FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS[1]

DEPARTMENT OF ENFORCEMENT, Complainant, v. FLAVIO G. VARONE (CRD No. 1204320), Respondent.	Disciplinary Proceeding No. 2006007101701 Hearing Officer – SNB **HEARING PANEL DECISION** August 20, 2008

For misuse of customer funds, in violation of Rule 2110, and failure to respond to Staff requests for information, in violation of Rules 8210 and 2110, Respondent is barred in all capacities. Respondent is also ordered to pay restitution in the amount of $17,866.51, plus interest.

Appearances

Richard S. Schultz, Esq., and UnBo Chung, Esq., for the Department of Enforcement.

Robert P. DeMarco, Esq., for the Respondent.

DECISION

I. Procedural History

On July 26, 2007, the Department of Enforcement ("Enforcement") filed a three-count Complaint against Flavio G. Varone ("Respondent"). The first two counts allege that Respondent accepted funds from two customers for investment purposes, but instead misused these funds, in at least one case depositing them into his personal account, in violation of Rule 2110. The third count alleges that Respondent failed to respond to written requests for information and documents, in violation of Rules 8210 and 2110. Respondent filed an Answer

[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.

denying the charges and requested a Hearing. The Hearing was held on January 23, 2008, before a Hearing Panel composed of a Hearing Officer, a former member of the District 8 Committee and a current member of the District 8 Committee.[2] Enforcement called five witnesses to testify, including Respondent, who refused to testify, claiming a Fifth Amendment right against self-incrimination.

On March 3, 2008, Enforcement filed a Post-Hearing Brief. On March 6, 2008, Respondent filed a motion to extend the time to file a Post-Hearing Brief, claiming that Respondent did not receive the hearing transcript. On March 11, 2008, the Hearing Officer denied the motion, because Respondent's request was filed late, and without a representation as to whether Respondent had attempted to obtain the hearing transcript.

II. Respondent

Respondent was initially registered with FINRA member firm John Hancock Mutual Life Insurance Company ("John Hancock") in May of 1983. Since then, Respondent has been registered with various member firms. In May of 2004, Respondent registered as an Investment Company and Variable Contracts Products Representative with USAllianz Securities, Inc. ("USAllianz"), and later, with its successor, FINRA member Questar Capital Corporation ("Questar"), a subsidiary of Allianz Life Insurance Company. Tr. 100-101. Respondent resigned from this position on November 29, 2006, and his registration was terminated on December 4, 2006. Respondent is currently not registered. CX-1; CX-3 p. 43.

[2] References to the testimony of the Hearing are designated as "Tr. __," with the appropriate page number. References to the exhibits provided by Enforcement are designated as "CX-__." Exhibits CX-1 through CX-22 were admitted into the record. Respondent did not enter any exhibits into evidence.

III. <u>Discussion</u>

A. Misuse of Customer Fund

1. The B&AM Account

Respondent's long-time clients, B&AM, a retired couple in their late seventies, readily agreed to switch their accounts from John Hancock to USAllianz in August of 2005, based upon Respondent's recommendation. Tr. 17-19. AM died just prior to the Hearing, but BM credibly testified as to the transaction at issue. Respondent offered no conflicting evidence.

In connection with the transfer of one of their accounts - a trust account for their son - John Hancock issued a check to B&AM dated August 1, 2005, in the amount of $17,866.51. In accord with Respondent's instructions, B&AM endorsed the back of the check and gave it to Respondent, who said he would invest the funds in a new USAllianz trust account for their son. CX-6 p. 4; Tr. 20-24, 35.

Some months later, BM called Respondent and requested $5,000 from this account so that B&AM could give the funds to their son for his birthday. Tr. 24-25. Respondent told her that she would receive a $5,000 check in a few weeks. Tr. 25. After she did not receive the check as promised, she called Respondent to follow up. He did not return her call. She kept calling, but Respondent did not answer. Id. When she finally reached Respondent, she asked for the remaining balance in the trust account. Id. Respondent told her that he would definitely send the funds to her; however, he never did. Tr. 26. Despite BM's numerous messages, Respondent never called her back. Tr. 27. BM ultimately retained an attorney to recover the funds from USAllianz; however, the firm was unwilling to return the funds, because there was insufficient documentation to trace them. CX-6 p. 6-7, 10; Tr. 27, 135-136.

2. The WC Account

In March 2006, Respondent's long-time client, WC, agreed to follow Respondent's recommendation to invest just under $500,000 in annuities. Like B&AM, WC was retired and in his late seventies at the time. WC died just prior to the Hearing, so his brother-in-law, FS, testified as to the transaction at issue based upon his conversations with WC prior to his death, and also authenticated WC's handwriting and signature on documents WC provided to FINRA prior to his death. CX-3 p. 11-15; Tr. 46, 57-58, 81. Again, Respondent offered no contravening evidence and refused to testify.

According to FS, in a conversation during March 2006, WC expressed his excitement about two new annuities recommended by Respondent, which would generate $4,000 per month. CX-3 p. 29-32; Tr. 49-50, 121-122. WC was so impressed with this investment that he gave FS Respondent's card, and encouraged FS to contact Respondent if he was interested in the investment. Tr. 51. In October 2006, WC again spoke to FS about Respondent. This time, however, WC's tone was much different; WC told FS that Respondent had stolen his money. Tr. 55. Specifically, WC explained that in March 2006, at Respondent's instruction, he wrote and gave to Respondent two checks: a check for $256,975.73 to Allianz Life Insurance Co. and a second check for $236,963.79 to Republic Bank. CX-3 p. 12-13; Tr. 59-61, 74. WC told FS that Respondent had apparently forged his endorsement and deposited this second $236,963.79 check into Respondent's personal bank account.[3] CX-3 p. 11-14; Tr. 58.

Several factors bolster this testimony. First, Respondent in fact had an account at Republic Bank. Second, while USAllianz records show that Respondent provided WC with a $236,963.79 quote for a USAllianz annuity, Respondent never purchased this annuity for WC.

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[3] Subsequently, WC retained an attorney to recover these funds, and USAllianz paid to settle the claim against it. CX-3 p. 108-114.

Third, Respondent deposited approximately $1,500 from his Republic Bank account directly into WC's personal account in an apparent attempt to give the impression that WC was receiving at least some of the annuity payment. Fourth, Republic Bank confirmed to a USAllianz investigator that a $236,963.79 deposit was made into Respondent's account. CX-3 p. 5-9, 13, 16, 19-22, 30; Tr. 60-66, 81, 115-118 123-126.

IV. Violations

A. Misuse of Customer Funds

Rule 2110 requires members and persons associated with members to "observe high standards of commercial honor and just and equitable principles of trade." It is well established that the misuse of customer funds violates Rule 2110. Dep't of Enforcement v. Patel, No. C02990052, 2001 NASD Discip. LEXIS 42, at **24-25 (NAC May 23, 2001) (affirming the decision of a Hearing Panel barring a representative for depositing customer funds into his own account rather than investing them as directed by the customers). "An associated person makes improper use of customer funds where he or she fails to apply the funds (or uses them for some purpose other than) as directed by the customer." Id.

BM credibly testified that, at Respondent's direction, she endorsed the $17,866.51 check and gave it to Respondent to open a new trust account for her son with USAllianz. However, Respondent did not open a new account as instructed, and no evidence was presented on the current disposition of the funds. Respondent offered no testimony or other evidence either to refute BM's testimony that she gave him the funds, or to prove that he invested them as she had instructed.

Moreover, FS credibly testified that his deceased brother-in-law, WC, told him that he wrote a $236,937 check to Republic Bank and gave it to Respondent to invest, but the funds

were never invested as directed.[4] Documentary evidence presented at the Hearing showed that the endorsement on the back of this check was forged and that Respondent deposited funds from his Republic Bank account into WC's bank account to give the impression that WC was receiving at least some of the annuity payment anticipated from a second USAllianz annuity. Once again, Respondent offered no testimony or other evidence that he did not receive the funds from WC or that he used them as WC instructed. In addition, the Panel noted that Respondent's conduct violated USAllianz procedures, which prohibited representatives from holding customer funds and from commingling them or depositing them in a representative's account. CX-3 p. 47; Tr. 103-109. Based upon the undisputed evidence, the Panel concluded that Respondent misused customer funds, in violation of Rule 2110.[5]

B. Failure to Respond

Rule 8210 authorizes FINRA to require any person subject to its jurisdiction to provide information and testimony related to any matter under investigation. The Rule serves as a key element in FINRA's oversight function and allows FINRA to carry out its regulatory functions without subpoena power. See, e.g., Dep't of Enforcement v. Valentino, No. FPI010004, 2003 NASD Discip. LEXIS 15, at *12 (NAC May 21, 2003), aff'd, 2004 SEC LEXIS 330 (Feb. 13, 2004) ("It is well established that because [FINRA] lacks subpoena power over its members, a

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[4] While Respondent objected to FS's testimony as hearsay, hearsay is admissible in administrative proceedings, particularly, as here, where factors establishing its reliability and probative value are present. John Montelbano, Exch. Act Rel. No. 47,227, 2003 SEC LEXIS 153 (2003), citing Charles D. Tom, 50 SEC 1142, 1145 (1992). Specifically, FS's testimony was under oath, and Respondent had the opportunity to cross-examine him; there was no evidence that FS was biased or had anything to gain; his testimony was mutually corroborative and consistent with the testimony of BM; and his testimony was corroborated by documentary evidence.

[5] Because there was credible, undisputed evidence supporting the misuse charge, it was not necessary for the Hearing Panel to draw negative inferences from Respondent's refusal during the Hearing, to answer specific questions regarding his conduct, based upon a Fifth Amendment privilege claim. See Baxter v. Palmigiano, 425 U.S. 308, 318 (1976); John Kilpatrick, 48 S.E.C. 481, 486 and n.18 (1986). Moreover, the Panel notes that the Fifth Amendment does not ordinarily apply in FINRA proceedings, and therefore Respondent was not entitled to claim the privilege. United States v. Shvarts, 90 F. Supp. 2d 219, 222 (E.D.N.Y. 2000).

failure to provide information fully and promptly undermines [FINRA's] ability to carry out its regulatory mandate.") (citation omitted); Joseph G. Chiulli, Exch. Act Rel. No. 42,359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for FINRA effectively to conduct its investigations, and emphasizing that FINRA members and associated persons must fully cooperate with requests for information). When an individual fails to provide requested documents and information, FINRA's ability to perform its regulatory responsibilities is subverted. Joseph P. Hannan, Exch. Act Rel. No. 40,438, 1998 SEC LEXIS 1955, at *9 (Sept. 14, 1998).

Here, among other things, the Staff requested specific information regarding Respondent's handling of checks from B&AM and WC, in order to determine whether Respondent converted their funds. Respondent's failure to respond interfered with the Staff's ability to complete its investigation, and to obtain a complete factual understanding of what transpired with regard to these customer accounts.

Respondent admitted that he did not respond to the Staff's Rule 8210 request for information, but explained that his refusal was based on his exercise of his Fifth Amendment rights, due to a pending criminal investigation. Tr. 11. However, Constitutional privileges, including the Fifth Amendment, provide protection against governmental, not private, action. The courts have consistently held that FINRA is a private entity, not a "state actor," and, therefore, that "questions put to [associated persons] by [FINRA] in carrying out its own legitimate investigative purposes do not activate the privilege against self-incrimination …."

United States v. Shvarts, 90 F. Supp. 2d 219, 222 (EDNY. 2000). See also, Marchiano v. NASD, 134 F. Supp. 2d 90, 95 (D.D.C. 2001).[6]

Accordingly, the Hearing Panel concludes that Respondent's failure to respond to the Staff's Rule 8210 request for information violated Rules 8210 and 2110.

V. Sanctions

A. Misuse of Customer Funds

The Sanction Guidelines ("Guidelines") recommend the consideration of a bar as the sanction for the improper use of customer funds unless the improper use resulted from a misunderstanding of the customer's intended use of the funds or other mitigation exists. Guidelines at 38 (2007 ed.). Here, there was no evidence that Respondent was confused or that there were any other mitigating facts. Rather, there are several aggravating factors under the Principal Considerations in the Guidelines. Respondent did not accept responsibility for his misconduct, nor did he pay restitution or attempt to remedy his misconduct. Moreover, the injury to customers was serious; he betrayed the trust of his elderly customers, misusing over $250,000 of their funds. Finally, Respondent refused to respond to FINRA's Rule 8210 requests for information, and did not cooperate with the Staff's investigation. A bar is therefore the appropriate remedial sanction for this violation.

To the extent that Respondent's customers have been injured by his conduct, restitution is also appropriate. "Where quantifiable customer harm has been demonstrated, or a respondent has been unjustly enriched, [FINRA] generally will order restitution or disgorgement." NASD Notice to Members 99-86 (October 1999). In this case, Respondent's firm settled WC's claims. However, at the time of Hearing, B&AM had not recovered $17,866.51 in funds that they gave

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[6] While the Fifth Amendment may apply to FINRA if its actions are "fairly attributable" to the government, Respondent has not even alleged, much less proved, that in this case. See D.L. Cromwell Investments, Inc., v. NASD Regulation, Inc., 279 F.3d 155, 162 (2d Cir. 2002).

to Respondent for investment purposes. Therefore, Respondent is ordered to pay restitution to B&AM in the amount of $17,866.51, plus interest, calculated pursuant to 26 U.S.C. § 6621(2)(2) from August 1, 2005, to the date of payment, to the extent restitution has not already been provided.

B. Failure to Respond

Under the Guidelines, "[i]f the individual did not respond in any manner, a bar should be standard. Where mitigation exists, or the person did not respond in a timely manner, consider suspending the individual in any or all capacities for up to two years." Guidelines at 35. Here, Respondent's refusal to respond interfered with the Staff's ability to complete the essence of its investigation as to whether Respondent converted customer funds. There are no mitigating circumstances that would warrant a lesser sanction. Accordingly, Respondent is barred from association with any FINRA member in any capacity for failing to provide information requested pursuant to Rule 8210.[7]

VI. Conclusion

For misuse of customer funds, in violation of Rule 2110, and failure to respond to Staff requests for information, in violation of Rules 8210 and 2110, Respondent is barred in all capacities. Respondent is also ordered to pay restitution in the amount of $17,866.51, plus interest.

HEARING PANEL.

By: Sara Nelson Bloom
Hearing Officer

[7] The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.

Copies to: Flavio G. Varone *(via overnight and first-class mail*)
Robert P. DeMarco, Esq. *(via facsimile and first-class mail*)
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