposed investment, NFOA also prepared individualized sales materials—an Installment Plan Flow Chart and a 1099 Statement. Similar to the Brochure

[44] Tr. 379; CX-65, at 5.

[45] *See generally* CX-2.

[46] *Id*. at 2.

[47] *Id*.

[48] *See* CX-1, at 4; CX-2.

[49] CX-2, at 2.

[50] *Id*.

and Flyer, the individualized sales materials also promised investors a profit.[51] The Flow Chart graphically depicted the terms of the NFOA Contracts for potential investors, demonstrating that the investors would receive a total payout in excess of their initial investment over the contract term.[52] It also estimated the allowable tax deduction and the resulting tax savings to the investors.[53] The 1099 Statement detailed the number and amount of scheduled payments investors would receive in exchange for their transferred assets.[54] It also listed the portion of the annual payment that could be "reported as tax free" and the portion that should be reported as "ordinary income."[55] Neither the Flow Chart nor the 1099 Statement provided any underlying information to investors such as the rate of return or the basis for the calculations.[56]

D. Winters Sells His First NFOA Contract and Introduces Rooney to NFOA

Upon reviewing the Brochure, Winters immediately thought AB would be an ideal candidate for the NFOA Contract.[57] AB, who was approximately 80 years old, was one of Winters' insurance customers, not a Fox customer.[58]

In approximately February 2007, Winters showed AB the Brochure and provided AB with NFOA-prepared, individualized sales materials, which reflected that, if AB exchanged his annuity with an accumulated value of approximately $250,000, he would

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[51] *See, e.g.*, CX-6, CX-16; *see also* CX-33, CX-34, CX-35, and CX-103 (identifying other NFOA investors to whom NFOA promised profits in the form of an increased value in the exchanged annuity and tax savings).

[52] CX-16, at 2.

[53] *Id.*

[54] *Id.* at 3.

[55] *Id.*

[56] CX-16, at 2-3.

[57] Tr. 41.

[58] Stip. ¶ 29; Tr. 50, 142.

receive a total payout of $322,494, and a tax deduction of $73,376.[59] AB decided to purchase the NFOA Contract.[60] He signed it and completed the required paperwork to transfer ownership of his annuity to NFOA.[61] Winters also signed the NFOA Contract as AB's Financial Advisor.[62] Thereafter, NFOA paid Winters a commission of approximately $20,000 for his sale to AB.[63]

After experiencing how easy his initial NFOA Contract sale was, Winters told Rooney about his sale to AB and why it was a "pretty good deal."[64] Winters also provided Rooney with the NFOA Brochure and Flyer, which Rooney reviewed.[65]

E. Rooney and Winters Converse with NFOA's President About Selling NFOA Contracts and Decide to Sell the Contracts

After learning about Winters' NFOA Contract sale and reviewing the NFOA sales materials, in late February or early March 2007, Rooney set up a conference call with NFOA's president and NFOA representatives, Winters, and another Fox registered representative.[66] Consistent with the NFOA sales materials, the NFOA president and his colleagues advised Rooney that NFOA was recognized by the IRS as a charitable non-profit organization under §501(c)(3) of the IRC, and that investors in NFOA would receive a tax deduction.[67] At some level, Winters must have thought the NFOA Contracts were too good to be true because he testified that he only had one question for NFOA's

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[59] Tr. 53-56. Winters had sold AB the annuity several years earlier. Tr. 41.

[60] Tr. 56.

[61] Tr. 56-57.

[62] Tr. 175.

[63] Tr. 115; CX-95, at 2.

[64] Tr. 63, 86.

[65] Stip. ¶¶ 21, 23; RX-13, at 2.

[66] Stip. ¶ 21; Tr. 64-65, 483.

[67] Stip. ¶ 22; Tr. 65, 437.

president: "Were you ever convicted of a crime?"[68] Nonetheless, during the call, neither Rooney nor any other Fox representative asked NFOA about the charities it was affiliated with, how it could absorb annuities at accumulated values without penalties, how it could guarantee income streams, how it treated investor funds, or how it determined the tax savings for investors.[69]

After the conference call, neither Rooney nor Winters did any independent research on NFOA or the assertions in its sales materials.[70] Instead, Winters decided to continue selling NFOA Contracts, and Rooney decided to begin selling them.[71] Neither Rooney nor Winters sought, or received, approval from Fox prior to engaging in the NFOA private securities transactions as required by Fox's WSPs.[72] Both believed that the NFOA Contracts were not securities. Winters believed that the NFOA Contracts were "donation[s] to a charity, fundraising basically."[73] Rooney believed that the NFOA Contracts were insurance products.[74] However, even with their mistaken understanding, they failed to complete the required forms to obtain approval for outside business activities.[75]

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[68] Tr. 66.

[69] Tr. 65-67.

[70] Stip. ¶ 25; Tr. 66-68, 96-97.

[71] Stip. ¶¶ 30, 31; Tr. 68.

[72] Tr. 134, 441.

[73] Tr. 146.

[74] Tr. 441.

[75] Tr. 59, 477-78.

F. Winters Sells Additional NFOA Contracts Utilizing NFOA Sales Materials; Rooney Fails to Supervise the Sales

In March and April 2007, Winters solicited and sold additional NFOA Contracts to OH and FK, two investors who were both in their 70s.[76] OH and FK were Winters' customers from his insurance business, not Fox customers.[77] Winters had previously sold them annuities.

When soliciting these sales, as stated in the Brochure and Flyer, Winters represented to each investor that NFOA was a §501(c)(3) tax-exempt organization and that they would therefore be entitled to obtain a tax deduction in connection with their respective NFOA investments.[78] Winters also presented OH and FK with individualized sales materials, the Flow Charts and 1099 Statements, illustrating the profit that they would realize in the form of an increased value for their annuities and tax savings.[79] For example, the individualized sales materials reflected that, if FK exchanged his annuity with a $59,136 accumulated value and a $57,203 surrender value for an NFOA Contract, NFOA promised a total payout of $80,025 and a tax deduction of $11,716.[80]

OH and FK agreed to exchange their annuities, signed the NFOA Contracts, and executed ownership transfer forms for their annuities.[81] Winters also signed the NFOA Contracts as their Financial Advisor.[82] He then forwarded the NFOA Contracts and

[76] Stip. ¶ 30; Tr. 68-70, 90; CX-3, CX-14.

[77] Stip. ¶ 30; Tr. 69, 89.

[78] Tr. 77, 97.

[79] Tr. 73, 90; CX-6, CX-16.

[80] CX-14, CX-16.

[81] CX-7, CX-8, CX-17, CX-18.

[82] CX-7, CX-17.

ownership transfer forms to NFOA.[83] In each instance, NFOA submitted the ownership transfer forms to the respective insurance companies for the annuities and requested that ownership be transferred to NFOA.[84] Consistent with his experience when selling the NFOA Contract to AB, Winters expected to receive a commission in connection with the sales of NFOA Contracts to OH and FK.[85]

Despite Rooney's awareness of Winters' additional sales of NFOA Contacts,[86] he took no steps to supervise Winters' NFOA-related activities. Rooney failed to: (1) ensure that Winters' sales were reviewed and approved, or disapproved if appropriate; (2) carefully review the NFOA sales materials to determine if they could appropriately be used by Winters; and (3) exercise due diligence regarding NFOA and its contract product.

First, as noted above, Rooney was the CCO and one of the designated principals to approve written requests from Fox registered representatives to engage in private securities transactions. From at least late February 2007, Rooney was aware that Winters intended to solicit and sell NFOA Contracts.[87] He was also aware that Winters expected to receive compensation in connection with his future sales of NFOA Contracts and that his future sales would occur away from the firm.[88] Although he and Winters discussed Winters' sales of NFOA Contracts, neither Rooney nor any other principal at Fox

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[83] Tr. 82-84, 101.

[84] When Winters submitted the NFOA Contract for investor AB, it was processed very quickly; however, the NFOA Contracts for OH and FK took longer. Tr. 85. Winters called the insurance company that held OH's annuity and the company transferred him to its in-house counsel. Tr. 87-88. Instead of the in-house counsel responding to Winters' questions about the delay in transferring the annuity, the in-house counsel began questioning Winters, which made Winters feel uncomfortable. Tr. 88, 103.

[85] Stip. ¶ 28.

[86] *Id.*

[87] *Id.*

[88] *Id.*

approved Winters' sales.[89] Contrary to Fox's WSPs, Rooney did not ensure that Winters provided Fox with the required notice and obtain the necessary approval from Fox before participating in the sales.[90]

Second, Rooney was the designated principal to approve all advertising and sales materials used by Fox's registered representatives.[91] Despite holding this designation and serving as Fox's CCO, Rooney testified, "I don't know that we actually ever engaged in any form of advertising, so I don't even know if that's inclusive on our WSPs . . . . It may be that we never addressed that issue."[92] "[A]s a matter of practice we never advertised. I mean, in 25 years, so I don't know that we even included that in our WSPs. We may have, because it was a template . . . ."[93] In fact, Fox's WSPs did address advertising and sales materials, and required Rooney to approve all sales materials prior to use.[94] The WSPs required Rooney to ensure that all sales materials did not: (1) omit material facts; (2) contain false, exaggerated, or misleading statements; or (3) claim or promise specific results.[95] Although Rooney reviewed the NFOA sales materials and was aware that Winters was selling additional NFOA Contracts,[96] he did not take steps to ensure their content complied with Fox's WSPs or NASD rules governing sales and advertising materials.

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[89] Stip. ¶¶ 24, 28; Tr. 59, 134, 476.

[90] Tr. 476-78. In 2007, Rooney was also responsible for the review and approval of outside business activities. RX-36, at 44-45, 50.

[91] Stip. ¶ 10.

[92] Tr. 478.

[93] Tr. 478-79.

[94] CX-42, at 16-22, 24.

[95] Stip. ¶ 9; CX-42, at 19.

[96] Stip. ¶¶ 20, 21, 23, 24, 28.

Third, Rooney was responsible for ensuring that due diligence was conducted with respect to products recommended by Fox's registered representatives.[97] He failed to conduct adequate due diligence regarding NFOA and its contract product. His due diligence consisted solely of his telephone conversations with NFOA's president and its representatives.[98]

Rooney failed to research NFOA and its product. Had Rooney conducted an internet search of NFOA, he would have learned that, in September 2006, approximately six months prior to Winters' sales, NFOA and two of its officers were the subject of a Cease and Desist Order issued by the State of Washington.[99] The Cease and Desist Order noted that NFOA officials knew "they had not been granted an exemption as a charitable organization by the IRS. . . ."[100]

He also would not have, as he acknowledged, "relied on the marketing material and the representations made by [NFOA's president] that they had achieved 501(c)(3)

[97] RX-36, at 50, 51.

[98] At the hearing, Rooney testified that he directed Fox's counsel to conduct due diligence on NFOA. Tr. 444, 505. According to Rooney, Fox's counsel tried to reach NFOA's president for one month, and then determined that NFOA was not a legitimate organization. Tr. 522-23. When questioned by the Hearing Panel as to why he would sell an NFOA Contract without having completed due diligence, Rooney stated that he sold the NFOA Contract expecting Fox's counsel to notify him that there were no problems associated with NFOA. Tr. 523-24. Other than Rooney's self-serving testimony, he provided no evidence that he engaged counsel to conduct due diligence at the time of the sales. In fact, there is evidence to the contrary. On March 25, 2008, Fox's CCO, a principal at Fox who replaced Rooney as the CCO in January 2008, represented to FINRA in response to a Rule 8210 request that "Fox Financial Management Corp. did not conduct an investigation [concerning the sale of NFOA products] before May 8, 2007." CX-98, at 7. Further, during Rooney's investigative testimony, he was represented by the same counsel that he now asserts conducted due diligence at the time of the sales. RX-36, at 3. At no time during Rooney's investigative testimony did he state that his counsel conducted due diligence at the time of the NFOA sales. *See* RX-36.

[99] CX-47. This Cease and Desist Order was publicly available on the State's website beginning on or about September 18, 2006. CX-47A.

[100] CX-47, at 3.

status and did no independent research above and beyond that."[101] Instead, he would have contacted the IRS and inquired about NFOA's status, something he failed to do.[102] Had he tested NFOA's assertions, he would have discovered that NFOA did not appear on the IRS's publicly available website as an approved §501(c)(3) organization.[103]

Rooney also failed to inquire about the identity of the charitable organizations to which NFOA purportedly donated.[104] According to Rooney, investors knew they were giving their assets "to National Foundation of America, much like when you give money to the United Way. They're just a frontline . . . . What they decide to do with your charitable donation is something that you trust the frontline to do."[105] He also failed to inquire about the percentage of investor funds that went to a charitable organization, stating "I didn't care how much of it went to charity."[106]

Rooney never requested that NFOA provide him with an explanation of how future payments would be funded or guaranteed, or any financial documentation to support its "guaranteed" returns.[107] Similarly, Rooney made no attempt to contact the institution that NFOA identified in its sales materials as custodian of its funds to: (1) investigate the manner in which NFOA funds would be invested; or (2) learn who would be making investment decisions on NFOA's behalf.[108] According to Rooney,

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[101] RX-36, at 151. Not only did Rooney accept NFOA's representations, he conveyed this information to his own client when selling an NFOA Contract during the same time period that Winters sold his NFOA Contracts. Stip. ¶ 35.

[102] RX-36, at 150-51.

[103] Stip. ¶ 25.

[104] Tr. 66; RX-36, at 197.

[105] RX-36, at 197.

[106] RX-36, at 151.

[107] Tr. 66-67.

[108] Tr. 481; RX-36, at 153.

"what [NFOA] did to try to generate a promised of (sic) return, you know, was really behind the scenes that we didn't have any interest in."[109] As a result, he never learned: (1) the extent to which NFOA's investor funds were subject to market risk; or (2) that NFOA funds held at the institution were not segregated by investor, but were instead pooled in accounts held in the name of NFOA.[110]

G. Rooney Sells NFOA Contracts Utilizing NFOA Sales Materials

Not only did Rooney fail to supervise Winters' sales of NFOA Contracts, he too sold an NFOA Contract. In the midst of Winters' sales, Rooney sold an NFOA Contract to JN, one of his Fox customers.[111] JN was a 61-year-old retiree in poor health.[112] JN was unmarried and had no children.[113] According to Rooney, JN relied on him for everything; Rooney was essentially JN's caretaker.[114]

In March 2007, Rooney solicited JN to purchase an NFOA Contract.[115] Under the terms of the proposed sale, JN would exchange his existing annuity for the NFOA Contract.[116] JN's annuity had an accumulated value of approximately $63,675, and a surrender value of approximately $55,314.[117] Rooney understood that the true value of the annuity was "whatever your surrender value is," and the NFOA Contract promised JN

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[109] RX-36, at 153.

[110] *See supra* footnotes 38 through 41 accompanying text.

[111] Stip. ¶ 31.

[112] *Id.*; RX-36, at 182. JN died on February 25, 2009, prior to the hearing. RX-1, RX-2.

[113] Tr. 433.

[114] Tr. 433.

[115] Stip. ¶ 31.

[116] *Id.* ¶ 34.

[117] *Id.* ¶ 38.

$63,661 in exchange for his annuity, an increase of $8,347 over the annuity's surrender value.[118]

In the course of soliciting the sale to JN, Rooney provided JN with NFOA-prepared individualized sales materials: an Explanatory Statement and a 1099 Statement.[119] The Explanatory Statement represented that JN's NFOA Contract would result in "a significant income tax deduction, which lowers . . . income tax liability, and creates spendable money."[120] It stated that JN's "annuity has an accumulated value of $63,675, with a 13% surrender penalty absorbed into the transaction by NFOA."[121] It further stated that the NFOA "contract would pay out for **10 years**" and that "the income stream would **begin immediately** upon your client transferring ownership of the existing annuity to NFOA. . . ."[122] The Explanatory Statement indicated that JN would receive monthly payments of $530, a total payout over the 10-year term of $63,661, an income tax deduction of $24,975, and a total tax-free amount of $49,780.[123] The 1099 Statement for JN reiterated the same financial data for JN's NFOA Contract.[124] NFOA, through its sales materials, promised JN a profit in two ways: (1) by realizing the $8,347 difference between the NFOA Contract's total payout and the surrender value of JN's annuity; and (2) by claiming the tax deductions.[125]

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[118] *Id*. ¶ 34; RX-36, at 245.

[119] Stip. ¶ 33.

[120] CX-22, at 2.

[121] *Id*.

[122] *Id*. (emphasis in original).

[123] Stip. ¶ 34.

[124] *See* CX-22, at 1.

[125] *Id.* at 2.

Similar to the individualized sales materials provided to other NFOA investors, the Explanatory Statement and the 1099 Statement that Rooney presented to JN failed to: (1) reflect that the total payout amount included a return on principal; (2) describe the rate of return; (3) offer detailed descriptions of the tax deductions and tax savings; or (4) provide an explanation of how NFOA calculated the tax-free amounts.[126]

During the course of the solicitation, Rooney also told JN that NFOA was a §501(c)(3) tax-exempt organization and that JN would obtain a tax deduction in connection with his NFOA investment.[127] According to Rooney, this was significant since it "would also provide [JN] an immediate tax deduction to utilize while he was alive that could offset up to 50 percent of his income and lower his tax bill for his foreseeably short predicted lifespan."[128] As noted, NFOA was not a tax-exempt organization, something Rooney would have known had he conducted basic due diligence prior to his NFOA Contract sale to JN.[129]

On March 20, 2007, JN signed an NFOA Contract and an ownership transfer form, enabling his annuity to be transferred to NFOA.[130] Rooney signed the NFOA Contract as JN's Financial Advisor.[131] Like Winters, Rooney expected to receive his commission from NFOA in connection with the sale of the NFOA Contract to JN.[132] He

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[126] CX-22.

[127] Stip. ¶ 35. JN's NFOA Contract also stated that NFOA was recognized by the IRS as a charitable, non-profit organization under §501(c)(3) of the IRC. Stip. ¶ 37.

[128] RX-36, at 195.

[129] *See supra* footnotes 86 through 110 and accompanying text discussing Rooney's failure to investigate NFOA and its contract product.

[130] Stip. ¶¶ 36, 40. JN also signed a form authorizing NFOA to directly deposit the NFOA installment payments into his checking account. *Id.* ¶ 41; CX-27; Tr. 296.

[131] Stip. ¶ 39.

[132] *Id.* ¶ 32.

immediately forwarded the NFOA Contract and ownership transfer form to NFOA.[133] Two days later, NFOA requested that the insurance company holding JN's annuity transfer ownership to NFOA.[134]

H. Rooney and Winters Cancel Their Sales of NFOA Contracts

On May 8, 2007, Rooney learned of an inquiry regarding NFOA by the Texas State Securities Board.[135] Rooney then asked Fox's counsel to contact NFOA.[136] Fox's counsel called NFOA's president who informed him that NFOA was experiencing regulatory issues and was not an approved §501(c)(3) organization.[137] Fox's counsel then shared this information with Rooney and advised him that Fox should end its relationship with NFOA.[138] Rooney and JN then contacted the insurance company that held JN's annuity in an effort to cancel the ownership transfer.[139] Because that insurance company had concerns about NFOA, it had not transferred ownership of the annuity to NFOA.[140]

Fox's counsel also contacted Winters and notified him that there were problems with NFOA.[141] After speaking with Fox's counsel, Winters cancelled the NFOA Contracts for OH and FK.[142]

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[133] CX-28.

[134] Stip. ¶ 43.

[135] *Id*. ¶ 46.

[136] RX-36, at 242.

[137] CX-98, at 7.

[138] *Id.*

[139] Stip. ¶ 48.

[140] *Id*. ¶ 49. When Rooney and JN contacted the insurance company, they learned that, upon the advice of its counsel, it had created an internal policy whereby it would not process any more NFOA Contracts. RX-36, at 244. In July 2007, JN received a check for $56,212, representing the surrender value of his annuity, from the insurance company that had held his annuity. CX-31, RX-28, RX-30. Rooney did not receive a commission for his sale of the NFOA Contract to JN. Stip. ¶ 45.

[141] Tr. 107.

[142] Tr. 108, 165.

I. NFOA Is Placed in Court-Ordered Receivership and Liquidated; NFOA's President Is Found Guilty of Criminal Charges

In June 2007, a Tennessee court placed NFOA into receivership.[143] In August 2007, after conducting an investigation of NFOA, the receiver petitioned the court for liquidation of NFOA due to NFOA's insolvency and to prevent further harm to investors.[144] The receiver noted that NFOA's records indicated that it sold over 300 NFOA Contracts, inducing sales by means of fraudulent representations.[145] NFOA sold these contracts in approximately 25 states, using approximately 65 selling agents, including Rooney and Winters.[146] NFOA's sales efforts resulted in NFOA Contract sales to more than 300 individuals, whose average age was 76.[147] The receiver learned that NFOA's president used investor funds for personal expenses, such as the purchase of a condominium and furniture, as well as daily living expenses.[148] According to the receiver, NFOA's president used NFOA's acquired funds as a "personal piggy bank."[149] The receiver also notified the court that NFOA was the subject of numerous state regulatory actions and civil lawsuits filed by NFOA Contract investors.[150] In September 2007, the Tennessee court ordered the liquidation of NFOA and an injunction.[151]

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[143] CX-52.

[144] CX-53.

[145] *Id*. at 6.

[146] Tr. 203-04.

[147] CX-53, at 6, 25. Approximately 346 investors filed claims with the receiver. Tr. 322.

[148] Tr. 226-27.

[149] Tr. 226.

[150] CX-53, at 7, 26.

[151] CX-55.

On March 7, 2013, a federal jury found NFOA's president guilty of mail fraud, wire fraud, and money laundering related to his operation of NFOA.[152] The jury determined that, through his operation of NFOA and the sales of the NFOA Contracts, NFOA's president defrauded investors, causing investors to lose approximately $30 million.[153]

III. CONCLUSIONS OF LAW

A. The NFOA Contracts Are Securities

Rooney argued that the NFOA Contracts were not securities. He stated that all of the charges against him, with the exception of the supervisory charge, depend upon a finding that the NFOA Contracts were securities.

A "security" is defined under federal law "to encompass virtually any instrument that might be sold as an investment," including any investment contract.[154] In *SEC v. W. J. Howey Co.*, the Supreme Court defined an investment contract as "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . ."[155] The *Howey* test contains three elements: (1) an investment of money; (2) in a scheme functioning as a common enterprise; (3) with the expectation that profits will be derived

[152] CX-58, at 1.

[153] *Id.*

[154] *SEC v. Edwards*, 540 U.S. 389, 393 (2004) (internal quotation and citation omitted). The term "investment contract" is not defined in the securities laws, but was developed to offer a flexible and adaptable definition of "security." *Id.* This term encompasses all the "'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" *Id.* (quoting *SEC v. W.J. Howey Co.*, 328 U.S. 293, 294 (1946)). Accordingly, "the term 'investment contract' has developed as a *catch-all provision* to cover a broad range of transactions . . . that do not fit neatly into the conventional categories of the definition of a 'security.'" *Dep't of Enforcement v. Strong*, No. E8A2003091501, 2008 FINRA Discip. LEXIS 19, at *8 (N.A.C. Aug. 13, 2008) (emphasis added).

[155] *Howey*, 328 U.S. 293, at 298-99.

solely from the efforts of individuals other than the investors. The NFOA Contracts meet these criteria.

First, the investment of money element is satisfied because investors exchanged cash, property, or stock for the NFOA Contracts.[156] Similar to other NFOA investors, Rooney's customer and Winters' two customers exchanged existing annuities for their NFOA Contracts. These annuities had a defined value and were given by the investors in consideration for the NFOA Contracts.

Second, purchasers of NFOA Contracts were investing in a "common enterprise." The common enterprise requirement focuses on "the extent to which the success of the investor's interest rises and falls with others in the enterprise."[157] Although courts have considered three types of commonality—horizontal, broad vertical, and strict vertical—to determine whether there is a common enterprise,[158] the Securities and Exchange Commission ("SEC") has stated that horizontal commonality establishes the common enterprise element.[159] Horizontal commonality exists where "investors' funds are pooled and their fortunes are interrelated."[160]

Here, NFOA pooled investor funds to achieve its goals. NFOA engaged a financial institution to develop an Investment Policy Statement. In connection with that policy, NFOA opened three accounts, all of which were held in NFOA's name—not

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[156] *See Strong*, 2008 FINRA Discip. LEXIS 19, at *10 n.8 (citing *Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-560 n.12 (1979) (expressly rejecting that a person's investment must take the form of cash only, rather than goods and services)).

[157] *The Law of Securities Regulation*, Sec. 1.6[2][B] at 42, Thomas Lee Hazen (4th ed. 2002).

[158] *See Dep't of Enforcement v. De Vietien*, No. 2006007544401, 2010 FINRA Discip. LEXIS 45, at *18 (N.A.C. Dec. 28, 2010).

[159] *See Martin R. Kaiden*, Exchange Act Rel. No. 41629, 1999 SEC LEXIS 1396, at *16 (July 20, 1999); *Ronald W. Gibbs*, Exchange Act Rel. No. 35998, 1995 SEC LEXIS 1824, at *12-13 (July 20, 1995).

[160] *Gibbs*, 1995 SEC LEXIS 1824, at *12.

segregated by individual investor. The pooling of investor funds establishes that the common enterprise element of the *Howey* test is met.

Third, the NFOA investors were led to expect a profit in connection with their investment. The relevant inquiry is not the motivations of a single investor, but an objective test based on the reasonable expectations of the investing public.[161] Here, NFOA's advertising and sales literature promised investors a profit. For example, the NFOA Flyer represented that investors would receive "a new contract issued at the accumulated value (of the exchanged annuity), not the [present day] surrender value," "guaranteed fixed income that grows each year," and an "immediate tax deduction."[162] NFOA's Brochure stated that its contracts provided investors with "a substantial income tax deduction" and "guaranteed, fixed, tax-favored income."[163] NFOA reiterated its claims of favorable tax treatment in the 1099 Statements it prepared for prospective investors, and its Flow Charts routinely represented that investors would receive a total

[161] *Fragin v. Mezei*, 2012 U.S. Dist. LEXIS 119064, at *29 (S.D.N.Y. Aug. 22, 2012); *Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2008) ("At the outset, we note that, while the subjective intent of the purchasers may have some bearing on the issue of whether they entered into investment contracts, we must focus our inquiry on what the purchasers were offered or promised."); *Alvin W. Gebhart*, Exchange Act Rel. No. 53136, 2006 SEC LEXIS 93, at *46 (Jan. 18, 2006) ("We 'must look to a reasonable investor, not the specific individuals in question.'"), *rev'd and remanded in part on other grounds*, 2007 U.S. App. LEXIS 27183 (9th Cir. Nov. 21, 2007); *SEC v. Wallenbrock and Assoc.*, 313 F.3d 532, 539 (9th Cir. 2002) ("Our benchmark is what a 'reasonable investor' would think, not what the 'specific individuals in question' might have thought.").

[162] CX-2; *see Warfield*, 569 F.3d 1015, at 1024 (noting that "periodic payments and tax benefits could deliver a return on the initial payment").

[163] CX-1, at 4. The Fifth Circuit has stated that tax benefits may constitute an expectation of profits under the *Howey* test. *AFFCO Investments 2001 LLC v. Proskauer Rose LLP*, 625 F.3d 185, 190 n.4 (5th Cir. 2010).

payout that exceeded their initial investment.[164]

The profits that NFOA promised were based on the efforts of others, not the investors. As detailed above, NFOA and its selected investment advisor controlled NFOA's finances. NFOA invested its funds in the market pursuant to the investment policy developed by its advisor and approved by NFOA. Investors had no control over the funds or input into how NFOA invested those funds, and they depended on NFOA's investment decisions for their promised payouts. Accordingly, the third element of the *Howey* test is met.

Based on the foregoing, the Hearing Panel finds that the NFOA Contracts purchased by investors, including JN, were securities.[165]

B. Rooney Engaged in Private Securities Transactions Without Notifying His Firm

NASD Rule 3040 requires an associated person to provide written notice to his FINRA-regulated broker-dealer employer prior to participating in any private securities transaction, which is defined as any securities transaction outside the scope of the associated person's employment. The notice must describe in detail the proposed transaction, the person's proposed role in it, and any compensation the person might

[164] When JN invested in NFOA, NFOA promised him a greater value than the surrender value of his exchanged annuity and tax savings. At the time JN executed the NFOA Contract, the surrender value of his annuity was approximately $55,314. However, his NFOA Contract promised receipt of monthly installment payments over a ten-year period based on the accumulated value of his annuity totaling approximately $63,661 – a net profit of approximately $8,347. The Explanatory Statement that Rooney presented to JN indicated that approximately $49,780 worth of his projected installment payments would be treated as tax free, and that JN would receive an income tax deduction of approximately $25,000. As discussed above, Rooney explained that the NFOA Contract "would also provide [JN] an immediate tax deduction to utilize while he was alive that could offset up to 50% of his income and lower his tax bill . . . ." NFOA promised JN and other investors a profit – both in the form of increased monetary value and tax benefits, and often in greater amounts. *See* CX-103.

[165] *See also* CX-43, at 3, Emergency Cease and Desist Order, issued by the Texas State Securities Board (identifying NFOA Contracts as securities); CX-46, Cease and Desist Order, issued by the Alabama Securities Commission (identifying NFOA Contracts as securities).

receive in connection with the transaction.[166] Where a transaction could involve compensation to the associated person and the transaction is approved, the FINRA member firm must supervise the transaction as though it were executed on the firm's behalf.[167] If the firm does not approve a proposed transaction involving compensation, the associated person is prohibited from participating in any manner, directly or indirectly.[168]

NASD Rule 2110 requires the observance of "high standards of commercial honor and just and equitable principles of trade." It is well established that a violation of other NASD rules is inconsistent with the "high standards" required by NASD Rule 2110 and so constitutes a violation of that rule as well.[169]

Here, Rooney solicited JN's purchase of the NFOA Contract which, as described above, was a security. Rooney's participation in the NFOA Contract transaction included: (1) presenting and discussing the Explanatory Statement and 1099 Statement with JN; (2) providing JN with the NFOA Contract, the form to transfer ownership of his annuity, and the form authorizing the NFOA installment payments to be directly deposited into JN's checking account; (3) signing the NFOA Contract as JN's Financial Advisor; and (4) collecting and forwarding all the required documents to NFOA. Rooney admitted that he never provided Fox with written notice of his participation in the sale of NFOA

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[166] NASD Rule 3040.

[167] *Id.*

[168] *Id*.

[169] *See Thomas W. Heath, III*, Exchange Act Rel. No. 59223, 2009 SEC LEXIS 14 (Jan. 9, 2009), *aff'd*, 586 F.3d 122 (2d Cir. 2009), *cert. denied*, *Heath v. SEC*, 2010 U.S. LEXIS 3029 (U.S. Apr. 5, 2010); *see also CMG Inst. Trading, LLC*, No. 2006006890801, 2010 FINRA Discip. LEXIS 7, at *3 n.2 (N.A.C. May 3, 2010); *Dep't of Enforcement v. Trende*, No. 2007008935010, 2011 FINRA Discip. LEXIS 54, at *11 and nn.12 & 13 (O.H.O. Oct. 4, 2011).

securities. Based on the foregoing, the Hearing Panel finds that Rooney violated NASD Rules 3040 and 2110.[170]

C. Rooney Lacked a Reasonable Basis for Recommending the NFOA Contract to His Customer

NASD Rule 2310 requires a member recommending an investment to have reasonable grounds for believing that the investment is suitable for a customer. However, prior to making a customer-specific suitability determination, a registered representative must ensure that he has a reasonable basis for recommending the investment product to his client.[171] "A recommendation may lack 'reasonable-basis' suitability if the broker: (1) fails to understand the transaction, which can result from, among other things, a failure to conduct a reasonable investigation concerning the security; or (2) recommends a security that is not suitable for any investors."[172] When conducting a reasonable-basis suitability analysis, a registered representative "must perform appropriate due diligence to ensure that [he] understands the nature of the product, as well as the potential risks and rewards

[170] Rooney argues that JN's underlying annuity never transferred to NFOA and therefore the sale was never completed. However, NASD Rule 3040 speaks to "participation" in a securities transaction and Rooney's actions clearly statify that standard. *See Mark H. Love*, Admin. Proc. File No. 3-11164, 2004 SEC LEXIS 318, at *7 (2004) (participation language in Rule 3040 should be read broadly). Further, pursuant to Rule 3040, Rooney is obligated to provide written notice to his firm *prior* to his participation in a private securities transaction.

[171] *Dep't of Enforcement v. Cody*, No. 2005003188901, 2010 FINRA Discip. LEXIS 8, *19 (N.A.C. May 10, 2010), *aff'd*, 2011 SEC LEXIS 1862 (May 27, 2011) (citing *Michael Frederick Siegel*, Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459, at *28 (Oct. 6, 2008), *aff'd in relevant part*, 592 F.3d 147 (D.C. Cir. 2010)).

[172] *Dep't of Enforcement v. Siegel*, No. C05020055, 2007 NASD Discip. LEXIS 20, at *38 (N.A.C. May 11, 2007), *aff'd*, Exchange Act Rel. No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008), *aff'd in relevant part*, 592 F.3d 147 (D.C. Cir. 2010).

associated with the product."[173] A violation of NASD Rule 2310 is also a violation of Rule 2110.[174]

Rooney consulted with NFOA representatives about the features of their product, but he admitted that he took their representations at face value. He also admitted that he conducted no further inquiry to independently verify the information they provided. Although NFOA's status as a tax-exempt §501(c)(3) corporation and the promised tax deduction were important features of the NFOA Contracts, Rooney failed to check with the IRS to confirm that the organization was an approved charitable organization under §501(c)(3). He also failed to inquire about the financial viability of NFOA or its track record concerning sales of its NFOA Contracts. Rooney failed to inquire how investor funds were invested and if they were subject to market risk. He failed to inquire about the identity of the charitable organizations that NFOA purportedly supported, or the amount of funds allocated to those organizations. As noted above, much of this important information was readily available.

Rooney failed to conduct a reasonable investigation into NFOA and the NFOA Contracts. The Hearing Panel finds that Rooney recommended that JN purchase the NFOA Contract without having a reasonable basis for the recommendation, in violation of NASD Rules 2310 and 2110.

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[173] Notice to Members 03-71. The type of due diligence that is appropriate will vary from product to product. *Id*. Common features that members must understand include, but are not limited to, the following: (1) tax consequences of the product; and (2) principal, return, and interest rate risks and the factors that determine those risks. *Id*.

[174] *See Cody*, Admin. Proc. File No. 3-13932, 2011 SEC LEXIS 1862, at *26.

D. Rooney Misrepresented Material Information to His Customer When Soliciting the NFOA Contract Sale

Misrepresentations and omissions are inconsistent with just and equitable principles of trade and therefore violate NASD Rule 2110.[175] A registered representative owes such a duty to his clients to disclose material information fully and completely when recommending a transaction."[176] "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information."[177] A misrepresentation is material "if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available."[178]

Rooney represented to JN that NFOA was an approved tax-exempt organization and that he was entitled to a tax deduction in connection with his NFOA investment. Both statements were false. NFOA's tax-exempt status and the promised tax deduction, which were prominently advertised by NFOA, were material as they were key features of the NFOA Contracts. These features would also be significant factors for any reasonable investor in choosing to invest in NFOA. Although Rooney may not have known that his representations regarding these features were false, a rudimentary investigation would have uncovered it. Accordingly, the Hearing Panel finds that Rooney made negligent misrepresentations of material fact to JN, in violation of NASD Rule 2110.

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[175] *Dep't of Market Regulation v. Burch*, No. 2005000324301, 2009 FINRA Discip. LEXIS 21, at *18 (O.H.O. Jun. 2, 2009); *see also* NASD Rule 2110.

[176] *Dep't of Enforcement v. Frankfort*, No. C02040032, 2007 NASD Discip. LEXIS 16, at *19 (N.A.C. May 24, 2007) (citations omitted).

[177] *Dep't of Enforcement v. Meyers,* No. C3A040023, 2007 NASD Discip. LEXIS 4, at *20 (N.A.C. Jan. 23, 2007) (quoting *Basic v. Levinson,* 485 U.S. 224, 240 (1988)).

[178] *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *14 (2004) (footnote omitted); *Dep't of Enforcement v. Cipriano*, No. C07050029, 2007 NASD Discip. LEXIS 23 (N.A.C. July 26, 2007).

E. Rooney Presented His Customer with Misleading Sales Materials When Soliciting the NFOA Contract Sale

NASD Rule 2210(d) governs content standards in communications with the public. NASD Rule 2210(d)(1)(A) provides that "[a]ll member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communication to be misleading." NASD Rule 2210(d)(1)(B) provides that "[n]o member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public." That rule further provides that "[n]o member may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading."

Rooney presented the Explanatory Statement and 1099 Statement to JN in the course of soliciting the NFOA Contract. Both documents constitute sales literature.[179] The Explanatory Statement promised JN monthly installment payments over a 10-year non-deferred term. It indicated the purported total payout, income tax deduction, and total tax-free amount or tax savings available with the proposed investment. Similarly, the 1099 Statement detailed the number and amount of scheduled payments that JN would

[179] *See* NASD Rule 2210(a)(2) (defining sales literature as "[a]ny written or electronic communication . . . that is generally distributed or made generally available to customers or the public, including circulars, research reports, performance reports or summaries, form letters, telemarketing scripts, seminar texts, reprints (that are not independently prepared reprints) or excerpts of any other advertisement, sales literature or published article, and press releases concerning a member's products or services").

purportedly receive, the portion of the annual payment which was to be "reported as tax free," and the portion that could be reported as "ordinary income."

The information that NFOA provided investors was oversimplified, incomplete, and misleading. The Explanatory Statement failed to: (1) reflect that the total payout amount includes a return of principal; (2) describe the rate of return; or (3) explain how NFOA derived the tax figures. And, both the Explanatory Statement and the 1099 Statement created the false impression that part of JN's investment would be tax-free income. In fact, none of the investors' investment could be tax free.

The Hearing Panel finds that Rooney distributed misleading sales materials, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110.

F. Rooney Failed to Supervise Winters' Sales of NFOA Contracts

"Proper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and NASD rules" and "is a critical component to ensuring investor protection."[180] NASD Rule 3010 requires Rooney to establish a "system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules."[181] "In addition to an adequate supervisory system, the duty of supervision includes the responsibility to investigate red flags that suggest that misconduct may be occurring and to act upon the results of such investigation."[182] "Once indications of irregularity arise, supervisors must

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[180] *Dennis S. Kaminski*, Exchange Act Rel. No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011) (citations omitted).

[181] NASD Rule 3010(a).

[182] *Ronald Pellegrino*, Exchange Act Rel. No. 59125, 2008 SEC LEXIS 2843, at *32-33 (Dec. 19, 2008) (internal quotation marks and brackets omitted).

respond appropriately."[183] "The standard of 'reasonable' supervision is determined based on the particular circumstances of each case."[184] A violation of NASD Rule 3010 is also a violation of Rule 2110.[185]

Rooney failed to adequately supervise Winters' sales of NFOA Contracts by: (1) failing to ensure that Winters' NFOA sales, private securities transactions, were effected in compliance with NASD Rule 3040 and Fox's WSPs; (2) failing to conduct a compliance-related review of NFOA sales materials to determine if they could appropriately be used by Winters; and (3) failing to exercise adequate due diligence regarding NFOA and its contract product.

1. Rooney Failed to Comply with Written Notice Provisions of Rule 3040

During 2007, Rooney was one of two supervisory principals designated to approve written requests by Fox's registered representatives to engage in private securities transactions. He was also Fox's CCO and the supervisor for all registered representatives. Although Rooney discussed the NFOA Contracts and was aware that Winters was going to sell additional NFOA Contracts, he did not ensure that Winters provided Fox with written notice as required by NASD Rule 3040 and Fox's WSPs.

2. Rooney Failed to Adequately Supervise the Content and Dissemination of NFOA Sales and Advertising Materials

Fox's WSPs required Rooney, as the designated supervisory principal, to review and approve all advertising, sales literature, and other similar materials used by Fox's

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[183] *Id.*

[184] *Id.*; *see Christopher Benz*, 52 S.E.C. 1280, 1284 (1997) (citing *Consol. Inv. Servs., Inc.*, 52 S.E.C. 582 (1996).

[185] *Dep't of Enforcement v. Midas Sec*, *LLC*, No. 2005000075703, 2011 FINRA Discip. LEXIS 62, at *21-23 (N.A.C. Mar. 3, 2011).

registered representatives. The WSPs further prohibited advertising or sales materials that included: (1) omissions of material fact; (2) false, exaggerated, misleading or unwarranted statements; or (3) claims and promises of specific results.

The NFOA Brochure and Flyer violated NASD Rule 2210 because they contained information that was false and misleading, failed to present a fair and balanced view of the NFOA product, and lacked any disclosure that investor funds were subject to market risk. Although Rooney reviewed the NFOA Brochure and Flyer and was aware that they would be utilized in future sales of NFOA Contracts, he failed to ensure that the content complied with NASD rules governing sales and advertising materials. Further, there was no evidence that Rooney documented his approval of the NFOA Brochure and Flyer prior to their distribution to investors in connection with Winters' sales of NFOA Contracts as required by NASD Rule 2210.[186]

3. Rooney Failed to Conduct Adequate Due Diligence Regarding NFOA

Rooney was responsible for ensuring that due diligence was conducted with respect to products recommended by Fox's registered representatives.[187] With regard to the NFOA Contracts, Rooney's due diligence consisted of telephone conversations with NFOA representatives. He accepted NFOA's representations and did nothing to confirm their veracity.

As stated above, Rooney conducted no independent research on NFOA, its product, or its finances. He failed to inquire about the identities of the charitable organizations to which NFOA purportedly donated, or the percentage of investor funds

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[186] *See* NASD Rule 2210(b)(1).

[187] RX-36, at 50-51.

that NFOA would allocate to a charitable organization. Rooney never requested that NFOA provide him with an explanation of how future installment payments would be funded or guaranteed, or any supporting financial documentation. Similarly, Rooney made no attempt to contact the institution that NFOA identified in its sales materials as custodian of its funds. In sum, Rooney failed to ensure that Winters was selling a legitimate securities product to the investing public.

In light of the foregoing, the Hearing Panel finds that Rooney failed to supervise the sales of NFOA Contracts by Winters, in violation of NASD Rules 3010 and 2110.

G. Rooney Failed to Establish that the Charges Were Time-Barred

Section 15A(b)(8) of the Exchange Act requires FINRA disciplinary proceedings to be conducted fairly.[188] Rooney argued that this proceeding was unfair, in violation of Section 15A(b)(8), due to the lapse of time from the commencement of FINRA's investigation to the filing of the complaint.

In this instance it is unnecessary to assess Enforcement's diligence in conducting the investigation because, in order to sustain the defense, Rooney must show that the alleged delay resulted in substantial prejudice to his ability to mount a defense.[189] Rooney contended that he was prejudiced because the delay caused evidence to become unavailable. Specifically, Rooney pointed to the fact that, prior to the hearing, on

[188] *See Dep't of Enforcement v. Kaweske*, 2007 NASD Discip. LEXIS 5, at *38 (N.A.C. Feb. 12, 2007). *Mark H. Love*, Exchange Act Rel. No. 49248, 2004 SEC LEXIS 318, at *14 (Feb. 13, 2004). In his answer, Rooney also cited section 19(e)(1)(A) of the Securities Exchange Act of 1934. Section 19(e)(1)(A) relates to the standard for review by the SEC on appeals, and not to FINRA disciplinary hearings.

[189] *Kaweske*, 2007 NASD Discip. LEXIS 5, at *39. Although it is not necessary to reach the timeliness of Enforcement's investigation in this case, the Hearing Panel finds that Rooney has not demonstrated that there was any unfair delay in the filing of the complaint. In fact, Enforcement presented very credible evidence from its lead examiner outlining the thorough and methodical approach FINRA took when investigating the facts and circumstances that led to the filing of this complaint. *See generally* Tr. 548 through 583 (providing a detailed timeline of Enforcement's investigation through the filing of the complaint).

February 25, 2009, JN died. However, the death of a witness does not necessarily establish prejudice.[190]

Here, Rooney has not shown that the absence of JN's testimony is prejudicial to his defense. At the hearing, Rooney simply stated, "if [JN] were here today, I think things would be very different in this matter."[191] But, Rooney's generic statement is not sufficient to demonstrate actual prejudice. Further, none of the five charges against Rooney hinged on the testimony of JN. The private securities transaction charge related to Rooney's failure to notify his firm. The reasonable-basis suitability charge required a showing that Rooney either: (1) failed to understand the transaction; or (2) recommended a security that was not suitable for any investors. Regarding the negligent misrepresentation charge, Rooney admitted that he told JN that NFOA was a §501(c)(3) tax-exempt organization and that JN would obtain a tax deduction in connection with his NFOA investment. The misleading sales materials charge related to the NFOA sales materials, not any testimony of JN. Lastly, the supervisory charge related to Rooney's supervision of Winters' NFOA-related activities.

Accordingly, the Hearing Panel determines that Rooney failed to establish that the proceeding is unfair due to any alleged delay from the commencement of FINRA's investigation to the filing of the complaint.

IV. SANCTIONS

A. Private Securities Transaction

The FINRA Sanction Guidelines ("Guidelines") for selling away (private securities transactions) suggest consideration of a number of factors and recommend a

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[190] *U.S. v. Campbell*, 2005 U.S. Dist. LEXIS 47046, at *14 (N.D. Ga. Oct. 24, 2005).

[191] Tr. 435.

range of sanctions for violations of NASD Rules 3040 and 2110. The first step in determining sanctions is to assess the extent of the selling away, including (among other considerations) the dollar amount of sales. Where the amount of sales is less than $100,000, as it is here, an adjudicator is to consider a suspension of up to three months.[192]

The second step is to examine the Principal Considerations for this type of violation.[193] Here, Rooney sold the NFOA Contract directly to JN, a Fox customer. As noted above, NFOA's president was found guilty of fraud in connection with the sale of these contracts. Although JN did not end up exchanging his annuity for an NFOA Contract, that was fortuitous because, in this instance, Rooney had taken every necessary step to complete the sale. The only reason the sale was not completed was because the insurance company that held JN's annuity had concerns about the NFOA Contract. As the NFOA receiver testified, but for any monies he could recoup through the liquidation of NFOA, investors in NFOA lost their investment. Moreover, while there is no suggestion that Rooney had a proprietary interest in the NFOA product he sold, he did expect to receive a commission for his sale to JN.

The third step is to review the General Principles applicable to all violations.[194] General Principle No. 1 requires that a sanction should be designed to deter future misconduct and improve overall business standards in the securities industry.[195] In this case, Rooney, the CCO of Fox, ignored the requirements of NASD Rule 3040 and Fox's WSPs. Although Rooney testified that he did not believe the NFOA Contracts were

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[192] FINRA Sanction Guidelines at 14-15 (2013), available at www.finra.org/sanctionguidelines.

[193] *Id.*

[194] *Id.*

[195] *Id.* at 2.

securities, he did not notify Fox of his NFOA-related activities in any manner, a necessary step for an outside business activity. Instead, he sold the product, without conducting any due diligence, expecting to receive a commission. This violation is egregious, and it is important that Rooney and others are deterred from such misconduct in the future in order to protect the investing public.

After careful consideration, the Hearing Panel determines that the appropriate remedial sanction is a $10,000 fine and a three-month suspension from associating with any FINRA member firm in any capacity. Rooney's misconduct demonstrates that he was unfamiliar with the requirements of NASD Rule 3040. Accordingly, the Hearing Panel requires Rooney to requalify by examination as a General Securities Representative.

B. Reasonable-Basis Suitability

For making a recommendation without a reasonable basis in violation of NASD Rules 2310 and 2110, the Guidelines recommend a fine of between $2,500 and $75,000, and a suspension of between 10 business days and one year. In egregious cases, an adjudicator should consider a suspension of up to two years or a bar.[196]

Here, other than accepting NFOA's representations, Rooney took no steps to learn about NFOA and its contract product. He had no understanding of the potential risks and rewards inherent in the NFOA Contracts. Therefore, he could not determine whether the securities were suitable for any person, let alone JN, who, according to Rooney, relied on him for everything as a result of his poor health. Rooney's failure to conduct a reasonable investigation with respect to the NFOA Contracts was egregious. The Hearing Panel determines that Rooney should be fined $25,000 and suspended from associating with

[196] *Id*. at 94.

any FINRA-registered firm in any capacity for 18 months. Because he clearly failed to appreciate his responsibilities prior to selling this security product, the Hearing Panel determines that it is necessary for Rooney to requalify by examination as a General Securities Representative.

C. Misrepresentation

For negligent misrepresentations or omissions in violation of NASD Rule 2110, the Guidelines recommend a fine of $2,500 to $50,000 and a suspension of up to 30 business days.[197] Rooney acknowledged that he told JN that (1) NFOA was an approved tax-exempt organization, and (2) he would receive a tax deduction in connection with his NFOA investment. A simple Internet search would have revealed that these representations were false. However, instead of conducting any independent research, he blindly accepted NFOA's representations. The Hearing Panel finds that Rooney's misconduct was egregious and warrants a $10,000 fine and a one-month suspension from associating with any member firm in all capacities.[198]

D. Misleading Sales Materials

For violations of NASD Rules 2210 and 2110 involving the intentional or reckless use of misleading communications, the Guidelines suggest a fine ranging from $10,000 to $100,000 and a suspension of the responsible person in any or all capacities for up to two years.[199] Although Rooney did not circulate the NFOA sales materials widely, the Hearing Panel finds Rooney's misconduct to be serious for several reasons. First, Rooney

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[197] *Id.* at 88.

[198] *Cf. Dep't of Enforcement v. Kelsey*, No. C8A020088, 2004 NASD Discip. LEXIS 48, at *26-28 (O.H.O. June 29, 2004) (imposing 60-day suspension in all capacities for making negligent and misleading misrepresentations about terms of certain variable universal life insurance policies).

[199] Sanction Guidelines at 80.

failed to detect any problems with the NFOA sales materials and simply provided the misleading sales materials to JN. Second, he was unaware that they constituted sales materials, and thus did not take any steps to approve them. Third, he did not believe that Fox had ever used sales materials and was uncertain whether its WSPs even addressed sales materials. Rooney was clearly reckless in his use of the NFOA sales materials. In light of the foregoing, the Hearing Panel determines that the appropriate remedial sanction is a $5,000 fine, a two-month suspension, and a requirement to requalify as a General Securities Representative.

E. Supervisory Violations

For violations of NASD Rules 3010 and 2110, the Guidelines suggest the imposition of a fine ranging from $5,000 to $50,000 and a suspension of up to 30 business days in all supervisory capacities.[200] In egregious cases, the Guidelines suggest suspending the responsible individual in any or all capacities for up to two years or a bar.[201] The Guidelines identify three specific considerations for failure to supervise: (i) whether Rooney ignored "red flags"; (ii) the nature, size, extent, and character of the underlying misconduct; and (iii) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and control.[202]

Rooney failed to supervise Winters' sales of NFOA Contracts in three areas. First, although he was aware that Winters would be selling additional NFOA Contracts and would presumably be receiving a commission as he had for his first NFOA Contract sale, Rooney did nothing to ensure that Winters complied with NASD Rule 3040 and Fox's

[200] *Id*. at 103.

[201] *Id.*

[202] *See id.*

WSPs. Second, although he received the NFOA sales materials from Winters and reviewed them, he failed to ensure that they complied with NASD Rule 2210 and Fox's WSPs. In so doing, he allowed misleading information to be presented to Winters' customers. Lastly, even though Rooney was tasked with supervising all registered representatives and ensuring that adequate due diligence was conducted on any product they sold, he permitted Winters to sell two additional NFOA Contracts without testing any of the assertions made by NFOA. Rooney's inaction coupled with NFOA's fraudulent activity put Winters' customers' investments at risk.

"It is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention."[203] As Fox's president, CCO, branch manager, supervisor of the registered representatives, and designated principal for approving private securities transactions and sales materials, Rooney was in a position of authority. Nonetheless, he ignored the "red flags," such as the misleading NFOA sales materials.

At the time of this misconduct, Rooney had been in the securities industry for almost 20 years. He became registered as a General Securities Principal in 1990.[204] "[T]he registration requirements are intended to ensure that principals 'maintain the requisite levels of knowledge and competence.'"[205] The SEC has stressed that a principal registration comes with certain important responsibilities.

> NASD's registration requirement "provides an important safeguard in protecting public investors," and "strict adherence" to that requirement is "essential" because it "serves a significant purpose in the policing of the securities markets" and in the protection of the public interest . . . . As we

[203] *Kaminski*, 2011 SEC LEXIS 3225, at *25-26.

[204] Stip. ¶ 3.

[205] *Hans N. Beerbaum*, Exchange Act Rel. No. 55731, 2007 SEC LEXIS 971, at *14 n.17 (May 9, 2007).

> also have observed, the "registered principal is the person at a broker-dealer to whom the NASD looks to ensure compliance with regulatory requirements."[206]

Although Rooney was Fox's CCO, he was unfamiliar with, or ignored, Fox's WSPs and the requirements in the NASD rules. The Hearing Panel finds that Rooney abdicated his supervisory responsibilities.

After careful consideration, the Hearing Panel finds that the appropriate remedial sanction is a $25,000 fine, an 18-month suspension from associating with any member firm in any supervisory capacity, and a requirement to requalify as a General Securities Principal.

V. ORDER

Based on careful consideration of all the evidence, the Hearing Panel imposes the following sanctions:[207]

For engaging in a private securities transaction, in violation of NASD Rules 3040 and 2110, Rooney is: (1) fined $10,000; (2) suspended for three months from associating with any member firm in any capacity; and (3) required to requalify as a General Securities Representative before acting in any capacity requiring that qualification.

For recommending a security to a customer without a reasonable basis for suitability, in violation of NASD Rules 2310 and 2110, Rooney is: (1) fined $25,000; (2) suspended for 18 months from associating with any member firm in any capacity; and (3) required to requalify as a General Securities Representative before acting in any capacity requiring that qualification.

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[206] *Id*. at *14.

[207] The Hearing Panel considered all of the parties' arguments. They are rejected or sustained to the extent that they are inconsistent with the views expressed herein.

For misrepresenting material information when recommending a security to his customer, in violation of NASD Rule 2110, Rooney is fined $10,000 and suspended for one month from associating with any member firm in any capacity.

For presenting misleading sales materials to his customer in connection with the sale of a security, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110, Rooney is: (1) fined $5,000; (2) suspended for two months from associating with any member firm in any capacity; and (3) required to requalify as a General Securities Representative before acting in any capacity requiring that qualification. Each of the above suspensions in all capacities, totaling two years, shall run consecutively.

For failing to supervise a registered representative and his sales of private securities, in violation of NASD Rules 3010 and 2110, Rooney is: (1) fined $25,000; (2) suspended for 18 months from associating with any member firm in any supervisory capacity; and (3) required to requalify as a General Securities Principal before acting in any capacity requiring that qualification. This 18-month suspension in all supervisory capacities shall run concurrently with the above all-capacities suspensions that total two years.

In addition, Rooney is ordered to pay the costs of this proceeding in the amount of $5,865.21, which includes an administrative fee of $750 and hearing transcript costs of $5,115.21.

These sanctions shall become effective on a date set by FINRA, but not earlier than 30 days after this Decision becomes the final disciplinary action of FINRA. However, if this Decision becomes the final disciplinary action of FINRA, the suspensions shall commence with the opening of business on October 6, 2014. The

supervisory suspension shall end at the close of business on April 5, 2016, and the all-capacities suspensions shall end at the close of business on October 5, 2016.

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Maureen A. Delaney
Hearing Officer
For the Extended Hearing Panel

Copies to:

James E. Rooney (via first-class mail and overnight courier)
Daniel E. Tapia, Esq. (via email and first-class mail)
Susan Light, Esq. (via email and first-class mail)
Josefina Martinez, Esq. (via email)
Tiffany A. Buxton, Esq. (via email)
Kevin E. Pogue, Esq. (via email)
Jeffrey D. Pariser, Esq. (via email)