FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. MICHAEL LEE BULLOCK (CRD No. 35037), Respondent.	Disciplinary Proceeding No. 2005003437102 Hearing Officer – LBB **EXTENDED HEARING PANEL DECISION** April 17, 2009

For accepting directed brokerage payments, making misrepresentations to clients concerning directed brokerage and investigations, and failing to inform his firm of receipt of a payment directly from an investment company, all in violation of Conduct Rule 2110; requesting or arranging for the direction of brokerage commissions conditioned on sales in violation of Conduct Rules 2830(k)(4) and 2110; and accepting a direct payment from an investment company in violation of Conduct Rules 2830(l)(1) and 2110, Respondent is suspended for six months in all capacities and fined $50,000. Respondent is suspended in all principal capacities for an additional six months and ordered to re-qualify as a principal before acting in the capacity of principal. Respondent is also ordered to pay costs.

Appearances:

Gary A. Carleton, Senior Special Counsel, and Paul M. Schindler, Director, Enforcement Center, Washington, DC, for the Department of Enforcement.

Ben Suter and Garrett R. Wynne, San Francisco, CA, for the Respondent, Michael Lee Bullock.

DECISION

I. Summary[1]

Respondent Michael Lee Bullock, a principal and sales representative for Securities America, Inc. ("SAI"), developed a business of selling mutual funds to 401(k) plans established by labor unions for their members, primarily in the western United States. The plans all included funds offered by Massachusetts Financial Services ("MFS"),[2] an investment company that manages a family of mutual funds. In March 2002, in an effort to expand his business, Respondent hired Patrick Collins, a former MFS employee who had contacts with trustees for union pension plans, hoping to use Collins's contacts to develop business with union 401(k) plans on the east coast. MFS, SAI, and Respondent agreed that MFS would direct $25,000 of brokerage per month to SAI, and that SAI would pay 40% of the directed brokerage, or $10,000, to Respondent to reimburse him for the cost of retaining Collins.[3]

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[1] References to the testimony set forth in the transcripts of the hearing are designated as "Tr. __," with the appropriate page number. References to the exhibits provided by the Department of Enforcement are designated as "CX-___," and Respondent's exhibits are designated as "RX-___."

[2] There are a number of entities within MFS. MFS Fund Distributors, Inc. ("MFD"), is a wholly owned subsidiary of MFS and serves as the distributor for certain MFS funds. Tr. 474, 481, 527 – 528; CX-12. The distinctions among the various affiliated MFS entities were not explored at the hearing and are not important here. During the hearing, the parties referred to all as "MFS," and for convenience this decision follows that convention.

[3] Directed brokerage typically involves the direction by a mutual fund company of purchases and sales of securities to a brokerage firm, often in exchange for services provided by the brokerage firm. It is not clear precisely how the directed brokerage operated here, but it appears that MFS directed the firm that executed its trades to pay some of its commissions to SAI, a practice known as "step-out" commissions. Tr. 580 – 583, 752 – 753. For a more detailed discussion of the mechanics of directed brokerage arrangements, see *Dep't of Enforcement v. American Funds Distributors, Inc.*, No. CE3050003, 2008 FINRA Discip. LEXIS 13 (N.A.C. Apr. 30, 2008), *appeal docketed*, No. 3-13055 (S.E.C. May 28, 2008).

When the first two directed brokerage payments did not arrive when expected, Respondent complained to SAI and then to MFS. In response, MFS made a direct payment to Respondent of $20,807.32. Respondent did not notify SAI that he had received the direct payment, and kept the money even after he later received the directed brokerage for March and April 2002 from SAI.

Respondent did not tell any of his clients that he was receiving directed brokerage payments from MFS. As part of their due diligence, some of his clients asked Respondent to identify all sources of compensation with respect to his work for them, and Respondent did not disclose his receipt of directed brokerage, believing that the question did not relate to directed brokerage. When a client asked questions that would have elicited the disclosure of the directed brokerage arrangement and FINRA's investigation of the roles of SAI and Respondent in directed brokerage, he avoided direct responses to the questions.

Respondent violated FINRA's rules by accepting directed brokerage payments, accepting direct payments from an investment company, failing to inform his firm of the receipt of the direct payment, failing to disclose the receipt of directed brokerage payments to his customers, and making misrepresentations to a customer. For these violations, Respondent is suspended in all capacities for six months, fined $50,000, suspended in all principal capacities for an additional six months, and ordered to re-qualify as a principal before acting in the capacity of principal.

II. Procedural Matters

The Department of Enforcement filed the Complaint on July 11, 2007, asserting five causes of action against Respondent.[4] Respondent answered the Complaint on August 8, 2007, denying that he had violated FINRA's rules, and asserting five affirmative defenses, although only two – unclean hands and *res judicata* – were true affirmative defenses. The *res judicata* defense has not been pursued since the answer was filed and therefore has been abandoned. The Extended Hearing Panel struck the unclean hands defense prior to the hearing.

A hearing was held in Los Angeles, California, from April 28 through May 7, 2008. Enforcement called eight witnesses, including Respondent. Respondent called five witnesses, including himself.[5]

III. Respondent

Respondent has been registered with FINRA since approximately 1972. From 1990 until June 2007, he was registered with SAI. He is currently associated with QA3 Financial LLC. CX-1. Respondent had no disciplinary problems prior to the events that are the subject of this

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[4] The First Cause of Action alleges that Respondent violated Conduct Rules 2830(k)(7)(C) and 2110 by receiving brokerage that was directed to SAI by MFS for Respondent's benefit. The Second Cause of Action alleges that Respondent violated Conduct Rules 2830(k)(4) and 2110 by requesting or arranging for directed brokerage commissions conditioned upon sales or a promise of sales. The Third Cause of Action alleges that Respondent violated Conduct Rule 2110 by misleading customers and potential customers concerning his receipt of directed brokerage from MFS in his responses to questions from some of his customers. The Fourth Cause of Action alleges that Respondent violated Conduct Rules 2830(l)(1) and 2110 by receiving compensation directly from MFS. The Fifth Cause of Action alleges that Respondent violated Conduct Rule 2110 by concealing from SAI his receipt of funds directly from MFS.

[5] As of July 30, 2007, NASD consolidated with the member regulation and enforcement functions of NYSE Regulation and began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA include, where appropriate, NASD. Following consolidation, FINRA began developing a new FINRA "Consolidated Rulebook." The first phase of the new consolidated rules became effective on December 15, 2008, including certain conduct rules and procedural rules. *See* Regulatory Notice 08-57 (Oct. 2008). This decision refers to and relies on the NASD Conduct Rules that were in effect at the time of Respondent's alleged misconduct. In addition, because the Complaint was filed before December 15, 2008, the NASD Procedural Rules were applied in this disciplinary proceeding.

case. CX-1; Tr. 417. He was a principal at SAI, but does not act in that capacity at QA3, although he is still registered as a principal. CX-1; Tr. 64 – 65.

Respondent developed a niche business, almost exclusively serving union pension plans as the broker for their defined contribution (401(k)) plans. Tr. 112. Since about 1990, Respondent has conducted his business under the name Innovative Employee Benefits Programs ("IEBP"), a "d/b/a" that has no formal legal existence, located in Calabasas, California. CX-1; Tr. 66, 96. In 2002 and 2003, at the time of the directed brokerage arrangement at issue in this case, Respondent represented about 17 union 401(k) plans, advising their trustees on the mutual funds that were made available to union members through the plans. Tr. 112 – 114; CX-68 at 2 – 6. IEBP, which was an independent contractor for SAI, consisted of Respondent and one or two employees. Tr. 90. Respondent was the only principal at IEBP, which was an office of supervisory jurisdiction ("OSJ")[6] for SAI. Tr. 66 – 67, 83.

IV. By Participating in the Directed Brokerage Arrangement, Receiving a Payment Directly from MFS, and Failing to Notify His Firm of the Payment, Respondent Violated Conduct Rules 2830(l)(1) and 2110

A. The Directed Brokerage Arrangement

1. Establishment of the Arrangement

In late 2001 or early 2002, Respondent believed there were opportunities to expand his client base by networking with Patrick Collins, who had marketed mutual funds to defined benefit union pension plans as an MFS employee. Respondent met with Martin Beaulieu, president of MFS Fund Distributors, Inc., to discuss the idea. Tr. 173 – 176, 474, 480 – 481, 1483.[7] Beaulieu liked the idea, but Collins had left MFS. Beaulieu proposed that IEBP hire

[6] *See* Conduct Rule 3010(g)(1).

[7] Although the parties disagreed on a number of the details of how the arrangement came into being, the differences are not material to this decision.

Collins, and that MFS would cover the cost to IEBP, using directed brokerage as the mechanism for reimbursement. Tr. 177, 179 – 180, 1484. MFS had paid directed brokerage to SAI pursuant to a "strategic alliance" between the firms since at least 1995. Tr. 731 – 734.[8] Beaulieu told Respondent that the payments would have to go through SAI, and that Respondent could not be paid directly by MFS. Tr. 486, 631.

Following negotiations between Respondent and Beaulieu, MFS agreed to direct brokerage payments of $25,000 per month, or $300,000 per year, to SAI, so that SAI could compensate Respondent for the cost to Respondent of hiring Collins. Under the arrangement, Respondent would receive $10,000 per month to cover Collins's $8,000 salary, plus about $2,000 in expenses. Tr. 198 – 200; CX-18; CX-20. The payments under this agreement were in addition to any other directed brokerage payments MFS made to SAI pursuant to their strategic alliance arrangement. Tr. 490 – 492. Collins agreed to join IEBP as "Eastern Regional Manager" at a salary of $8,000 per month, plus expenses, and started work on March 1, 2002. Tr. 202 – 203, 210, 1200, 1202.

The arrangement was not contingent on a specific amount of sales of MFS funds or on Respondent meeting specific sales goals. Tr. 536 – 538, 607 – 608, 677, 679, 757 – 758. In addition, either MFS or SAI could terminate the arrangement at any time. Tr. 595 – 596, 600, 697 – 698, 776.

2. The Direct Payment by MFS to Respondent

In late April or early May 2002, after Collins had been employed by IEBP for several weeks, Respondent realized that he had not received any directed brokerage payments. He complained to SAI, threatening to quit SAI and seek arbitration if he did not receive payment.

[8] SAI had about 30 strategic alliances with investment companies in place. Tr. 731, 747.

Tr. 216 – 217, 220 – 223; CX-16. When SAI told Respondent that MFS had not done the trades to generate the directed commissions, Respondent called Chris Doucet at MFS, who told Respondent, "We understand that you're having a problem with the financial situation. We understand that we have not shown any activity. What we'd like to do is we'll send you a check to expedite this process." Respondent said to Doucet, "If you can do that, fine." Tr. 229 – 230, 307, 308. Doucet told Respondent that MFS needed documentation for the accounting department to show Collins's date of employment and that Respondent had incurred expenses for Collins. Tr. 231 – 232, 307. Respondent sent the documentation to MFS that showed he had incurred expenses of $20,807.32. Tr. 235 – 236; CX-86. Respondent did not send a copy of this letter to anyone at SAI. Tr. 235 – 236.

Upon receiving the documentation from Respondent, MFS sent a check to Respondent in the amount of $20,807.32. CX-86; Tr. 240 – 241. MFS's check was made payable to:

> Securities America Inc.
> c/o Innov. Employ. Benefit Prog
> 26585 West Agoura Rd. Suite 307
> Attn: Mike Bullock
> Calabasas, CA 91302

CX-86. Respondent endorsed the check "Michael Bullock/For deposit only" and deposited it in the IEBP bank account. CX-87; CX-88; Tr. 247 – 249, 1702 – 1703. He did not notify SAI that he had received the check. Tr. 246 – 247.

SAI's compliance manual and branch office manager's manual required that any compensation received by a representative, including marketing reimbursements, was to be forwarded to SAI to be processed through its compensation department. Tr. 163 – 164, 725 – 728, 806 – 809, 1028 – 1029, 1034 – 1035; CX-79 at 172; CX-80 at 69; CX-83. Respondent was unaware of this policy. Tr. 162. He assumed the check was just an expedited way of getting his

40% share of the directed commissions to him, and that the transaction had been "run through" SAI and approved by it. Tr. 246 – 247, 302, 307, 309 – 310. Respondent assumed that SAI would get its 60% share, or $30,000, directly from MFS. Tr. 307.

On June 19, 2002, about two weeks after Respondent had received the direct payment from MFS, SAI made a payment to Respondent of $40,000 as Respondent's share of directed commissions for March through June. The regular spreadsheet that IEBP received from SAI listing all of IEBP's commissions shows two directed brokerage payments, one for $30,000 that is identified as covering March through May, and a separate entry for $10,000 for June. Tr. 255 – 256; RX-173 at 25.

3. The End of the Directed Brokerage Arrangement

MFS suspended all of its directed brokerage programs in November 2003. Tr. 502. Early in 2004, Respondent was short of funds. He had somebody in his office look at the commission runs and learned that he had not received directed brokerage payments for three or four months. Respondent called Chris Doucet at MFS, who told him that MFS did not do directed brokerage anymore. Tr. 281 – 282. Respondent terminated Collins's employment soon thereafter because he could not afford to continue to employ him. Tr. 282. Collins was employed by IEBP from March 2002 until February 2004. He was not successful in bringing in any clients. Tr. 1207.

SAI paid Respondent a total of $262,500 as his share of the directed brokerage commissions received from MFS. Tr. 284, 497 – 498; Answer to Complaint, Ex. 7; CX-141. He received payments for January 2002 through October 2003, although Respondent testified,

incorrectly, that he did not receive payments for January and February 2002, the two months before he hired Collins. CX-141; Tr. 468.[9]

B. Respondent Violated Conduct Rule 2110 by Receiving Directed Brokerage Payments

The First Cause of Action charges that Respondent violated Conduct Rule 2110 by sharing in the directed brokerage that SAI received from MFS. The Hearing Panel finds that SAI violated Rule 2830 by granting participation in directed brokerage to Respondent, and that Respondent violated Rule 2110 by his substantial participation in the establishment and operation of an improper arrangement.[10]

SAI violated Rule 2830(k)(7)(C)[11] by funneling directed brokerage payments to Respondent. Rule 2830(k)(7)(C) prohibits member firms from granting any participation in directed brokerage to sales personnel. The Rule provides:

> No member shall, with respect to such member's retail sales or distribution of investment company shares:
>
> > (C) grant to salesmen, branch managers or other sales personnel any participation in brokerage commissions received by such member from portfolio transactions of an investment company whose shares are sold by such member, or from any covered account, if such commissions are directed by, or identified with, such investment company or any covered account ….

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[9] SAI asked MFS in May 2003 if the arrangement with Respondent covered all of 2003. MFS told SAI that it believed the arrangement with Bullock was retroactive to January 1, 2002. CX-23; CX-24. This was not what MFS had actually intended, and might have been the result of a misunderstanding by Beaulieu's assistant. MFS typically set directed brokerage targets on an annual basis, and she might have assumed that the arrangement with Bullock was intended to be based on $25,000 per month for 12 months rather than the actual number of months for which Collins was employed. *See* Tr. 686 – 690.

[10] The First Cause of Action charged that Respondent violated both Rule 2830(k)(7)(C) and Rule 2110 by sharing in the directed brokerage payments. Because the Hearing Panel finds that Respondent violated Rule 2110 by accepting directed brokerage payments, it is unnecessary to decide if his conduct also violated Rule 2830(k)(7)(C).

[11] At the time of the alleged violations, the Rule was 2830(k)(6)(C). *See* NTM No. 05-04, 2005 NASD LEXIS 12 (Jan. 14, 2005).

SAI granted participation in brokerage commissions it received for portfolio transactions of MFS, an investment company, to Respondent, who was a salesman. The commissions were directed by and identified with MFS. The transactions were with respect to retail sales, both SAI's overall retail sales and Respondent's retail sales to his clients.[12] Without admitting or denying the charges but consenting to the entry of FINRA's findings, SAI settled FINRA's charges related to the directed brokerage arrangement that is the subject of the Complaint in this matter on July 11, 2007. SAI paid a fine of $375,000. CX-11; RX-156.

Respondent made no independent effort to determine if his conduct violated FINRA's rules, consistently showing a complete lack of diligence, or even interest, in knowing the applicable rules, much less in taking responsibility for complying with them. He had not read Rule 2830(k) and was unaware of it in 2003. He did not read FINRA's Notices to Members. Tr. 317 – 318. Respondent should have been concerned about whether the directed brokerage arrangement was permissible under FINRA's rules, especially since this was an unfamiliar arrangement (Tr. 182, 192 – 193; Answer to Complaint at 7), which should have been a "red flag," alerting him to the potential for compliance problems. Instead, he simply relied on others for compliance. "I gotta trust somebody that has stuff – MFS, they invented the mutual fund.

[12] "Retail sales" and "distribution" are not defined in Rule 2830, but Respondent's business was unquestionably retail sales and distribution. He received commissions on each purchase by union members, and trailing commissions on the account of each union member. He recommended investment companies' funds to the trustees, and thus was in a position to be influenced by directed brokerage payments, precisely the situation that Rule 2830, the "Anti-Reciprocal Rule," was designed to address. *See* NTM No. 84-40, 1984 NASD LEXIS 75 (July 26, 1984); *American Funds* at *11 ("The rule's goal is to curb conflicts of interest that might cause retail firms to recommend investment company shares based upon the receipt of commissions from that investment company.")

Securities America has 1,800 reps. I mean, I have to rely on their internal policies." Tr. 193; *see also* Tr. 1731 – 1732. Reliance on others is not an excuse for failure to follow FINRA's rules.[13]

At the time of the violations, Respondent had been registered with FINRA for 30 years,[14] he was the only principal of his OSJ, and he had been selling mutual funds to union pension plans since at least 1984. CX-68. Respondent should have known the requirements of Rule 2830, and as a registered person, he is presumed to know them. *Dep't of Market Reg. v. Ko Securities, Inc.*, 2004 NASD Discip. LEXIS 21, *9 – *10 (N.A.C. Dec. 20, 2004). Furthermore, negligent conduct may violate Rule 2110.[15]

By his substantial participation in an arrangement that violated FINRA's rules, Respondent violated Rule 2110. Rule 2110 provides, "A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade."[16] The Rule applies both to conduct that violates other rules and to conduct that is unethical but might not violate any other specific rule. *Dep't of Enforcement v. Shvarts*, 2000 NASD Discip. LEXIS 6 (N.A.C. June 2, 2000). "The principal consideration is whether the misconduct reflects

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[13] *Philippe N. Keyes*, Exchange Act Rel. No. 54723, 2006 SEC LEXIS 2631, at *22 (Nov. 8, 2006) ("As a participant in the securities industry, however, [respondent] is responsible for compliance with regulatory requirements and cannot shift his responsibility for compliance to his supervisors"); *Dep't of Enforcement v. Merhi*, 2007 NASD Discip. LEXIS 9, at *27 – *28 (N.A.C. Feb. 16, 2007) ("'A registered representative is responsible for his actions and cannot shift that responsibility to the firm or his supervisors.'") (quoting *Rafael Pinchas*, 1999 SEC LEXIS 1754, at *14, 54 S.E.C. 331, 338 (Sept. 1, 1999)).

[14] In discussing sanctions for selling away, the SEC recently found that a respondent's claimed ignorance of the rule against selling away was an aggravating factor due, in part, to the respondent's 15 years in the industry. *Keyes* at *21.

[15] *Dep't of Enforcement v. Pellegrino*, 2008 NASD Discip. LEXIS 10, at *15 n.13 (N.A.C. Jan. 4, 2008); *Paul Joseph Benz*, Exchange Act Rel. No. 51046, 2005 SEC LEXIS 116 (Jan. 14, 2005) (president of firm violated Rule 2110 by permitting firm to operate with insufficient net capital, despite good faith effort to comply); *Robert Tretiak*, Exchange Act Rel. No. 47534, 2003 SEC LEXIS 653, at *21 n.21 (Mar. 19, 2003).

[16] FINRA's rules, including Conduct Rule 2110, are applicable to a person associated with a member firm pursuant to Rule 115(a). *Dep't of Enforcement v. Kaweske*, 2007 NASD Discip. LEXIS 5, at *14 n.8 (N.A.C. Feb. 12, 2007); *Dep't of Enforcement v. Gerace*, No. C02990022, 2001 NASD Discip. LEXIS 5, at *8 n.8 (N.A.C. May 16, 2001).

on an associated person's ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the public." *Dep't of Enforcement v. Davenport*, No. C05010017, 2003 NASD Discip. LEXIS 4, at *8 – *9 (N.A.C. May 7, 2003); *cf. Robert J. Prager*, Exchange Act Rel. No. 51974, 2005 SEC LEXIS 1558, at *33 – *34 (July 6, 2005) (recklessly ignoring red flags of market manipulation, violating Rule 2110).

Respondent violated Rule 2110 by accepting directed brokerage payments. Especially in light of Respondent's experience and responsibility, and his substantial role in putting the arrangement together, his active participation in the operation of the arrangement for nearly two years, and his acceptance of prohibited payments, Respondent's conduct did not comport with the high standards of conduct that are necessary in this industry.

C. Respondent Violated Conduct Rule 2830(k)(4) by Requesting and Arranging for the Payment of Directed Brokerage Conditioned upon Sales or a Promise of Sales

The Second Cause of Action alleges that Respondent violated Rule 2830(k)(4),[17] which provides:

> No member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of shares of an investment company.

Although there was no express requirement for any sales, Respondent understood that MFS expected the agreement to generate sales for MFS. Tr. 184 – 186, 607. MFS similarly

[17] At the time of the alleged violations, the rule was numbered 2830(k)(3). It changed to 2830(k)(4) in 2003. *See* NTM No. 05-04, 2005 NASD LEXIS 12 (Jan. 14, 2005).

hoped and anticipated that the arrangement would ultimately lead to increased sales of MFS funds. Tr. 489.[18]

By requesting the directed brokerage payments and working to arrange the payments, Respondent violated Rules 2830(k)(4) and 2110.

D. Respondent Violated Conduct Rules 2830(l)(1) and 2110 by Accepting a Payment Directly from MFS

The Fourth Cause of Action charges Respondent with violating Conduct Rules 2830(l)(1) and 2110 by accepting the $20,807.32 payment directly from MFS. Conduct Rule 2830(l)(1) provides:

> In connection with the sale and distribution of investment company securities:
>
> (1) Except as described below, no associated person of a member shall accept any compensation from anyone other than the member with which the person is associated.

The prohibition on accepting compensation from anyone other than an associated person's own firm was intended to increase the ability of members to supervise their sales practices. NASD NTM 98-75, 1998 NASD LEXIS 90 (Sept. 1998); NASD NTM 89-51, 1989 NASD LEXIS 63 (July 1989). SAI's ability to supervise Respondent's relationship with MFS was diminished because SAI was unaware that Respondent was compensated directly by MFS. SAI did not have the opportunity to determine if the receipt of the direct payment could have compromised Respondent's objectivity and resulted in him favoring MFS funds over other funds.

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[18] Almost 15 months after the arrangement had been implemented, MFS's Carol Geremia wrote to Respondent, telling him that MFS had assigned him a goal of $60 million in sales. CX-25. There is no suggestion in the letter or other evidence that the goal was tied to the directed brokerage arrangement, and neither Respondent nor MFS thought it was. Respondent testified that this letter was unsolicited, he thought it was "crazy" to assign such a large goal to him, and there was no agreement that he would achieve that level of sales. Tr. 205 – 208. MFS's Beaulieu described the sales goal as aspirational, "somewhere between a pipe dream or a wish or a hope." Tr. 676 – 678.

Respondent violated Rule 2830(l)(1) by accepting compensation directly from MFS, someone other than the member with which Respondent was associated.[19] The compensation was clearly in connection with the sale and distribution of investment company securities. As discussed earlier, Respondent understood that MFS entered into the directed brokerage arrangement to help him generate sales of MFS funds to union 401(k) plans, a hope confirmed by MFS's Beaulieu. Tr. 184, 489.

By accepting compensation directly from MFS, Respondent violated Conduct Rules 2830(l)(1) and 2110.

E. Respondent Violated Conduct Rule 2110 by Failing to Inform His Firm that He Had Received a Payment from MFS and Failing to Notify MFS and His Firm of the Double Payment

The Fifth Cause of Action, entitled "Concealment of Funds," alleges:

> Bullock personally endorsed the check for $20,807.32 made payable to "Securities America, Inc." and then kept the receipt of those funds secret from his firm, SAI – conduct that is inconsistent with the high standards of commercial honor.

When Respondent did not receive the directed commission payments for March and April 2002, he called MFS, which sent him a check for $20,807.32 as an "advance" on the directed brokerage payment that Respondent expected to receive. A few weeks later, he received the $20,000 for March and April from SAI.

SAI's policies required Respondent, upon receiving MFS's check, to forward it to the firm's main office in Omaha. CX-79 at 172; Tr. 1028 – 1035. SAI's compliance manual stated, "RRs [registered representatives] may not accept (directly or indirectly) cash or non-cash compensation from outside firms or persons." Even though the funds were intended for him, at a

[19] The exceptions to the prohibition on accepting compensation from anyone other than an associated person's member firm are not relevant here.

minimum he should have notified the firm that he had received the check so the firm could determine if he would be permitted to retain the funds as an exception to the firm's written procedures. By failing to notify the firm that he had received the check, he deprived the firm of the opportunity to exercise oversight of his receipt of the funds and to record it on the firm's books and records. Tr. 726 – 728, 1028 – 1035.

Respondent's failure to be diligent in determining whether he received a double payment compounded his failure to report the direct payment to SAI.[20] Respondent believed that the check was an advance payment of the amount that he was supposed to get under the directed brokerage arrangement but would not receive until MFS directed its clearing firm to pay brokerage to SAI. According to Respondent's hearing testimony, MFS's Doucet told him that MFS would send him a check to "expedite the process." Tr. 229 – 230, 307. "I just thought it was an expedited way of getting me the 40 percent and that the 60 percent was going the normal way through Securities America." Tr. 246 – 247; *see also* Tr. 307, 310, 1785, 1786. Yet he never informed SAI that he had received the money, and never checked his commission runs to determine if he received the directed brokerage for March and April 2002 that the direct payment was intended to cover. In fact, as noted above, on June 12, 2002, SAI paid Respondent his share of the directed brokerage for March and April, but Respondent claims that he first realized sometime in the spring of 2007 that he had received payments both from MFS directly and from SAI for March and April 2002, after he had testified at an OTR by FINRA in 2006, and after he received the Wells letter from FINRA. Tr. 267, 469 – 470, 1694 – 1695.

[20] Enforcement made a belated attempt to equate the allegation of concealment to a charge of conversion. However, the Complaint does not charge Respondent with conversion, and the Hearing Panel therefore does not decide if the evidence supports this uncharged offense.

By failing to notify his firm that he had received the direct payment, and failing to take steps to ensure that he did not receive a double payment, Respondent violated Conduct Rule 2110.

V. Respondent Violated Conduct Rule 2110 by Making Certain of the Misrepresentations Alleged in the Complaint

Respondent did not disclose the directed brokerage arrangement to his clients. Because he was advising his clients on the selection of mutual funds, his failure to disclose the arrangement was deceptive. In addition to the failure to disclose, Enforcement alleges that six specific communications to clients were deceptive. The Hearing Panel finds that four were deceptive, but two were not.

A. Material Misrepresentations to Clients Violate Conduct Rule 2110

"Misrepresentations and omissions … are inconsistent with just and equitable principles of trade and therefore are a violation of NASD Conduct Rule 2110." *Dep't of Enforcement v. Meyers*, No. C3A040023, 2007 NASD Discip. LEXIS 4, at *18 n.6 (N.A.C. Jan. 23, 2007). A negligent misrepresentation that does not rise to the level of fraud may nevertheless violate Rule 2110. *Dep't of Enforcement v. Kelsey*, No. C8A020088, 2004 NASD Discip. LEXIS 48, at *26 – *27 (O.H.O. June 29, 2004); *Tretiak* at *21 n.21.

Material omissions may also be violations of Rule 2110. "Liability for failing to disclose material information is 'premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.' A registered representative owes such a duty to his clients to disclose material information fully and completely when recommending a transaction." *Dep't of Enforcement v. Frankfort*, No. C02040032, 2007 NASD Discip. LEXIS 16, at *19 (N.A.C. May 24, 2007) (citations omitted). A duty to disclose occurs when, in light of the statements made and the surrounding circumstances, disclosure of particular facts is necessary to

avoid misleading impressions. *Brody v. Transitional Hospitals Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002).

"[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information." *Meyers* at *20, quoting *Basic v. Levinson,* 485 U.S. 224, 240 (1988). A misrepresentation is material "if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available." *Dane S. Faber*, 2004 SEC LEXIS 277, at *14 (footnote omitted); *Dep't of Enforcement v. Cipriano*, No. C07050029, 2007 NASD Discip. LEXIS 23 (N.A.C. July 26, 2007).

B. Respondent Violated Conduct Rule 2110 by Failing to Disclose the Directed Brokerage Arrangement to Clients

Respondent had a relationship of trust and confidence with the trustees of the various 401(k) plans, and regularly recommended mutual funds to them.[21] In recommending mutual funds to the trustees, Respondent had a duty to disclose any potential biases that the trustees might have regarded as potentially affecting his recommendations.

Respondent did not disclose the directed brokerage arrangement to his clients. Tr. 326 – 327, 341, 404, 406; CX-3 at 33 (OTR at 126). In making recommendations, his failure to disclose the arrangement with MFS was misleading because he had a potential conflict of interest. This unusual compensation arrangement would create an appearance of a conflict that would have "altered the total mix of information available" to Respondent's clients. Clients would likely have felt that this arrangement gave Respondent an incentive to stay on MFS's

[21] Respondent looked at himself as a fiduciary, but was not certain that he was truly a fiduciary because he was advised that he was only a fiduciary if he received a fee for acting in that capacity. He believed that he did have a duty to disclose any biases to his clients. Tr. 144 – 151; CX-48.

"good side" by marketing MFS funds to all clients, so that MFS would continue to subsidize Respondent's employment of Collins. "The case law has consistently held that a failure to disclose information related to a registered representative's own self-interest constitutes a material omission."[22]

Respondent's own testimony suggests that he thought the information was material. He testified, "I don't want my trustees, or the trustees, to be biased by anything" and "I don't want my trustees to rule out a good opportunity because of me." Tr. 374, 1820.[23] Presumably the trustees would not have been biased, or ruled out a good opportunity, if they thought the information was not material. Respondent's rationale that he did not disclose the information because he was concerned that his clients might make a mistake by considering the information to be important is not a basis for the failure to disclose the information. In deciding whether to continue their relationship with Respondent or to look more closely at his recommendations, it was for the clients, not Respondent, to decide how to take into account information that some might regard as important or revealing a conflict of interest.[24]

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[22] *Meyers* at *20; *see also Vernazza v. SEC*, 327 F.3d 851, 859 (9th Cir. 2003); *Dist. Bus. Conduct Comm. v. Kunz*, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *35 – *36 (N.A.C. July 7, 1999) (finding that consulting relationship between representative and issuer of stock was material), *aff'd*, 55 S.E.C. 551 (2002), *aff'd*, 64 F. App'x 659 (10th Cir. 2003); *G. Bradley Taylor*, 2002 SEC LEXIS 2429, at *22 – *23 (A.L.J. Sept. 24, 2002).

[23] Respondent also testified that he did not think the trustees of the union pension plans would care about the directed brokerage arrangement. Tr. 358. This testimony was inconsistent with his testimony about his concern that the trustees might consider the information in their decision making, and with his testimony that he did not know if the trustees would want to know about the arrangement. Tr. 365. The Hearing Panel found his testimony that he did not think the trustees would care not credible.

[24] Both parties presented testimony of Respondent's former customers, but their testimony differed on whether it would have been material to them to learn about the directed brokerage arrangement. The individual customers' views are of little value because "the standard for materiality is objective, not subjective." *Tretiak* at *24 n.26; *Meyers* at *20. Both because the testimony did not clearly support either Enforcement or Respondent and because of the limited weight given to customer testimony on matters of materiality, the Hearing Panel does not rely on the customer testimony.

The existence of the directed brokerage arrangement was material information that should have been disclosed to Respondent's customers. By failing to disclose the directed brokerage arrangement, Respondent violated Rule 2110.[25]

C. Enforcement Has Not Established that Respondent's Responses to General Questions from the Sheet Metal Workers 401(k) Plans Concerning How He Was Compensated Were Misleading for Failing to Disclose the Directed Brokerage Arrangement

Enforcement contends that Respondent's responses to three similar questions from the Sheet Metal Workers' plans concerning how he was compensated and the costs his clients would incur as a result of using his services were misleading. Respondent reasonably understood the questions to be asking about the out-of-pocket costs the Sheet Metal Workers would incur for using Respondent's services. Directed brokerage payments were paid out of the assets of the funds managed by MFS, and not directly out of the pockets of Respondent's clients, so Respondent believed the questions did not relate to directed brokerage. Respondent did not tell the Sheet Metal Workers anything about the arrangement with MFS until after the Complaint was filed in 2007. Tr. 404, 406.

On February 7, 2003, almost a year after the start of the directed brokerage arrangement, counsel for the Sheet Metal Workers' Local 105 asked Respondent to "itemize all fees and other sums that you receive for your company's services, including without limitation 12(b)(1) fees, contingent deferred sales charges, and any sums that you receive in connection with your services." CX-40 at 9. On June 5, 2003, counsel for the Sheet Metal Workers' Local No. 9

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[25] The Complaint does not charge actual bias, but Enforcement attempted to prove that Respondent favored MFS funds over other funds as a result of the directed brokerage arrangement. Respondent adamantly insisted that the arrangement did not bias him. Tr. 327, 344. Enforcement offered statistics concerning investments by union members and Respondent's sources of compensation resulting from those choices, and Respondent offered statistics that allegedly showed an absence of bias. Both sets of statistics were unpersuasive, with many obvious flaws. Because the charge is not in the Complaint, those flaws are not discussed here.

401(k) Annuity Plan asked Respondent to disclose "the commissions that your company earns on investments made with Plan assets." CX-34. In May 2003, a consultant for the plan informed Respondent:

> [The union's president] would like a detailed explanation of all fees, costs, compensation and related cash flow process involved by hiring IEBP. This would include all compensation received by IEBP, and if and how any of this compensation is captured by the plan. It is very important that there is a detailed accounting of all costs, expenses and compensation associated with the plan.… In your explanation, please include a detailed accounting of all costs and compensation, as well as how costs are paid.

Tr. 954, 979, 981 – 982; CX-43.

Respondent responded to each of these inquiries by identifying only the 12b-1 and finder's fees. CX-41 at 27; CX-35; CX-44.[26] He did not think any of these questions related to the directed brokerage arrangement. He believed the purpose of questions about how he was compensated was to inquire about the costs to the plan of using Respondent's services. Tr. 340 – 341, 350 – 352, 363 – 364, 1516 – 1519, 1525, 1530 – 1533. Respondent's interpretation of the questions was reasonable and credible. His clients' main concern appears to have been to understand how much money would come out of the union members' pockets for using Respondent's services, not to uncover any ulterior motives Respondent might have had in his recommendations of the menu of mutual funds that would be offered to the union members. The directed brokerage payments were not contingent on sales to the Sheet Metal Workers, and would not affect the cost of using Respondent's services.

[26] Respondent received two forms of compensation for the sale of investment company securities. When a plan participant invested in a mutual fund, Respondent received a "finder's fee," or sales commission, although the practices of the mutual fund companies varied with respect to the payment of the finder's fee. In addition, he received 12b-1 fees, or trailing commissions, based on the amount of assets in the accounts of plan participants. Tr. 115 – 116.

Although he should have disclosed the directed brokerage arrangement to all of his clients, Respondent's understanding of the questions from the Sheet Metal Workers 401(k) plans was reasonable, and his answers responded to the questions as he understood them. Where Respondent reasonably answered the question that he reasonably understood his clients to be asking, his truthful response did not violate Conduct Rule 2110.

D. Respondent's Responses to Questions Concerning Directed Brokerage, Mutual Fund Scandals, and Investigations Were Misleading, but a Report that Described the MFS Settlement with the SEC Was Not

The Complaint charges that Respondent misled IATSE[27] Local 33 concerning his role in the mutual fund scandals involving directed brokerage when he circulated a quarterly trust report to IATSE Local 33 that reported on MFS's settlement with the SEC, and again when he responded to specific questions concerning the involvement of IEBP and the mutual fund in directed brokerage, investigations relating to mutual funds, and the "scandals." While the quarterly report was not misleading, the responses to IATSE's specific questions was.

1. MFS Settlement with the SEC

On March 31, 2004, MFS settled charges brought by the SEC relating to directed brokerage, paying a civil penalty of $50 million and agreeing to a censure and a cease-and-desist order. Neither the SEC's press release nor the settlement with MFS mentions Respondent, SAI, or any arrangements with individual brokers. RX-61; CX-12. The press release and order focused on "shelf space" arrangements in which MFS allegedly "directed brokerage commissions on fund portfolio transactions to the brokerage firms in exchange for heightened visibility within the brokerage firms' distribution networks." The press release describes the agreements between MFS and broker-dealers as "based upon negotiated formulas" by which

[27] IATSE is the acronym for the International Alliance of Theatrical Stage Employes [sic].

"MFS paid brokerage firms anywhere from 15 to 25 basis points (bps) on mutual fund gross sales and/or 3 to 20 bps on assets held over one year." *Id.*

2. FINRA's Investigation of Respondent and SAI

The investigation that led to the filing of the Complaint against Respondent began when the directed brokerage arrangement was discovered during the course of the investigation involving SAI. Tr. 1050. FINRA served Respondent with a request for documents on December 12, 2005, and a follow-up request for information on April 7, 2006. CX-68. Respondent testified at an on-the-record interview on April 5, 2006. CX-3. FINRA sent a Wells letter to Respondent on July 26, 2006. CX-75.

3. Respondent's Communications to IATSE Local 33 401(k) Plan Concerning Directed Brokerage, Mutual Fund "Scandals," and Investigations

a. In a Report to a Client Reporting on MFS's Settlement with the SEC, It Was Not Misleading to Fail to Disclose that Respondent Had Received Directed Brokerage from MFS

On April 20, 2004, Respondent provided a quarterly report to IATSE Local 33. Among other things, Respondent reported on the SEC and other investigations of the mutual fund industry. He reported that MFS had settled with the SEC "based on improper disclosure of the use of brokerage commissions …." CX-54. The report did not mention that he had received directed brokerage, through SAI, from MFS.

Although Respondent's report did not mention the directed brokerage arrangement, there is nothing in the SEC's press release that suggests that the settlement was related to Respondent's arrangement for the receipt of directed brokerage. In fact, the SEC's press release states that the settlement was for MFS's agreements with brokerage firms that expressly tied payment of directed brokerage to sales or assets held over one year, using specific formulas. Respondent's arrangement was not tied to sales by any specific formulas, but was based on his

employment of Collins to develop new clients with the goal of developing new sales. There was no mention in the SEC press release or its settlement with MFS of any arrangements that related to directed brokerage to individual brokers, or any arrangements in which there was not a direct link between the payment of directed brokerage and the mutual fund sales or assets under management.

Given the differences between MFS's alleged offenses as described in the SEC's press release and settlement and Respondent's directed brokerage agreement, it was not misleading to fail to mention the directed brokerage arrangement when describing the MFS settlement.

b. Respondent's 2006 Communications to IATSE Local 33 401(k) Plan Concerning Directed Brokerage, Mutual Fund "Scandals," and Investigations Were Misleading

On June 14, 2006, Respondent responded to a request for information from consultants who were advising IATSE Local 33 with respect to its 401(k) program. CX-55. Among the questions was a detailed question concerning "the recent mutual fund and investment company scandals."

> Please describe in detail involvement in, and response to, the recent mutual fund and investment company scandals, of your company and of each of the companies whose mutual funds you use, including, at the very least, the following information:
>
> a. The nature of any subpoenas that have been served and the response thereto; …
>
> c. A description of any government investigations, and the status thereof; …
>
> f. Whether brokerage commissions have been directed out of Fund[28] assets to securities firms that sell the fund or bring it new clients and whether the practice will continue; and

[28] In this question, "Fund" appears to refer to the I.A.T.S.E. Local 33 401(k) Trust Fund, and not to the mutual funds. "Fund" is capitalized throughout the letter when it asks about the 401(k) plan.

> g. Disclosure of possible illegalities or questionable practices of any kind that may prove embarrassing in the future.
>
> This list is not intended to be all-inclusive. We would like full disclosure of all matters that may impact services or performance or the public perception thereof.

Respondent avoided a direct answer, saying in response, "This question relates directly to the mutual fund industry and as such is answered singularly by MFS." CX-55 at 16. He testified that he gave this answer because he thought "all this mutual fund scandal applied to mutual funds, not to me." Tr. 448.

In February 2007, Respondent submitted a proposal to IATSE Local 33 that responded to the same question that was asked in June 2006. CX-58 at 26. Respondent again responded by stating that the question was for the mutual fund companies:

> IEBP understands Question 33 to be directed to the mutual funds and/or investment companies with which IEBP has dealings, as opposed to IEBP itself. The response below has been provided by MFS Retirement Services, Inc. IEBP is requesting responses from all of the outside mutual funds and investment companies recently added to the plan, and will provide such additional responses upon request.

CX-58 at 39.

Respondent's responses to IATSE's questions implied that he had no independent information that was relevant to the questions, but, in fact, the questions were as applicable to him and SAI as to MFS. Respondent's responses were misleading, falsely implying that he had

nothing to disclose. By evading the questions, Respondent avoided disclosing that he and SAI had received directed brokerage commissions, and were the subject of a FINRA investigation.[29]

The failure to address the question about "the nature of any subpoenas that have been served and the responses thereto" was misleading because, at the time of this question, Respondent and SAI had responded to requests from FINRA pursuant to Procedural Rule 8210, supplying documents and testifying at OTRs. While an 8210 request is not a subpoena, from a client's point of view it would certainly be the same thing. Respondent did not mention the Rule 8210 requests and responses or the OTRs, nor did MFS. This evasive response was misleading.

Similarly, Respondent did not respond substantively to the union's request for "a description of any government investigations," and the MFS response did not mention FINRA's investigation of SAI or Respondent. While FINRA is not a government agency, the distinction would not have been important to Respondent's clients. The request was broad, encompassing a description of the "involvement in, and response to, the recent mutual fund and investment company scandals, of your company and of each of the companies whose funds you use, including, at the very least, the following information." Given the breadth of this inquiry, the distinction between a FINRA investigation and a government investigation was plainly not material, and it was misleading to fail to disclose FINRA's investigation in response to this request.

The response to IATSE's question about "[w]hether brokerage commissions have been directed out of Fund assets to securities firms that sell the fund" was also misleading. Although

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[29] Respondent's response to the IATSE Local 33 Request for Proposals was reviewed and approved by SAI's compliance department, consistent with SAI's procedures. Tr. 820 – 835, 841 – 843, 1553, 1555; RX-51. When SAI's head of compliance learned that the compliance officer who reported to him had approved the communication to IATSE Local 33 without requiring Respondent to disclose that he was under investigation by FINRA, he told her to direct Respondent to disclose the investigation. Tr. 831 – 834. Apparently as a result, Respondent's counsel disclosed the investigation to the trustees. CX-50.

the IATSE Local 33 assets were a small part of the assets used to generate the directed brokerage commissions, the import of the question was clearly a request for disclosure of directed brokerage commissions that SAI or Respondent received, especially since the IATSE Local 33 401(k) plan offered only MFS funds.

Finally, Respondent's failure to respond substantively to questions about "possible illegalities or questionable practices that may prove embarrassing in the future" was misleading. At the time Respondent failed to respond to this question, he had provided documents to FINRA, testified at an OTR, and, at the time of the second response, received a Wells letter advising him that FINRA staff had made a preliminary determination to recommend that disciplinary action be brought against Respondent. This was clearly not a question that was either directed to or singularly answered by MFS. Given the status of FINRA's investigation, it was misleading to fail to disclose the directed brokerage arrangement and the staff's allegations of illegality in response to the question asked by Respondent's client.

VI. Sanctions

There are no recommendations in the FINRA Sanction Guidelines for violations of Conduct Rule 2110 by accepting directed brokerage payments, requesting or arranging for the direction of brokerage commissions conditioned on sales in violation of Conduct Rules 2830(k)(4) and 2110, or for accepting a payment from an entity other than an associated person's member firm in violation of Conduct Rule 2830(l)(1), or "concealment of funds." The Sanction Guidelines recommend a suspension of up to 30 days for negligent misrepresentations, or ten business days to two years for intentional or reckless misconduct, and consideration of a bar in egregious cases. In addition, the Sanction Guidelines recommend a fine of $2,500 to $50,000 for negligent misrepresentations, or $10,000 to $100,000 for intentional or reckless misrepresentations. *FINRA Sanction Guidelines* at 93.

A. Relevant Principal Considerations

In determining the appropriate sanctions, the Hearing Panel looked at the following principal considerations.

1. Disciplinary History

Respondent has no history of disciplinary problems. Principal Consideration No. 1. The absence of a disciplinary history is not a mitigating factor,[30] but in determining the sanction, the Hearing Panel does not need to take recidivism into account.

2. Acceptance of Responsibility

Respondent has not accepted responsibility for his conduct. Principal Consideration No. 2. He was unaware of the rules governing his conduct, and blames those upon whom he says he relied – SAI and MFS – for any violations. Respondent was never concerned about whether the arrangement raised compliance issues because he relied on MFS and SAI to determine if the arrangement was permissible. Tr. 193 – 194, 343 – 344.

Respondent's failure to acknowledge that he acted improperly is an aggravating factor.

3. Injury

Enforcement does not allege that MFS's investors or Respondent's clients were harmed by the directed brokerage arrangement. Principal Consideration No. 11. The arrangement created a potential conflict of interest, and therefore could have injured the union members who invested through the 401(k) plans. *See Dep't of Enforcement v. American Funds Distributors, Inc.*, No. CE3050003, 2008 FINRA Discip. LEXIS 13, at *43 – *44. (N.A.C. Apr. 30, 2008), *appeal docketed*, No. 3-13055 (S.E.C. May 28, 2008).

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[30] *See, e.g., Dep't of Enforcement v. Fergus*, No. C8A990025, 2001 NASD Discip. LEXIS 3, at *58 – *59 (N.A.C. May 17, 2001).

There is no evidence that Respondent's acceptance of the direct payment from MFS or his concealment of the funds from SAI caused any actual injury to SAI. The funds were not ultimately intended for SAI, and SAI received everything to which it was entitled under the directed brokerage arrangement. SAI paid Respondent only what it was supposed to pay under the directed brokerage arrangement, and was not injured by Respondent's receipt of the double payment. SAI disclaims ownership of the direct payment. Respondent's retention of the double payment might have injured MFS, but MFS also disclaims ownership of the funds.

There is no evidence that the failure to disclose the directed brokerage arrangement to his clients or the misrepresentation to IATSE Local 33 concerning the FINRA investigations and Respondent's involvement in directed brokerage harmed the unions' 401(k) plans. There is also no evidence that Respondent's misrepresentations caused any actual injury to IATSE Local 33.

4. Cooperation with FINRA's Investigation

Respondent cooperated with FINRA's investigation. Tr. 1719 – 1720. Principal Consideration No. 12.

5. Intent

Respondent's misconduct was largely the result of recklessness. Principal Consideration No. 13. Respondent admits that he is not knowledgeable about FINRA's rules or the requirements of securities laws. Tr. 152. He doubts that he ever read, or was even aware of, Rule 2830(k) in 2002 or 2003. He does not read Notices to Members from FINRA. Tr. 317. His attitude was, "Wouldn't they be inclined to correct me if I should [not] be doing this?" Tr. 437; *see also* Tr. 165 ("I'm relying on the mutual fund companies, and I'm relying on Securities America. They should know this."). The complete failure to keep abreast of the requirements of FINRA's rules and his firm's own rules was reckless conduct. *Dep't of*

Enforcement v. Van Dyk, No. C3B020013, 2004 NASD Discip. LEXIS 12, at *27 – *28 (N.A.C. Aug. 9, 2004).

Respondent's acceptance of the direct payment and failure to inform his firm of the payment was also reckless, stemming substantially from his failure to know that Rule 2830(l)(1) prohibited the receipt of the direct payment, his failure to know his firm's own procedures on handling incoming funds, and his lack of attention to the operation of his office.

Respondent explains his failure to know that he had received the duplicate payment by claiming that it was consistent with how he ran his office and his lack of attention to financial matters. While Respondent took great pains to establish that he did not keep track of the details of the operation of his OSJ, his inattention to the affairs of his office is a further cause for concern, not a mitigating factor. Especially when he knew he was getting a payment out of the ordinary course of business, he should have been more diligent in ensuring that the payment was handled properly.

Respondent's failure to notify his clients of the directed brokerage arrangement resulted from Respondent's failure to appreciate the importance of disclosure of information. Respondent did not believe that the information should have been material to his clients because he did not believe that he was biased, but the decision on materiality belonged to the clients, not to Respondent.

Respondent's responses to the questions asked by IATSE Local 33 appear to have been the result of a conscious decision to avoid answering fairly direct questions, and not mere negligence. The questions were direct and should have elicited a direct response. The responses were so evasive that they reflect an intention to avoid providing information that was unfavorable to Respondent.

6. Monetary Benefit

There is no evidence that Respondent received any monetary benefits from his misconduct, except for his failure to return the duplicate payment of $20,807.32. Principal Consideration No. 17. The directed brokerage arrangement had the potential for gain, but there was no actual financial benefit because Collins never generated any sales, and the payments merely covered Respondent's cost of hiring Collins. At most, Respondent benefited by having an employee, without cost to Respondent, who attempted to develop business.

Respondent's misrepresentations potentially resulted in monetary benefit, because he might have lost business if he had made proper disclosures to his clients. Some clients might have felt that the conflict rendered his advice unreliable and not wanted to use his services, or at least to take a closer look at his recommendations.

Respondent testified that he now believes that he received a double payment, but he has not repaid anyone for the double payment. Tr. 278 – 279.[31] The retention of the double payment is a monetary benefit and an aggravating factor, although neither SAI nor MFS claims that it is entitled to the money. To some extent, the inability to determine who should have the money is the result of Respondent's improper acceptance of a direct payment and his failure to notify SAI that he had received the check. If Respondent had handled the check properly, the situation almost certainly could have been resolved in 2002.

B. Sanctions Imposed

The Hearing Panel has considered all of the factors, and finds that it is appropriately remedial to impose suspensions in all capacities and as a principal, as well as a fine. The

[31] He has offered, through his attorney, to repay the money, but does not know to whom to make the payment. Answer to Complaint at 8; Tr. 278, 1696.

Hearing Panel suspends Respondent from associating with any FINRA member for six months in all capacities, and for an additional six months as a principal. In addition, the Hearing Panel imposes a fine of $50,000. In determining the amount of the fine, the Hearing Panel considered the amount of funds Respondent received in direct payment from MFS, as well as the nature of the violations and the potential financial benefit from the arrangement. Restitution of the direct payment would not be appropriate because neither MFS nor SAI claims the funds, and the firms have been sanctioned by the SEC and FINRA respectively for their directed brokerage activities.[32]

Respondent demonstrated a lack of appreciation for the importance of knowledge of FINRA's rules, as well as a lack of familiarity with FINRA's rules. Until Respondent demonstrates a greater familiarity with the applicable rules, he should not function as a principal. Respondent is suspended in all principal capacities for six months in addition to the suspension for six months in all capacities, and ordered to re-qualify before functioning in any principal capacity.

VII. Conclusion

For accepting directed brokerage payments, making misrepresentations to clients, and failing to inform his firm of the receipt of the payment that he received directly from MFS, all in violation of Conduct Rule 2110, requesting or arranging for the direction of brokerage commissions conditioned on sales in violation of Conduct Rules 2830(k)(4) and 2110, and accepting a direct payment from MFS in violation of Conduct Rule 2830(l)(1) and his firm's policies, Respondent is suspended for six months in all capacities and fined $50,000. In

[32] Nobody has ever asked for repayment of the money. Tr. 1696, 1704. MFS does not claim any entitlement to the funds. Tr. 512 – 513.

addition, Respondent is suspended in all principal capacities for six additional months, to run consecutively with the suspension in all capacities, and ordered to re-qualify as a principal before acting in the capacity of principal. Respondent is also ordered to pay costs of $15,653.16, which includes an administrative fee of $750 and the cost of the hearing transcript.

If this decision becomes FINRA's final disciplinary action, the suspensions shall begin on June 15, 2009. The suspension in all capacities shall end on December 14, 2009, and the suspension in all principal capacities shall end on June 14, 2010.[33]

HEARING PANEL

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By: Lawrence B. Bernard
Hearing Officer

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