

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

MUTUAL SERVICE CORPORATION
(CRD No. 4806),

DENNIS S. KAMINSKI
(CRD No. 1013459),

SUSAN COATES
(CRD No. 1563043),

MICHAEL POSTON
(CRD No. 1863133),

DENISE ROTH
(CRD No. 2749209),

GARI C. SANFILIPPO
(CRD No. 4151931),

KEVIN L. COHEN
(CRD No. 4527236),

and

RESPONDENT T,

Respondents.

Disciplinary Proceeding

No. EAF0400630001

Hearing Officer—Andrew H. Perkins

EXTENDED HEARING PANEL DECISION

December 16, 2008

Mutual Service Corporation is fined a total of \$1,535,000 for failing to supervise its variable annuity business, creating and maintaining inaccurate books and records, failing to conduct timely internal reviews, and failing to respond fully to requests for information issued by FINRA staff. Respondents Dennis S. Kaminski and Susan Coates are suspended in all principal capacities for six months and fined

\$50,000 each for failing to supervise the firm’s variable annuity business. Respondents Denise Roth, Gari C. Sanfilippo, and Kevin L. Cohen are each barred in all capacities for creating and maintaining inaccurate books and records. Respondent Michael Poston is suspended in all principal capacities for six months and fined \$10,000 for failing to supervise the firm’s variable annuity business. In addition, Poston is suspended in all principal capacities for 30 days and fined \$10,000 for failing to conduct timely internal reviews. And Respondent T is given a letter of caution for his involvement in the creation of inaccurate books and records. Respondents Mutual Service Corporation, Dennis S. Kaminski, Susan Coates, Denise Roth, Michael Poston, Kevin L. Cohen, and Gari C. Sanfilippo are also ordered to jointly and severally pay the costs of this proceeding.

Appearances

For the Complainant: Jeffrey P. Bloom, Lane A. Thurgood, Maureen Delaney, and Jill G. Fieldstein, FINRA, DEPARTMENT OF ENFORCEMENT, Washington, DC.

For Respondents Mutual Service Corporation, Dennis S. Kaminski, Susan Coates, Denise Roth, and Respondent T: Peter J. Anderson, Cheryl L. Haas-Goldstein, Olga Greenberg, and Michael K. Freedman, SUTHERLAND, ASBILL & BRENNAN, LLP, Atlanta, GA.

For Respondent Michael Poston: Michael J. King, Brian W. Stolarz, and Bethany M. Nikfar, KIRKPATRICK & LOCKHART PRESTON GATES ELLIS, LLP, Washington, DC.

For Respondent Gari C. Sanfilippo: William Edick and Peter E. McLeod, PICKARD AND DJINIS, Washington, DC.

For the Respondent Kevin L. Cohen: Kelly B. Kramer and David A. Feldman, NIXON PEABODY, LLP, New York, NY.

DECISION

I. INTRODUCTION

The Department of Enforcement (“Enforcement”) brought this disciplinary proceeding against Respondents Mutual Services Corporation (“MSC” or the “Firm”), Dennis S. Kaminski (“Kaminski”), Susan Coates (“Coates”), Michael Poston (“Poston”), Denise Roth (“Roth”), Gari C. Sanfilippo (“Sanfilippo”), Kevin L. Cohen (“Cohen”), and Respondent T (collectively, “Respondents”). Enforcement alleges that the Respondents

violated certain NASD Conduct Rules and provisions of the Securities Exchange Act of 1934 (“the Exchange Act”) in the review and supervision of MSC’s variable annuity business.

II. BACKGROUND AND PROCEDURAL HISTORY

This disciplinary proceeding arose after investigation into concerns regarding MSC’s supervision of its variable annuity business that FINRA staff uncovered during MSC’s cycle examination in October 2003. Ultimately, the staff focused its inquiry on MSC’s supervision of so-called “1035 Exchanges,” and, in particular, 1035 Exchanges transacted between March 15 and May 31, 2004. A “1035 Exchange” refers to a tax-exempt exchange of one annuity contract for another under Section 1035 of the Internal Revenue Code.¹ The staff concluded from its investigation that MSC failed to conduct timely suitability reviews of the 1035 Exchanges during the relevant period and that it created and maintained false records relating to the reviews. In addition, the staff concluded that MSC provided false and misleading information during the investigation in an attempt to conceal that it had falsified its books and records relating to its reviews of 1035 Exchanges.

Enforcement filed a Complaint with the Office of Hearing Officers on July 23, 2007. Each Respondent filed an Answer and requested a hearing. Enforcement’s Complaint contains five causes of action. In the First Cause of Action, Enforcement alleges that MSC, Kaminski, Coates, Poston, Sanfilippo, and Cohen violated NASD Conduct Rules 3010(a) and 2110 by failing to reasonably supervise the Firm’s review of its variable annuity exchanges between March 15 and May 31, 2004. In the Second Cause of Action, Enforcement alleges that MSC, Roth, Sanfilippo, Cohen, Respondent T, and Poston violated NASD Conduct Rules 3110 and 2110, Section 17(a) of the Securities

¹ See 26 U.S.C. § 1035 (tax exempt status for various exchanges of life insurance, endowment, and annuity contracts).

Exchange Act of 1934 (“Exchange Act”), and SEC Rules 17a-3 and 17a-4 by creating and maintaining inaccurate books and records relating to the Firm’s suitability reviews of variable annuity transactions. In the Third Cause of Action, Enforcement alleges that MSC, Roth, Cohen, and Sanfilippo violated NASD Conduct Rules 3010(a) and 2110 by failing to reasonably supervise the creation of accurate books and records documenting the Firm’s reviews of variable annuity transactions. In the Fourth Cause of Action, Enforcement alleges that MSC and Poston violated NASD Conduct Rules 3010(b) and (c) and Rule 2110 by failing to conduct annual internal reviews for the years 2002 and 2003. Finally, Enforcement alleges in the Fifth Cause of Action that MSC violated NASD Procedural Rule 8210 and NASD Conduct Rule 2110 by providing false and misleading information in connection with FINRA’s investigation into MSC’s review of variable annuity transactions.

In the Complaint, Enforcement alleges that, beginning in February 2004, MSC began to fall behind in its daily review and approval of variable annuity exchanges. MSC had established a daily review procedure to identify transactions that triggered one or more “red flags.” Enforcement further alleges that MSC suspended all reviews of variable annuity transactions from March 15, 2004, through May 31, 2004 (“the backlogged transactions”) and that the review of these transactions did not begin until August 2004.² The red flag transactions appeared on a daily blotter called the New Variable Business Pending Approval Report (“the Red Flag Blotter”).³

Based on Kaminski’s, Poston’s, Coates’, Cohen’s, and Sanfilippo’s status as supervisors at MSC, Enforcement alleges in the Complaint that they failed to adequately supervise the reviews of the Red Flag Blotters. Specifically, Enforcement alleges that

² Compl. ¶¶ 31-32.

³ The Red Flag Blotter sometimes is referred to in the record as the “Pending Approval Blotter.” For clarity, the term Red Flag Blotter is used consistently throughout this Decision.

each of them knew that the Red Flag Blotters were not being reviewed in a timely manner, “but each failed to take appropriate action.”⁴

Enforcement further alleges that MSC (acting through Roth, Sanfilippo, Cohen, Respondent T, and Poston) created and maintained inaccurate books and records.⁵ First, Enforcement claims that Respondent T intentionally entered false information into the Firm’s computerized records system in connection with his review of 597 variable annuity exchanges that appeared on the Red Flag Blotters for the period March 15, 2004, through May 31, 2004. Enforcement claims that Respondent T and Roth backdated the Red Flag Blotters for the relevant period to make it appear that their reviews had been conducted timely.⁶ Enforcement further claims that Roth, Cohen, and Sanfilippo failed to reasonably supervise the review and approval of the transactions that appeared on the Red Flag Blotters.⁷ Second, Enforcement claims that Poston modified the Firm’s Written Supervisory Procedures in May 2004 and then directed his assistant to backdate them to December 30, 2003, “to make it appear that the section regarding a new 1035 Exchange monthly trend report had been inserted on that date, when that section was not actually inserted [into the Firm’s written procedures] until mid-May 2004.”⁸ Third, Enforcement claims that the Firm’s Compliance Department (acting through Cohen and Sanfilippo) created false letters to make it appear that MSC had utilized a new monthly trend report for 1035 Exchanges beginning in January 2004.⁹

⁴ Compl. ¶ 52.

⁵ Compl. ¶ 55.

⁶ Compl. ¶¶ 56-57.

⁷ Compl. ¶ 63.

⁸ Compl. ¶ 58.

⁹ Compl. ¶ 59.

In the Fourth Cause of Action, Enforcement claims MSC and Poston failed to conduct an annual internal audit for 2002, and failed to conduct a timely internal audit for 2003.¹⁰ MSC and Poston did not contest this charge.

Finally, Enforcement alleges that MSC provided false and misleading information in connection with FINRA's investigation of MSC's failure to timely review variable annuity transactions during the relevant period. Enforcement alleges that MSC changed or "de-backdated"¹¹ its falsified books and records before it provided the documents to FINRA in an effort to conceal the Firm's wrongdoing.¹²

The Hearing Panel, comprised of a former member of the National Adjudicatory Council and FINRA's District 9 Committee, a former member of FINRA's District 3 Committee, and the Hearing Officer, conducted a hearing in North Miami, Florida from March 3, 2008, to March 12, 2008.¹³ During the 8-day hearing, the Hearing Panel heard testimony from 15 witnesses, including the individual respondents, Scott DeArme ("DeArme"), the Associate Director of FINRA's Atlanta office, Maureen Delaney ("Delaney") and Robert Moreiro ("Moreiro"), FINRA Enforcement attorneys, Kari Turigliatto ("Turigliatto"), MSC's General Counsel, Hugh Harvey Makens ("Makens"), MSC's outside counsel, and John Dixon ("Dixon"), MSC's Chairman and Chief Executive Officer. On May 1, 2008, the parties filed post-hearing briefs with the Office of Hearing Officers.

¹⁰ Compl. ¶¶ 67-70.

¹¹ Enforcement coined the term "de-backdating" to refer to MSC's efforts to revise its records to reflect the actual review dates. In some cases this involved restoring the date originally entered by Respondent T, and in other cases it involved selecting a new date based on data captured automatically in the firm's computer system.

¹² Compl. ¶¶ 73-76.

¹³ The hearing transcript is cited as "Tr." The exhibits are labeled to identify the submitting party. Enforcement's exhibits are labeled "CX"; MSC's, Kaminski's, Coates', Roth's, and Respondent T's exhibits are labeled "MSC"; Poston's exhibits are labeled "P"; and Sanfilippo's exhibits are labeled "GS." The joint exhibits are labeled "JX." Cohen did not label his exhibits with an identifying prefix.

Based upon a preponderance of the evidence, the Hearing Panel makes the following findings of fact and conclusions of law.

III. FINDINGS OF FACT¹⁴

A. Background

1. Mutual Service Corporation

MSC has been a member of FINRA since 1970. MSC is headquartered in West Palm Beach, Florida, and has more than 1200 registered personnel in over 800 branches nation wide. MSC describes itself as one of the largest independent contractor firms in the securities industry.¹⁵ All of the Firm's registered representatives are independent contractors, and approximately 70-80% of them are assigned to an office of supervisory jurisdiction ("OSJ").¹⁶ The OSJ/Branch Managers are responsible for reviewing transactions effected by the registered representatives in their respective branch offices.¹⁷ MSC's home office conducts the primary review of the transactions conducted by the remaining registered representatives who are not assigned to an OSJ.

Variable annuities comprise a substantial portion of MSC's overall business. Coates estimated that in 2004 variable annuity trades comprised 30% of MSC's total business.¹⁸ During 2004, MSC processed variable annuity transactions worth more than

¹⁴ The facts contained herein are either undisputed or are the findings of the Extended Hearing Panel based upon the credibility or believability of each witness. In making credibility determinations, the Extended Hearing Panel considered all of the circumstances under which the witness testified, including: the relationship of the witness to the parties; the interest, if any, the witness has in the outcome of the proceeding; the witness's appearance, demeanor, and manner while testifying; the witness's apparent candor and fairness, or lack thereof; the reasonableness or unreasonableness of the witness's testimony; the opportunity of the witness to observe or acquire knowledge concerning the facts to which he or she testified; the extent to which the witness was contradicted or supported by other credible evidence; and whether such contradiction related to an important detail at issue. When necessary and appropriate, the Extended Hearing Panel comments on the credibility of a witness or the weight given to a witness's testimony.

¹⁵ Ex. C-31, at 3.

¹⁶ Tr. 1003.

¹⁷ Ex. C-10, at 11-12.

¹⁸ Tr. 834.

\$900 million, and 28% of those transactions involved 1035 Exchanges worth \$210,546,708.49.¹⁹

During 2004, the Compliance and Operations Departments in MSC's home office were responsible for reviewing variable annuity transactions. The Operations Department had a supervisory role for variable annuity transactions.²⁰ Kaminski, the Executive Vice President and Chief Administrative Officer, was responsible for supervising the Compliance and Operations Departments. Those departments were structured as follows:

- *Operations:* Coates, a Senior Vice President, ran the Operations Department. Roth, a First Vice President who was promoted to Vice President in March 2005, reported directly to Ms. Coates.
- *Compliance:* Poston, Vice President and Chief Compliance Officer, ran the Compliance Department. Jenifer Aracri ("Aracri"), a First Vice President, reported directly to Poston until her departure in April 2004.

Within the Compliance Department was the Trade Review Team ("TRT"), which provided heightened supervision of variable annuity transactions. Sanfilippo and Cohen staffed TRT during 2004. Sanfilippo, the Trade Review Team Supervisor, reported directly to Aracri until her departure, and then reported directly to Poston. Cohen, a Compliance Examiner, reported to Sanfilippo until Poston reorganized the Compliance Department in August 2004. After that, Cohen reported directly to Poston (and later to Kaminski), and Sanfilippo continued as Cohen's immediate manager.

2. Dennis S. Kaminski

Kaminski, MSC's Executive Vice President and Chief Administrative Officer, has been involved with the securities industry for 33 years.²¹ He began his career with FINRA (formerly NASD) in its Cleveland office where he eventually became an investigator.²² Kaminski left FINRA after about five years to take a position in branch

¹⁹ Ex. C-24; Ex. C-25.

²⁰ Tr. 332.

²¹ Tr. 499, 1225.

²² Tr. 1224-25.

management with Prudential Securities.²³ He then served as president of a start-up broker-dealer in Iowa before joining MSC in March 1986.²⁴ Kaminski has been registered with FINRA in a number of capacities since 1986, including as a General Securities Principal.²⁵ During 2004, Kaminski was responsible for MSC's daily operations.²⁶ The Compliance, Operations, and Legal Departments reported to him, and he was a member of the Firm's management committee.²⁷ Also, he assumed the responsibility of Chief Compliance Officer in October 2004 when the then head of compliance left the Firm.²⁸ Everyone in the Compliance Department reported to Kaminski from October 2004 to October 2005.²⁹

3. Susan Coates

Coates, the current Senior Vice President and Director of MSC's Operations Department, has been employed by MSC and its predecessor since she entered the securities industry in 1985. Over her twenty-three-year career at MSC, Coates has worked in every area of the Operations Department.³⁰ During 2004, as head of the Operations Department, she reported to Kaminski and served as a member of the Firm's management committee.³¹ In January 2005, she became a member of MSC's Executive Committee as well. She currently is registered with FINRA in several capacities, including as a General Securities Principal, as she was in 2004.³²

²³ Tr. 1226.

²⁴ Tr. 1226.

²⁵ Ex. C-40, at 3; Tr. 500.

²⁶ Tr. 500.

²⁷ Tr. 499-501.

²⁸ Tr. 501.

²⁹ Tr. 501.

³⁰ Tr. 818.

³¹ Tr. 405-06; Ex. C-45, at 3.

³² Ex. C-38, at 2 (Coates CRD record).

4. Denise Roth

Roth began her career in the securities industry in 1991 at a Canadian brokerage firm in Nova Scotia. She moved to Florida and joined MSC in 1996 as a Customer Service Representative in the Operations Department. She became registered as a General Securities Representative in 1996, as a General Securities Principal in 1997, and a Municipal Securities Principal in 2001. MSC promoted her to Supervisor in the Operations Department in 1998 and then to First Vice President and Assistant Operations Manager in 2000. In 2005, after the events at issue in this proceeding, MSC promoted her to Vice President and Operations Manager. At all times relevant to the Complaint, she reported to Coates, Senior Vice President and Director of Operations for MSC, as she does currently.³³

In 2004, Roth was the Operations Principal at MSC responsible for reviewing and approving a number of reports and blotters, including the Red Flag Blotter.³⁴

5. Michael Poston

Poston started work in the securities industry as a securities analyst with the Florida Division of Securities in about 1983, shortly after graduating from college. After two years with the Florida Division of Securities, he joined FINRA as a compliance examiner in Atlanta, GA. Poston worked at FINRA for approximately four years and then went to work at a broker-dealer as its compliance director.³⁵ Thereafter, Poston worked either as an independent compliance consultant or as a member of a broker-dealer's compliance department until June 1992 when he joined MSC.³⁶ Poston left MSC in October 2004 and currently is registered with another FINRA member firm.³⁷

³³ C-32, at 2.

³⁴ Tr. 334; C-11, at 1 (MSC Operations Manual).

³⁵ Tr. 1576-77.

³⁶ Tr. 1577-78.

³⁷ Tr. 1578; Ex. C41, at 2.

During 2004, Poston held the position of Vice President and Chief Compliance Officer and was registered with FINRA in several capacities, including as a General Securities Principal. For his entire tenure at MSC, Poston reported to Kaminski.³⁸

6. Gari C. Sanfilippo

Sanfilippo entered the securities industry in November 1999 as a compliance examiner at MSC. In 2000, Sanfilippo became registered as a General Securities Representative and a General Securities Principal.³⁹ The following year, Sanfilippo was promoted to senior compliance examiner, and in 2003 he was assigned responsibility for managing TRT.⁴⁰ MSC discharged Sanfilippo in November 2005.⁴¹ Currently, Sanfilippo is registered with another FINRA member firm.⁴²

During 2004, Sanfilippo's primary responsibilities as supervisor of TRT included the review of numerous trade and exception reports, including the Red Flag Blotter. He also managed the Firm's branch office examination program, monitored the Firm's continuing education program, and monitored the securities and insurance license renewal process for MSC's registered representatives.

In addition to the foregoing responsibilities, in late 2003 to early 2004, Poston assigned Sanfilippo to head up the Firm's breakpoint review process.⁴³ Sanfilippo was tasked with developing the procedures MSC would follow based upon FINRA's

³⁸ Tr. 1579.

³⁹ Tr. 277.

⁴⁰ Tr. 281.

⁴¹ C-43, at 2.

⁴² *Id.* at 1.

⁴³ In 2003, FINRA required certain member firms that had more than a minimal amount of mutual fund transactions in front-end load mutual funds over the prior two years to assess whether they had missed opportunities to provide customers with available discounts in the calculation of sales load charges. Based on an evaluation of the assessments, FINRA directed about 450 firms to send letters and claim forms to their mutual fund customers who purchased Class A mutual fund shares since January 1, 1999, notifying them that they may be due refunds as a result of the firms' failure to provide breakpoint discounts. MSC was one of the firms required to send such notices to its customers. In 2004, MSC sent breakpoint claim forms to approximately 85,000 customers. Tr. 1601-02.

breakpoint guidelines, as well as implementing a system to track and document the reviews as they were completed. As the breakpoint review process progressed, Sanfilippo also had to undertake the review of breakpoint claims as they were received. In the first half of 2004, the breakpoint review process consumed the majority of Sanfilippo's time.⁴⁴ Ultimately, the breakpoint review process became so time consuming that Poston directed the Compliance Department to suspend all other reviews in order to meet the breakpoint review deadline mandated by FINRA.⁴⁵

During the relevant period, and up until October 2004, Sanfilippo reported to Poston, the Firm's Chief Compliance Officer.⁴⁶ After Poston left MSC in October 2004, Sanfilippo, along with the rest of the Compliance Department personnel, was placed under the direct supervision of Kaminski, who assumed the role of interim Chief Compliance Officer.

7. Kevin L. Cohen

Cohen had no experience in the securities industry before he joined MSC in February 2002 as a junior compliance examiner.⁴⁷ He graduated from the University of Florida in 1993 with a bachelor's degree in finance. Following graduation, he worked a variety of odd jobs while he pursued a career in education. In 1998, he was hired to teach high school business in Stuart, Florida, which position he held until he joined MSC. Once he joined MSC, Cohen registered as both a General Securities Representative and a General Securities Principal.⁴⁸

⁴⁴ See Tr. 1926.

⁴⁵ Tr. 301, 1931.

⁴⁶ Tr. 286. Sanfilippo reported to Jennifer Aracri, First Vice President of Compliance, until she left that position in April 2004. Tr. 1925.

⁴⁷ Tr. 77-78.

⁴⁸ C-39, at 1 (Cohen CRD record).

Cohen was assigned to TRT in September 2002.⁴⁹ His primary responsibility with TRT was to monitor variable annuity trading by reviewing the variable annuity blotters. For most of the time Cohen was assigned to TRT, he reported to Sanfilippo.⁵⁰ On or about August 5, 2004, Poston reorganized the Compliance Department, after which all of the compliance staff reported directly to him.⁵¹ Nonetheless, as head of TRT, Sanfilippo continued to provide day-to-day instructions to Cohen.

In April 2005, after the events at issue in this proceeding and at the time FINRA staff was interviewing him on-the-record about his role in TRT, MSC promoted Cohen to the position of senior compliance examiner. Thereafter, in November 2005, MSC changed course and discharged Cohen because of his role in the creation of false books and records related to the review of variable annuity transactions by the Firm's Compliance Department.⁵² Cohen's registrations with FINRA terminated on November 18, 2005, and he has not been associated with a FINRA member firm since that date.⁵³

8. Respondent T

Respondent T has been in the securities industry for approximately 22 years and is licensed as a General Securities Representative. Respondent T has never been registered as a General Securities Principal.

Respondent T started with MSC in June 1998 in its marketing department as a marketing service representative.⁵⁴ In 2006, MSC promoted him to senior marketing service representative. In MSC's marketing department, Respondent T has four areas of responsibility: retirement plans; direct participation programs; brokerage services; and

⁴⁹ Tr. 117.

⁵⁰ Tr. 289.

⁵¹ Tr. 81-82; GS-54 (Poston e-mail).

⁵² Tr. 2119; C-39, at 7.

⁵³ C-39, at 1.

⁵⁴ Tr. 150.

electronic order entry. Respondent T's job is to assist the Firm's registered representatives with their questions in those areas.⁵⁵ While in the marketing department, Respondent T reported to Sherri Ryan, Senior Vice President of Marketing. Respondent T is a salaried employee; he has no supervisory responsibilities.⁵⁶ Apart from the present charges, Respondent T has no disciplinary history, and he has never been the subject of a customer complaint.⁵⁷

In August 2004, although Respondent T had no prior compliance experience, Kaminski temporarily assigned him to the Compliance Department to help it catch up on various delinquent reports, including the Red Flag Blotters for the period March 15 to May 31, 2004.⁵⁸ Respondent T reported to the Compliance Department on August 9, 2004, at which time he was assigned to TRT and directed to work on the backlogged Red Flag Blotters. Respondent T worked on the backlogged Red Flag Blotters from August 9 to October 20, 2004. While assigned to the Compliance Department, Respondent T reported directly to Kaminski and received day-to-day instructions from Cohen and Sanfilippo.⁵⁹ Once he finished with the backlogged Red Flag Blotters, he returned to the marketing department.

B. MSC's Supervision and Review of Variable Annuity Transactions

MSC has a history of failing to supervise sales and exchanges of variable annuities adequately. In December 2001, MSC entered into an Acceptance, Waiver, and Consent ("2001 AWC") with FINRA pursuant to Procedural Rule 9216 in which it accepted numerous findings related to its deficient supervision of variable annuity

⁵⁵ Tr. 1161.

⁵⁶ In 2004, Respondent T's salary was approximately \$32,000 per year. In addition, he received an annual bonus of approximately \$6,000. Tr. 1162.

⁵⁷ Tr. 1160.

⁵⁸ Tr. 153-54, 1163.

⁵⁹ Tr. 154.

transactions between January 1996 and June 1999.⁶⁰ Among other findings, MSC accepted FINRA's determination that MSC failed to establish, maintain, and enforce adequate written supervisory procedures to address: (1) the manner in which home office principals were to review and approve the suitability of variable product sales by principals in its offices of supervisory jurisdiction; (2) the manner in which exception reports were to be utilized by MSC in supervising variable product business; and (3) the manner in which MSC's principals were to review, approve, and otherwise supervise variable life insurance business.⁶¹ In addition, MSC accepted FINRA's determination that MSC had failed to establish and maintain a system to supervise the activities of its registered representatives with respect to exchange transactions in variable products effected by certain principals in MSC's offices of supervisory jurisdiction.⁶²

In connection with the 2001 AWC, MSC submitted a Corrective Action Statement to FINRA that documented the corrective measures MSC instituted to address the violations.⁶³ A central feature of the Corrective Action Statement was the formation of TRT as a separate unit within the Compliance Department. MSC established TRT to provide heightened supervision of variable annuity transactions, including 1035 Exchanges.⁶⁴ MSC also created and implemented the Red Flag Blotter, which was designed to capture variable annuity transactions that triggered one or more red flags in MSC's back office electronic surveillance system for review by a Compliance Principal

⁶⁰ Ex. C-5. MSC entered into the 2001 AWC following a variable products sweep exam FINRA conducted in 1999. Under the terms of the 2001 AWC, MSC was censured and fined \$35,000.

⁶¹ Ex. C-5, at 4.

⁶² *Id.* at 5.

⁶³ Ex. C-6.

⁶⁴ Tr. 79-80, 190-91; Ex. C-7, at 38 (Written Supervisory Procedures (Nov. 20, 2003 ed.)). In part, TRT grew out of the efforts of MSC's variable annuity task force, which started a review of the Firm's supervisory procedures for variable annuities in 1998 or 1999. Tr. 1241-47. MSC spent several years looking at how it could better utilize technology to review variable annuity transactions. Tr. 1243-44.

in TRT.⁶⁵ TRT's primary role was to review the details of all transactions on the daily Red Flag Blotter, document the Compliance Principal's suitability determinations, investigate any trading irregularities, and approve or reject each transaction.⁶⁶ In essence, the system was designed to identify and review transactions that warranted extra suitability review.⁶⁷

1. Variable Annuity Review Process

TRT reviewed variable annuity transactions by looking at various screens in MSC's back-office system. These screens were populated with client information entered in MSC's front-office system by the registered representative in the field.⁶⁸ If questions arose after reviewing the computerized information, a member of TRT would call the responsible registered representative for additional information. TRT also had the ability to request additional documentation, including a letter of explanation signed by the registered representative's customer. However, TRT would not contact customers directly.⁶⁹ TRT would then approve or deny the transaction, and state the reasons for doing so by entering dates and comments in the appropriate fields in the Trade Review Form in the back-office system.⁷⁰ TRT's comments usually consisted of any comments entered by registered representative in the field, to which a TRT principal would add his own comments.⁷¹ To evidence the completed review, a TRT principal would select his

⁶⁵ Tr. 192-93; Ex. C-7, at 38-39; Ex. C-8, at 39. The red flags included missing age or financial information; age over 70; amount of trade greater than 15% of net worth; annual income less than \$25,000; amount of trade greater than or equal to 25% of annual income; amount of trade greater than \$150,000; IRA within a qualified account; holding period of less than five years; surrender charges greater than \$1,000; and inappropriate sub-account allocation.

⁶⁶ Tr. 79-80, 193, 284, 288. MSC maintained a three-day deadline for TRT to complete its review of each Red Flag Blotter. Tr. 287.

⁶⁷ Tr. 284.

⁶⁸ Tr. 90, 1002-03. MSC used the computer system called "Advisor Online."

⁶⁹ Tr. 293.

⁷⁰ Tr. at 83-84, 92, 97-98.

⁷¹ Tr. 95.

name from a drop-down menu in the “Approved By” field and enter the date he completed the review in the “Date Approved” field.⁷² TRT would then deliver the blotter to the Operations Department.⁷³

After TRT completed its review, a principal in the Operations Department would review the transactions on a screen in the back-office system and check TRT’s reasons for approving or denying the transaction.⁷⁴ The operations principal would verify that no red flags had been missed, that all customer data were entered, and determine if anything about the transaction raised unaddressed questions.⁷⁵ If the operations principal agreed with TRT’s conclusions about the transaction, the operations principal would approve, date, and sign the blotter.⁷⁶

During 2004, Cohen was the designated TRT principal responsible for reviewing the transactions on the Red Flag Blotter, and Roth was the principal in the Operations Department responsible for the final review and approval of the blotters. If Roth had any concerns about the transactions on the Red Flag Blotters, she would discuss them with Coates, the head of the Operations Department.⁷⁷

Roth also was responsible for reviewing a number of other blotters. Among those were: (1) the “New Business Daily Report by Rep Number,” which included all direct business excluding 1035 Exchanges that did not hit any of the red flags established by the TRT Committee; (2) the “New Business Daily 1035 Exchange Report by Rep Number,” which included all 1035 Exchanges that did not hit the Red Flag Blotter; (3) “the Direct

⁷² Tr. 92.

⁷³ Tr. 93, 98.

⁷⁴ Tr. 338-39, 409, 1257-58; Ex. C-32, at 4.

⁷⁵ Tr. 829-30, 1013; Ex. C-11, at 5-6; Ex. C-32, at 4.

⁷⁶ Tr. 339; Ex. C-11, at 5 (MSC’s Operations Manual).

⁷⁷ Ex. C-32, at 4.

Participation Programs & Private Placements Blotter” (“DPP Blotter”); and (4) the “New Business Pending Approval Blotter for Limited Partnerships” (“LP Blotter”).⁷⁸

2. Backlog and Suspension of 1035 Exchange Reviews in 2004

All parties agree that MSC fell behind in its review of the Red Flag Blotter in early 2004. By the end of February 2004, TRT was two or more weeks behind, which meant that Roth could not complete her final review and approval of the Red Flag Blotters timely.⁷⁹ Roth raised her concern about the backlog to her supervisor, Coates, as well as to Aracri, who headed up TRT at the time. Roth expressed her view that TRT was understaffed in light of the new business being generated from the acquisition of another firm, NPA, and asked Aracri if she had plans to add staff in TRT. Aracri responded that she had not realized the depth of the problem, but she would encourage TRT to catch up. She further advised Roth that there were no definite plans to add additional personnel.⁸⁰

Although Aracri stated that she would address the backlog, the situation continued. On March 3, 2004, Roth alerted Coates by e-mail that she had not received a Red Flag Blotter in approximately two weeks and that reviews of transactions on the LP Blotters were months behind.⁸¹ Coates forwarded this e-mail to Poston and Kaminski and requested a meeting with Poston to assess the situation.⁸² In a later meeting with Poston, Coates confirmed that TRT was two weeks behind in its review of the Red Flag Blotters.⁸³ Nevertheless, she did not propose any action to rectify the backlog, nor did she

⁷⁸ Ex. C-11 (MSC’s Operations Manual).

⁷⁹ Tr. 534, 1062; Ex. C-14, at 2.

⁸⁰ Ex. MSC-2.

⁸¹ Tr. 412-13; Ex. C-14.

⁸² Tr. 414-15; Ex. C-14.

⁸³ Tr. 413-16.

follow up with Roth to ascertain whether TRT corrected the situation.⁸⁴ Kaminski did not respond at all to Coates' March 4 e-mail.⁸⁵

By March 2004, Poston had concluded that the Compliance Department could not meet the breakpoint deadline while continuing to perform reviews of the Red Flag Blotter.⁸⁶ Poston shared his conclusion with Kaminski, and they decided to suspend the Red Flag Blotter reviews to concentrate their efforts on meeting the breakpoint deadline.⁸⁷ Accordingly, on March 15, 2004, Poston instructed the Compliance Department to stop reviews of all exception blotters and concentrate on the breakpoint reviews.⁸⁸ At the same time, Poston temporarily reassigned Cohen from TRT to the breakpoint reviews.⁸⁹ Thereafter, the Compliance Department continued a "total dedication" to the breakpoint reviews until June 1, 2004.⁹⁰

Although Coates knew that TRT had suspended all reviews of the Red Flag Blotter,⁹¹ she did not advise Roth of this decision immediately. Consequently, Roth continued to update Coates on the status of the backlogs, warning her that conditions were not improving. On April 7, 2004, Roth sent an e-mail to Coates in which she stated that the situation was "getting worse by the day."⁹² Roth advised Coates that she had not received any variable annuity or DPP blotters from TRT in weeks. She further told Coates that she could not assist TRT with blotter reviews because her spare time was devoted to the issues surrounding MSC's acquisition of NPA.

⁸⁴ Tr. 426.

⁸⁵ Tr. 529.

⁸⁶ Tr. 223-24.

⁸⁷ Tr. 223-26.

⁸⁸ Tr. 104-05; 301-02, 1931-32.

⁸⁹ Tr. 223-26.

⁹⁰ Tr. 216, 228.

⁹¹ Tr. 226.

⁹² Ex. C-14, at 1.

Despite the fact that Coates knew that MSC was unable to review its variable annuity business, she did little in response. Although Coates knew that Roth could not perform her review and approval of the Red Flag Blotters until TRT completed its review, Coates merely forwarded Roth's e-mail to Poston with the question, "R we in trouble?" Coates took no other action to address the problem. In turn, Poston forwarded Coates' e-mail to Sanfilippo with the comment that they needed to meet and "regroup."⁹³ However, there is no evidence that anyone took immediate corrective action.

It was not until the middle of the following month that MSC made an effort to add personnel to TRT.⁹⁴ On May 17, 2004, Cohen spent a few hours training three people from the Operations Department on how to review various red flags and what to do to confirm trade suitability.⁹⁵ But the effort was unsuccessful because the selected personnel were not capable of conducting the reviews. They did not possess enough knowledge about variable annuities to evaluate the transactions. Accordingly, they never undertook any reviews following their training.⁹⁶ When this effort failed, MSC did not designate others to help TRT with the Red Flag Blotter reviews until August 2004.⁹⁷

Instead of catching up with the backlog, in May 2004, Kaminski and Poston determined that TRT would resume daily review of Red Flag Blotters as they were received starting on June 1. Poston instructed Cohen to ignore the backlogged transactions.⁹⁸ MSC did not begin work on the backlogged transactions until August 2004, and did not complete those reviews until October 2004.

⁹³ C-14, at 1.

⁹⁴ Ex. MSC-69.

⁹⁵ Ex. C-19.

⁹⁶ Tr. 2101.

⁹⁷ Tr. 109-10.

⁹⁸ Tr. 105-06.

3. Backdating of Red Flag Blotters and Related Trade Review Forms

In August 2004, Kaminski finally took some action in an attempt to address MSC's failure to supervise its variable annuity business. He transferred three people from other departments to assist the Compliance Department. One of the three was Respondent T, a Marketing Department employee with no compliance experience. However, because Respondent T had familiarity with variable annuities from his work in marketing, Sanfilippo and Cohen assigned him to review the 597 backlogged transactions.⁹⁹

Respondent T started in TRT on August 9, 2004, whereupon Cohen trained him in how to conduct suitability reviews of the transactions on the Red Flag Blotters.¹⁰⁰ Cohen testified that the training he gave Respondent T was similar to that which he gave to the three individuals who had been designated to assist TRT in May 2004.¹⁰¹ Cohen told Respondent T to review the transactions and then to document his review on the on-line Trade Review Forms by selecting Kevin Cohen's name as the reviewer from the drop down box and entering the current date in the "Date Approved" field.¹⁰² Cohen told Respondent T that there likely would be no need for him to contact any of the Firm's registered representatives about the transactions, and Respondent T never did.¹⁰³ Cohen instructed Respondent T to bring him the working copy of each blotter after Respondent T completed his review of the transactions on the blotter. Cohen needed to receive a copy of the blotters because MSC's written procedures required a registered principal to conduct the reviews, and Respondent T was not a registered principal. Respondent T understood from Cohen's instructions that Cohen would review all of his work and

⁹⁹ Tr. 111, 154, 156, 2104.

¹⁰⁰ Tr. 109-11.

¹⁰¹ Tr. 2106.

¹⁰² Tr. 112-13, 170, 309-10. Cohen told Respondent T to select his name from the drop-down menu because Respondent T's name was not an available option. Tr. 1171.

¹⁰³ Tr. 115.

provide the final Compliance Department sign-off for the backlogged transactions.¹⁰⁴

Cohen further instructed Respondent T to take a second copy of each blotter to Roth in the Operations Department.¹⁰⁵ Respondent T followed Cohen's instructions.

Once Cohen completed the initial training on the first day, Respondent T was left to work largely unsupervised. Although Kaminski designated himself as Respondent T's direct supervisor while he was assigned to TRT, Kaminski made no effort to supervise him. Indeed, Kaminski testified that he did not know what Respondent T was doing in TRT on a day-to-day basis.¹⁰⁶ Nor did Kaminski delegate his supervisory responsibilities to others. Neither Sanfilippo nor Cohen supervised Respondent T.¹⁰⁷ Although Cohen's name appeared on the Trade Review Forms as the person who performed the reviews, he did not thoroughly review Respondent T's work. Cohen testified that he spot-checked about five or six transactions per week.¹⁰⁸

Shortly after Respondent T began reviewing the Red Flag Blotters, Roth noticed that he had entered the actual dates of his reviews on the Trade Review Forms.¹⁰⁹ The difference in time between the transaction date and the recorded review date indicated that the reviews were not occurring within the time frame prescribed by MSC's supervisory procedures, adopted to implement the terms of the 2001 AWC. Roth brought the discrepancy between the transaction and review dates to Coates' attention, which led to a discussion with Coates about how Roth completed her review and approval of the Red Flag Blotters. Coates asked Roth to show her how TRT documented its reviews of the blotters.¹¹⁰ During their meeting in Coates' office, they looked at one of the blotters

¹⁰⁴ Tr. 1168, 2140.

¹⁰⁵ Tr. 177, 1166, 1170.

¹⁰⁶ Tr. 547.

¹⁰⁷ Tr. 308.

¹⁰⁸ Tr. 114.

¹⁰⁹ Tr. 1035.

¹¹⁰ Tr. 430.

and some representative transactions in MSC's on-line system.¹¹¹ Coates immediately expressed her concern that the dates did not coincide, and she told Roth to speak to the Compliance Department about the issue.¹¹² Roth objected because she did not consider it her position to speak to the Compliance Department about the manner in which it performed its work.¹¹³ Roth then returned to her office.

Within a few minutes, Coates came to Roth's office and continued their discussion about the review dates. While they were discussing the issue, either Sanfilippo or Poston walked by and was asked to join the conversation. After further discussion, Coates expressed her view that TRT should enter a date close in time to the transaction date. Roth concluded from her discussions with Coates that she and TRT were to backdate their reviews.¹¹⁴

Thereafter, Roth instructed Sanfilippo and Cohen to direct Respondent T to enter dates a few days after the trade dates rather than the actual dates he completed his review.¹¹⁵ Cohen testified that Roth came to TRT in the second half of August and questioned why TRT was using the actual review dates rather than dates closer to the transaction dates.¹¹⁶ According to Cohen, Roth said she would speak to Kaminski about the matter.¹¹⁷

Sanfilippo likewise testified that Roth came to TRT and said she did not like the fact that Respondent T was entering the actual dates he completed his review of the backlogged transactions.¹¹⁸ Sanfilippo gave a detailed account of his conversation with

¹¹¹ Ex. J-13, at 24, 93-94; Ex. C-32, at 6.

¹¹² Ex. J-13, at 24, 94-95.

¹¹³ Ex. J-13, at 24, 95, 98; Ex. C-32, at 6.

¹¹⁴ Ex. J-13, at 98.

¹¹⁵ Tr. 317-21.

¹¹⁶ Tr. 118-19; 2116.

¹¹⁷ Tr. 120.

¹¹⁸ Tr. 317.

Roth. He testified that they began their discussion in TRT and concluded it in Roth's office. According to Sanfilippo, while they were discussing which date to use, they asked Kaminski for his opinion.¹¹⁹ Roth then told Sanfilippo to backdate the reviews, which was consistent with Sanfilippo's interpretation of Kaminski's direction to "get it done."¹²⁰

Following Sanfilippo's directions to do as Roth instructed, Cohen told Respondent T to retrieve the completed Red Flag Blotters and change the approval dates to ones closer to the transaction dates.¹²¹ Respondent T then went back into the computer system for each backlogged transaction he had reviewed and changed the "Date Approved" field to one that was within one or two days of the transaction date.¹²² Thereafter, Respondent T backdated all of his reviews, which made it appear from MSC's records that the backlogged transactions had been reviewed and approved timely.¹²³ Respondent T finished reviewing the backlogged transactions on October 20, 2004, at which time he was transferred back to the Marketing Department.¹²⁴

When Roth began receiving backdated Trade Review Forms from Respondent T, she backdated her reviews to correspond with the dates Respondent T had selected.¹²⁵ She dated her signature to make it appear that she had completed her review and approval shortly after the date Respondent T had entered to evidence TRT's review. Roth testified at her on-the-record interview that she backdated the blotters at Coates' direction so that the review dates on the Red Flag Blotters would correspond with the dates TRT entered on the Trade Review Forms.¹²⁶

¹¹⁹ Tr. 319.

¹²⁰ Tr. 319, 321, 1952-54.

¹²¹ Tr. 123, 170, 321-22.

¹²² Tr. 126-27, 174-75.

¹²³ Tr. 174-75.

¹²⁴ Tr. 176.

¹²⁵ Tr. 370, 372, 375, 382, 1036-37.

¹²⁶ Ex. J-13, at 23-24.

However, at the hearing, Roth substantially recanted the account she gave at her on-the-record interview in June 2005 of hers and Coates' role in the decision to backdate the Red Flag Blotters and related Trade Review Forms. In general terms, Roth either tailored her story to Coates' testimony or claimed that she could not recall the specifics of her conversations with Coates. Roth repeatedly testified that she did not have a clear recollection of her meeting with Coates at which they discussed the variable annuity review dates.¹²⁷ Nor could she recall Coates ever ordering her to backdate the Red Flag Blotters.¹²⁸ Roth attributed the notable divergence from her prior testimony to her being upset and confused at her on-the-record interview.¹²⁹ Roth testified that her on-the-record interview testimony did not make any sense.¹³⁰

The Hearing Panel concluded that Roth's on-the-record testimony was more credible than her hearing testimony. During her on-the-record testimony, Roth provided a highly detailed and specific narrative of her meeting with Coates. At no point during her on-the-record interview did she indicate that she was upset or confused. Further, the transcript of her on-the-record interview reveals that she was represented by counsel, who also did not raise any question about Roth's state of mind or the accuracy of her testimony. Following the conclusion of the on-the-record interview, Roth reviewed the interview transcript with her attorneys, but neither she nor her attorneys told FINRA that the transcript contained any inaccuracies.

¹²⁷ Tr. 384.

¹²⁸ Tr. 397.

¹²⁹ Tr. 1154.

¹³⁰ Tr. 383.

C. MSC Provided False Information to FINRA Regarding the Backlogged Transactions

During the course of FINRA's investigation of MSC's supervision of 1035 Exchanges, FINRA staff learned of the backlogged transactions.¹³¹ While reviewing internal MSC documents in preparation for a scheduled on-the-record interview of Poston in February 2005, the staff noticed an e-mail between Poston and Sanfilippo that referenced the backlogged transactions. Although the staff had completed on-the-record interviews of Cohen, Sanfilippo, Roth, Coates, and Kaminski before February 2005, none had mentioned that MSC suspended reviews of the Red Flag Blotters between March 15 and June 1, 2004, or that MSC had backdated its records. Further, on February 14, 2005, MSC gave FINRA staff copies of falsified Trade Review Forms, without disclosing that the recorded review dates were inaccurate.¹³²

On March 24, 2005, after the staff learned of the variable annuity backlog, the staff sent Turigliatto a request for further documentation.¹³³ The staff requested "all documentation pertaining to the 1035 exchanges that were reflected on MSC's Variable Annuity Pending Approval blotter during the time period of March 15 through June 1, 2004," as well as the date each transaction was reviewed.¹³⁴ In addition, the staff directed MSC to provide a written explanation "[i]f any responsive information has been deleted, overwritten, lost or is otherwise no longer in [its] possession."¹³⁵

On March 16, 2005, approximately one week before FINRA staff issued the written request for documents relating to the backlogged transactions,¹³⁶ Coates reviewed

¹³¹ Tr. 573-74.

¹³² Ex. C-3. In addition, MSC did not inform the staff that Respondent T had performed the reviews, not Cohen.

¹³³ Tr. 574-77; Ex. C-26.

¹³⁴ Ex. C-26, at 1.

¹³⁵ *Id.*

¹³⁶ *Id.*

a sample of the backdated Red Flag Blotters with Roth.¹³⁷ After reviewing the Firm's records and consulting with Kaminski and Turigliatto, Coates directed Donna Cronin ("Cronin"), an employee in the technology department, to determine if she could retrieve from MSC's computer system the actual review dates for all the backdated Trade Review Forms.¹³⁸ Cronin reported to Coates that the system captured the date a reviewer first entered data into the on-line Trade Review Forms, and Coates then went to Cronin's office to review her findings.¹³⁹

Coates met with Cronin again on March 18, 2005, at which time they had a conference call with Turigliatto. Coates and Turigliatto instructed Cronin to run a report that showed the date Respondent T entered data into the on-line Trade Review Forms.¹⁴⁰ MSC then used this information to change the review dates on the backdated Trade Review Forms.¹⁴¹ MSC did not preserve records reflecting the original dates or create a control log documenting the changes.

In response to FINRA's document request, on April 7, 2005, MSC produced the corrected records. Turigliatto sent a cover letter with the documents that stated, "[t]he MSC Review Trade forms reflect the review completed by TRT and the date the trade was approved."¹⁴² Turigliatto did not disclose the fact that MSC's original records had been falsified or that MSC had destroyed those records shortly before her response.

Turigliatto sent a second letter the same day in which she addressed numerous issues related to FINRA's on-going investigation.¹⁴³ With respect to MSC's late reviews

¹³⁷ Tr. 432-33.

¹³⁸ Tr. 446.

¹³⁹ Tr. 448-49.

¹⁴⁰ Tr. 452, 455, 458-59; Ex. MSC-31.

¹⁴¹ Tr. 439-40, 474-75, 874.

¹⁴² Ex. C-28.

¹⁴³ Ex. C-27.

of variable annuity transactions, she stated, “[t]he reviews of the prior transactions from March 15 through June 1, 2004, were completed from August to October 20, 2004.”¹⁴⁴ But again she did not mention the backdating or the later changes MSC made to the dates on the Trade Review Forms. Turigliatto testified that she omitted all reference to backdating because she and Makens had concluded that the best strategy for MSC was to report the issue at a face-to-face meeting rather than in writing.¹⁴⁵ Both Turigliatto and Makens testified that they planned to report the backdating violations at a meeting with FINRA staff on April 13, 2005, which supports the Hearing Panel’s conclusion that Turigliatto understood that the staff’s document request required MSC either to produce its original records for the period March 15 through June 1, 2004, or to provide an explanation of why it did not produce them.

In preparation for the April 13 meeting with Enforcement counsel, Delaney and Moreiro, Turigliatto prepared an outline of discussion points and topics, including the backdating, which she intended to review. Turigliatto testified that she substantially relied on those notes during the meeting.¹⁴⁶ Turigliatto and Makens claimed that they left the meeting under the impression that they had reported the backdating incident.¹⁴⁷ She further testified that the staff had little reaction to this news. She said there was a brief discussion about the backdating and that Delaney calmly replied, “Please let us know what you find out and keep us informed as to your progress.”¹⁴⁸ On the other hand, in their testimony, Delaney and Moreiro denied that either Turigliatto or Makens ever mentioned backdating.¹⁴⁹ Delaney and Moreiro argued that had they learned of the

¹⁴⁴ Ex. C-27, at 3.

¹⁴⁵ Tr. 1543.

¹⁴⁶ Ex. MSC 35, at 2-5; Tr. 1533-35, 1539-40, 1705.

¹⁴⁷ *See* Tr. 1713.

¹⁴⁸ Tr. 1541, 1706-07.

¹⁴⁹ Tr. 582, 591, 658, 662.

backdating at the meeting they surely would have had further questions given the serious nature of the information.¹⁵⁰ Furthermore, Delaney's notes from the meeting do not refer to backdating.¹⁵¹

Delaney and Moreiro testified that the first time they heard about backdating was 12 days later at Cohen's on-the-record interview.¹⁵² In support of their version of events, they point to the fact that an argument immediately erupted among counsel concerning the lack of disclosure by MSC when Cohen testified about the backdating. Both sides were shocked to hear the other's perception of the facts.¹⁵³ Unable to resolve their differences, FINRA completed Cohen's examination and soon thereafter began to investigate the facts surrounding MSC's backdating of the Trade Review Forms.¹⁵⁴

The Hearing Panel found that Turigliatto and Makens' discussion at the April 13 meeting of the outstanding issues surrounding MSC's review of its variable annuity business did not adequately respond to FINRA's information request. To the extent that Turigliatto used her prepared notes during the meeting, she did not do so in a way that clearly conveyed the new information concerning backdating. Without question, Delaney and Moreiro did not understand from MSC's presentation that it had backdated the Trade Review Forms or that the dates on the forms it produced had been altered just before they were produced in response to FINRA's information request. All of the evidence other than Turigliatto's and Makens' testimony supports this conclusion. Moreover, MSC was

¹⁵⁰ Tr. 625.

¹⁵¹ Ex. MSC-37.

¹⁵² Turigliatto and Makens advised Cohen to be forthright about the backdating at his on-the-record interview. Tr. 1713-14.

¹⁵³ See Tr. 1542-43; 1712.

¹⁵⁴ See Ex. C-29 (Letter from MSC to FINRA dated May 11, 2005, responding to FINRA's request for additional information dated April 28, 2005).

obligated to respond promptly in writing to FINRA's request for information or to explain why it could not.¹⁵⁵

D. Misrepresentations Regarding the Status of the 1035 Exchange Exception Report and Related Written Supervisory Procedures

MSC (through Dixon, Kaminski, Poston, and MSC's President, John Poff ("Poff")) also misled FINRA regarding certain improvements it had pledged to undertake to enhance its supervision of variable annuity transactions. Specifically, MSC had represented to FINRA in connection with the 2003 examination that it was developing an additional surveillance report for 1035 Exchanges. The report eventually became known as the 1035 Exchange Exception Report. However, contrary to MSC's representations, it did not develop a prototype report until May 2004 and did not implement such a report and the review procedures associated with the report until October 2004.

1. May 2004 Version of the 1035 Exchange Exception Report

In April 2004, FINRA followed up with MSC regarding the unresolved issues from the 2003 routine examination. Among the various issues FINRA wanted MSC to address was whether it had developed certain reports to bolster its supervision of 1035 Exchanges. DeArmey set forth the staff's concerns in a letter to Poston dated April 19, 2004.¹⁵⁶ In particular, DeArmey wanted MSC to say whether they had such reports or not.¹⁵⁷ The meeting was scheduled for May 18, 2004.

Dixon, Poff, Kaminski, and Poston met several times in April and May 2004 to prepare for the meeting with FINRA staff.¹⁵⁸ Among the topics they reviewed was the

¹⁵⁵ See, e.g., *Charles C. Fawcett*, Exchange Release Act No. 56,770, 2007 SEC LEXIS 2598, at *18-19 (Nov. 8, 2007).

¹⁵⁶ Ex. C-49.

¹⁵⁷ Tr. 1669.

¹⁵⁸ Tr. 241-43, 1669-70.

need to demonstrate to FINRA that MSC had developed adequate reports and written supervisory procedures covering 1035 Exchanges.¹⁵⁹ In those meetings, it was decided that MSC should create a report that tracked excessive exchange activity to exhibit MSC's enhanced supervisory procedures for 1035 Exchanges. Accordingly, in May 2004, MSC developed a prototype report designed to identify client accounts that had been subject to two or more 1035 Exchanges over the previous 12 months ("Prototype 1035 Exchange Exception Report").¹⁶⁰ Once the report was developed, MSC ran the report with data going back to January 2004. Dixon, Poff, Kaminski, and Poston intended to give FINRA staff a copy of the new report with the data from January 2004 at their meeting in Atlanta on May 18, 2004.¹⁶¹

MSC also drafted revised supervisory procedures in preparation for the meeting with FINRA staff.¹⁶² Poston drafted the proposed revisions to include the Prototype 1035 Exchange Exception Report and forwarded them to Kaminski and Turigliatto for their input.¹⁶³ To conform to the date of the data on the report MSC intended to give FINRA staff, Poston instructed his assistant to backdate the revised procedures earlier than January 2004.¹⁶⁴ Accordingly, his assistant backdated the final draft to December 30, 2003.¹⁶⁵ However, MSC never incorporated the draft revisions into its written supervisory procedures. Poston kept the drafts on the computer drive used by the Compliance

¹⁵⁹ Tr. 241; Ex. C-49.

¹⁶⁰ Tr. 233-35.

¹⁶¹ Tr. 252. Although Poston voiced his concern that if FINRA staff asked for work product or reviews of reports going back to January, MSC would have nothing to show them, Poff nevertheless insisted that the report include data from January 2004. Tr. 1905; Ex. C-15.

¹⁶² Tr. 241-42, 252, 1690.

¹⁶³ Tr. 250-51; Ex. C-22.

¹⁶⁴ Tr. 255; Ex. C-22, at 1.

¹⁶⁵ Ex. C-9.

Department, which was not accessible to the Firm's registered representatives generally.¹⁶⁶

Dixon, Poff, Kaminski, and Poston represented MSC at the Atlanta meeting with FINRA staff on May 18, 2004, and gave a presentation that included a discussion of MSC's variable annuity supervisory practices.¹⁶⁷ In addition, they gave the staff copies of the Prototype 1035 Exchange Exception Report and a copy of MSC's supervisory procedures dated May 2004 that referenced the Prototype 1035 Exchange Exception Report.¹⁶⁸ Dixon, Poff, Kaminski, and Poston jointly represented that the Prototype 1035 Exchange Exception Report had been in use since January 2004.¹⁶⁹

The following day, Poston summarized the results of the Atlanta meeting in an e-mail to Kaminski. Poston wrote,

In some ways it was almost too easy answering [FINRA's] concerns. We all agree it was a serious meeting, and we were able to dodge yet again. Maybe we are getting too good at this game? ... *I think that us being able to provide the evidence of the reports at the meeting was all the difference in the world with a favorable result.*¹⁷⁰

In addition to misleading FINRA about the Prototype 1035 Exchange Exception Report at the Atlanta meeting, Dixon, Poff, Kaminski, and Poston misrepresented MSC's supervisory efforts related to the Red Flag Blotters. They told the staff that MSC had made improvements to the supervision process dating back to late 2003, and they specifically discussed the Red Flag Blotter.¹⁷¹ But they made no mention of the fact that

¹⁶⁶ Tr. 1560.

¹⁶⁷ Tr. 265-66.

¹⁶⁸ Tr. 266-67, 744. Enforcement did not claim that MSC tendered the draft written supervisory procedures dated December 2003.

¹⁶⁹ Tr. 743-44.

¹⁷⁰ Ex. C-13 (emphasis added).

¹⁷¹ Tr. 268, 742.

MSC had suspended reviews of the Red Flag Blotters between March 15 and June 1, 2004.¹⁷²

Immediately following the Atlanta meeting, a member of FINRA's staff wrote a three-page memorandum that detailed the staff's concerns and MSC's responses.¹⁷³ The memorandum reflects, and DeArme testified, that for the most part the staff was satisfied with MSC's response to the staff's concerns about the handling of 1035 Exchanges.¹⁷⁴ The memorandum identified three unresolved issues, one of which was the staff's insistence that MSC present side-by-side cost comparisons when doing 1035 Exchanges.¹⁷⁵ MSC strongly disagreed with the staff's position and was unwilling to institute such a procedure.

On June 9, 2004, the Director of FINRA's Atlanta office met with Kaminski and Poston in Fort Lauderdale, FL, and discussed the three remaining issues. FINRA treated the June 9 meeting as a Compliance Conference, which is the most serious disposition following a routine examination short of formal disciplinary action, and requested MSC provide a written response to each of the three issues.¹⁷⁶ FINRA staff decided not to pursue a formal disciplinary complaint at that time because the staff was satisfied that MSC had taken adequate steps to address the issues from the 2003 examination.¹⁷⁷ Significantly, DeArme testified that the staff would have recommended formal action against MSC if the staff had known that MSC had not followed through with the corrective measures MSC represented it had undertaken.¹⁷⁸

¹⁷² Tr. 268.

¹⁷³ Ex. C-51; Tr. 747.

¹⁷⁴ Tr. 747-48; Ex. C-51.

¹⁷⁵ Ex. C-51, at 3.

¹⁷⁶ Tr. 750; Ex. C-52, at 1.

¹⁷⁷ Tr. 750.

¹⁷⁸ Tr. 751-52.

MSC provided its written response in a letter from Kaminski dated July 14, 2004. In the letter, Kaminski confirmed that MSC used certain exception reports to review 1035 Exchanges. Kaminski specifically referred to the Prototype 1035 Exchange Exception Report, which he represented had allowed MSC to better track 1035 Exchanges since January 2004.¹⁷⁹ Kaminski knew at the time he sent the letter that this information was false because MSC had never used the Prototype 1035 Exchange Exception Report. In fact, MSC never implemented the Prototype 1035 Exchange Exception Report. Instead, MSC developed a replacement report in October 2004.

2. October 2004 Version of the 1035 Exchange Exception Report and Falsification of Related Records

Between August and October 2004, MSC worked on developing a working version of the Prototype 1035 Exchange Exception Report. MSC determined that the prototype was not useable. In the end, the version MSC adopted was designed to identify registered representatives that transacted five or more 1035 Exchanges in a month (“October 1035 Exchange Exception Report”).¹⁸⁰ Kaminski directed TRT to implement the new October 1035 Exchange Exception Report, and Sanfilippo in turn instructed Cohen to review the reports from January 2004.¹⁸¹ Cohen understood from Sanfilippo’s instructions that he was to make it appear that MSC had been performing the monthly reviews since January 2004.¹⁸²

Sanfilippo and Cohen worked together to develop procedures and forms to implement the new report, including a form letter that would be sent to the registered representatives whose names appeared on the reports.¹⁸³ The purpose of the letter was to

¹⁷⁹ Ex. C-53, at 8.

¹⁸⁰ Tr. 131-32; Ex. C-54.

¹⁸¹ Tr. 1956-57.

¹⁸² Tr. 134.

¹⁸³ Tr. 133.

request additional information from registered representatives whose names appeared on the report.

To carry out Sanfilippo's instructions, Cohen prepared a spreadsheet of the names of the registered representatives who appeared on the monthly reports between January and October 2004, along with the dates of their 1035 Exchanges. Cohen discussed the spreadsheet with Sanfilippo and then used the spreadsheet to calculate the dates that would have appeared on the follow-up letters from TRT if it actually had used those reports between January and October 2004.¹⁸⁴ Next, Cohen prepared 49 letters addressed to the registered representatives appearing on the October 1035 Exchange Exception Reports and dated the letters as if they had been sent shortly after the report dates.¹⁸⁵ Cohen then made copies of the letters for MSC's files and disposed of the originals.¹⁸⁶ In this way, he made it appear from MSC's records that MSC had been using a version of the October 1035 Exchange Exception Report each month starting in January 2004, which was not true.¹⁸⁷

In December 2004, Cohen falsely testified during his on-the-record interview that MSC had been running a 1035 Exchange Exception Report each month beginning with January 2004.¹⁸⁸ Cohen was represented at his on-the-record interview by MSC's attorneys, Turigliatto and Makens. At the hearing, Cohen admitted that he knew at the time of his on-the-record interview that his testimony was untruthful.

¹⁸⁴ Tr. 136; Ex. J-5, at 113.

¹⁸⁵ Tr. 141.

¹⁸⁶ *Id.*

¹⁸⁷ Tr. 136-37, 141.

¹⁸⁸ Tr. 2166-68.

E. Annual Audits for 2002 and 2003

As MSC's written supervisory procedures reflect, MSC was required to conduct an annual internal review pursuant to NASD Conduct Rule 3010(c). Poston was the designated supervisory principal with responsibility for the Firm's annual internal reviews.¹⁸⁹ Poston and MSC admit that they failed to conduct timely annual internal reviews for 2002 and 2003. They never completed an internal review for 2002, and MSC did not complete its 2003 review until March 2005.

IV. CONCLUSIONS OF LAW

A. Failure to Supervise

1. Legal Standard

"Assuring proper supervision is a critical component of broker-dealer operations."¹⁹⁰ NASD Conduct Rule 3010(a) requires that FINRA members "establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [FINRA]."¹⁹¹ Conduct Rule 3010(b) further requires that a member "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of [FINRA]."¹⁹² Rule 3010 also states that a member's review of trading activity must be "reasonably designed to assist in detecting and preventing

¹⁸⁹ Ex. C-7, at 46.

¹⁹⁰ *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007).

¹⁹¹ NASD Conduct Rule 3010(a).

¹⁹² NASD Conduct Rule 3010(b).

violations....” The standard of “reasonableness” is determined based on the particular circumstances of each case.¹⁹³

A violation of Conduct Rule 3110 also is a violation of Conduct Rule 2110, which requires member firms to observe high standards of commercial honor and just and equitable principles of trade.¹⁹⁴

2. MSC’s Supervisory Violations

During the relevant period in 2004, MSC failed to maintain and enforce an adequate supervisory system to detect and prevent potential rule violations relating to its variable annuity business. The evidence demonstrates that MSC’s managers responsible for compliance with applicable securities laws and regulations and the NASD Conduct Rules approached the compliance function as a “game,”¹⁹⁵ the object of which was to conceal MSC’s shortcomings from FINRA staff. Indeed, Kaminski candidly admitted that one of his objectives when interacting with FINRA staff was to withhold “incriminating information.”¹⁹⁶ Furthermore, Kaminski instructed the Compliance Department to take a similar tact. For example, in preparing for the May 2004 meeting with FINRA staff, Kaminski advised Poston to “ensure we do NOT have any incriminating info we are going to exchange with them.”¹⁹⁷ At the hearing, Kaminski explained that this advice was consistent with his normal practice.¹⁹⁸

The Hearing Panel rejected MSC’s argument that its supervisory deficiencies should be excused at least in part due to the regulatory demands FINRA and other

¹⁹³ See, e.g., *Christopher Benz*, Exchange Act Release No. 38,440, 1997 SEC LEXIS 672, at *12 (Mar. 26, 1997) (citing *In re Consol. Inv. Servs., Inc.*, Securities Exchange Act Rel. No. 36,687, 52 S.E.C. 582, 1996 SEC LEXIS 83 (Jan. 5, 1996)).

¹⁹⁴ *Kresge*, 2007 SEC LEXIS 1407, at *42.

¹⁹⁵ See Ex. C-13.

¹⁹⁶ Tr. 554.

¹⁹⁷ Ex. C-15, at 4 (emphasis in original).

¹⁹⁸ Tr. 554.

regulators imposed in 2004.¹⁹⁹ The Hearing Panel recognized that member firms faced extraordinary regulatory burdens during 2003 and 2004, including inquiries regarding mutual fund breakpoints and market timing. While the Hearing Panel recognized that these burdens might have required MSC to make reasonable interim adjustments to its supervisory procedures, the Hearing Panel found that MSC's failures far exceeded any reasonable response, and that MSC never sought to engage FINRA in any honest discussion of the challenges it faced when these burdens were exacerbated by MSC's loss of compliance personnel. Quite simply, MSC elected to muddle through, and its most senior executives chose not to allocate sufficient resources to meet its compliance needs. Notably, Poff, Dixon, and Kaminski did not address the Compliance Department's personnel problems adequately. Although they knew that the Compliance Department lacked a sufficient number of experienced compliance professionals, they made little effort to correct the problem. The Hearing Panel was particularly concerned by Poff, Dixon, and Kaminski's failure to authorize salary levels to attract qualified full-time employees or to authorize an adequate budget for temporary help. Poston repeatedly reported his inability to hire qualified people at the approved salary levels, but MSC made no adjustments. Kaminski essentially left Poston to manage as best he could with an inadequate staff. As Kaminski explained, he left Poston to "sink or swim" because Poff and Dixon would not support requests for additional compliance resources.²⁰⁰ Equally troubling was the fact that MSC proceeded with an aggressive business expansion when the Operations and Compliance Departments could not keep up with the pre-existing workload. MSC's acquisition of NPA with about 75 additional registered representatives significantly contributed to MSC's supervision problems. MSC did not have an adequate supervisory system to accommodate this added business.

¹⁹⁹ Cf. *Department of Enforcement v. Pellegrino*, No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *77 (Jan. 4, 2008) (rejecting the argument that it was mitigating that the respondent had to comply with many new regulations and several FINRA examinations during the relevant period).

²⁰⁰ Tr. 1407; Ex. P-23, at 1.

In addition, to whatever extent unexpected or extraordinary circumstances disrupt the normal exercise of supervisory procedures, they can never serve as an excuse to mislead FINRA. Contrary to MSC's arguments, it did not honestly address the issues FINRA staff raised in connection with the 2003 routine examination. As discussed above, the staff continued to have concerns about MSC's supervisory review of variable annuity exchanges following MSC's 2003 examination, and MSC had been putting the staff off by reporting that it was implementing corrective measures. When FINRA staff finally required MSC to demonstrate that it had in fact accomplished what it had been promising, MSC presented the staff with reports and written supervisory procedures at the meeting on May 18, 2004, in Atlanta. But the reports and procedures Poff, Dixon, Kaminski, and Poston discussed at the meeting had never been implemented, a fact they withheld from their presentation.

Poff, Dixon, Kaminski, and Poston deliberately misrepresented MSC's supervisory procedures and practices to avoid possible disciplinary charges. MSC's supervision of variable annuities, including 1035 Exchanges, had been the subject of the 2001 disciplinary action against MSC, and Poff, Dixon, Kaminski, and Poston realized that MSC could be charged again if it could not demonstrate improved supervisory practices and procedures at the May 18 meeting. Their deception was successful. Ultimately, the staff was satisfied that MSC had taken appropriate action to shore up its supervision of 1035 Exchanges, and the staff declined to recommend disciplinary action. Poston expressed the significance of the meeting and the importance of their deception in the e-mail he sent later that day to Kaminski. Poston first acknowledged, "We all agree it was a serious meeting, and we were able to dodge yet again."²⁰¹ He then posed the

²⁰¹ Ex. C-13.

rhetorical question, “Maybe we are getting too good at this game?”²⁰² At the time, no one at MSC took issue with Poston’s assessment and characterization.

In addition, MSC failed to supervise TRT to ensure that its records regarding the review of the Red Flag Blotter were accurate. Over a period of months, Roth and Respondent T entered false dates on the Trade Review Forms. MSC’s supervision of Roth and Respondent T was inadequate.

In summary, the Hearing Panel finds that MSC failed to reasonably supervise its variable annuity business between March 15 and June 1, 2004.²⁰³ Accordingly, the Hearing Panel concludes that MSC violated NASD Conduct Rules 3110(a) and 2110, as alleged in the First and Third Causes of Action.

3. Kaminski’s Supervisory Violations

Enforcement also charged Kaminski with failure to supervise TRT’s review of the Red Flag Blotter from March 15 to June 1, 2004.²⁰⁴ Kaminski contended in his defense that he acted reasonably under the circumstances and that he should not be held strictly liable for any supervisory failures of other MSC employees. In particular, Kaminski argued that he should not be held strictly liable for Poston’s directive to stop the review of the Red Flag Blotter because he did not learn of Poston’s action until July 2004. According to Kaminski, until then, he had no reason to question Poston’s assurances that TRT was current in its review of the Red Flag Blotter.²⁰⁵

²⁰² *Id.*

²⁰³ The evidence showed that MSC failed to reasonably supervise its variable annuity business for a significantly longer period than charged. However, since Enforcement only charged MSC with failing to supervise between March 15 and June 1, 2004, the Hearing Panel’s findings of a violation are limited to this period.

²⁰⁴ Enforcement did not charge Kaminski with failing to supervise in connection with TRT’s falsification of records.

²⁰⁵ *See* Kaminski’s Post-Hr’g Br. 8-10.

Although Kaminski testified that he had no knowledge that the review of the Red Flag Blotter had been suspended between March and June 2004, the Hearing Panel found his testimony not credible when viewed against the testimony of Poston and the e-mails among the individual Respondents concerning the inability of TRT to stay current with the reviews. By March 2004, Kaminski knew that the Compliance Department was in crisis. Poston had advised Kaminski that the Compliance Department could not meet the breakpoint deadline unless Cohen was taken off the Red Flag Blotter reviews.²⁰⁶ Accordingly, Kaminski authorized Poston to suspend all other work by the Compliance Department so that it could concentrate on completing the breakpoint review process.

Kaminski's defense also failed to take into account the totality of the facts and circumstances surrounding his supervisory responsibilities. As discussed above, Kaminski was on notice no later than the third quarter of 2003 that the Compliance Department faced serious and persistent staffing problems. Although Kaminski directed Poston to prepare a written plan to address those problems in late 2003, Kaminski did nothing with the report. He never responded to Poston's recommendations or otherwise addressed the staffing issues outlined in Poston's memorandum dated January 2004.²⁰⁷ Kaminski attributed his inactivity in face of the Compliance Department's mounting problems over the first three months of 2004 to the lack of support he could expect if he raised the issues with his superiors. As Kaminski testified, it was not his practice to push his superiors for added staff.²⁰⁸

On the issue of Kaminski's involvement in the decision to suspend reviews of the Red Flag Blotters, the Hearing Panel credited Poston's testimony over Kaminski's for several reasons. First, it was undisputed that Poston lacked the authority to suspend

²⁰⁶ Tr. 223-26.

²⁰⁷ Tr. 1398-99.

²⁰⁸ Tr. 519.

reviews of the Red Flag Blotter. MSC considered the Red Flag Blotter to be the most important suitability review performed by TRT. As such, only someone as senior as Kaminski would have had the authority to suspend the Red Flag Blotter reviews. Second, the overwhelming weight of the evidence led to the conclusion that Poston would not have undertaken the responsibility for such action even if he thought he had the authority to suspend the reviews. Throughout Poston's tenure at MSC, he consistently sought Kaminski's approval on all significant actions. There is no evidence that would corroborate Kaminski's contention that Poston acted on his own. Third, Kaminski's position is illogical. Poston could not have suspended the Red Flag Blotter reviews without Kaminski's knowledge. Because TRT performed only the preliminary review of the blotters, Poston knew that any action to suspend the flow of blotters to the Operations Department would be reported immediately to Kaminski because he headed both departments. Thus, Poston could not have taken such action secretly. Finally, Kaminski held weekly management meetings throughout the relevant period at which Kaminski, Coates, and Poston discussed issues in the Operations and Compliance Departments. Kaminski's claim that they did not discuss the inability of those departments to perform the required supervisory reviews of the variable annuity blotters for several months is not credible.

The Hearing Panel also did not credit Kaminski's testimony because of certain inconsistencies in his testimony regarding the reports he received. Although at one point Kaminski testified that he first learned of the backlogged transactions on July 23, 2004, when Sanfilippo gave him a report listing the Firm's backlogged reports, at another point Kaminski conceded that he had received similar reports before.²⁰⁹ In addition, Kaminski testified at another point that he first learned of the Compliance Department backlogs in March 2004, which is when MSC stopped reviewing the Red Flag Blotters.²¹⁰ On

²⁰⁹ Tr. 1321.

²¹⁰ Tr. 1417.

balance, the Hearing Panel concluded that Kaminski's claim that he did not know about the backlogged transactions until July 2004 was not credible.

However, even if the Hearing Panel were to accept Kaminski's contention that he did not know that the Compliance Department had halted all reviews of the Red Flag Blotters between March 15 and June 1, 2004, the evidence demonstrated that Kaminski failed to carry out his supervisory responsibilities. Contrary to Kaminski's argument, the evidence did not demonstrate that he acted reasonably in response to his knowledge of the significant problems in the Compliance Department. Kaminski was involved in the decision-making for the Firm on a regular basis. In addition, he had direct supervisory responsibility for Poston, and overarching supervisory responsibility for the Compliance Department. Under these facts and circumstances, even if Poston was qualified, Kaminski nonetheless retained the responsibility to follow up and review that Poston was properly exercising his delegated supervisory duties.²¹¹ Kaminski did not discharge that duty. Had he done so, he would have discovered that the Compliance Department had ceased nearly all compliance functions between March 15 and June 1, 2004, other than the breakpoint reviews.

Moreover, once Poston raised serious problems with Kaminski, he was obligated to address those problems appropriately.²¹² However, aside from making some general suggestions to Poston about where to search for replacement compliance staff, Kaminski let Poston flounder. Kaminski failed to take decisive action to remedy the myriad and serious problems facing MSC and the Compliance Department in particular.

²¹¹ *Kresge*, 2007 SEC LEXIS 1407, at *35-36.

²¹² *See, e.g., Market Surveillance Comm. v. Markowski*, No. CMS920091, 1998 NASD Discip. LEXIS 35, at *52 (N.B.C.C. July 13, 1998), *aff'd on other grounds Michael J. Markowski*, Exchange Act Release No. 43259, 2000 SEC LEXIS 1860 (Sept. 7, 2000), *aff'd sub nom Markowski v. SEC*, 274 F.3d 525 (D.C. Cir. 2001).

Kaminski mischaracterized the evidence when he claimed that he reasonably addressed each concern that was brought to his attention.²¹³ He did not. For example, when some of the temporary employees Poston hired to assist with the breakpoint review did not prove effective, Kaminski directed Poston to try to get replacements at a lower cost.²¹⁴ Given the months of difficulty MSC experienced finding qualified staff, restricting Poston even further was not a reasonable response. Kaminski, as the person with overarching supervisory responsibility for compliance, should not have taken a hands-off approach in the face of numerous red flags that indicated it had become impossible for the Compliance Department to reasonably fulfill the supervisory responsibilities that MSC management had assigned to it.

Finally, the Hearing Panel rejected Kaminski's argument that some of Poston's e-mails could be read to state that the Compliance Department was able to stay current with the Red Flag Blotter reviews. Kaminski's construction of these e-mails can only be seen as his attempt to disclaim responsibility for his actions. For example, Kaminski points to the thread of e-mails that originated with Roth's e-mail to Coates on March 3, 2004, in which she reported that TRT was at least two weeks behind on the variable annuity blotters and offered her opinion that TRT is understaffed.²¹⁵ Coates forwarded the e-mail to Poston and sent a copy to Kaminski. Poston responded to Coates on March 4, 2004, with a copy to Kaminski, and stated, "I view your concerns as a serious issue, and they will be addressed!!! We will talk soon."²¹⁶ Kaminski incorrectly characterized Poston's response as an assurance that TRT was up to date on the reviews of the Red Flag Blotter. Not only do the e-mails not state that the blotters are up to date; they actually state the opposite. Roth stated clearly that TRT was two weeks behind and

²¹³ Kaminski's Post-Hr'g Br. 11.

²¹⁴ Tr. 1604-05; Ex. P-27.

²¹⁵ Ex. MSC-5.

²¹⁶ *Id.*

understaffed. Kaminski cannot justify his lack of response by relying on Poston's vague assurance to Coates that he intended to address the issue. Poston did not present an action plan to correct the Compliance Department's deficiencies. Under these circumstances, Kaminski was obligated to follow up and make sure that the Compliance Department was functioning properly—which he knew was not the case—and then take appropriate corrective action.

In conclusion, the Hearing Panel found that Kaminski violated NASD Conduct Rules 3010(a) and 2110 for failing to supervise the timely review of 1035 Exchanges between March 15 and June 1, 2004, as alleged in the First Cause of Action.

4. Coates' Supervisory Violations

The keystone of MSC's supervisory system for the review of its variable annuity business was the Operations Department. Historically, the Operations Department reviewed, approved, and documented each transaction. In about 2001, after MSC was charged with inadequate supervision of variable annuity transactions, MSC added another level of review for certain transactions. As discussed above, MSC modified its supervisory system and added TRT to perform this supervisory review. Importantly, however, MSC did not decrease the Operations Department's overall supervisory responsibility. The Operations Department remained responsible for the final review and approval of all variable annuity transactions. TRT, and the Compliance Department as a whole, could not approve variable annuity transactions. Thus, the review of the 1035 Exchange transactions that appeared on the Red Flag Blotter could not be completed until the Operations Department reviewed them. TRT's function was to screen certain transactions, such as those that appeared on the Red Flag Blotter, to assist the Operations Department.

Coates was responsible for the management and oversight of the Operations Department.²¹⁷ All operations principals reported to her. Under the Firm's written supervisory procedures, Coates had oversight responsibilities for all variable transactions.

Between March and June 2004, Coates observed the complete meltdown of MSC's supervisory system for the review of variable annuity transactions without taking reasonably appropriate steps to correct the situation.²¹⁸ In early 2004, Coates knew that both MSC's Operations Department and its Compliance Department were understaffed and unable to meet their daily supervisory responsibilities. Despite Roth's reports that MSC was not performing the supervisory reviews required by the Firm's supervisory procedures in a timely manner, Coates did very little to assure that her department would fulfill its supervisory responsibilities in this area. For example, when Coates received Roth's e-mail dated April 7, 2004, in which Roth reported that the "situation was getting worse by the day," Coates forwarded the e-mail to Poston with the note, "R we in trouble?"²¹⁹ Coates' response was not sufficient in light of all the circumstances. She knew at the time that MSC was not reviewing—and could not review—variable annuity transactions as required by the Firm's written supervisory procedures. Under these circumstances, Coates should have aggressively followed up to rectify the serious and persistent problems with MSC's supervision of variable annuity transactions. Nonetheless, Coates did not follow up.²²⁰

Coates continued to receive reports that signaled the depth of the supervisory crisis in the second quarter of 2004. On April 28, 2004, Roth advised Coates by e-mail that the Compliance Department needed assistance keeping up with the blotters. Coates

²¹⁷ Ex. C-11, at 1.

²¹⁸ Coates, like Kaminski, is only charged in the First Cause of Action with failure to supervise the timely review of variable annuity transactions between March 15 and June 1, 2004.

²¹⁹ Ex. C-14.

²²⁰ Tr. 423-24.

again took no action even though Roth indicated that the situation was so serious she felt compelled to lend a hand to the Compliance Department even though she was not able to keep up with her own workload in the Operations Department.²²¹

Coates also did not respond appropriately in May 2004 after Roth reported that her attempt to assist the Compliance Department had failed. On May 17, 2004, Roth reported in an e-mail to Coates that the Red Flag Blotters were backed up in the Compliance Department from March 12th.²²² Roth also reported that she had held a meeting at which an attempt had been made to train three members of the Operations Department staff to conduct the Red Flag Blotter reviews. However, the attempt was not successful because those employees were not qualified to do the reviews.²²³ Although Coates discussed the issue with Roth, she did not follow up with an alternative proposal.²²⁴

Coates argued that she could not be found to have violated FINRA's supervision rule (Conduct Rule 3010) because she acted reasonably under the circumstances.²²⁵ Coates stressed that Enforcement improperly sought to apply a standard of perfect or flawless supervision. Coates argued that she took "numerous proactive steps ... to assist Compliance with certain tasks in an effort to maintain client and representative satisfaction and ensure suitable sales."²²⁶ For example, she pointed to the fact that she approved or authorized personnel from the Operations Department to assist with breakpoint reviews and volunteered her staff in March 2004 to temporarily take complete charge of the reviews of the DPP Blotters.

²²¹ Ex. GS-26.

²²² Ex. C-19.

²²³ Tr. 428.

²²⁴ Tr. 1087-92.

²²⁵ See Coates' Post-Hr'g Br. at 9-11.

²²⁶ *Id.* at 5-6.

In concluding that Coates violated Conduct Rule 3010, the Hearing Panel took into consideration the controlling legal standard governing such cases, which is that supervision must be found reasonable under all of the facts and circumstances of the particular case under review.²²⁷ As both FINRA and the SEC have held, “It is not enough to demonstrate that an individual is less than a model supervisor or that the supervision could have been better.”²²⁸ But Coates’ arguments were based on an infirm interpretation of this standard and her supervisory responsibilities once she was confronted with overwhelming evidence that both the Operations Department and the Compliance Department had defaulted on their respective obligations to review the Firm’s variable annuity business.

Nor in this instance did Coates present evidence that she made any meaningful attempt to remedy the supervisory deficiency, but was obstructed from doing so. As discussed above with respect to Kaminski, both he and Coates were aware that MSC’s supervisory responsibilities over variable annuity sales were not being performed, and they made no effort to add resources or otherwise assure that the personnel reporting to them were meeting their obligations. The limited action Coates attributes to herself was inadequate and unreasonable, as was her reliance on Poston’s assurances that he would address the situation in an unspecified manner and at an unspecified time. Coates’ analysis failed to take into account that her department, not the Compliance Department, was responsible for the suitability reviews of the backlogged transactions. Thus, her entire argument that she was not responsible for the backlog is incorrect. In addition, Coates lacked a reasonable basis for her contention that she concluded from Poston’s responses that TRT was conducting its review as required by MSC’s written supervisory

²²⁷ See, e.g., *Dist. Bus. Conduct Comm. V. Lobb*, No. C07960105, 2000 NASD Discip. LEXIS 11, at *16 (N.A.C. Apr. 6, 2000).

²²⁸ *Id.* at *17 (citations omitted).

procedures.²²⁹ Coates knew from Roth's reports this was not the case. But regardless of Poston's reports, Coates was obligated to investigate and take aggressive affirmative action when she learned that the Operations Department could not carry out the reviews required under the Firm's written supervisory procedures. In short, the Hearing Panel concluded that Coates did not act reasonably under all of the facts and circumstances.

In conclusion, the Hearing Panel found that Coates violated NASD Conduct Rules 3010(a) and 2110 for failing to supervise the timely review of 1035 Exchanges between March 15 and June 1, 2004, as alleged in the First Cause of Action.

5. Poston's Supervisory Violations

The Complaint also charged Poston with failure to supervise TRT's review of the Red Flag Blotters from March 15 to June 1, 2004. Poston was MSC's Chief Compliance Officer during the relevant period, and he was Cohen's and Sanfilippo's designated supervisor. As the Chief Compliance Officer, Poston was responsible for TRT's review of the Red Flag Blotters, and Cohen and Sanfilippo were responsible for performing those reviews.

As the head of the Compliance Department, Poston was responsible for implementing MSC's written supervisory procedures insofar as they assigned supervisory duties to the Compliance Department. However, Poston failed to maintain and enforce those procedures throughout the first six months of 2004. Indeed, on March 15, 2004, he directed the Compliance Department to suspend nearly all compliance functions other than the breakpoint review process. In ordering this action, Poston took no steps to ensure that the Firm's variable annuity transactions received reasonable suitability review. While the Hearing Panel heard testimony and considered the burdens which regulatory breakpoint reviews placed upon MSC and other firms, neither Poston nor any other MSC principal explored less draconian alternatives to the suspension of all compliance

²²⁹ See Tr. 852-53.

functions related to the suitability of MSC's variable annuity business, such as temporarily reducing the TRT trigger criteria, prioritizing and reviewing only a sample of the items on the TRT report, or exploring whether other qualified principals were available temporarily within the firm to undertake TRT reviews.

Moreover, Poston himself made no effort to screen any of the transactions on the Red Flag Blotters between March 15 and June 1, 2004. This is a particularly significant factor because Poston reassigned the entire TRT team to the breakpoint review process on March 15, 2004. As a result, no one in the Compliance Department other than Poston had responsibility for reviewing the red flag transactions for more than 19 weeks.²³⁰

Poston argued that he acted reasonably under the circumstances. He emphasized the operational difficulties MSC faced at the time as well as his efforts to keep Kaminski informed. But these factors do not justify his decision to all but close down the Compliance Department for 11 weeks.²³¹ As the head of the Compliance Department, it was Poston's responsibility to establish and implement an adequate supervisory system with sufficient resources to carry out its mission. Accordingly, the Hearing Panel found that Poston violated NASD Conduct Rules 3010(a) and 2110 for failing to supervise the timely review of 1035 Exchanges between March 15 and June 1, 2004, as alleged in the First Cause of Action.

6. Sanfilippo—Supervision Charge in the First Cause of Action Dismissed

During the first quarter of 2004, Poston directed Sanfilippo to focus his efforts on the breakpoint review process.²³² The breakpoint review process was a significant

²³⁰ MSC did not begin to review the backlogged transactions until early August 2004. Poston ordered Cohen to skip the backlogged transactions when he returned to TRT on June 1, 2004.

²³¹ *Dep't of Enforcement v. Pellegrino*, No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *77 (N.A.C. Jan. 4, 2008) (rejecting the argument that excessive workload demands excused respondent's failure to carry out his supervisory responsibilities).

²³² Tr. 209-210, 302, 1961.

undertaking that required MSC to send a letter to customers who had purchased mutual funds and request that they supply information on a breakpoint refund claim form so that the Firm could investigate whether a breakpoint refund was owed to the customer. MSC was required to investigate and respond within 90 days of receiving a customer's breakpoint refund claim form.²³³

The tasks Poston assigned to Sanfilippo included, among other things, analyzing the guidelines that FINRA had mandated; developing MSC's procedures for conducting the breakpoint reviews; training MSC staff on how to conduct reviews of the breakpoint refund claim forms; creating a system to track the reviews as they were completed; compiling the number of claim forms coming in; distributing the claim forms to MSC staff; monitoring the various staff members that were working on the project, and updating Poston on the status of the breakpoint review process.²³⁴ In January and February 2004, MSC sent out approximately 85,000 breakpoint letters.²³⁵ As the breakpoint refund claim forms were returned to MSC beginning in March of 2004, Kaminski, Poston, and Sanfilippo realized that the Compliance Department lacked the capacity to meet the 90-day deadline. Accordingly, as discussed in detail above, MSC ceased other compliance functions, including the review of the Red Flag Blotter.

On March 15, 2004, Poston instructed the entire Compliance Department to concentrate on the breakpoint review process and suspend reviews of the variable annuity blotters. Hence, at that point, Sanfilippo was relieved of his responsibility for the timely review of the Red Flag Blotter. This situation continued until June 1, 2004, when Kaminski and Poston directed TRT to recommence review of the blotters.

²³³ Tr. 1260-62, 1601, 1762.

²³⁴ Tr. 1764-65, 1778, 1855, 1925-27.

²³⁵ Tr. 1601-02.

Based on the foregoing, the Hearing Panel concluded that the charge in the First Cause of Action against Sanfilippo should be dismissed. Sanfilippo did not have supervisory responsibility for the Red Flag Blotter between March 15 and June 1, 2004.

7. Cohen—Supervision Charge in the First Cause of Action Dismissed

The Hearing Panel dismissed the charge against Cohen that he failed to supervise the timely review of 1035 Exchanges between March 15 and June 1, 2004. The evidence showed that Cohen was reassigned to the breakpoint reviews during this period. Like Sanfilippo, he had no responsibility for the Red Flag Blotter between March 15 and June 1, 2004.

B. Falsification of MSC's Books and Records

In the Second Cause of Action, Enforcement charged MSC, Roth, Sanfilippo, Cohen, Respondent T, and Poston with creating and maintaining inaccurate books and records, in violation of NASD Rules 3110 and 2110, Section 17(a) of the Exchange Act, and Exchange Act Rules 17(a)(3) and 17(a)(4). NASD Rule 3110(a) requires member firms to “make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of [FINRA] and as prescribed by SEC Rule 17a-3.” Compliance with these recordkeeping rules is essential to the proper functioning of the regulatory process. “Indeed, the SEC has stressed the importance of the records that broker-dealers are required to maintain pursuant to the Exchange Act, describing them as the ‘keystone of the surveillance of brokers and dealers by our staff and by the securities industry's self-regulatory bodies.’”²³⁶ Entering inaccurate information in a member firm’s books or records violates NASD Rule 3110 and also violates NASD Rule

²³⁶ *Trevisan*, 2008 FINRA Discip. LEXIS 12, at *35 (quoting *Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979)).

2110's requirement that members observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business.²³⁷

1. Respondent T, Roth, Sanfilippo, and Cohen's Records and Related Supervision Violations

Respondent T, Roth, and Cohen admitted that they falsified certain of MSC's records. Respondent T backdated 597 Trade Review Forms between August and October 2004 in connection with his review of the backlogged transactions, and the evidence showed that Sanfilippo directed Respondent T to backdate the Trade Review Forms.²³⁸ In addition, Roth admitted that she backdated the related Red Flag Blotters to make it appear that she had conducted her reviews close in time to the backdated Trade Review Forms. And Cohen admitted that he falsified MSC's records by creating and signing 49 fictitious letters that requested information from certain registered representatives regarding their 1035 Exchange activity between January and October 2004. Although Cohen never intended to send the letters, and in fact did not send any of them, he nonetheless placed copies of the letters in the Firm's records to make it appear that the letters had been sent out and MSC had been using the monthly 1035 Exchange Exception Report between January and October 2004. Accordingly, the Hearing Panel found that MSC, Respondent T, Roth, Sanfilippo, and Cohen violated NASD Rules 3110 and 2110, Section 17(a) of the Exchange Act, and Exchange Act Rules 17(a)(3) and 17(a)(4) thereunder by either creating or maintaining inaccurate firm books and records.

In the Third Cause of Action, Enforcement also charged Roth, Sanfilippo, and Cohen with failing to supervise Respondent T to ensure that the Trade Review Forms

²³⁷ See, e.g., *Fox & Co. Inv., Inc.*, Exchange Act Release No. 52,697, 2005 SEC LEXIS 2822, at *30-32 (Oct. 28, 2005).

²³⁸ The Hearing Panel dismissed the charge that Respondent T falsified the Trade Review Forms for the backlogged transactions by selecting Cohen's name from the on-line system and entering it in the "Approved By" field. Cohen was the principal assigned to review the Red Flag Blotter in TRT. When Respondent T completed his preliminary review of the backlogged transactions, Cohen was required to review them. Respondent T did not have the authority or knowledge to complete the reviews, and he understood when he entered Cohen's name that Cohen would in fact perform that function.

and Red Flag Blotters were accurate. The Hearing Panel dismissed this charge because they were not designated as Respondent T’s supervisor while he was assigned to TRT. During that period, Respondent T reported directly to Kaminski. Roth, Sanfilippo, and Cohen lacked oversight authority over Respondent T at the time he entered the false data into the Firm’s on-line records. Roth, Sanfilippo, and Cohen each lacked the power to control Respondent T’s activities or to enforce any appropriate restrictions on his conduct. In addition, the Hearing Panel concluded that it would be “inappropriate and inconsistent” to make additional findings of deficient supervision with respect to the same violations for which the Hearing Panel found them substantively responsible.²³⁹ Roth’s, Sanfilippo’s, and Cohen’s failures to act appropriately in response to the situations at MSC in 2004 are part of the equation the Hearing Panel used in determining that they were primary actors in the Firm’s failure to create and maintain accurate books and records.

2. Poston—Records Charge in the Second Cause of Action Dismissed

In the Second Cause of Action, Enforcement charged that Poston modified MSC’s written supervisory procedures in May 2004 and directed his administrative assistant to backdate them to make it appear they had included a reference to the monthly 1035 Exchange Exception Report since December 2003.²⁴⁰ Poston did not dispute these core allegations. He admitted that he drafted the referenced revisions to MSC’s written supervisory procedures in May 2004 and directed his assistant to backdate the draft to December 2003. He further admitted that he knew that MSC wanted the draft to support the position it intended to take at the meeting with FINRA staff on May 18, 2004—that it

²³⁹ *Market Surveillance Comm. v. Markowski*, No. CMS92001, 1998 NASD Discip. LEXIS 35, at *52 (citing *Johnson & Co., Inc.*, 48 S.E.C. 943, 947 at n.14 (1998) (holding that since the respondent had been found to be substantively responsible for certain misconduct, additional findings of deficient supervision as to the same violations were “inappropriate and inconsistent”) (citing *Fox Sec. Co., Inc.*, 45 S.E.C. 377, 383 (1973)).

²⁴⁰ Compl. ¶ 58.

had implemented the monthly 1035 Exchange Exception Report in January 2004—which was untrue. But MSC never adopted Poston’s draft or incorporated it into the official version of the Firm’s written supervisory procedures. Accordingly, the Hearing Panel found that Poston did not falsify MSC’s records.

The official versions of the Firm’s written supervisory procedures in effect between November 2003 and August 2004 were dated November 20, 2003, and May 2004.²⁴¹ The May 2004 version added a reference to the prototype monthly 1035 Exception Report, which was first created that month for the meeting with FINRA staff on May 18, 2004.²⁴² These are the versions Poston and Turigliatto originally produced when requested by FINRA during the investigation in this matter. On April 30, 2004, in response to a request from Enforcement, Poston produced the written supervisory procedures dated November 20, 2003.²⁴³ Subsequently, on August 24, 2004, Enforcement requested Poston to provide “MSC’s complete supervisory procedures,” including on-line materials, and to “indicate, if not clearly reflected on the documents, what time period each was in effect.”²⁴⁴ Turigliatto responded by letter on September 23, 2004, and provided the November 30, 2003, and May 2004 versions.²⁴⁵ In addition, the undisputed evidence showed that MSC never published the December 2003 version on its Intranet site.²⁴⁶ MSC never made that version available to its supervisors and other registered representatives.

Enforcement pointed to MSC’s written response to another information request in September 2005 as evidence that MSC had adopted the December 2003 draft. In or about

²⁴¹ Tr. 1679-80; Ex. C-7; Ex. C-8.

²⁴² Ex. C-8, at 41.

²⁴³ Ex. P-76, at 2, 6, 8-35; Tr. 1683-86.

²⁴⁴ Ex. P-66, at 5.

²⁴⁵ Ex. P-66, at 8; Tr. 1687-90.

²⁴⁶ Tr. 1549, 1680, 1800-01.

April 2005, Cohen discovered two other versions of the Firm's written supervisory procedures, which he disclosed to Turigliatto and Makens in connection with the preparation for an upcoming on-the-record interview.²⁴⁷ Cohen found the documents on a computer disk drive available only to the Compliance Department.²⁴⁸ One was dated December 2003 and the other was dated January 2004.²⁴⁹ Cohen testified that he had not seen a copy of the December 2003 document until he found it on the compliance disk drive in 2005.²⁵⁰

Cohen testified about finding these two documents at his on-the-record interview in June 2005. Then, by letter dated September 7, 2005, FINRA requested clarification of when MSC added a reference to the monthly 1035 Exchange Exception Report into its written supervisory procedures. In addition, FINRA requested MSC to provide a copy of each version of its written supervisory procedures that had been in effect between December 1, 2003, and July 31, 2004.²⁵¹

Turigliatto responded to FINRA's request by letter dated September 14, 2005, without first checking with Poston or his assistant.²⁵² In her response, she erroneously stated, "The provision relating to the 1035 Exchange Exception Report was inserted into MSC's [written supervisory procedures] on December 30, 2003. Subsequent revisions were made on January 28, 2004, May 6, 2004 and on a second, unspecified date in May 2004."²⁵³ But, as discussed above, MSC had not inserted the language concerning the 1035 Exchange Exception Report in December 2003. Indeed, that draft document contains an "OSJ-Branch Manager List As of 5-2004" and a list of the "Home Office

²⁴⁷ At the time, Turigliatto and Makens represented Cohen as well as MSC.

²⁴⁸ Tr. 2125-26; Ex. J-5, at 128-31.

²⁴⁹ Tr. 2125.

²⁵⁰ Tr. 2150.

²⁵¹ Ex. P-78.

²⁵² Tr. 1548-49.

²⁵³ Ex. C-30.

Principals As of 5-4-04.”²⁵⁴ Moreover, Cohen told Enforcement during his on-the-record interview in June 2005 that the two computer files he found bore creation dates of May 2004.²⁵⁵ Clearly, the draft written supervisory procedures dated December 2003 was Poston’s non-public working file, which MSC had not adopted as the Firm’s procedures.

In consideration of the foregoing, the Hearing Panel concluded that the December 2003 document was never adopted as an official record of the Firm. MSC had Poston draft the 2003 version to bolster its false representation to FINRA on May 18, 2004, that the Firm had implemented the monthly 1035 Exchange Exception Report in January 2004. MSC made that representation and provided FINRA with a copy of its written supervisory procedures dated May 2004.²⁵⁶ But there is no evidence that the draft was ever used for any other purpose. Accordingly, the charge against Poston in the Second Cause of Action that he violated NASD Rules 3110 and 2110, Section 17(a) of the Exchange Act, and Exchange Act Rules 17(a)(3) and 17(a)(4) by falsifying MSC’s records must be dismissed.²⁵⁷

C. Failure to Conduct Annual Internal Reviews

NASD Conduct 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.

²⁵⁴ Tr. Ex. P-78, at 5-6.

²⁵⁵ Ex. J-5, at 128.

²⁵⁶ See Ex. C-8.

²⁵⁷ In light of this finding, the Hearing Panel did not reach the issue of whether the Complaint properly charged Poston with a violation of NASD Conduct Rule 3110 and Exchange Act Rules 17a-3 and 17a-4. The Hearing Panel notes that the requirement to establish, maintain, and enforce written supervisory procedures is not addressed by those rules, but rather by NASD Conduct Rule 3010(b)(1) and Exchange Act Rule 17a-4(e)(7).

MSC's written supervisory procedures designated Poston as the supervisory principal with responsibility for conducting the annual internal inspections.²⁵⁸ MSC and Poston admit that they failed to conduct the annual internal inspections in 2002 and 2003. Indeed, they never completed the 2002 internal inspection, and MSC did not complete the 2003 internal inspection until March 2005, after the SEC requested a copy.²⁵⁹

Accordingly, the Hearing Panel found that MSC and Poston violated NASD Conduct Rules 3010(c) and 2110 by failing to conduct the required internal inspections in 2002 and 2003.

D. Providing False and Misleading Information

NASD Procedural Rule 8210(a)(1) requires members to “provide information orally, in writing, or electronically and to testify, under oath or affirmation ... if requested, with respect to any matter involved in any investigation.” Providing false and misleading information to FINRA staff during an investigation “‘mislead[s] [FINRA] and can conceal wrongdoing’ and thereby ‘subvert[s]’ [FINRA’s] ability to perform its regulatory function and protect the public interest.”²⁶⁰ 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.”²⁶¹

²⁵⁸ Ex. C-7, at 46; MSC Ans. ¶ 9.

²⁵⁹ MSC Ans. § 9; Poston Ans. § 9.

²⁶⁰ *Geoffrey Ortiz*, Exchange Act Release No. 58,416, 2008 SEC LEXIS 2401, at *32 (Aug. 22, 2008) (quoting *Michael A. Rooms*, Exchange Act. Release No. 51,467, (Apr. 1, 2005), 85 SEC Docket 444, 450, *aff'd*, 444 F.3d 1208 (10th Cir. 2006)).

²⁶¹ *See, e.g., Brian L. Gibbons*, 1996 SEC LEXIS 1291, at *9 (May 8, 1996) *aff'd*, 112 F.3d 516 (9th Cir. 1997) (table format).

In this case, Enforcement charged MSC with providing false and misleading information in response to FINRA’s document and information request dated March 24, 2005. FINRA sent this request to MSC after it learned of MSC’s failure to review the Red Flag Blotters between March 15 and June 1, 2004. FINRA requested all documentation relating to the backlogged transactions along with a detailed explanation if any requested information had been “deleted, overwritten, lost or [was] otherwise no longer in [MSC’s] possession.”²⁶² In response, on April 7, 2005, MSC produced Trade Review Forms that had been changed to reflect the actual date Respondent T first completed the forms.²⁶³ MSC represented that the Trade Review Forms reflected “the date the trade was approved.”²⁶⁴ MSC also sent FINRA a detailed letter explaining the backlogs MSC experienced in its Compliance Department, but MSC did not mention that it had backdated the Trade Review Forms covering the period March 15 to June 1, 2004.²⁶⁵ MSC did not produce the corresponding Red Flag Blotters.²⁶⁶ MSC did not produce the blotters until May 10, 2005.²⁶⁷

By not providing information about the backdated and corrected records, MSC violated NASD Procedural Rule 8210 and Conduct Rule 2110. This was information concerning serious misconduct, which MSC was obligated to disclose pursuant to FINRA’s information request.

²⁶² Ex. C-26.

²⁶³ Ex. C-28.

²⁶⁴ *Id.*

²⁶⁵ Ex. C-27; Tr. 580.

²⁶⁶ Tr. 652.

²⁶⁷ Tr. 653.

Despite the incontrovertible evidence that MSC did not respond completely and truthfully to the request for information dated March 24, 2005, MSC nonetheless contended that it did not intend to mislead FINRA. Rather, MSC claimed that its counsel, Turigliatto and Makens, decided that they should report the backdating to FINRA in person so that they would have the opportunity to answer any questions the staff might raise.²⁶⁸ For this reason, MSC omitted the information in its written responses.

On April 13, 2005, MSC's counsel, Turigliatto and Makens, did meet with Enforcement attorneys, Delaney and Moreiro.²⁶⁹ Delaney and Moreiro testified that Turigliatto and Makens requested the meeting to get a better handle on where FINRA's investigation stood.²⁷⁰ Turigliatto and Makens testified that during the meeting they told FINRA about the backdating and that MSC was still investigating the matter.²⁷¹ They both further testified that they are certain they mentioned the backdating issue because it was one of the topics in the handwritten notes Turigliatto used at the meeting.²⁷² On the other hand, Delaney and Moreiro testified that neither Turigliatto nor Makens mentioned backdating.²⁷³ According to Delaney and Moreiro, they first learned of the backdated records 12 days later during Cohen's on-the-record interview.²⁷⁴ The transcript of Cohen's on-the-record interview reflects Delaney and Moreiro's surprise when Cohen

²⁶⁸ See Tr. 1704.

²⁶⁹ Tr. 577.

²⁷⁰ Tr. 578, 649.

²⁷¹ Tr. 1533-34, 1539-40.

²⁷² Tr. 1535, 1539-40, 1705; Ex. MSC-35, at 5.

²⁷³ Tr. 582, 658.

²⁷⁴ Tr. 588, 687.

mentioned the backdated documents and their disagreement with Turigliatto and Makens' assertion that they had disclosed the backdating in the April 13 meeting.²⁷⁵

The Hearing Panel found that even if Turigliatto and Makens' recollection regarding what transpired at the April 13 meeting is accepted, MSC did not comply with NASD Procedural Rule 8210. First, Enforcement requested a written response to its request for information, and MSC was obligated to provide its response in that manner. Indeed, the miscommunication in this case highlights the importance of a written response. MSC did not have the unilateral right to disregard Enforcement's instructions regarding the format of its response.

Second, even if Turigliatto read her notes exactly as written, MSC did not make an adequate disclosure of the backdating problem. Her notes do not disclose that MSC intentionally backdated the Trade Review Forms and the Red Flag Blotters, nor do they disclose that MSC corrected the dates on the Trade Review just before they were produced to Enforcement. Instead, Turigliatto's notes imply that MSC had uncovered a data entry problem, which it then corrected.²⁷⁶

Accordingly, for the reasons discussed above, the Hearing Panel found that MSC violated NASD Procedural Rule 8210 and Conduct Rule 2110.

V. SANCTIONS

A. Failure to Supervise—First and Third Causes of Action

The Hearing Panel considered the FINRA Sanction Guidelines ("Sanction Guidelines") principal considerations and the specific considerations for each violation in

²⁷⁵ Ex. J-4, at 27-28.

²⁷⁶ Ex. MSC-35, at 8.

deciding upon the appropriate sanctions in this case. The Sanction Guidelines for failing to supervise recommend, in egregious cases, suspending the responsible individual in any or all capacities for up to two years or imposing a bar. The Sanction Guidelines further recommend a fine \$5,000 to \$50,000, which amount may be increased by the amount of the respondent's financial benefit.²⁷⁷ In a case against a member firm involving systemic supervision failures, the Sanction Guidelines recommend suspending the firm with respect to any or all activities or functions for up to two years or expulsion of the firm.²⁷⁸

1. MSC's Supervisory Violations

The Hearing Panel determined that the numerous aggravating factors in this case warrant a fine against MSC of \$500,000. The Hearing Panel rejected MSC's contention that the evidence shows significant mitigation.

First, MSC's relevant disciplinary history must be taken into account.²⁷⁹ In 2001, MSC entered into the 2001 AWC with FINRA pursuant to Procedural Rule 9216 in which it accepted numerous findings related to its deficient supervision of variable annuity transactions between January 1996 and June 1999.²⁸⁰ Under the terms of the 2001 AWC, MSC was censured and fined \$35,000. Among other findings, MSC accepted FINRA's determination that MSC failed to establish, maintain, and enforce adequate written supervisory procedures to address among other things the manner in which MSC's principals were to review, approve, and otherwise supervise variable life insurance business.²⁸¹ In addition, MSC accepted FINRA's determination that MSC had

²⁷⁷ FINRA Sanction Guidelines 108 (2007) (Failure to Supervise), <http://www.finra.org/RegulatoryEnforcement/FINRAEnforcementMarketRegulation/FINRASanctionGuidelines/index.htm>.

²⁷⁸ *Id.*

²⁷⁹ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 1).

²⁸⁰ Ex. C-5.

²⁸¹ Ex. C-5, at 4.

failed to establish and maintain a system to supervise the activities of its registered representatives with respect to certain 1035 Exchanges.²⁸²

Following the 2001 AWC, MSC repeatedly assured FINRA that it had undertaken several corrective measures regarding its supervisory system and procedures, among which were the creation of TRT and the implementation of the Red Flag Blotter. MSC also assured FINRA that it would institute in the near future additional changes in its automated surveillance capability. Nevertheless, by 2004, MSC had not rectified its supervision of variable annuity transactions, as FINRA's examiners uncovered during the 2003 examination.

Even more disturbing, however, is the fact that MSC deceived FINRA staff regarding the status of its supervisory system and procedures related to the review of its variable annuity business.²⁸³ In early 2004, MSC's senior management knew that MSC likely would face disciplinary action if FINRA discovered that the Firm could not review the Red Flag Blotter on a timely basis and that it had not implemented other promised measures to improve its supervision of its variable annuity business. Through a series of meetings in April and May 2004, MSC's managers and executives therefore agreed on a scheme to deceive FINRA staff at the meeting scheduled for May 18, 2004, in FINRA's Atlanta office. As found above, Dixon, Poff, Kaminski, and Poston agreed to withhold any information about the backlog of blotters, including the backlogged transactions. They also agreed to represent to FINRA staff that MSC had implemented the monthly 1035 Exchange Exception Report as of January 2004. In addition, Dixon, Poff, and Kaminski directed Poston to draft a backdated set of written supervisory procedures that reflected the Prototype 1035 Exchange Exception Report in order to support their story that MSC had implemented the report as of January 2004. Through this scheme, MSC

²⁸² C-5, at 6.

²⁸³ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 10).

convinced the staff that MSC had taken the supervisory issues seriously and had made significant and effective steps to improve its supervisory system. In sum, MSC intentionally misled FINRA staff.²⁸⁴

By suspending all reviews of the Red Flag Blotter from March 15 to June 1, 2004, 597 transactions were not reviewed fully for suitability until Respondent T commenced their review in August 2004. However, even at this point, MSC did not properly carry out the review process. Respondent T was not qualified to conduct the review, and Cohen only checked a handful of the transactions. Thus, a significant number of customers were exposed to potential harm by MSC's failure to implement and maintain an adequate supervisory system. The Hearing Panel does not agree with the Respondents' argument that the lack of actual customer harm is a mitigating factor under these circumstances. The potential for harm in this case was significant considering the nature and amount of the 1035 Exchanges at issue.

In addition, MSC failed to supervise Cohen and Respondent T, who created and maintained false Firm records by backdating the Trade Review Forms and creating dummy letters designed to evidence reviews of 1035 Exchanges that had never been undertaken. Roth knew of and participated in Respondent T's creation of false records relating to the review of the Red Flag Blotter, and Sanfilippo knew of and participated in Cohen's creation of the false letters relating to the 1035 Exchange Exception Report.

The Hearing Panel rejected MSC's argument that it should not be sanctioned because the violations resulted from the acts of four rogue employees. MSC went to great lengths to prove that Poston, Sanfilippo, Cohen, and Respondent T acted "without the knowledge, consent, or direction of management."²⁸⁵ MSC further argued that it should be credited with its swift corrective action once management learned of the problems. In

²⁸⁴ Sanction Guidelines at 7 (Principal Considerations in Determining Sanctions, No. 13).

²⁸⁵ Ex. C-31, at 2-3; MSC's Post-Hr'g Br. at 12-13.

particular, MSC points out that it fired Poston and Cohen when their misconduct was uncovered. But the overwhelming weight of the evidence, and all reasonable inferences drawn from the evidence, contradicted MSC's arguments. MSC's failure to supervise variable annuity transactions, and in particular the backlogged transactions, cannot be attributed to the isolated acts of a few rogue employees. MSC experienced a complete failure of its supervisory system over a substantial period. MSC's management was aware that MSC could not meet its supervisory responsibilities, but did nothing to correct the situation. In fact, to the contrary, MSC's management participated in a scheme to deceive FINRA staff to avoid detection. MSC (acting through Dixon, Poff, Kaminski, and Poston) misrepresented its supervisory system and procedures and by omission of material facts misled the staff about the timeliness of the required suitability reviews for 1035 Exchanges.

Furthermore, MSC's argument that it acted swiftly and appropriately when it discharged Poston and Cohen overlooks the totality of the evidence. For example, MSC took no disciplinary action against Roth even though she admitted that she knew Respondent T backdated the Trade Review Forms and that she falsified the review dates on the printed Red Flag Blotters for March 15 through May 31, 2004. Indeed, MSC promoted both Roth and Respondent T following their wrongful conduct.²⁸⁶ And the corrective measures MSC eventually undertook were only implemented after FINRA initiated the investigation that led to this disciplinary proceeding.²⁸⁷

²⁸⁶ Tr. 391, 1184. Moreover, the Hearing Panel notes that MSC represented in its Wells Submission dated December 20, 2005, that it intended to discipline Roth and place her under more comprehensive supervision to ensure that she would not repeat her misconduct. Ex. C-31, at 24. And in Roth's Wells Submission, MSC indicated that it had intended to suspend Roth for 15 days and require her to retake the Series 24 Principal's Examination. Ex. C-32, at 7. In fact, MSC took no disciplinary action against Roth for her admitted violations.

²⁸⁷ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 4) ([w]hether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct).

For the foregoing reasons, the Hearing Panel concluded that MSC's supervisory violations were egregious and that a significant sanction was required to remediate its misconduct and protect the investing public. Accordingly, the Hearing Panel will fine MSC \$500,000 for failing to supervise the timely review of variable annuity transactions between March 15 and June 1, 2004, and failing to supervise the creation of accurate books and records, as alleged in the First and Third Causes of Action.

2. Kaminski's and Coates' Supervisory Violations

The Hearing Panel found Kaminski's and Coates' supervisory failures to be serious. Each ignored numerous red flag warnings of the critical problems with MSC's supervisory system and procedures over an extended period. While they may not have been able to foresee in 2003 the complete disintegration in 2004 of MSC's Compliance Department, they knew of the commitments MSC had made in connection with the 2001 AWC to improve its variable annuity supervision, as well as the growing regulatory demands upon MSC. They also soon became aware of the full depth of the problem.²⁸⁸ Early on, they knew that the Operations and Compliance Departments were understaffed and unable to complete required compliance reviews. They also soon saw evidence of the fact that a number of important blotters were not being reviewed timely. Over the first several months of 2004, they received reports that indicated the growing severity of the problem, which ultimately led MSC to suspend the reviews of most blotters, including the Red Flag Blotters.

The quality and degree of their implementation of MSC's supervisory procedures in the face of these red flags was poor. Moreover, their continued reliance on Roth and Poston was unreasonable once it became clear that they could not address the problems effectively. Kaminski knew by early March 2004 that Poston was not properly

²⁸⁸ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 9) ([w]hether the respondent engaged in the misconduct over an extended period of time).

implementing the Firm's supervisory procedures, which is best evidenced by the various reports Kaminski admits he received showing all of the backlogged blotters and reports in the Compliance Department, and Coates knew from Roth that MSC's supervisory system was not functioning properly. Nonetheless, Kaminski and Coates did not investigate and act decisively to correct the situation. The limited supervisory steps they took were ineffective and often only undertaken in response to increased regulatory pressure from FINRA.²⁸⁹

For the foregoing reasons, the Hearing Panel concluded that Kaminski and Coates failed to supervise reasonably the timely review of variable annuity transactions, as alleged in the First Cause of Action. They thereby violated NASD Conduct Rules 3010(a) and 2110. Accordingly, the Hearing Panel will suspend each of them in any and all principal capacities for six months and fine each of them \$50,000.

3. Poston's Supervisory Violations

The quality and degree of Poston's implementation of MSC's supervisory procedures was inadequate and ineffective over a substantial period. The earliest evidence of his failure to carry out his responsibilities dates back to 2002, when he failed to conduct the annual internal review required by the Firm's written supervisory procedures. He also failed to conduct an internal annual review in 2003.

In 2004, the quality of Poston's supervision deteriorated further in face of mounting problems in the Compliance Department. Except for Poston's repeated requests for additional staffing—which the Hearing Panel finds mitigates his conduct to some extent—the supervisory steps Poston took were ineffective, and in some cases reflect a complete neglect of his supervisory responsibilities. Poston ultimately shut down most of

²⁸⁹ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 4) ([w]hether the respondent voluntarily and reasonably attempted, prior to detection and intervention, to ... remedy the misconduct).

the Compliance Department's functions to concentrate on the breakpoint review process and participated in efforts to conceal the extent of MSC's problems from FINRA.

Poston contended that it was mitigating that he had to ensure MSC's compliance with a number of regulatory sweeps, including the breakpoint review process. But the fact that his workload may have been heavy does not excuse or mitigate his misconduct.²⁹⁰ As the head of the Compliance Department, it was Poston's responsibility to establish and implement an adequate supervisory system with sufficient resources to carry out its mission.

Poston also argued that he rejected Poff's instructions to present FINRA with backdated written supervisory procedures in an effort to conceal the fact that MSC had not implemented some of the supervisory improvements it had represented were in place by January 2004. However, the evidence showed that Poston nonetheless prepared the backdated written supervisory procedures and only objected to releasing them to FINRA after he realized that MSC did not have supporting documentation to support the proposed deception. Poston was concerned about getting caught, not the impropriety of the proposed scheme. Moreover, Poston went along with MSC's presentation in May 2004 that left the false impression that MSC had implemented a 1035 Exchange Exception Report in January 2004. Indeed, Poston celebrated the Firm's deception in his e-mail to Kaminski following the meeting in which he acknowledged that they had dodged detection successfully yet again. The Hearing Panel found these factors aggravating. It is also aggravating that Poston has sought to shift the blame to others instead of accepting responsibility for his conduct.²⁹¹

²⁹⁰ *Pellegrino*, 2008 FINRA Discip. LEXIS 10, at *77 (N.A.C. Jan. 4, 2008) (rejecting the argument that excessive workload demands excused respondent's failure to carry out his supervisory responsibilities).

²⁹¹ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 2) ([w]hether an individual ... accepted responsibility for and acknowledged the misconduct to his or her firm ... or a regulator prior to detection and intervention by the firm ... or a regulator).

After careful consideration of these circumstances, the Hearing Panel concludes that serious sanctions are needed to deter Poston from again engaging in supervisory violations. On the other hand, the Hearing Panel notes that his immediate supervisor concurred in his decision to shut down the Compliance Department temporarily, failed to support his pleas for the necessary resources to add staff, and that MSC's senior managers participated in the deception regarding the status of MSC's promised improvements to its supervisory procedures. Therefore, to protect investors and remedy Poston's misconduct, the Hearing Panel will suspend Poston in all principal capacities for six months and fine him \$10,000 for his failure to supervise the review of variable annuity transactions between March 15 and June 1, 2004, as alleged in the First Cause of Action. In addition, the Hearing Panel will suspend Poston for 30 days in all principal capacities, and fine him \$10,000 for his failure to conduct the annual internal reviews, as alleged in the Fourth Cause of Action. The suspensions shall run consecutively.²⁹²

**B. Falsification of Records and Recordkeeping Violations—
Second Cause of Action**

In deciding upon appropriate sanctions for the recordkeeping violations, the Hearing Panel considered the Sanction Guidelines' principal considerations applicable to all sanction determinations and the considerations that are specific to recordkeeping violations. The Sanction Guidelines for recordkeeping violations by an individual recommend a fine of \$1,000 to \$10,000 and a suspension for up to 30 business days.²⁹³ In egregious cases, the Sanction Guidelines suggest a fine of \$10,000 to \$100,000 and a

²⁹² In setting these sanctions, the Hearing Panel rejected Poston's argument that his lack of disciplinary history was mitigating. *See Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) ("Lack of a disciplinary history is not a mitigating factor."). The Hearing Panel also did not give any consideration to the fact that MSC terminated Poston's employment. Disciplinary sanctions in FINRA proceedings are independent of a firm's decision to terminate or retain an employee. *Dep't of Enforcement v. Prout*, No. CO1990014, 2000 NASD Discip. LEXIS 18, at *8-11 (N.A.C. Dec. 18, 2000) (giving respondent credit for firm-imposed suspension, but not termination).

²⁹³ Sanction Guidelines at 30 (Recordkeeping Violations).

lengthier suspension (of up to two years) or a bar. In the case of a member firm, the Sanction Guidelines suggest a fine of \$1,000 to \$50,000 and a suspension of the firm with respect to any or all activities or functions for up to 30 business days. In an egregious case, the Sanction Guidelines suggest that the firm be suspended for a lengthier period (up to two years) or that the firm be expelled.²⁹⁴

Where applicable, the Hearing Panel also consulted the Sanction Guidelines for falsification of records. The Sanction Guidelines for falsification of records suggest a fine of \$5,000 to \$100,000.²⁹⁵ In addition, where mitigation exists, the Sanction Guidelines suggest suspending the responsible individual in any or all capacities for up to two years. In egregious cases, the Sanction Guidelines suggest a bar.

1. MSC, Roth, Sanfilippo, and Cohen's Record Keeping Violations

The Hearing Panel concluded that MSC's, Roth's, Sanfilippo's, and Cohen's record keeping violations were egregious. The records in question were important components of MSC's supervisory system and material to FINRA's ability to evaluate the quality of MSC's supervisory review of variable annuity transactions. There are no mitigating factors in the record to suggest that these individual respondents had a good faith belief that their actions were proper. Indeed, the Hearing Panel found that they intentionally falsified MSC's records to deceive FINRA staff.

Another aggravating factor the Hearing Panel considered was the volume of documents the principals of the Firm falsified over a period of months. There were 597 falsified Trade Review Forms as well as the falsified daily Red Flag Blotters for each day between March 15 and May 31, 2004. Also, there were 49 fake letters Cohen created and

²⁹⁴ *Id.*

²⁹⁵ Sanction Guidelines at 39 (Forgery and/or Falsification of Records).

placed in MSC's files to support MSC's misrepresentations regarding the date it implemented the 1035 Exchange Exception Report.

Further, in arriving at an appropriate sanction, the Hearing Panel considered the evident pattern of deceit practiced by numerous principals at MSC at all levels of management.²⁹⁶ The backdating of the Trade Review Forms and Red Flag Blotters, as well as the creation of the fake letters regarding the 1035 Exchange Exception Report, are related directly to MSC's efforts to mislead FINRA staff and avoid disciplinary action for its inadequate supervision of 1035 Exchanges in 2003 and 2004. MSC's senior managers and registered principals fostered a culture of gamesmanship when it came to regulatory compliance, which is best evidenced by the e-mail Poston sent immediately after MSC met with FINRA staff on May 18, 2004, in which he referred to the Firm's compliance approach as a "game."²⁹⁷ In fact, he acknowledged that MSC had employed this strategy for some time and rhetorically questioned in his e-mail whether it was getting too easy to dodge FINRA's questions.

The Hearing Panel also took note of the fact that MSC did not discipline Roth for her confessed violations. Rather, MSC promoted her after it learned that she had backdated the Red Flag Blotters. This action further evidences MSC's lax approach to compliance that permeated the Firm in 2004.

Finally, with respect to Roth, the Hearing Panel took into consideration her unique role in MSC's supervisory system as well as her efforts to protect Coates and Kaminski by covering up the full extent of the violations. As discussed above, Roth occupied an important position in MSC's supervisory system. Not only was she the designated principal responsible for the final approval of the Red Flag Blotters, but she also had supervisory responsibility for the review process. Roth served as the critical

²⁹⁶ Sanction Guidelines at 6 (Principal Considerations in Determining Sanctions, No. 8) ([w]hether the respondent engaged in numerous acts and/or a pattern of misconduct).

²⁹⁷ Ex. C-13 (emphasis added).

interface between the Operations Department and TRT. Thus, her participation in the backdating of the Firm's records was a significant aggravating factor that materially contributed to the Firm's supervisory violations. Because Roth reviewed and approved many blotters that first went through TRT, Roth knew the full extent of the problems in the Compliance Department even though she was not in charge of TRT. Moreover, any plan to falsify the Trade Review Forms and the Red Flag Blotters could not have been carried out without her knowledge and cooperation. Roth's misconduct was egregious, and there were no factors that mitigate its seriousness.

With respect to Roth, another aggravating factor was her attempt to exonerate Coates and Kaminski. During her on-the-record interview, Roth provided a detailed account of Coates' and her involvement in the backdating of the Red Flag Blotters. However, at the hearing Roth recanted her earlier sworn testimony and claimed not to recall many of the facts she had detailed during her on-the-record interview. The Hearing Panel found that Roth's hearing testimony was not credible and that her willingness to craft her testimony to exonerate others evidenced a lack of integrity and a disregard for the regulatory process, which warranted serious sanctions.

In conclusion, MSC's, Roth's, Sanfilippo's, and Cohen's willingness to falsify important records, and to misrepresent their compliance efforts, evidences a serious lack of respect for the rules and regulations governing the securities industry. The Hearing Panel therefore will fine MSC \$1million and bar Roth, Sanfilippo and Cohen from associating with any member firm in any capacity.

2. Respondent T's Record Keeping Violation

The Hearing Panel first concluded that Respondent T did not intend to falsify MSC's records although his carelessness did cause its records to be inaccurate. Respondent T was not involved in any of the decision-making that led up to his temporary assignment in the Compliance Department, nor was he given any information

about MSC's problems other than that TRT had gotten behind because of employee turnover.²⁹⁸ Respondent T therefore lacked sufficient contextual knowledge to understand the importance of his assigned duties in TRT.

Respondent T had spent his entire career at MSC in its Marketing Services Department. He had no knowledge of home office or compliance procedures.²⁹⁹ His role at MSC was to answer registered representatives' questions concerning certain products and the Firm's on-line order entry system.³⁰⁰ Before Kaminski assigned him to assist TRT in August 2004, he had no compliance experience, nor had he ever supervised anyone. And, when Kaminski transferred him to TRT, MSC did not provide him with even a general overview of the compliance function he was ordered to fulfill. Respondent T's instruction was limited to the mechanics of how to enter information into MSC's electronic Trade Review Forms for Cohen's review and approval. In this regard, it is important to note that Respondent T was told that Cohen would review and approve all of his work. At no point did anyone at MSC tell Respondent T that he was responsible for MSC's suitability review of the backlogged transactions. Respondent T testified, "I was gathering data for supervisory review by the compliance officer and by an operations principal."³⁰¹ Moreover, Respondent T was not a licensed principal, and he therefore had no reason to believe that he was to assume responsibility for such suitability reviews. The evidence that Cohen instructed Respondent T not to call any of the registered representatives if he had questions about a particular transaction corroborates Respondent T's view of his limited role, as does the fact that he lacked the authority to deny a

²⁹⁸ See Ex. J-16, at 36, 39; Ex. J-17, at 15.

²⁹⁹ Tr. 1169.

³⁰⁰ Tr. 1161-62.

³⁰¹ Tr. 1168-69.

transaction.³⁰² If Respondent T identified an issue, he was to flag it for Cohen's or Sanfilippo's attention.³⁰³

Finally, when Cohen directed Respondent T to change the dates on the Trade Review Forms, Cohen did not explain the reason for the change other than to state the directive came from Roth.³⁰⁴ Respondent T did not question the change. He testified at his on-the-record interview on June 2, 2005, that he did not think about the propriety of the instruction. He explained, "I was there doing what I considered to be very clerical work, and I wanted to get back to my regular job. And so whatever it took for me to get that done and get back, that's what I wanted to do."³⁰⁵

Because the record supports a finding that Respondent T's actions were careless, and not intentional,³⁰⁶ the Hearing Panel concluded that it was more appropriate to apply the Sanction Guidelines for recordkeeping violations than for falsification of records.³⁰⁷ By failing to ensure the accuracy of the information he entered on the Trade Review Forms, he caused MSC's books and records to contain false information about the dates the suitability reviews for backlogged transactions were completed.

The Hearing Panel next considered the substantial mitigating factors in this case that apply to Respondent T, which support the Hearing Panel's determination that the appropriate sanction is a letter of caution. Respondent T's misconduct had no potential for monetary gain for himself.³⁰⁸ Respondent T's compensation was not connected in any

³⁰² Tr. 1169; Ex. J-16, at 50.

³⁰³ Ex. J-16, at 52-53.

³⁰⁴ Tr. 1172, 1178.

³⁰⁵ Ex. J-17, at 47.

³⁰⁶ See Sanction Guidelines at 7 (Principal Considerations in Determining Sanctions, No. 13 ("[w]hether the respondent's misconduct was the result of an intentional act, recklessness or negligence")).

³⁰⁷ Cf. *Dep't of Enforcement v. Trevisan*, No. E9B2003026301, 2008 FINRA Discip. LEXIS 12, at *31, n.14 (Apr. 30, 2008) (finding it more appropriate to use guideline for inaccurate books and records where respondent negligently entered improper disability waivers for mutual fund customers).

³⁰⁸ See Sanction Guidelines at 6-7 (Principal Considerations in Determining Sanctions No. 17 ("[w]hether the respondent's misconduct resulted in the potential for respondent's monetary or other gain")).

way with the Firm's sales activity. He was paid an annual salary, and typically received a modest bonus based on his performance.³⁰⁹

Further, at the time, Respondent T did not understand that he did anything wrong in following the Compliance Department's instructions.³¹⁰ Indeed, the lack of proper supervision at the Firm was a significant contributing factor to Respondent T's misconduct. However, once he understood the issue, he cooperated fully with MSC's and FINRA's investigations.³¹¹ He provided on-the-record testimony to FINRA investigators in April and June 2005. At no point during those interviews did he decline to accept responsibility for his actions.³¹²

The Hearing Panel also considered Respondent T's sincere remorse. He testified at the hearing that he fully accepted responsibility and that he would exercise far greater care in the future.³¹³ There is no evidence in the record to support Enforcement's argument that severe sanctions are needed to prevent future misconduct. The Hearing Panel concluded that Respondent T posed no future risk to the investing public.

The Hearing Panel found that Respondent T's careless conduct in entering inaccurate review dates on the Trade Review Forms for the backlogged transactions evidences an oversight of his obligation to comply with the recordkeeping rules. However, the significant mitigating factors discussed above led the Hearing Panel to conclude that a Letter of Caution is sufficient to remediate Respondent T's misconduct

³⁰⁹ Tr. 1162. In 2004, his bonus was about \$6,000.

³¹⁰ Tr. 172.

³¹¹ See Sanction Guidelines at 6-7 (Principal Considerations in Determining Sanctions No. 10 (“[w]hether the respondent attempted to conceal his or her misconduct or lull a regulator or a firm into inactivity) and No. 12 (“[w]hether the respondent provided assistance to FINRA in its investigation”)).

³¹² See Tr. 1173-74.

³¹³ Tr. 1173-75.

and protect the investing public. A greater sanction would not serve any remedial purpose under the facts and circumstances of this case.³¹⁴

C. Providing False and Misleading Information to FINRA—Fifth Cause of Action

In the case of a firm, the Sanction Guidelines state that in egregious cases expulsion is the appropriate standard. If there are mitigating factors present, the Sanction Guidelines recommend consideration of a suspension for up to two years with respect to any or all activities or functions. In the case of a firm that responded untimely, the Sanction Guidelines recommend consideration of a suspension for up to 30 business days. In addition, the Sanction Guidelines recommend monetary sanctions from \$2,500 to \$50,000 depending on the nature of the violation.³¹⁵

The Sanction Guidelines list two principal considerations for adjudicators to assess in determining appropriate sanctions for violations of Procedural Rule 8210, as well as the principal considerations and general principles applicable to all violations. First, the Sanction Guidelines direct adjudicators to consider the nature of the information requested. Second, they direct adjudicators to consider whether the information was provided and, if so, the number of requests made, the time it took the respondent to respond, and the degree of regulatory pressure required to obtain a response.³¹⁶

In this case, the Hearing Panel found that FINRA’s request in March 2005 concerned important information regarding MSC’s failure to supervise variable annuity transactions timely. Despite the importance of the information requested, MSC provided incomplete responses to FINRA’s request that hindered its investigation. The Hearing

³¹⁴ *Dist. Bus. Conduct Comm. v. Greenberg*, No. C9B9200008, 1993 WL 968256, at *5 (N.B.C.C., Aug. 3, 1993) (Letter of Caution in lieu of censure and fine because censure and fine “would not serve any remedial purpose” and taking into consideration the respondent’s state of mind, his inexperience, the lack of supervision afforded him, and the nature of the offense).

³¹⁵ Sanction Guidelines at 35.

³¹⁶ *Id.*

Panel rejected MSC's mitigation arguments, which understated the importance of strict compliance with investigatory requests for information issued pursuant to Procedural Rule 8210.

Although the Hearing Panel found that MSC's failure to respond fully and completely to FINRA's request was a serious violation of Procedural Rule 8210 and MSC's obligations thereunder, the panel also took into consideration several mitigating factors in determining the appropriate sanction.³¹⁷ The panel noted that MSC intended to present a more complete response orally in the meeting it had scheduled for just one week after it made its written responses. Thus, the incomplete response spanned a short period. Moreover, MSC encouraged Cohen to answer fully any questions regarding the backdated records at his on-the-record interview, which was held later the same month. Finally, the panel considered Enforcement's representations that, apart from this incident, MSC had been consistently cooperative with FINRA throughout the investigation process.³¹⁸

In light of the foregoing, and under the particular facts and circumstances of this case, the Hearing Panel will impose a \$25,000 fine upon MSC. Such sanction is appropriately remedial under the circumstances and reflects the serious nature of MSC's violation. Further, such sanction will discourage MSC and other broker-dealers and associated persons from engaging in similar misconduct.

³¹⁷ The Hearing Panel rejected MSC's argument that the lack of customer harm should be considered a mitigating factor. "The harm in such instances, as here, is to the self-regulatory process and to investors' confidence in that process. *Dep't of Enforcement v. Dieffenbach*, No. C06020003, 2004 NASD Discip. LEXIS 10, at *40 n.18 (N.A.C. July 30, 2004), *aff'd on other grounds, Rooms v. SEC*, 444 F.3d 1208 (10th Cir. 2006).

³¹⁸ Tr. 573, 666.

VI. ORDER

Based on careful consideration of all the evidence, the Hearing Panel imposes the following sanctions:³¹⁹

A. Mutual Service Corporation

MSC is fined a total of \$1,535,000 as follows:

MSC is fined \$500,000 for failing to reasonably supervise its variable annuity business, in violation of NASD Conduct Rules 3110(a) and 2110, as alleged in the First Cause of Action; and for failing to supervise the creation of accurate books and records, in violation of NASD Conduct Rules 3010(a) and 2110, as alleged in the Third Cause of Action.

MSC is fined \$1million for creating and maintaining inaccurate books and records, in violation of NASD Conduct Rules 3110 and 2110, Section 17(a) of the Exchange Act, and SEC Rules 17a-3 and 17a-4, as alleged in the Second Cause of Action.

MSC is fined \$10,000 for failing to conduct timely internal inspections for the years 2002 and 2003, in violation of NASD Conduct Rules 3010(c) and 2110, as alleged in the Fourth Cause of Action.

MSC is fined \$25,000 for failing to respond fully and completely to FINRA's requests for information, in violation of Procedural Rule 8210 and NASD Conduct Rule 2110, as alleged in the Fifth Cause of Action.

B. Dennis S. Kaminski and Susan Coates

Dennis S. Kaminski and Susan Coates are each suspended in all principal capacities for six months and fined \$50,000 for failing to reasonably supervise the Firm's

³¹⁹ 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.

variable annuity business between March 15 and June 1, 2004, in violation of NASD Conduct Rules 3110(a) and 2110, as alleged in the First Cause of Action. If this Decision becomes FINRA's final disciplinary action in this proceeding, the foregoing suspensions shall begin on February 16, 2009, and end on August 16, 2009.

C. Michael Poston

Poston is suspended in all principal capacities for six months and fined \$10,000 for failing to reasonably supervise the Firm's variable annuity business between March 15 and June 1, 2004, in violation of NASD Conduct Rules 3110(a) and 2110, as alleged in the First Cause of Action.

In addition, Poston is suspended in all principal capacities for 30 days and fined \$10,000, for failing to conduct timely internal reviews for the years 2002 and 2003, in violation of NASD Conduct Rules 3010(c) and 2110, as alleged in the Fourth Cause of Action.

If this Decision becomes FINRA's final disciplinary action in this proceeding, the foregoing suspensions, which shall run consecutively, shall begin on February 16, 2009, and end on September 14, 2009.

D. Roth, Sanfilippo and Cohen

Roth, Sanfilippo and Cohen are barred from associating with any firm in any capacity for creating and maintaining inaccurate books and records, in violation of NASD Conduct Rules 3110 and 2110, Section 17(a) of the Exchange Act, and SEC Rules 17a-3 and 17a-4, as alleged in the Second Cause of Action.

The foregoing bars shall become effective immediately if this Decision becomes FINRA's final disciplinary action in this proceeding.

E. Respondent T

This Decision shall serve as a Letter of Caution to Respondent T regarding his participation in the creation of inaccurate books and records, in violation of NASD Conduct Rules 3110 and 2110, Section 17(a) of the Exchange Act, and SEC Rules 17a-3 and 17a-4, as alleged in the Second Cause of Action.

Except for the bars and suspensions detailed above, the remaining sanctions shall become effective on a date set by FINRA, but not earlier than 30 days after this Decision becomes FINRA's final disciplinary action.

In addition, MSC, Kaminski, Coates, Roth, Poston, Cohen, and Sanfilippo are jointly and severally ordered to pay \$19,846 in costs.³²⁰

Andrew H. Perkins
Hearing Officer
For the Extended Hearing Panel

³²⁰ The costs are composed of an administrative fee of \$750 and transcript costs of \$19,096.

Copies to:

Mutual Service Corporation (FedEx and first-class mail)
Dennis S. Kaminski (FedEx and first-class mail)
Susan Coates (FedEx and first-class mail)
Michael Poston (FedEx and first-class mail)
Denise Roth (FedEx and first-class mail)
Gari C. Sanfilippo (FedEx and first-class mail)
Kevin L. Cohen (FedEx and first-class mail)
Respondent T (FedEx and first-class mail)
Peter J. Anderson, Esq. (electronic and first-class mail)
Michael J. King, Esq. (electronic and first-class mail)
David A. Feldman, Esq. (electronic and first-class mail)
William D. Edick, Esq. (electronic and first-class mail)
Jeffrey P. Bloom, Esq. (electronic and first-class mail)
David R. Sonnenberg, Esq. (electronic mail)