FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. ANTHONY G. MANAIA (CRD No. 1506665), Respondent.	Disciplinary Proceeding No. 2009018818101 Hearing Officer – MC **HEARING PANEL DECISION** June 28, 2013

For making negligent misrepresentations and omissions of material fact, thereby engaging in conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of NASD Rule 2110 and FINRA Rule 2010, the Hearing Panel suspends Respondent Anthony G. Manaia from associating with any FINRA member firm for 30 business days, fines him $54,472, and assesses costs.

Respondent did not fraudulently or recklessly make misrepresentations or omissions of material fact. The Hearing Panel therefore dismisses the cause of action alleging that he violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, and NASD Rules 2120 and 2110.

Appearances

Helen G. Barnhill, Esq., and Jacqueline D. Whelan, Esq., for the Department of Enforcement.

Mark L. Kowalsky, Esq., for Respondent.

I. Introduction

The Complaint in this case alleges that Respondent Anthony G. Manaia[1] engaged in two related types of wrongdoing. The first, and most serious, charge is that he engaged in fraudulent

[1] Manaia first became registered with FINRA through a member firm in 1986 as a General Securities Representative. He subsequently found employment with four other FINRA member firms before joining Intervest International Equities Corporation as a General Securities Representative and Principal in 2007. Intervest terminated

misconduct by making material misrepresentations and omissions of fact in a letter to customers, in which he recommended investing in a private offering known as MedCap VI. The second is that he engaged in negligent misconduct, by making other misrepresentations and omissions in the same letter, and in emails to customers concerning MedCap VI and related offerings.

Manaia does not dispute that he made the alleged misrepresentations and omissions, which the Hearing Panel concluded were material, in connection with the purchase or sale of a security. Thus, the key issue in this case is Manaia's intent when he recommended the investment to his customers. For the reasons set forth below, the Hearing Panel finds that, although the evidence is insufficient to establish that Manaia acted recklessly, he acted negligently. Accordingly, the Hearing Panel concludes that Manaia violated Rule 2010, which requires FINRA members to observe high standards of commercial honor and just and equitable principles of trade,[2] and dismisses the fraud charge.

II. The Applicable Law

A. Fraudulent Statements and Omissions

Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 promulgated thereunder, and FINRA Rule 2020,[3] contain anti-fraud provisions that proscribe making material

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Manaia's securities registrations on July 5, 2010. He has not since associated with another member firm. The Department of Enforcement filed the Complaint on June 24, 2011. FINRA has jurisdiction over Manaia for the purposes of this disciplinary proceeding because Enforcement filed the Complaint within two years after he ceased to be associated with a FINRA member and the Complaint arises from conduct occurring while Manaia was associated with Intervest. Although he is no longer registered with FINRA, Manaia currently manages client assets as a Registered Investment Advisor. Hearing Tr. 362-63.

[2] Pursuant to Rule 0140, FINRA Conduct Rules apply to persons associated with a FINRA member firm, and such persons have the same duties and obligations as a member under the Rules.

[3] In its Pre-Hearing Brief, Enforcement noted that it "inadvertently charged a violation of NASD Rule 2120 in Cause One of its Complaint, rather than FINRA Rule 2020." NASD Rule 2120 was superseded by current FINRA Rule 2020 on December 15, 2008. *See* NASD to FINRA Conversion Chart Spreadsheet, *available at* http://www.finra.org. Because the conduct at issue in the Complaint's first cause of action occurred on December 22, 2008, FINRA Rule 2020 is the applicable Conduct Rule. The Rules are identical and state: "No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or

misstatements and omissions in connection with the sales of securities. Rule 10b-5 prohibits making "any untrue statement of a material fact" as well as failing "to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[4] To find Manaia liable for violating the anti-fraud rules, the evidence must establish that: (1) he made misrepresentations or omissions in connection with the purchase or sale of a security; (2) the misrepresentations or omissions were material; and (3) the misrepresentations or omissions were made with scienter,[5] which has been described as the "mental state embracing intent to deceive, manipulate, or defraud."[6] In a case such as this, where Enforcement does not contend that the respondent acted with fraudulent intent, the element of scienter may be established by proof of reckless conduct.[7]

B. Recklessness

"Reckless conduct has been defined as a highly unreasonable misrepresentation or omission, 'involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care … [presenting] a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware

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other fraudulent device or contrivance." FINRA's Rules (including NASD Rules) are available at www.finra.org/Rules.

[4] 17 C.F.R. § 240.10b-5.

[5] *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *13-14 & n.11 (Feb. 10, 2004); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1967). Misrepresentations in violation of NASD Rule 2120 also violate NASD Rule 2110. *Robert Tretiak*, 56 SEC 209, 227-28 (2003).

[6] *Dep't of Enforcement v. Abbondante*, No. C10020090, 2005 NASD Discip. LEXIS 43, at *27 (N.A.C. April 5, 2005), *aff'd*, Exchange Act Rel. No. 53066, 2006 SEC LEXIS 23 (Jan. 6, 2006)(*quoting Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976)). Scienter requires proof of intent to deceive, manipulate, or defraud and "is a necessary element of a violation of § 10 (b) and Rule 10b-5." *Aaron v. SEC*, 446 U.S. 680, 686, 691(1980).

[7] *Dep't of Enforcement v. Gebhart*, No. C02020057, 2005 NASD Discip. LEXIS 40, at *42-43 (N.A.C. May 24, 2005), *aff'd*, Exchange Act Rel. No. 53136, 2006 SEC LEXIS 93 (Jan. 18, 2006)(*citing Dep't of Enforcement v. Apgar*, No. C9B020046, 2004 NASD Discip. LEXIS 9, at *16 (N.A.C. May 18, 2004)); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990).

of it.'"[8] Further, "the danger of misleading buyers must be actually known or so obvious that any reasonable man would be legally bound as knowing."[9] In other words, to prove recklessness, the evidence must demonstrate that a respondent "either knew the statement [or omission] was false or was reckless in disregarding a substantial risk that it was false;" that he either knew the danger he ran of misleading customers, or the danger was "so obvious" that he "must have been aware of it."[10] The evidence is insufficient to establish that Manaia's conduct met this rigorous standard.

C. Negligence

Conduct that does not rise to the level of recklessness is nonetheless improper if it is negligent. It is negligent for a registered representative to fail "to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation … [Negligence] connotes culpable carelessness."[11] The standard of care imposes a duty on a registered representative to take reasonable steps to become informed about a recommended security, and to do much more than to rely unquestioningly on information provided by an issuer.[12] A registered representative must acquire "an adequate basis to recommend a security"[13] and has an obligation "to investigate and verify consistently optimistic assertions before repeating them to others."[14] Making material misrepresentations, including "exaggerated and misleading claims,

[8] *Abbondante*, 2005 NASD Discip. LEXIS 43, at *28 (*quoting Hollinger v. Titan Capital Corp*., 914 F.2d 1564, 1569-71 (9th Cir. 1990)).

[9] *Id.*

[10] *Makor Issues & Rights, Ltd., v. Tellabs Inc.*, 513 F.3d 702, 704 (7th Cir. 2008).

[11] *John P. Flannery*, 2011 SEC LEXIS 3835, at *104 (Oct. 28, 2011) (*quoting Black's Law Dictionary* 1056 (7th ed. 1999)).

[12] *Dep't of Enforcement v. Reynolds*, No. CAF990018, 2001 NASD Discip. LEXIS 17, at *42-43 (N.A.C. June 25, 2001).

[13] *Gebhart*, 2005 NASD Discip. LEXIS 40, at *39.

[14] *Jay Houston Meadows*, 52 S.E.C. 778, 785 (1996), *aff'd*, 119 F.3d 1219 (5th Cir. 1997).

… and omitting material information" violates this standard of care, and is inconsistent with the high standards of commercial honor and the just and equitable principles of trade mandated by NASD Rule 2110 and FINRA Rule 2010.[15]

Negligent misconduct, even grossly negligent misconduct, may approach yet not cross the line separating it from reckless misconduct.[16] That line may not always be easily discernible, but it is well established that the two – negligence, on the one hand, and recklessness on the other – are distinct, and that the line between them separates fraudulent misconduct from misconduct that is less egregious.[17] In this case, the evidence establishes that although Manaia did not cross the line from negligence to recklessness, he acted negligently and violated the standard of care imposed upon him by NASD Rule 2110 and FINRA Rule 2010.

III. The Facts

A. Background: The MedCap Offerings

This case concerns Manaia's recommendations from April through December 2008 of private offerings issued by Medical Capital Holdings, Inc. ("MedCap") while he was employed by member firm Intervest International Equities Corporation ("Intervest").

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[15] *Reynolds*, 2001 NASD Discip. LEXIS 17, at *44. In July 2007, NASD consolidated with the member regulation and enforcement functions of NYSE Regulation. The consolidated entity began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References to FINRA include, where appropriate, NASD. When the first phase of the new consolidated rules became effective on December 15, 2008, *see* Regulatory Notice 08-57 (Oct. 2008), FINRA Rule 2010 superseded NASD Rule 2110. In this case, the Complaint's second cause of action alleges negligent misconduct beginning when NASD Rule 2110 was effective and ending after the adoption of FINRA Rule 2010. However, the two rules are identical.

[16] *Id.* at *44-45, finding respondent's grossly negligent conduct violative of NASD Rule 2110 but without scienter required to render it fraudulent; *Kevin D. Kunz*, No. C3A960029, 1999 NASD Discip. LEXIS 20, at *45 (N.A.C. July 7, 1999), *aff'd*, 2002 SEC LEXIS 105 (Jan. 16, 2002)(finding that "respondents' conduct -- albeit negligent and inconsistent with high standards of commercial honor and just and equitable principles of trade -- did not rise to the level of recklessness.").

[17] *Reynolds*, 2001 NASD Discip. LEXIS 17, at *45 n.28 (*citing Bd. of Cnty. Comm'rs v. Liberty Grp.*, 965 F.2d 879, 883-84 (10th Cir. 1992) (proper standard for a fraud claim based on SEC Rule 10b-5 is intent or recklessness and not gross negligence, although the line between recklessness and gross negligence is a fine one); *Reiger v. Altris Software, Inc.*, No. 98-CV-528 TW (JFS), 1999 U.S. Dist. LEXIS 7949, at *22-23 (S.D. Cal. May 3, 1999)(gross negligence is not sufficient to prove scienter under SEC Rule 10b-5; conduct must have been at least reckless).

MedCap was a medical receivables financing company. Its primary business purpose was to provide financing to healthcare providers – hospitals and physicians – by purchasing their accounts receivable. As MedCap explained in the private placement memoranda ("PPMs") for the offerings, its business model was to acquire a healthcare provider's accounts receivable at a discount and earn a profit by collecting more on the receivables than it paid for them.[18]

From 2001 through 2009, MedCap sponsored a series of private offerings issued by special purpose corporations, MedCap I through VI, which MedCap described as affiliated offerings.[19] The PPMs described them as involving significant risk, suitable only for accredited investors with no need for liquidity, who could afford to lose their entire investment.[20] The proceeds of the first MedCap offering, MedCap I, were invested wholly in healthcare receivables.[21] Subsequent offerings, however, strayed from the original business model and led MedCap to invest a significant percentage of offering proceeds in businesses unrelated to medical receivables.[22]

MedCap claimed to provide protections designed to give investors confidence in the safety of the offerings. The most important was the presence of a trustee bank to oversee the operation of the special purpose corporations. Each special purpose corporation appointed a trustee bank to receive investor funds, monitor the activities of the special purpose corporation, and release the funds to the special purpose corporation only after reviewing and approving of

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[18] Compl. ¶ 4; Answer ¶ 4; *see, e.g.*, MedCap IV PPM, CX-5, at 8, MedCap VI PPM, CX-7, at 6. As Manaia explained it, the money MedCap paid to the health care provider was considered to be a kind of "loan:" if MedCap was unable to collect as much as it had loaned the provider, the provider would return to MedCap the difference between the amount it received and the amount MedCap collected. Tr. 425-26.

[19] *See, e.g.*, CX-5, at 9 of 54.

[20] CX-2-CX-7.

[21] CX-2, at 16 of 52.

[22] For example, MedCap III allowed the special purpose corporation to divert up to 20 percent of investor proceeds for purposes other than purchasing medical receivables. CX-3, at 17 of 53.

the assets the corporation proposed to purchase. MedCap claimed investors' notes were secured by the assets the special purpose corporation purchased with offering proceeds. According to the PPMs, each special purpose corporation maintained funds on deposit with the trustee bank sufficient to repay principal to all investors, providing a 100 percent "collateral coverage ratio" to protect the investors. The offering PPMs represented that the special purpose corporation's obligations to pay investors were secured by a grant of a security interest to the trustee bank in the collateral, and that no distributions from the trust account would be made to the special purpose corporation until after all notes had been "paid in full."[23]

The PPMs also, however, had other provisions that significantly diminished the protections purportedly provided by the trustee bank by placing limitations on its responsibility, role, and authority. For example, the PPMs for MedCap II and the offerings which followed it did not require the bank to verify the accuracy of representations by MedCap as to the medical receivables purchased, or to confirm the actual collateral coverage ratio.[24] As a result, the trustee banks relied simply on MedCap's representations about the receivables purchased and the collateral held.

Nonetheless, for years MedCap I through V met their obligations to repay all investors interest and principal when due. Then, in July 2008, MedCap II and III missed deadlines for repayment of principal to some investors.[25] Soon afterward, on August 5, 2008, MedCap issued a letter notifying the broker-dealers who had sold MedCap II and III notes that MedCap was

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[23] *See, e.g.*, CX-2, at 10, 33-34(PPM for MedCap I), CX-3, at 8, 35 (PPM for MedCap II), CX-7, at 7-8, 33-36 (PPM for MedCap VI).

[24] Compl. ¶ 8; Answer ¶ 8; CX-3, at 34, CX-5, at 36 of 54, CX-6, at 37 of 55, CX-7, at 34 of 53 ("The trustee will not … have any obligation to monitor, supervise or verify our actions or omissions … [or] to make any calculations of principal or interest, or to independently determine any collateral coverage ratios, or to otherwise make any inquiry or investigation or have any responsibility as to whether we are in default or have breached any obligation.").

[25] Compl. ¶ 9; Answer ¶ 9.

"experiencing a temporary liquidity issue" and therefore would not be able to repay some investors their principal on schedule, although the notes were still "secure."[26]

On August 5, 2008, the same date of its letter about missed principal repayments, MedCap launched MedCap VI, its final offering. MedCap VI offered up to $400 million in two-, three-, and six-year notes, with interest rates from nine to nine and a half percent.[27] As with the earlier offerings, MedCap VI was to pay note holders interest on their investment monthly until their notes matured, when MedCap would return the investors' principal. Like the PPMs for the earlier offerings, the MedCap VI PPM acknowledged that investing involved "significant risk." Like MedCap IV and V, but unlike the first three MedCap offerings, MedCap VI allowed up to 40 percent of the proceeds from the sale of notes to be used for purposes other than investing in healthcare receivables. The MedCap VI PPM pointed out that the company's lack of diversified operations and limited experience in investments other than healthcare receivables might result in higher default rates than anticipated.[28]

MedCap VI's PPM also contained a significant misrepresentation. Despite the missed payments to investors in MedCap II and III in August 2008, it stated: "Our affiliates have never defaulted in the payment of their obligations … and all interest payments on those securities were made when due."[29] In November 2008, the Bank of New York Mellon, trustee for MedCap II, and Wells Fargo, the trustee for MedCap III, sent notices of default to note holders. Wells

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[26] CX-9.

[27] Compl. ¶ 6; Answer ¶ 6.

[28] CX-7, at 9-11, 14 of 53.

[29] CX-7, at 7 of 53.

Fargo sent another notice in December 2008.[30] Despite the defaults, MedCap VI's PPM contained this misrepresentation until May 27, 2009, when it issued a revised PPM.[31]

In July 2009, the Securities and Exchange Commission sued the chief executive officer and the president of the MedCap companies; MedCap; MedCap VI; and MedCap's affiliated operating company, Medical Capital Corporation, for fraud in the offer and sale of MedCap VI. The SEC also alleged the defendants misappropriated MedCap VI offering proceeds to pay administrative fees to the operating company. Subsequently the U.S. District Court for the Central District of California placed MedCap in receivership.[32] In its sixth report to the Court, the Receiver disclosed preliminary findings of a forensic accounting: the only MedCap offering that generated a profit was MedCap I; no MedCap offering generated enough profit to pay its investors' principal and interest, as represented in the PPMs; MedCap, however, paid itself administrative fees in excess of $323 million; MedCap transferred assets between the special purpose corporations allowing repayments of earlier investors' principal to be made from new investor funds, and as a result, investors lost principal of approximately $1.079 billion.[33] In effect, the MedCap offerings were a Ponzi scheme.[34]

B. Manaia's Experience With MedCap

Manaia's familiarity with MedCap predated his employment with Intervest. When first exposed to MedCap, Manaia was wary. His practice was to recommend only listed securities to his customers.[35] Thus, when his former business partner, prior to Manaia's employment at

[30] CX-12-13A.

[31] CX-10.

[32] Compl. ¶ 10; Answer ¶ 10.

[33] CX-35, at 6.

[34] CX-39, at 22.

[35] Tr. 370-72.

Intervest, enthusiastically suggested Manaia "take a look at" MedCap offerings, Manaia refused.[36] Later, when the president of the firm, whom Manaia held in high regard, said that he should consider recommending MedCap, Manaia initially declined. Then the president of the firm, who had been invited to a four-day "due diligence meeting" at MedCap's headquarters, asked Manaia to go in his place, suggesting that Manaia "should at least go and hear them out." Manaia agreed.[37] He was "willing to take a look" because his firm and its president had given it their "stamp of approval." Furthermore, the investment "paid a reasonable rate of interest, supposedly didn't have a correlation to the financial markets, paid interest monthly and would redeem in one year."[38]

The MedCap due diligence meeting turned out to be a conference with approximately 30 registered representatives from various firms in attendance. It lasted four days. Manaia met MedCap's leadership, managers, and employees.[39] He spoke at length with the company's CEO, its president, and other company leaders.[40] Over the course of the conference, MedCap managers presented the company's business plan and explained its operation.[41] They said that a number of well-known companies—GE Capital, Wells Fargo, and Merrill, Lynch for example—were also involved in the medical receivables business and were MedCap's competitors. This gave Manaia confidence in the legitimacy of the MedCap business model.[42]

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[36] Tr. 371-72.

[37] Tr. 372-73.

[38] Tr. 377.

[39] Tr. 374-75.

[40] Tr. 374-76.

[41] Tr. 375.

[42] Tr. 375-76.

Manaia was impressed with MedCap's "track record" of meeting obligations to pay investors principal and interest when due,[43] the guarantee of 100 percent collateralization in the PPMs, what MedCap managers described to Manaia as its overcollateralization,[44] and, most importantly, the role of a trustee bank as a "layer of protection" for investors. He believed the role of the trustee was to "guard over the funds, release the funds to Medical Capital when the assets of the receivables were verified, and maintain order so there would be no hanky-panky."[45]

Manaia understood that investor funds were initially deposited with the trustee bank, not received by MedCap, and the bank held the funds until it approved the medical receivables that MedCap proposed to purchase with the proceeds of each offering.[46] He was impressed as well by the people attending the meeting; he knew a number of them and was familiar with broker-dealers involved in recommending MedCap.[47]

Based on what he learned at the conference, his review of the offering PPMs, and his assessment that the rate of return seemed reasonable given what MedCap managers told him about their profit margin,[48] Manaia concluded that MedCap was an appropriate alternative investment for some of his customers and began to recommend it in 2006.[49]

Despite reviewing PPMs of the various MedCap offerings, Manaia was unaware of some of the provisions that were at odds with what MedCap management told him and what he read in other documents. For example, Manaia believed that the affiliated offerings were not permitted to transfer funds and assets from one to the other. Thus, he was unaware that MedCap could

[43] Tr. 378.

[44] Tr. 378-79.

[45] Tr. 523-24.

[46] Tr. 379-81.

[47] Tr. 381-82.

[48] Tr. 389-90.

[49] Tr. 369.

transfer funds raised by MedCap VI to other special purpose corporations, and sell loans and accounts receivable from one affiliated corporation to another—a practice that the Receiver ultimately concluded led to Ponzi-like transfers.[50] When questioned about this provision of the PPMs, Manaia testified, "I may have read it, but it didn't stick." Instead, he relied on what he was told.[51] Another source of Manaia's enthusiasm about MedCap was his belief in management's representations that it was overcollateralized—representations he did not, and said he could not, verify.[52]

Following the MedCap conference, he continued to believe that MedCap provided a safe place for some customers to invest some of their funds, short-term, to earn interest for a year or two and then recover their principal, particularly during the economic turbulence that seemed to be getting worse by 2008.[53] He had come to embrace the MedCap concept, and recommended MedCap III to 12 customers when he was at his previous firm.[54] He testified that MedCap was the only "alternative investment" he ever recommended to customers because "it was the only one that [he] believed in."[55]

C. Intervest's Review and Approval of MedCap

Manaia introduced MedCap to Intervest when he joined the firm.[56] In April 2007, shortly after Manaia joined the firm, Intervest approved sales of MedCap offerings.[57]

[50] Tr. 512-17.

[51] Tr. 518-19.

[52] Tr. 521-22.

[53] Tr. 367-68.

[54] Compl. ¶ 5; Answer ¶ 5.

[55] Tr. 604.

[56] Tr. 47-48.

[57] Tr. 48-49.

Before deciding to do so, Intervest's president and chief operating officer, Robert Copus, together with the chief compliance officer, conducted a due diligence review of the PPMs for the MedCap II and IV offerings. Copus made the final decision. Subsequently, Copus also approved MedCap V.[58] While at Intervest, Manaia sold investments in MedCap V to approximately 38 customers before MedCap VI became available.[59]

For MedCap VI, Copus and Intervest's new chief compliance officer, Ed Hindman, conducted the due diligence review. This consisted of an examination of the offering memorandum for MedCap VI and a review of the performance of previous MedCap offerings to ascertain how MedCap had performed with regard to "what they said they would do in their offering memorandum."[60]

Satisfied with the results of the review, Copus signed a sales agreement for MedCap VI on behalf of Intervest on August 14, 2008.[61] According to Copus, Intervest's approval did not place "undue emphasis" on MedCap VI or encourage its representatives to sell MedCap VI more than it did "any other product or service."[62]

The fact that Intervest had conducted its own due diligence and approved these MedCap offerings contributed to Manaia's comfort level in recommending MedCap.[63] When MedCap VI became available in August 2008, Manaia informed customers who were due to receive repayments of principal from earlier MedCap investments. Of his client base of approximately

[58] Tr. 49-50.

[59] Compl. ¶ 5; Answer ¶ 5.

[60] Tr. 53-54.

[61] CX-16.

[62] Tr. 57-58.

[63] Tr. 377-78.

200 clients, approximately 30 expressed an interest in MedCap VI.[64] On August 25, 2008, however, Intervest placed a moratorium on all sales of MedCap VI.

D. Intervest's Moratorium on Sales of MedCap VI

The trigger for the suspension of sales of MedCap VI was the discovery by Intervest's trading desk principal that MedCap had failed to make timely scheduled interest payments to several Intervest customers who held notes for MedCap III.[65] Upon learning of this, Copus and Hindman stopped further sales of MedCap VI and placed a hold on processing the paperwork for Intervest customers who had already signed subscription agreements.[66] Intervest turned over to its clearing firm the funds it had already received from investors for MedCap VI.[67] Copus and Hindman originally intended to maintain the moratorium until MedCap resumed making prompt payments to investors, and thought the ban on new sales would last only a month while they investigated what was happening.[68]

During the moratorium, Hindman monitored a series of teleconferences in which the trustee bank for MedCap VI participated. In addition, Intervest's trading desk principal made an onsite visit to MedCap's offices and reported back to Intervest. Hindman and Copus reviewed again MedCap VI's offering memorandum, and spoke with MedCap's president in the fall of 2008.[69] Intervest decided to extend the moratorium, in part to obtain a better understanding of the reasons for the missed payments.[70]

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[64] Tr. 404-05.

[65] Tr. 58-59.

[66] Tr. 59-60.

[67] Compl. ¶ 11; Answer ¶ 11.

[68] Tr. 61.

[69] Tr. 51-52.

[70] Tr. 61-62.

E. Intervest's Resumption of Sales and the 'Hold Harmless' Letter

In December 2008, Intervest decided to lift the moratorium, permit resumption of sales of MedCap VI, and approve processing of the paperwork for those customers who had already subscribed. Three Intervest principals participated in the decision: Copus, Hindman, and Dave Smith, Intervest's Chief Executive Officer. Manaia was not involved.[71] They concluded, based largely on the teleconferences with the bank trustee and information they obtained from MedCap's leadership, that MedCap's difficulty in meeting its obligations was a "market-driven phenomenon" related to the national debt crisis, and that MedCap's leadership was in a good position to "weather this storm."[72]

However, the decision was conditional. Intervest would permit customers to invest in MedCap VI only if they signed a "hold harmless" letter in which they (i) acknowledged that they were "aware of the current defaults regarding" MedCap II and III; (ii) indicated they still wished to purchase a MedCap VI note "despite the above default information;" and (ii) agreed to hold Intervest and Manaia "harmless for any loss" incurred as a result of their MedCap VI investment.[73] The purpose of the hold harmless letter was to ensure that customers who invested in MedCap VI did so fully aware of "defaults in prior [MedCap] programs."[74] As Copus testified, Intervest "wanted to make sure that our clients were going into the purchase with their eyes wide open."[75]

Intervest assigned the responsibility for sending the hold harmless letter to Manaia. Manaia, without Intervest's knowledge, wrote a cover letter and directed his assistant to send it

[71] Tr. 64.

[72] Tr. 65.

[73] Compl. ¶ 12; Answer ¶ 12; CX-18.

[74] Tr. 66-68.

[75] Tr. 70.

with the hold harmless letter.[76] Ultimately, 12 of his customers signed and returned the hold harmless letter, and invested a total of $1,345,000 in MedCap VI.[77]

F. Manaia's Cover Letter: The Allegedly Fraudulent Misrepresentations

Manaia testified that he wrote the cover letter to "explain" Intervest's hold harmless letter and "to reiterate what the company was saying about the current status of the notes." He based the representations in the letter largely on what MedCap managers were telling him.[78] In the cover letter, Manaia included two statements that are the basis for the most serious charges in the Complaint. The two statements are:

(i) "With a 16 year perfect track record, and all clients receiving monthly interest, I have no reason to doubt [MedCap];" and

(ii) "With interest rates very low and going lower, moneymarket accounts hardly paying anything, the medical receivable business growing, MedCap's competitors (the banks) out of business, MedCap looks stronger than ever."

The Complaint alleges that because Manaia made these misrepresentations after MedCap defaulted on principal repayments in connection with MedCap II and III, he "knew or was reckless in not knowing" that it was misleading to claim, without disclosing the defaults in two previous MedCap offerings, that (i) MedCap had a 16-year perfect track record, and (ii) MedCap was stronger than ever.[79]

After sending the cover letter, Manaia testified that he called MedCap's president on a weekly basis to keep apprised of developments on behalf of his customers.[80] Manaia also

[76] CX-20.

[77] Tr. 510-11.

[78] Tr. 460, 467.

[79] Compl. ¶¶ 19, 20.

[80] Tr. 468

conferred with other registered representatives whom he met when he visited MedCap, as well as checking investment news and communicating with clients.[81] MedCap's president was readily available to Manaia and answered all of his questions. Although he did not always tell Manaia what he wanted to hear, he felt MedCap's president was being "truthful and honest," and "always had a plan of action." These factors, including the fact that "the guy running the company" answered all his questions, reassured Manaia and contributed to his confidence in MedCap.[82] As the Complaint states, "Manaia believed [MedCap] management's representations and therefore concluded that MedCap VI would not encounter the same problems as MedCap II and III" which had experienced defaults.[83]

Manaia testified that the basis for his representation that MedCap had a "16-year perfect track record" was his understanding that from its first issuance of notes in 1993, "clients were getting monthly interest" albeit "maybe not on a timely basis, but … money was coming into the accounts."[84] Manaia's assertion that "MedCap looks stronger than ever" was a statement of his opinion, and was based on a letter he had received from MedCap, and letters concerning the credit crisis afflicting the nation that he received and believed the clients also received.[85] Manaia testified that he did not intend his cover letter to minimize the impact of the hold harmless letter.[86] Nonetheless, the language of the cover letter appears designed to do just that.

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[81] Tr. 471.

[82] Tr. 469.

[83] Compl. ¶ 26.

[84] Tr. 465-66.

[85] Tr. 466.

[86] Tr. 463.

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Enforcement's theory of the case is that Manaia was reckless. At the hearing, Enforcement asserted repeatedly that when Manaia made the two allegedly fraudulent misrepresentations in the cover letter, he did not act with the intent to defraud, but acted recklessly.[87] The Complaint's charge is that "by omitting to tell investors that actual defaults had occurred," when Manaia made the two statements in the cover letter,[88] Manaia "was recklessly disregarding the truth."[89]

The Panel disagrees. While it is true that Manaia's cover letter did not specifically mention the defaults experienced by investors in MedCap II and III, Manaia's customers did not receive the cover letter alone. Manaia sent the cover letter enclosed with the hold harmless letter, which explicitly informed the investors of "the current defaults regarding" MedCap II and III. The purpose of the hold harmless letter was to require the investors to sign an acknowledgement of the defaults and confirm their decision to invest in MedCap VI "despite the above default information."[90] Had Manaia sent the cover letter without the hold harmless letter, we might be compelled to reach a different result. Sending the two together ensured that customers received notice of the defaults. Thus Manaia did not fail to disclose the defaults, and therefore did not recklessly disregard them.

For these reasons, we find the evidence insufficient to find Manaia culpable for the fraud violations charged in the Complaint's first cause of action, and we dismiss it.

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[87] Tr.643-45, 647, 659

[88] Compl. ¶ 20.

[89] Tr. 643.

[90] CX-18.

H. Manaia's Cover Letter: The Allegedly Negligent Misrepresentations

Manaia made other representations in the cover letter that the Complaint alleges were not fraudulent, but were negligently misleading. At the beginning of the cover letter, he stated that MedCap was experiencing a "short term liquidity issue" with MedCap II and III, with a "few clients who were not paid at maturity (which technically put them in default)." Manaia wrote that he had just spoken with MedCap management and went on to "quote them" as having stated:

(i) "Your investment is safe;"

(ii) "We currently have collateral of over 250%;"

(iii) "We believe that this situation is temporary and should be resolved as quickly as possible."

Manaia then went on to state "Medical Capital has assured me that 100% of these monies will be invested ONLY in medical receivables… I have no reason to doubt them." Manaia also asserted that MedCap's "profit margins on the receivables business are 31%." He ended with a request: "Please sign and return the enclosed form in the envelope to proceed with this investment."[91]

It is clear to the Hearing Panel that Manaia intended these representations to counteract the cautionary tone of the accompanying hold harmless letter. His representations were misleading because, in making them, Manaia did not mention the fact that, as the MedCap VI PPM stated, this was a risky investment suitable only for investors capable of withstanding loss of their entire investment. Reminding customers of this would have tempered the MedCap management assertion that an investment in MedCap VI was "safe." Manaia's contention that it was unnecessary for him to remind customers of this because the customers had all received

[91] CX-20.

copies of the PPM is unavailing.[92] In this context, it was negligent for Manaia to minimize the defaults by characterizing them as consisting of merely a "few clients who were not paid at maturity." Manaia had a responsibility to his customers not to gloss over the defaults, but to point out that, as the PPM acknowledged, the investment presented "significant risk." Omissions to disclose the risks associated with an investment are material.[93] Manaia was negligent in not ensuring that his customers considered the risks inherent in MedCap VI when he recommended in the cover letter that they "proceed with this investment."[94]

Manaia also had a duty not to assert without qualification that MedCap had "collateral of over 250%." Manaia testified that this statement came originally from a letter MedCap sent him in October 2008 claiming to have "collateral of 132%", but changed the percentage because "the guy running the company" told him in a later conversation that MedCap had over 250 percent collateralization.[95] He believed what he was told because he thought MedCap's managers were in the best position to know.[96] Manaia took no steps to verify this representation; in fact, he did not believe it was his responsibility to verify or review MedCap's claims about collateral, and he could not because he had no access to any relevant documentation.[97] Thus, Manaia admits he simply repeated what MedCap told him.

Similarly, Manaia accepted as credible and relied entirely on a spreadsheet MedCap management showed him for *his* representation, not a quote of a MedCap representation, that

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[92] Tr. 530-31.

[93] *Reynolds*, 2001 NASD Discip. LEXIS 17, at *29.

[94] CX-20, at 2. *See Reynolds*, 2001 NASD Discip. LEXIS 17, at *44 (respondent found negligent for participating in publishing advertising that, among other things, omitted material facts).

d. at *44 (respondent found negligent for participating in publishing advertising that, among other things, omitted material facts).

[95] Tr. 593-94.

[96] Tr. 521.

[97] Tr. 521-22.

MedCap's profit margin on its medical receivables business was 30 percent.[98] Manaia failed to inform the customers that he was relying wholly on MedCap's representation and that he had no means by which to verify these representations.[99] It is not permissible for a registered representative, when making a recommendation, to rely upon "an issuer's 'self-serving statements.'"[100] It was incumbent upon him, when he echoed MedCap's claims while recommending MedCap VI, at least to let his customers know that he was relying on MedCap's assertions, which he had not verified and could not verify.[101]

The other representations in the cover letter are also problematic. The quote he attributed to MedCap management, "this situation is temporary and should be resolved as quickly as possible," should have been accompanied by the disclosure that MedCap's payment problems dated back to July 2008, six months prior to the date of the cover letter. Referring to the problem as one in which a "few clients" were "not paid at maturity," and that this "technically put them in default" was misleading without also pointing out that MedCap had issued two notices of actual default. When Manaia asserted that he had no reason to doubt management's promise to invest "100%" of investors' funds "**ONLY** in medical receivables," he should have brought to the reader's attention that the PPM for MedCap VI allowed MedCap to invest as much as 40 percent of the offering proceeds in assets other than medical receivables, and allowed MedCap management to sell or loan assets from one offering to another. This meant that management had the ability, contrary to the promise, to direct MedCap VI investor funds to other MedCap

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[98] Tr. 550-51.

[99] Tr. 521-22.

[100] *Gebhart*, 2005 NASD Discip. LEXIS 40, at *38 (*citing Dan King Brainard*, 47 S.E.C. 991, 996 (1983)).

[101] *Hanly v. SEC*, 415 F.2d 589, 596-97 (2d Cir. 1969)("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders" and when he lacks essential information, he should disclose this fact).

offerings that were unable to make payments to their investors. Failing to disclose these material facts allowed investors to repose unfounded confidence in the safety of MedCap VI.

I. Additional Alleged Negligent Misrepresentations

The Complaint also alleges that Manaia made misrepresentations about MedCap to two customers separate from the cover letter. In April 2008, he told one who had expressed concerns about MedCap offerings that he believed "them to be very safe … they are OVER collateralized."[102] In June 2008, he told the same customer that MedCap "fits you perfect … No costs or fees! A great return, little risk and great income."[103]

In October 2008, in response to a question from a customer who had invested in MedCap V and VI and asked whether MedCap was "still solid," Manaia wrote: "They've had a few issues with the credit crisis but speaking with them, they assured me that that is <u>their</u> problem, not the investors."[104] To the same customer, he later sent an email in December 2008 attaching a letter stating, "Your investment is safe", and, "We currently have collateral of over 250%."[105] Subsequently, when this customer received a supplemental PPM from MedCap describing MedCap VI as highly risky, the customer asked Manaia if the warning applied only to MedCap VI and not to the earlier MedCap offerings he had invested in. Manaia responded that the SEC requires companies to send warnings "designed to scare the hell out of investors … Throw that stuff away and get out on the golf course … Med Cap VI is probably their safest offering."[106]

Manaia acted both negligently and unethically by making these misrepresentations to both customers while failing to disclose the risks inherent in MedCap offerings. Furthermore, it

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[102] CX-25.

[103] CX-27.

[104] CX-29.

[105] CX-30.

[106] CX-31.

was negligent to urge the second customer to disregard the risk warnings in the supplemental PPM by denigrating the value of regulatory requirements mandating that issuers disclose investment risks.

IV. Sanctions

For negligent misrepresentations and omissions, FINRA's Sanction Guidelines suggest a fine of $2,500 to $50,000, and a suspension in any or all capacities for up to 30 business days.[107]

Enforcement, characterizing Manaia's conduct as "serious" but not "egregious," made its sanction recommendations for both the fraudulent and the negligent misconduct charged in the Complaint, and did not make separate recommendations predicated on a finding that Manaia engaged only in negligent misconduct. Enforcement recommends suspension for a year in all capacities and a fine of $64,472, including "disgorgement" of $54,472, the amount Manaia earned in commissions for sales of MedCap VI, plus $10,000.[108]

Manaia urges the Hearing Panel not to impose any sanctions. He argues that "he's already been penalized" as a result of his departure from Intervest.[109] Manaia testified that "this Med Cap mess" led to a "breakdown" in his relationship with Intervest, and he resigned as Intervest dismissed him.[110] Copus, however, testified that Intervest terminated Manaia's employment because he had violated the firm's procedures concerning use of an unauthorized email address, and engaged in business-related communications in a state where he was not registered.[111] Thus, the reasons for his leaving Intervest are unclear. In the absence of evidence

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[107] *FINRA Sanction Guidelines* 88 (2011).

[108] Tr. 659-60; Enforcement's Pre-Hearing Br. 33.

[109] Tr. 710-11.

[110] Tr. 491-93.

[111] Tr. 93.

that Intervest disciplined Manaia for the “same misconduct at issue prior to regulatory detection,”[112] the Panel cannot factor his dismissal from Intervest into its sanctions analysis.[113]

Manaia also argues that he deserves credit because the type of misconduct alleged here was aberrational.[114] He testified that he declined to recommend “alternative” investments in financial products other than “plain vanilla” bonds, listed stocks and mutual funds, until he became acquainted with MedCap.[115] In this regard, his decision to recommend MedCap was a significant departure from his past practice. Even so, it involved more than a momentary lapse of judgment. Manaia’s negligent misconduct occurred in a series of related acts extending over a number of months. Whether a respondent’s misconduct consists of numerous acts or a pattern occurring over an extended period of time is a factor the Panel should consider.[116] In this case, Manaia sent his emails to the two customers in April, June, October, and December 2008, and his cover letter is dated December 22, 2008.[117]

Manaia argues that he deserves credit because he did not conceal his misconduct from his firm or from FINRA. While there is no evidence Manaia failed to cooperate with FINRA, members and associated persons are expected to assist FINRA in examinations and investigations.[118] As for being forthright with his firm, it is unclear whether Manaia circumvented Intervest’s review of his cover letter. Manaia testified that he assumed the firm

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[112] *Guidelines* at 7 (Principal Consideration No. 14).

[113] “We consider the disciplinary sanctions we impose to be independent of a firm's decisions to terminate or retain an employee. We neither credit a respondent who was terminated by a firm, nor seek additional remedies against a respondent who was retained by a firm.” *Dep’t of Enforcement v. Prout,* No. C01990014, 2000 NASD Discip. LEXIS 18, at *11(N.A.C. Dec. 18, 2000).

[114] Tr. 708.

[115] Tr. 365.

[116] *Guidelines* at 6 (Principal Considerations Nos. 8, 9).

[117] CX-25, 27, 29, 30.

[118] FINRA is entitled to the “full and prompt cooperation” of all persons subject to its jurisdiction when it investigates. *Michael David Borth*, 51 S.E.C. 178, 180 (1992).

approved the cover letter before the assistant mailed it.[119] Copus, in response to a FINRA request for information during the investigation, wrote that Manaia assumed his assistant would submit the cover letter for Intervest's approval, and the assistant assumed that Manaia had already done so.[120] It is indisputable, however, that Intervest did not approve the cover letter before Manaia's assistant mailed it.[121]

The Panel agrees with Enforcement's assessment that Manaia's misconduct in this case was serious, but not egregious. By his negligent misrepresentations and omissions, Manaia failed to provide his customers with a balanced overview of the risks of an investment in MedCap VI.

Manaia took significant steps to conduct a due diligence review, including attending a four-day conference at MedCap headquarters. He attempted to learn what he could about MedCap, and after Intervest imposed the moratorium on sales of MedCap VI, he attended conference calls and contacted management repeatedly. Yet he allowed himself to be convinced by MedCap management's carefully manicured description of the MedCap offerings, and he failed to take sufficient heed of provisions in the PPMs that were contrary to management's rosy representations.

As the Receiver's report revealed, he was not alone in succumbing to the MedCap pitch. And it is fortunate that he recommended MedCap VI only to a small percentage of his customers. Nevertheless, in the end, Manaia failed to fulfill his ethical obligations as a registered securities industry professional to give those customers a fair, balanced, informed basis for assessing the risks to which MedCap exposed them.

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[119] Tr. 502.

[120] CX-26.

[121] Tr. 76-77.

Furthermore, the Panel finds it troubling that Manaia has not accepted responsibility and acknowledged the wrongfulness of his conduct, an important consideration in any sanctions analysis.[122]

For all of these reasons, the Panel finds it appropriate to adopt, in part, Enforcement's recommendations. We impose a suspension in all capacities for 30 business days, and a fine of $54,472, the amount Manaia earned from commissions on the sales of MedCap VI to the customers to whom he sent his cover letter with the hold harmless letter, who then chose to invest.[123]

V. CONCLUSION

For making negligent misrepresentations and omissions of material fact in a cover letter and in email communications to customers, and thereby engaging in conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of NASD Rule 2110 and FINRA Rule 2010, the Hearing Panel suspends Respondent Anthony G. Manaia from associating with any FINRA member firm for 30 business days, and fines him $54,472.[124] In addition, he is ordered to pay the costs of the hearing in the amount of $6,427.65, including an administrative fee of $750 and the cost of the transcript.

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[122] *Guidelines* at 6 (Principal Consideration No. 2).

[123] Because MedCap VI has been placed in receivership and the Receiver is engaged in an ongoing effort to collect MedCap assets to be distributed for the benefit of investors, Enforcement is not requesting a restitution order, and the Hearing Panel declines to order restitution. Enforcement's Pre-Hearing Br. 33 n.78; CX-35, at 5.

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

If this Decision becomes FINRA's final disciplinary action, Manaia's suspension shall become effective on the opening of business on Monday, August 19, 2013, and shall end at the close of business on Monday, September 30, 2013. The fine and costs shall be due and payable on Manaia's return to the securities industry.

HEARING PANEL.

By: Matthew Campbell
Hearing Officer