FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS[1]

DEPARTMENT OF ENFORCEMENT, Complainant, v. STONEGATE PARTNERS, LLC (CRD No. 43034), and BRIAN W. BERNIER (CRD No. 1298285), Respondents.	Disciplinary Proceeding No. E112005002003 Hearing Officer—DMF **HEARING PANEL DECISION** May 15, 2008

Summary

Respondents (1) violated Rule 2110 by providing misleading information to FINRA in connection with an examination of Respondent firm, and (2) violated Rules 3010 and 2110 by failing to maintain and enforce an adequate supervisory system and written procedures relating to the collection and retention of suitability information and by failing to preserve written reports of annual internal inspections. For these violations, Respondent Bernier is suspended in all principal capacities for one year and ordered to re-qualify as a principal, and Respondents are fined $25,000, jointly and severally. In addition, Respondent firm violated Rules 3011 and 2110 by failing to develop and implement an Anti-Money Laundering program in a timely manner. For this violation, Respondent firm is fined an additional $10,000. In addition, Respondents are ordered to pay costs.

Appearances

Paul D. Taberner, Esq., Boston, MA, and Gregory R. Firehock, Esq., Washington, D.C., for the Department of Enforcement

Robert B. Lovett, Esq., Cooley Godward Kronish LLP, Boston, MA, for Respondents

[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD.

DECISION

I. Introduction

On March 20, 2007, the Department of Enforcement filed a three-cause complaint against Respondents StoneGate Partners, LLC, and Brian W. Bernier, StoneGate's Managing Director, charging that (1) Respondents violated Rule 2110 by providing false and misleading information to a FINRA examiner in connection with a routine examination of the firm; (2) Respondents violated Rules 3010 and 2110 by failing to establish, maintain and enforce an adequate supervisory system and written procedures, and by failing to preserve written reports of annual internal inspections; and (3) StoneGate violated Rules 3011 and 2110 by failing to develop and implement an Anti-Money Laundering (AML) program. Respondents contested the charges and requested a hearing, which was held on December 12 and 13, 2007. The parties subsequently filed post-hearing briefs and reply briefs.

II. Respondents

StoneGate has been a FINRA member since 1997. At the time of the hearing StoneGate had just seven employees – four registered representatives, a vice president for operations, a compliance officer, and Respondent Bernier, its Managing Director. StoneGate's business has been limited to the sale of unregistered private placements to accredited investors, pursuant to Regulation D,[2] except that during a portion of the period at issue in this case, the firm also sold interests in registered private real estate investment trusts to its customers. (Tr. 140, 165-67, 292-93; CX-1, CX-3 at 2.)[3]

[2] Regulation D, promulgated by the SEC pursuant to the Securities Act of 1933, provides exemptions from the Securities Act's registration requirements, which may allow smaller companies to offer and sell their securities to "accredited investors" without having to register the securities with the SEC. Accredited investors include individuals who have a net worth, or a joint net worth with a spouse, of more than $1 million at the time of purchase, and individuals with income exceeding $200,000, or joint income with a spouse exceeding $300,000, in each of the two preceding years and a reasonable expectation of the same income level in the current year.

[3] In this Decision, "Tr." refers to the transcript of the hearing, "CX" refers to Complainant's Exhibits, and "RX" refers to Respondents' Exhibits.

Bernier is registered as a general securities representative and general securities principal. At all relevant times, he functioned as StoneGate's only principal, and was responsible for all compliance and supervision areas, including the firm's written supervisory procedures (WSPs), AML procedures, and overall operations. Bernier has approximately a one-third ownership interest in StoneGate, with the balance held by approximately 60 investors. (Tr. 29-31, 140, 169, 181, 186, 298-304; CX-2, CX-3 at 17, CX-5.)

III. Facts

A. Supervisory Procedures

Rule 3010(a) requires FINRA member firms to "establish and maintain a system to supervise the activities of each registered representative … that is reasonably designed to achieve compliance with … applicable … Rules," and Rule 3010(b) requires each member to "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives … that are reasonably designed to achieve compliance with … applicable Rules …." Applicable rules include Rule 2310(a), which provides that "[i]n recommending to a customer the purchase … of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer …," and Rule 2310(b), which provides that "[p]rior to the execution of a transaction recommended to a non-institutional customer … a member shall make reasonable efforts to obtain information concerning," inter alia, the customer's financial status, tax status and investment objectives.

In January 2002, the SEC sent StoneGate a letter listing deficiencies identified by the SEC in a 2001 examination of the firm. Among the deficiencies noted by the SEC was "that StoneGate, prior to its recommendations to customers to invest in … private offerings, had not made a reasonable effort to obtain information concerning the customers' financial status, and/or

their investment objectives, in violation of NASD Conduct Rule 2310 – Recommendations to Customers (Suitability)." (CX 13 at 3.)

In a February 2002, Bernier, on behalf of StoneGate, responded to the SEC, asserting that StoneGate had "actual knowledge of the financial status and/or investment objectives of all the participants in StoneGate's private equity offerings," but advising that "to better document the suitability screening process" the firm had revised its supervisory procedures in two respects. First, Bernier represented that the firm would collect suitability information from each customer, and record the information in a "Confidential Investor Questionnaire" that would be "reviewed by StoneGate prior to a registered representative being authorized to make a recommendation to such customer." Second, Bernier represented that "before sending out materials relating to a particular offering, a registered representative [would be required to] complete a 'Transaction Send Sheet' indicating that information is on file with respect to the customer to whom the information is sent." Bernier attached examples of the Questionnaire and the Send Sheet (referred to collectively in this Decision as the "Suitability Forms") to the response. (CX-14; Tr. 228-29.)

The Questionnaire called for the customer's name, address, and social security number or federal tax I.D., as well as the customer's business affiliation, educational level, net worth, liquidity, income, tax rate, and investment objectives, and required the signatures of the person who entered the information (the customer or a StoneGate representative, based on information provided by the customer), and the supervisor who reviewed the data. In each case, Bernier would be the reviewer, because he was the firm's only supervisor. (CX 14 at 6-8; Tr. 233-34.)

The Send Sheet required the representative to confirm that StoneGate had the customer's suitability information on file, enter a limited amount of that information on the Send Sheet, indicate the nature of the customer's relationship with StoneGate, and obtain a sign-off from a

supervisor, before sending a customer any information regarding an offering. Again, by default, Bernier would be the approving supervisor. (CX-14 at 4; Tr. 232-33.)

In keeping with the letter to the SEC, StoneGate's WSPs for 2002 required the firm and its representatives to use the Suitability Forms. But all references to the Suitability Forms were deleted from the firm's 2003 and 2004 WSPs, which simply directed registered representatives to "be sure that such transaction [sic] are completely compatible with the individual client's particular investment objectives, financial resources, age and sophistication before accepting the transaction." Neither the 2003 nor the 2004 WSPs required that StoneGate collect or record specific suitability information through the Questionnaire or any alternative procedure, or that representatives confirm that the firm had suitability information from each customer, through a Send Sheet or any alternative procedure, before recommending a new offering to the customer. Although Bernier testified that he did not authorize the deletion of the requirement for use of the Suitability Forms from the WSPs, and was unaware that it had occurred, he acknowledged that he bore responsibility for the firm's WSPs. (CX-6 at 17, CX-7 at 17, CX-8 at 18: Tr. 56, 161-64, 245-47, 324.)

Bernier testified that StoneGate used the Suitability Forms until early 2003, but then stopped using them, at least on a consistent basis. Bernier was aware that StoneGate was no longer using the Suitability Forms, because he was no longer approving them, or completing them for his own customers. StoneGate did not resume using the Suitability Forms consistently until after its failure to use them was cited as a deficiency by FINRA in the 2005 examination that led to this proceeding. During this "lapse" period, StoneGate took on approximately 50 new clients. There was, however, no allegation or evidence that StoneGate recommended any unsuitable investment to any customer. (Tr. 51-52, 108, 133-34, 141, 160-61, 166, 257-58, 266, 344; CX-21; RX-2 at 32 (OTR Tr. 120).)

B. AML Procedures

Pursuant to Rule 3011, by April 24, 2002, all FINRA member firms were required to "develop and implement a written [AML] program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act … and the implementing regulations promulgated thereunder by the Department of the Treasury."[4] Rule 3011 lays out minimum requirements for AML programs, and provides: "Each member's [AML] program must be approved, in writing, by a member of senior management." Once again, by default, this would have to be Bernier. (Tr. 186.)

FINRA took a variety of steps to ensure that member firms knew of, and had the ability to comply with, their AML program obligations, both before and after the rule came into effect.[5] But, although Bernier testified that he saw notices from FINRA, StoneGate did not develop or implement an AML program by April 24, 2002. Bernier testified that in January 2005 StoneGate's attorney advised him that StoneGate was required to have an AML program, but he took no steps to develop and implement an AML program prior to being notified of an upcoming FINRA examination, as described below. As Bernier testified, "I had been delinquent up to that point, in terms of putting [an AML program] in place." StoneGate eventually implemented an AML program in October 2005. (Tr. 72, 119, 187-88, 194.)

C. FINRA's 2005 Examination of StoneGate

On March 7, 2005, a FINRA examiner called Bernier to notify him that she would arrive at StoneGate's offices on March 21 to begin a routine FINRA examination of the firm.[6] She advised him that before the examination began she would send him a list of documents that she

[4] Rule 3011. The requirement that broker-dealers adopt AML programs was imposed by federal law, pursuant to Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001) ("USA PATRIOT Act").

[5] See Notice to Members 02-21, Notice to Members 03-34.

[6] At the time, the SEC prohibited FINRA examiners from giving a firm more that two weeks advance notice of a routine examination. (Tr. 23-24.)

would need, but she alerted him to three standard categories of documents, required for every examination, so he could begin gathering them: (1) financial records for the prior three months, (2) the firm's WSPs, and (3) the firm's AML procedures. Although Bernier knew that StoneGate did not have any AML procedures in place, he did not disclose that to the examiner.[7] (Tr. 24-25, 64, 143-44.)

Bernier testified that after he spoke to the examiner on March 7, he began gathering the documents that the examiner had told him she would need, with the assistance of MS (his wife) and JH, both of whom were unregistered, temporary employees, and BC, a consultant. These included WSPs dated March 25, 2002, December 1, 2003, and December 1, 2004. The documents they gathered were placed on a table in the firm's conference room. Bernier reviewed the WSPs, but failed to note that the 2003 and 2004 WSPs did not contain provisions requiring the use of the Suitability Forms. (Tr. 145-46, 246-47.)

Bernier was away on a previously-planned vacation with his wife and family from March 11 until Saturday, March 19. On Friday, March 18, while he was away, the examiner sent him an email again notifying him that the examination would begin on March 21. The email included a link to a Records Request List describing the various categories of documents the examiner would need for the examination. As the examiner had previously advised, the request specifically asked for financial records for the preceding three months, the firm's WSPs from July 2001 to the date of the exam, and the firm's AML procedures, as well as documents relating to independent testing of the AML program, which is required by Rule 3011. (Tr. 32-33, 144; CX-4; RX-7.)

[7] Bernier testified that during the March 7 call he might have told the examiner that StoneGate did not have AML procedures. (Tr. 315-17.) But this testimony was both tentative and not credible, because it was inconsistent with the examiner's later actions. The examiner testified credibly that during the examination she never received an indication that the firm had no AML program; if she had, she would have noted that immediately as a deficiency, and would not have reviewed the AML procedures the firm gave her. (Tr. 64, 119-21.)

Knowing that StoneGate had not adopted AML procedures, before he left on vacation Bernier directed JH to obtain AML materials from StoneGate's attorney. His first day back in the office was Monday, March 21, the day the examination began, and he reviewed additional documents JH had collected while he was away. He testified that he did not ask JH whether she had received AML materials from the firm's attorney, but assumed she had, and had provided them to the examiner. But, although he reviewed the other documents StoneGate provided to the examiner, he did not review the AML procedures that JH had obtained. (Tr. 146, 148-50, 317, 325-26.)

In fact, JH had received an email from StoneGate's attorney on March 18. Attached to the email were AML procedures that, according to the email, the attorney had prepared for another broker-dealer client in 2002. The attorney explained that the procedures had not been updated to reflect any changes in the relevant law, but that "they should be generally sound." Some time between the receipt of the email on March 18 and March 21, someone printed the AML procedures attached to the attorney's email, and attached them to the copies of StoneGate's 2003 and 2004 WSPs (but not the 2002 WSPs) provided to the examiner. In addition, someone (presumably the same person) made several revisions to the text of the 2003 and 2004 WSPs provided to the examiner (but not the 2002 WSPs) that suggested, falsely, that StoneGate had an AML program in place during those years. Bernier testified that he did not direct, authorize or know of any of this; he does not know who did these things, but assumes it must have been JH, acting on her own.[8] He did not review the WSPs after he returned from his vacation, and therefore was unaware that the AML procedures were attached to the 2003 and 2004 WSPs. (Tr. 40-43, 146-47, 192, 196-97, 319-20; CX-6, CX-7, CX-8; RX 6.)

[8] Bernier testified that when he tried to contact JH after the Complaint was filed, she would not speak to him. (Tr. 159-60.)

On the morning of March 21, the examiner and Bernier sat in the firm's conference room with the documents that had been collected and reviewed the Records Request List. Bernier pointed out some categories of requested documents, such as "Expense Agreements," that were not applicable to StoneGate. He also indicated that he did not believe the firm was required to have a business continuity plan, another category of documents listed in the Records Request List, but the examiner explained that StoneGate was required to have such a plan, and provided a standard FINRA template to help the firm craft an appropriate plan. Although Bernier knew that StoneGate had not adopted or implemented any AML procedures, once again he did not disclose that to the examiner.[9] (Tr. 35-38, 87-88, 148-49, 190-91.)

During the on-site portion of the examination the week of March 21, the examiner noted in her file that she had received the WSPs and attached AML procedures, but she did not review the AML procedures in detail. When she held an initial exit conference with Bernier and MS on April 25, 2005, she listed the AML procedures as an "open item" on the memorandum that Bernier signed on behalf of StoneGate, because she had not yet reviewed them. Later she began her review of the AML procedures and noted that they listed a person who was not, and never had been, associated with StoneGate as the designated principal responsible for monitoring the firm's compliance with the procedures. Concerned, she called Bernier, who told her that the document "was a template and it just hadn't been tailored to StoneGate." Bernier also told her that the firm had not done the annual independent testing of the program, as required by Rule 3011(c). But he did not disclose that StoneGate had never approved or implemented the procedures she was reviewing, much less that, since receiving the procedures from its attorney on March 18, StoneGate had done nothing to develop or implement an AML program. As a

[9] As with the March 7 telephone call, Bernier testified he did not "recall if I mentioned anti-money laundering specifically or not" during his March 21 review of the Records Request List with the examiner (Tr. 191), but once again, the Panel found that the examiner's subsequent actions confirmed that Bernier did not disclose that the firm did not have an AML program.

result, the examiner continued her review of the AML procedures attached to the WSPs. (Tr. 34, 59-67, 93-97, 102, 106, 153; CX-4, CX-15.)

In the memorandum for the final exit conference on September 7, 2005, the examiner listed several deficiencies in the AML procedures, including that they had not been approved in writing by senior management, were not specifically designed for StoneGate, and named a person not associated with StoneGate as the designated compliance principal. The examiner also noted that, "as of 3/20/2005, no independent testing of the firm's [AML] Compliance Program had been conducted." Although she found these deficiencies in the AML procedures, she believed that the firm had been following them since 2003, and did not realize the firm had no AML procedures in place. Even though Bernier was aware that the AML procedures the examiner was addressing had never been adopted or implemented by the firm, it did not occur to him to disclose that to the examiner during the final exit conference. (Tr. 67-69, 110-11, 119-21, 223; CX 16 at 4.)

On September 15, in a letter signed by Bernier, the firm responded to the final exit conference, stating with regard to the AML deficiencies:

> We agree that [StoneGate's] AML policy and compliance program was insufficient. …
>
> [W]e recognize that [StoneGate] did not have an approved AML procedure in place. Our counsel had advised [us] prior to the Exam that we had an obligation to adopt an AML. We received a template from our counsel's office to be used as a guideline in developing our own AML procedure that would reflect the nature of [StoneGate's] business. By insufficient review of the template received, we did not realize that it had not been customized to [StoneGate's] particular operations, practices and personnel. We further compounded our lapse by forwarding this "template" AML with insufficient review and sign-off by me. …
>
> We are in the process of revising the AML template previously provided to you. We will have the revised document reviewed by counsel and we anticipate it will be fully implemented within 30 days.

(CX 17 at 4.)

This response failed clearly to disclose that: (1) StoneGate had never implemented any AML program; (2) the firm's counsel had advised Bernier of the need to have an AML program in January 2005; (3) the firm had received the "template" on March 18, 2005, just before the examination began; and (4) Bernier had conducted no review of the AML procedures before they were provided to the examiner.

The examiner, finding statements in the letter ambiguous, sent Bernier an email on September 19, asking, "When did you receive the template? Was it a matter of not having time before the exam to tailor the template specifically to StoneGate?" (Tr. 70-72, 124-28; CX 18.)

Later the same day, Bernier responded:

> We had discussions with counsel regarding an AML procedure in early 2005, January to the best of my recollection …. We received an electronic version of the template from our attorney on March 18, 2005 via email. This timing was very close to the Exam, and we were making an effort to provide a written policy statement in conjunction with the Exam. There was clearly insufficient review and sign-off before providing this template to you. It is my belief that both the timing relative to the Exam and the fact that StoneGate does not have any customer accounts nor ever take possession of any funds contributed to the lack of immediate attention to review this policy.

(CX 19 at 1.)

The examiner testified that it was not until she received this email that she realized that StoneGate had never implemented the AML procedures. (Tr. 72.)

IV. Discussion

A. Respondents violated Rules 3010 and 2110 by failing to maintain and enforce an adequate supervisory system and written procedures relating to the collection and retention of suitability information, and by failing to preserve written reports of internal inspections.

1. Collection and retention of suitability information

In response to the SEC's 2001 examination, StoneGate established a specific supervisory system to ensure that the firm and its registered representatives complied with the suitability requirements imposed by Rule 2310, and written procedures to implement the system. Rule

3010 requires, however, that supervisory systems be maintained and written procedures enforced, not merely that they be established. When StoneGate stopped using the Suitability Forms consistently, without establishing any alternative supervisory system, it violated Rule 3010, because it did not "maintain a supervisory system" that was "reasonably designed" to ensure that the firm and its associated persons complied with the suitability obligations imposed by Rule 2310. Similarly, when StoneGate deleted all references to the Suitability Forms from its WSPs, without substituting any alternative written procedures, it violated Rule 3010(b), because it did not "maintain, and enforce written procedures" that were "reasonably designed" to ensure compliance with the requirements of Rule 2310.[10] Bernier was responsible for these violations because he was effectively the president of the firm, as well as the only functional principal and supervisor.[11]

Bernier testified that he was not "consciously ignoring" StoneGate's failure to utilize the Suitability Forms, and that the references to them were removed from the WSPs without his knowledge or approval. But Bernier must have known he was no longer approving Suitability Forms, and he admits he was not using them even for his own customers. He also admitted he

[10] "Whether a particular supervisory system or set of written procedures is in fact 'reasonably designed to achieve compliance' depends on the facts and circumstances of each case." Richard F. Kresge, Exchange Act Rel. No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007). Here, however, when it failed to utilize the Suitability Forms, and deleted reference to them from its WSPs, StoneGate was left with no supervisory systems or written procedures regarding suitability, apart from the purely hortatory direction to its representatives to "be sure that such transaction [sic] are completely compatible with the individual client's particular investment objectives, financial resources, age and sophistication before accepting the transaction." (CX-7 at 17.) In that regard, the Panel notes that because StoneGate's business was limited to private placements and real estate investment trusts, it did not establish accounts for its customers, and accordingly did not collect the suitability information that firms normally gather through account-opening documents. Furthermore, StoneGate did not maintain any central customer files, in which suitability information could be documented and retained, but rather organized its files by offering, with individual files for each customer who participated in the offering. (Tr. 46-47.)

[11] The SEC has held that the president of a broker-dealer is responsible for the firm's compliance "with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his or her duties." Richard F. Kresge, 2007 SEC LEXIS 1407, at *29. Bernier acknowledged his responsibility for ensuring StoneGate's compliance with regulatory requirements, for creating and maintaining the firm's WSPs, and for ensuring that StoneGate's recommendations were suitable. (Tr. 169, 225.)

was responsible for the WSPs, and testified that he reviewed them without noting the deletion of the references to the Suitability Forms.[12]

Bernier also testified that even when StoneGate was not using the Suitability Forms, StoneGate's representatives still assured themselves that the investments they recommended were suitable for their customers. (Tr. 261.) But StoneGate had no supervisory system and no written procedures, as required by Rule 3010, to guide the representatives, or to allow supervisors or regulators to confirm that required suitability information was gathered and applied by the representatives when making recommendations to the firm's customers.

Bernier also testified that he believed the subscription agreement forms that private placement offerors used to collect information from the customers to establish that they were accredited investors were adequate substitutes for the Suitability Forms. (Tr. 258.) But a determination that a customer is an accredited investor, and therefore eligible to purchase a Regulation D private placement, is not equivalent to a determination that the particular investment is suitable for that customer. The suitability determination requires a separate consideration of the individual customer's circumstances, taking into consideration information beyond that required to establish that the customer is an accredited investor. The Suitability Forms captured the information required to make a suitability determination; the subscription agreement forms in the record generally did not. (CX-9 through CX-12; RX-3 through RX-5.)

Moreover, Bernier testified that StoneGate stopped using the Suitability Forms when it began selling registered private real estate investment trusts, which could be sold to non-

[12] Bernier testified that a turnover in administrative support personnel, whom he viewed as "quarterbacking" the process, contributed to the firm's failure to use the Suitability Forms, but acknowledged that the registered representatives were responsible for completing the Forms and he was responsible for approving them. (Tr. 237-41.) He also speculated that the references to the use of the Suitability Forms may have been dropped from the 2003 and 2004 WSPs because BC, a consultant who was registered with a different firm, created a page referring to the Suitability Forms and inserted it in the 2002 WSPs, but forgot to insert it in the 2003 and 2004 WSPs. But Bernier had not confirmed, or even discussed, his speculation with BC, and, in any event, Bernier, not BC, was responsible for the WSPs. (Tr. 323-24.)

accredited investors. (Tr. 166.) But StoneGate's representatives had the same suitability obligations when recommending registered real estate investment trusts to customers as they did when recommending private placements, yet when doing so they did not have even the limited information collected in private placement subscription agreements. As a result, it was more important, not less, for StoneGate to use the Suitability Forms to collect information from customers when recommending registered real estate investment trusts.

Finally, Bernier testified that StoneGate's customers are generally very high net worth individuals whose average net worth, he estimated, is $20 million. Even assuming that is correct, the same suitability rules applied to StoneGate's recommendations to those customers as to customers of more modest means, and StoneGate had the same obligation to have supervisory systems and written procedures that would reasonably ensure compliance with those rules.

Accordingly, the Panel found that Respondents violated Rule 3010, and by violating that rule also violated Rule 2110.[13]

2. Written Reports of Internal Inspections

Rule 3010(c) requires each member to conduct an annual review that is "reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable NASD rules." The rule also requires members to retain a written record of the dates of the reviews. Bernier represented that StoneGate conducted the required reviews, but admitted that it did not retain any written record of them. Bernier was responsible for StoneGate's failure.

Therefore, Respondents violated Rules 3010(c) and 2110.

[13] "It is well settled that a violation of a rule promulgated by the Commission or by NASD also violates Conduct Rule 2110." Richard F. Kresge, 2007 SEC LEXIS 1407, at *42.

B. StoneGate Violated Rules 3011 and 2110 by Failing to Develop, Adopt, and Implement an AML Program

StoneGate was required to develop and implement an AML program, approved in writing by Bernier, by April 24, 2002. It is undisputed that the firm failed to begin to develop an AML program until 2005, and did not implement an AML program until October 2005.

Accordingly, the Panel found that StoneGate violated Rule 3011, and by violating that rule also violated Rule 2110. Bernier was not charged with this violation.

C. Respondents Violated Rule 2110 by Providing Misleading Information to FINRA Staff in Connection with a FINRA Examination.

Providing false and misleading information to FINRA staff subverts FINRA's regulatory function.[14] For that reason, the SEC has held that "[p]roviding misleading and inaccurate information to [FINRA] is conduct contrary to high standards of commercial honor and is inconsistent with just and equitable principles of trade."[15]

In this case, in connection with a FINRA examination, the FINRA examiner requested, among other documents, StoneGate's "[AML] Compliance Program Procedures." StoneGate had no AML program. Nevertheless, among the documents that StoneGate provided to the examiner in response to the request were purported AML procedures, which were attached to the firm's 2003 and 2004 WSPs. StoneGate had just received the procedures from its attorney, and they had not been adapted to StoneGate's business, adopted in writing by StoneGate's management (Bernier), or implemented by the firm, all as required by Rule 3011. These facts came to light only after the examiner carefully reviewed the procedures, identified several deficiencies, and finally asked, point-blank, when StoneGate had received them from its attorney.

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[14] See Dep't of Enforcement v. Ortiz, Complaint No. E0220030425-01, 2007 FINRA Discip. LEXIS 3 (N.A.C. October 10, 2007), appeal pending, No. 3-12889 (S.E.C. filed Nov. 15, 2007).

[15] Brian L. Gibbons, 52 S.E.C. 791, 795 (1996) aff'd, 112 F.3d 516 (9th Cir. 1997) (table format); see also, Dep't of Enforcement v. Rogala, 2005 NASD Discip. LEXIS 44 at *21 (N.A.C. Oct. 11, 2005).

Bernier argues that he did not know the AML procedures were attached to the WSPs and did not intend to mislead the examiner. But Bernier also testified that he knew the examiner would need accurate information in order to conduct the examination (Tr. 182), and assumed that JH had received AML procedures from the firm's attorney and had provided those procedures to the examiner. Yet, by his own admission, he never asked JH whether she had received AML procedures while he was gone, or asked to review them. And even though he assumed JH had provided the AML materials to the examiner, he did not tell the examiner that the firm had just received them from its attorney, and had not adapted them to its business or implemented them.

Citing her "inexperience," Respondents argue that the examiner should have reviewed the AML procedures earlier and noticed that they were in a different typeface from the rest of the WSPs, which should have alerted her that they were merely a "template" that had not been implemented by StoneGate. The Panel rejects these arguments; responsibility for misleading the examiner lies squarely on Bernier's shoulders.

The examiner's document request was clear; it asked for StoneGate's AML procedures. The only accurate response to this request was, "StoneGate has none." Instead, as Bernier expected, the examiner was provided a set of AML procedures, without further explanation. Even if they had not been attached to the WSPs, it would have been reasonable for the examiner to assume that they were the StoneGate AML procedures she had requested. They did not on their face appear to be a "template," in the sense that they were merely "a pattern; a model" for procedures that had not been developed or implemented.[16] On the contrary, on their face, subject to the deficiencies the examiner identified in the final exit conference, they appear to be complete, implemented AML procedures—as indeed they were, but for a different firm.

[16] The examiner explained that, recognizing that developing an AML program was difficult for many small firms, in their initial examinations after Rule 3011 came into effect, FINRA examiners gave firms credit for simply trying to implement an AML program, even if the program was not properly tailored to the firm's operations. (Tr. 128-29.)

Unlike the examiner, Bernier was well aware that StoneGate did not have an AML program. He had an opportunity to be candid during the initial call from the examiner on March 7, but he was not; he had another opportunity to be candid during his meeting with the examiner at the outset of the examination on March 21, but he was not; he had a third opportunity to be candid at the initial exit conference on April 25, but he was not; he had a fourth opportunity to be candid when the examiner called him to ask about the person listed as the responsible principal for the AML program, and when she asked whether StoneGate had conducted annual testing of its AML program, but he was not; and he had a fifth opportunity to be candid when the examiner listed deficiencies in StoneGate's AML program in the final exit conference, but he was not.

The records request did not cite Rule 8210, which authorizes FINRA staff to inspect and copy, and require production of, member firm documents in connection with an examination, and the Complaint did not charge Respondents with violating Rule 8210.[17] The records request was, however, a formal request for specific categories of documents in connection with an examination of StoneGate, and Bernier acknowledged that he understood the request and the importance of providing accurate information. Nevertheless, in response to the request for the firm's AML procedures, StoneGate, with Bernier's knowledge, provided AML procedures that the firm had not developed or implemented, and did not disclose that to the examiner, which was misleading. Bernier and StoneGate thereby failed to "observe high standards of commercial honor and just and equitable principles of trade," as required by Rule 2110.

V. Sanctions

Enforcement argued that for the supervisory violations and for providing misleading information to FINRA the Panel should suspend Bernier in all capacities for one year and require him to re-qualify as a principal, and should fine Respondents $50,000, jointly and severally.

[17] Accordingly, the Panel did not find that Respondents violated Rule 8210. The Panel notes, however, that nothing in Rule 8210, or any other provision of the rules, requires the staff to cite that rule when requesting documents.

Enforcement argued that StoneGate should be fined an additional $15,000 for failing to develop and implement an AML program. Respondents argued that the sanctions proposed by Enforcement would put StoneGate out of business, because Bernier generates most of the firm's revenues, and that any sanctions should not exceed a 30-day suspension for Bernier, in supervisory capacities only, and a $50,000 joint and several fine, in total.

The Sanction Guidelines do not address violations relating to misleading information provided in response to requests for information that are not made pursuant to Rule 8210. The Guidelines for violations of Rule 8210 are helpful, however, insofar as they direct Adjudicators to consider the nature of the information requested, as well as whether it was ever provided and the time and degree of regulatory pressure required to obtain it. FINRA Sanction Guidelines at 35 (2007). In this case, accurate information regarding StoneGate's AML procedures was required for the examiner to complete a specific, required element of FINRA's examination. Respondents eventually provided correct information, but only after the final exit conference, in response to specific questions from the examiner.

For deficient written supervisory procedures, the Sanction Guidelines recommend that Adjudicators impose a fine of $1,000 to $25,000 and that they consider suspending the responsible individual and the firm in egregious cases, and they direct Adjudicators to consider whether the supervisory deficiencies allowed violative conduct to occur, and whether the deficiencies made it difficult to identify the persons responsible for specific areas of supervision or compliance. Id. at 109. There are no Guidelines specifically addressing AML violations, but the Panel found the considerations set forth in the Guidelines for deficient written supervisory procedures relevant.

Here there is no evidence that StoneGate's deficient supervisory procedures, or its lack of an AML program, contributed to any violative conduct, or to any uncertainty regarding the

person responsible for supervision or compliance. There was no allegation or evidence of any unsuitable recommendations, or any suspicious transactions, and there was no uncertainty about Bernier's responsibility for all areas of supervision and compliance during the relevant period.

The Panel also consulted the Sanction Guidelines' general considerations applicable to all violations, and found several relevant in this case. Id. at 6-7.

- Respondents did not acknowledge or correct the deficiencies in StoneGate's supervisory procedures, or its failure to have an AML program, prior to detection by FINRA.
- StoneGate's deficient supervisory procedures and its failure to implement an AML program continued for two years or more.
- Respondents were reckless in providing AML procedures to the examiner that StoneGate had not implemented, without disclosing that fact, because they were obviously likely to mislead the examiner.
- The deficiencies in StoneGate's supervisory procedures occurred in spite of the SEC's prior examination findings and Respondents' assurances to the SEC, and StoneGate failed to develop and implement an AML program in spite of notices from FINRA and the advice of the firm's attorney.

All of these circumstances suggest the need for substantial sanctions to remediate Respondents' misconduct.

The Panel notes, however, that a number of potentially aggravating factors are not present. In particular, there was no allegation or evidence of any injury to customers and Respondents have no disciplinary history.

The Panel also considered the unmistakable fact that the violations all stemmed from a single deficiency: Bernier. As he acknowledged, "I think it's been established that I have not

been very good at being a supervisor …." (Tr. 258.) The Panel does not believe that a brief suspension, such as Respondents urge, would remedy this deficiency. Rather, it would allow Bernier to resume his role at StoneGate after a brief period, without any assurance that he would be able to function any more effectively than he did during the period at issue in this case.

Therefore, the Panel finds that a lengthy suspension of Bernier, in a principal capacity, is required to accomplish FINRA's remedial goals. While Respondents argue that a lengthy suspension could have a devastating impact on StoneGate, because of Bernier's role in the firm, Bernier himself testified that the firm needs a new Chief Executive Officer to oversee its operations, explaining, "I recognize that my strengths are on the sales side, and I am not a manager, a very good manager …." (Tr. 314.) In any event, the Panel's obligation is to fashion remedial sanctions that will prevent and deter future violations, and a brief supervisory suspension would not accomplish that end.

On the other hand, the Panel does not believe it is necessary to suspend Bernier in all capacities, as Enforcement urges. The violations all relate to his inadequacies as a supervisor; there is no indication that he poses any threat "on the sales side." Further, the Panel agrees with Respondents that suspending Bernier in all capacities would have a disproportionately severe impact on StoneGate, its employees, and its owners, because Bernier accounts for 70-80% of the firm's revenues. (Tr. 140.) In this regard, as well as in calculating appropriate fines, the Panel considered StoneGate's very modest size and resources, "with a view toward ensuring that the sanctions imposed are not punitive but are sufficiently remedial to achieve deterrence." Sanction Guidelines at 2 ("General Principles Applicable to All Sanction Determinations"). Suspending Bernier for a lengthy period as a principal will be sufficiently remedial to achieve deterrence; a lengthy suspension in all capacities would be punitive.

Taking all these circumstances into account, for the supervisory violations and providing misleading information to FINRA staff, the Panel will suspend Bernier in all principal capacities for one year and order him to re-qualify as a principal, and fine Respondents, jointly and severally, $25,000. In addition, for failing to develop, adopt and implement an AML program in a timely manner, StoneGate will be fined $10,000.

VI. Conclusion

Respondents (1) violated Rule 2110 by providing misleading information to a FINRA examiner, and (2) violated Rules 3010 and 2110 by failing to maintain and enforce an adequate supervisory system and written procedures relating to the collection and retention of suitability information and by failing to preserve written reports of Respondent StoneGate's annual internal inspections. For these violations, Respondent Bernier is suspended in all principal capacities for one year and ordered to re-qualify before functioning in any principal capacity, and Respondents are fined $25,000, jointly and severally. In addition, Respondent StoneGate violated Rules 3011 and 2110 by failing to develop and implement an Anti-Money Laundering program in a timely manner. For this violation, StoneGate is fined an additional $10,000. Respondents are also ordered to pay costs in the amount of $3520, which includes a $750 administrative fee and the cost of the hearing transcript.

The monetary sanctions will be due and payable on a date set by FINRA, but not less than 30 days after this decision becomes FINRA's final disciplinary action in this matter, and if

this becomes FINRA's final action, Respondent Bernier's suspension shall begin on July 7, 2008, and end on July 6, 2009.[18]

HEARING PANEL

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By: David M. FitzGerald
Hearing Officer

Copies to: StoneGate Partners, LLC (via overnight and first class mail)
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David Sonnenberg, Esq. (via electronic and first class mail)
Mark P. Dauer, Esq. (via electronic and first class mail)

[18] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.