FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RICHARD BLAIR (CRD No. 2256412), Respondent.	Disciplinary Proceeding No. 2011027271901 Hearing Officer–MC **HEARING PANEL DECISION** March 17, 2015

Respondent willfully failed to disclose two customer complaints on his Form U4, in violation of FINRA Rules 1122 and 2010. For these violations, he is suspended in all capacities for four months and fined $10,000. Because the violations were willful, Respondent is subject to statutory disqualification. Respondent also inaccurately reported information relating to the customer complaints to FINRA, in violation of NASD Rule 3070 and FINRA Rule 2010. For these violations, he is fined an additional $7,500. Respondent is also assessed costs.

The Department of Enforcement did not prove by a preponderance of the evidence that Respondent violated Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010, by fraudulently failing to disclose material information in connection with the sale of securities. Therefore, that charge is dismissed.

Appearances

Michael A. Gross, Esq. and David B. Klafter, Esq., Boca Raton, Florida, and Christopher M. Burky, Esq., Chicago, Illinois, for the Department of Enforcement.

Gene R. Besen, Esq., Dallas, Texas, for Respondent Richard Blair.

DECISION

I. Introduction

Respondent Richard Blair owned and was sole principal of a firm that was both a FINRA member and a registered investment advisor ("RIA"). The Department of Enforcement's central

charge against Blair is that he defrauded over 60 of his investor advisor clients, most of whom were teachers or retired teachers, by selling them shares in a real estate investment trust while failing to disclose a material fact—that they were entitled to a discounted price if he waived his commission and instead charged them a fee as their investment advisor.

In Enforcement's view, "[t]his is a very simple case" of securities fraud by omission, based upon Blair's "conscious, deliberate and calculated decision" not to disclose the availability of the discounted price.[1] For this conduct, the Amended Complaint's first cause of action charges Blair with violating Section 10(b) of the Securities Exchange Act of 1934, SEC Rule 10b-5 thereunder, and FINRA Rules 2010 and 2020.[2]

The Amended Complaint also charges Blair with ancillary violations in two additional causes of action.[3] One charges Blair with willfully failing to disclose two separate written customer complaints containing claims for compensatory damages exceeding $5,000 that he was required to disclose on his Uniform Application for Securities Industry Registration or Transfer ("Form U4"), in violation of FINRA Rules 1122 and 2010. The other charges him with failing to accurately report the customer complaints in notices he was required to file with FINRA, in violation of NASD Rule 3070 and FINRA Rule 2010.

After a four-day hearing, the Hearing Panel concluded that Enforcement failed to prove by a preponderance of the evidence that Blair fraudulently omitted to disclose the availability of the discount to his clients. Therefore the Panel dismisses the first cause of action of the Amended Complaint. However, the Panel concluded that Blair willfully failed to make required disclosures on his Form U4, and imposes a four-month suspension in all capacities and a fine of $10,000. Because Blair acted willfully, he is subject to statutory disqualification. Finally, the Panel found that Blair filed inaccurate notices with FINRA, and imposes an additional fine of $7,500.

II. Jurisdiction

Blair entered the securities industry in 1992. In 1993, he formed United Global Solutions, Inc. The Firm became a FINRA member broker-dealer in 1994 and a Texas Registered Investment Advisor in 2005. In February 2010, Blair changed the name of the Firm to Wealth Solutions.[4] The Firm filed a Form BDW to withdraw from FINRA membership in October 2012. In December 2012 FINRA accepted the Form BDW, terminating the Firm's FINRA membership. The Firm remains an RIA in Texas.[5]

[1] Hearing Transcript ("Tr.") 7-8.

[2] Enforcement filed the original Complaint on June 13, 2013. On September 25, 2013, Enforcement filed an uncontested motion for leave to file an Amended Complaint and it was granted.

[3] The Amended Complaint included three other unrelated charges that Enforcement voluntarily dismissed, with prejudice, prior to the hearing.

[4] Blair testified that the two names refer to the same legal entity. Tr. 121. As used in this Decision, therefore, "Firm" refers to the firm both before and after the name change,.

[5] Tr. 121-22.

Blair solely owned and controlled the Firm and served as its President. While the Firm was a FINRA member, Blair was registered with FINRA through the Firm in a variety of capacities, including General Securities Representative and General Securities Principal. During the relevant period, from May 2009 through May 2011, in addition to serving as President of the Firm, Blair was the Firm's only representative selling securities, its sole General Securities Principal, and its Chief Compliance Officer. He was the sole person at the firm responsible for deciding whether an amended Form U4 or an NASD Rule 3070 report had to be filed.[6]

Blair has not been registered with FINRA since the termination of the Firm's FINRA membership. However, he remains the owner and President of the Firm.[7] Although Blair is not currently associated with any FINRA member, he remains subject to FINRA jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because the Complaint was filed on June 13, 2013, within two years of when he ceased to be associated with a FINRA member, and the Complaint alleges misconduct committed while he was registered or associated with a FINRA member.

III. The Fraud Charge

A. Facts

1. The Cole REIT Investment

During the relevant period, 68 of the Firm's broker-dealer customers who were also investment advisory clients of the Firm purchased shares of the stock of Cole Credit Property Trust III, Inc. (the "Cole REIT"), a real estate investment trust, through Blair.[8] Most of the clients were teachers and retired teachers.[9] The Cole REIT was one of a series of related real estate investment trusts intended for sale primarily to long-term investors who were seeking income.[10]

FINRA member Cole Capital Corporation ("CCC") served as the "distribution manager" for selling investments in the Cole REIT and priced it at $10 per share. CCC charged a commission of nine percent on each sale. The actual sales, however, were made by FINRA member broker-dealers that entered into "dealer management agreements" with CCC or by "non-registered investment advisory representatives that [were] affiliated with FINRA-registered broker-dealers …."[11] Thus, an RIA could purchase Cole REIT shares for a client through an

[6] CX-1 at 2; Tr. 119, 122-25, 251-52.

[7] Tr. 124.

[8] CX-18; CX-19; CX-20; Tr. 56-57, 62-63.

[9] Tr. 134.

[10] Tr. 165-68, 318, 320, 446.

[11] CX-14, at 149; Tr. 324-26.

affiliated FINRA member.[12] Blair entered into a dealer management agreement with CCC to purchase Cole REIT shares for his investment advisor clients.[13]

2. The Two-Tier Pricing Structure

From its nine percent commission, CCC kept two percent and "reallowed" seven percent to the dealer manager. Thus, Blair could receive a seven percent commission for each share of the Cole REIT that he sold.[14] However, when Blair sold shares to an investment advisor client in his capacity as a registered investment advisor, he could waive the seven percent commission. When an investment advisor waived the commission, CCC applied the seven percent to purchase additional shares of the Cole REIT, effectively reducing the price of each share to the purchaser from $10.00 to $9.30. This was the "two-tier pricing structure" for the Cole REIT.[15]

According to CCC, the purpose of the two-tier pricing structure was to accommodate registered representatives selling the investment. CCC recognizes that some representatives charge their clients commissions, whereas registered investment advisors employ different billing methods and do not charge commissions.[16]

The Cole REIT prospectuses disclose the two-tier price structure. As an early prospectus dated April 30, 2009, explained:

> "Except as provided below, we will pay our dealer manager selling commissions of 7% of the gross offering proceeds …. We expect our dealer manager to utilize two distribution channels to sell our shares, FINRA-registered broker-dealers and non-registered investment advisory representatives that are affiliated with FINRA-registered broker-dealers, which have different selling commissions, and consequently, a different purchase price …. In the event of the sale of shares … by other broker-dealers that are members of FINRA, the purchase price will be $10.00 per share …. In the event of the sale of shares … through an investment advisory representative, the purchase price for such shares will be $9.30 per share … reflecting the fact that our dealer manager will waive the 7% selling commission on such shares."[17]

To obtain the reduced price for clients, the investment advisor needed only to check a box on the subscription agreement. The box was accompanied by the following explanation:

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[12] Tr. 324.

[13] Tr. 179, 324.

[14] CX-14, at 149-50; Tr. 326-27.

[15] Tr. 327, 336-37.

[16] Tr. 329.

[17] CX-14, at 149-50.

> RIA (check only if subscription is made through an RIA administered account that has a *"wrap" or some other fixed billing arrangement*. The RIA must be affiliated with a FINRA licensed broker-dealer and the [Investment Advisor Representative] must be properly listed as an agent of the RIA. RIAs not affiliated with a FINRA licensed broker-dealer are not allowed to participate in this offering. The IAR must confirm with the broker-dealer that these are acceptable assets to be held in an RIA program.)[18] (Emphasis supplied.)

Although the precise language varied somewhat over time as successive offering documents were issued, all the prospectuses and subscription documents used during the relevant period disclosed and implemented the two-tier structure for Cole REIT purchases.[19] Blair knew of the two-tier pricing structure when he sold Cole REIT shares to his investment advisor clients.[20]

3. Blair's Commissions and Advisory Fees

It is undisputed that when Blair sold Cole REIT shares to his investment advisor clients, he did not check the box, and did not waive the commission.[21] Thus, Blair earned a commission on every purchase. The commissions he earned from purchases by the 68 investment advisor clients during the relevant period totaled $109,210.55.[22]

In addition, as a registered investment advisor, Blair charged investment advisor clients an annualized fee equal to one percent of the value of the assets under management in their investment advisor accounts, including their shares of the Cole REIT.[23] During the relevant period, Blair earned a total of $33,288.93 in investment advisory fees he assessed his clients for their Cole REIT shares, in addition to his commissions.[24] Enforcement calls this practice a "double dipping scheme."[25]

In his defense, Blair testified that if a client had elected to purchase Cole REIT shares at the discounted price, he would have increased the client's advisory fee to two percent. He claimed that it was his practice to charge a reduced advisory fee when he received a commission on transactions. According to Blair, clients liked the lower advisory fee. Blair claimed: "I've

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[18] CX-14, at 239.

[19] CX-15, at 175; CX-16, at 208 ("We will not pay any selling commissions in connection with the sale of shares to investors whose contracts for investment advisory and related brokerage services include a fixed or 'wrap' fee feature.").

[20] Tr. 171.

[21] Tr. 48, 148, 201.

[22] Tr. 61; CX-18, at 17.

[23] CX-12, at 3, 10; Tr. 170, 533-34.

[24] Tr. 61; CX-18, at 17.

[25] Amended Compl. ¶ 1.

always -- the broker-dealer always received a commission. And then for managing the entire portfolio, I would charge a reduced advisory fee … [clients] like that benefit of me receiving a commission and charging a lower advisory fee."[26]

4. Blair's Investigative Testimony

In an on-the-record interview ("OTR"), Enforcement repeatedly asked Blair if he disclosed the two pricing options to clients who purchased shares of the Cole REIT, and he said he did not, because he "considered these clients brokerage clients whether they did an IA agreement or not …." Enforcement then asked: "But that disclosure was not made to the customers about the two options, either paying a -- $10 a share or the $9.30 a share; is that correct?" Blair responded: "That's correct. I mean, because they were -- I looked at an analysis, and I felt like it was in their best interest." Again, Blair was asked: "[W]ith respect to the ones that were still IA clients, even in that situation, that wasn't disclosed to the investors, correct?" And Blair responded: "Right." [27] In another OTR, Blair testified he knew of the discount pricing option, but "just didn't use it."[28]

Relying on this testimony, Enforcement concluded that Blair failed to disclose the two tier price structure to his investment advisor clients. Enforcement proceeded to charge Blair with fraud and did not attempt to contact the clients.[29]

5. Hearing Testimony

At the hearing, Blair conceded that he did not obtain the seven percent discount for any of his clients,[30] and that he should have told them that they could purchase shares at the discounted price.[31] He also acknowledged that in his OTR he testified that he did not inform clients of the availability of the discount.[32]

However, Blair testified that his OTR testimony was incorrect. He claimed that he answered as he did at the OTR because he had been unable to recall informing specific clients about the discount.[33] He testified that he should have instead said he was "unsure" of whether he had disclosed the discount to clients.[34] Blair testified that at the OTR, he "just couldn't remember" what he had said to clients. The OTR was in 2012, and he had spoken to his clients

[26] Tr. 457.

[27] CX-148, at 3-4.

[28] CX-147, at 2.

[29] Tr. 66-67.

[30] Tr. 202.

[31] Tr. 212-13.

[32] Tr. 206-09.

[33] Tr. 205.

[34] Tr. 210.

long before, in 2009 and 2010, after he "had done a lot of … other investments." He testified that he should have "answered more thoroughly" at the OTR. Instead, he claimed, he had answered "incorrectly."[35]

Blair insisted that although he could not say positively that he specifically disclosed the two-tier structure to each client, he was certain that he "reviewed the prospectus extensively with every client," for "two to three hours" and "went through the prospectus in great detail with all the clients."[36] Blair testified that it was his practice always to review a prospectus with clients "thoroughly … through each section … from the beginning to the end."[37]

6. Blair's Clients' Testimony

Blair called five of his investment advisor clients as witnesses. They all testified that when they invested in the Cole REIT Blair informed them of the two-tier price structure and they chose not to pay the discounted price.

TK testified that he has been Blair's client for about seven years, and that his wife has been a client for even longer. He testified that he and his wife purchased Cole REIT shares after Blair explained the investment. TK said that Blair "spent an hour or two showing us the prospectus, past earnings, future projected earnings, several different tier programs that are in it as commission fees and possible returns." He further testified: "I remember it was a two-tier fee schedule … my best recollection is we went over the fees and I chose the one that was most advantageous to myself and my wife."[38]

EL testified that she has been Blair's client since 1992. She said she discussed the Cole REIT investment with Blair before purchasing shares, recalled reviewing the prospectus with him, and that there were pricing options. She remembered that one option was $10 per share, while the other was $9.30 or $9.50, and that she elected to purchase at $10.[39]

KN testified that he has been a client of Blair since 2009, and his wife has been a client since 2007. He, too, testified that he met with Blair before investing in the Cole REIT and that Blair reviewed the prospectus with him. He recalled purchasing Cole REIT shares at $10.[40] KN was initially uncertain about having been informed of pricing options.[41] He later testified, however, that he "decided on the $10 price because that looked like the most advantageous for

[35] Tr. 211.

[36] Tr. 204-05.

[37] Tr. 211-12. Blair testified that he also had conducted an "analysis" that led him to conclude that the $10 per share price was in the best interest of his clients. Tr. 446-48, 456-63, 485; RX-48. The Panel makes no finding as to the veracity of Blair's claim, however, as it does not bear on whether he disclosed the fee structure to his clients.

[38] Tr. 586-87.

[39] Tr. 610-15.

[40] Tr. 628-30.

[41] Tr. 630-31.

myself … I think the other price had some repetitive costs involved, and for myself personally, if you see something repetitive but you can do a one-time fee, it's much better … than [to] have a repetitive cost over the period of years, which would cost you more than that one-time fee." In response to further questions, he testified: "I think the $10 price was the higher price. I don't remember what the other price was exactly, but it had some repetitive features to it."[42]

MM testified that she and her husband have been Blair's clients since 2010. She testified that Blair spent an hour and a half to two hours with her reviewing the Cole REIT and another potential investment, and that she put some money in each. She recalled reviewing the prospectus with him and that there were pricing options. She testified that Blair discussed the pricing options with her, but she did not recall the details.[43]

Finally, TG testified that she and her husband have been Blair's clients since 2000.[44] She recalled going over Blair's recommendation of the Cole REIT with her husband at her husband's office and discussing the product.[45] She also recalled that they discussed two ways of purchasing it, one involving simply a price per share and the other involving a fee. TG testified that Blair "explained the two options, and then my husband and I … made the choice" to pay $10 per share.[46]

Enforcement did not offer testimony from any of Blair's other clients.

B. Discussion

1. Enforcement's Predicate for Charging Fraud

Section 10(b) of the Exchange Act makes it unlawful "to use or employ, in connection with the purchase or sale of any security … any … deceptive device or contrivance." SEC Rule 10b-5 implements this provision by prohibiting "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." It makes it unlawful to "make any untrue statement of a material fact or to omit 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." FINRA Rule 2020 similarly prohibits any FINRA member or associated person from "effect[ing] any transaction in … any security by means of any … deceptive or other fraudulent device or contrivance." Rule 2010 requires, more generally, that members and associated persons "observe high standards of commercial honor and just and equitable

[42] Tr. 631-32.

[43] Tr. 646-51.

[44] Tr. 665.

[45] Tr. 666-67.

[46] Tr. 669-70.

principles of trade." In this case, the basis for the Rule 2010 violation is Blair's alleged fraudulent failure to disclose the two-tier pricing structure.[47]

To establish that Blair violated Section 10(b), Rule 10b-5 and FINRA Rules 2010 and 2120, as alleged in the Amended Complaint, Enforcement needed to prove by a preponderance of the evidence that (1) under the two-tier pricing structure, Blair could have waived his commissions on the investment advisor clients' purchases of Cole REIT shares; (2) Blair failed to disclose the two-tier pricing structure to the clients in connection with their purchases of Cole REIT shares; (3) the two-tier pricing structure was a material fact; (4) disclosure of the two-tier pricing structure was necessary in order to make Blair's statements to purchasers, in light of the circumstances under which they were made, not misleading; and (5) Blair failed to disclose the two-tiered price structure with the required state of mind, or scienter; that is, he knowingly or recklessly failed to disclose the pricing structure.

Blair argues that Enforcement did not satisfy the second of these requirements. He argues that "[t]his is an omissions case"[48] and the "omission alleged is that Mr. Blair failed to disclose that there were two different prices."[49] However, all five clients who testified said unequivocally that they knew about the two-tier pricing of Cole REIT shares, refuting the allegation that Blair made the omission critical to Enforcement's fraud case.[50]

Blair makes additional arguments. He contends that he was not eligible for a commission waiver under the two-tier pricing structure as described in the Cole REIT subscription documents, or at least he had reason to be uncertain of his eligibility, because the prospectus stated that CCC would permit waiver of the commission only if he charged investment advisor clients a "wrap" fee or "other fixed fee arrangement."[51] He insists that he "did not have a wrap fee or a fixed billing arrangement."[52]

Blair further contends that, even if he could have waived the commission, it was not material to his investment advisor clients because in that event, he would have raised the

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[47] "It is well established that a violation of other NASD rules or securities laws or regulations also constitutes a violation of Rule 2110." *Kirlin Securities*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *65 (Dec. 10, 2009).

[48] Tr. 707.

[49] Tr. 710.

[50] Tr. 710-11.

[51] Tr.449-50; 720-21. Blair acknowledged that if he had checked the RIA box on the Cole REIT subscription agreement, his investment advisor clients could have purchased at $9.30 per share, rather than at the $10.00 per share for sales on which a seven percent commission was paid. He contended, however, that when he made the sales he was uncertain whether it was permissible for him to check the RIA box, because he "did not have a wrap fee or a fixed billing arrangement." Tr. 182, 449.

[52] Tr. 182. It was undisputed that the Firm did not charge investment advisor clients a wrap fee. Tr. 72. The parties disagreed, however, as to whether the Firm's annualized fee of one percent, the amount of which would vary with changes in the value of the client's assets under management, was a "fixed fee arrangement," as that phrase was used in the Cole REIT documents. Tr. 73, 77-80, 84-85, 103, 111, 144, 200.

investment advisor fee he charged them to offset the loss of revenue.[53] And he asserts that he did not have an obligation to disclose the two-tier pricing structure because it was already disclosed in the prospectus for the Cole REIT.[54] Finally, he argues that, under all the circumstances, he acted without the requisite scienter.[55]

There is no need for the Hearing Panel to address these additional arguments, however, because Enforcement did not establish that Blair failed to disclose the two-tier pricing option for purchases of Cole REIT shares to his investment advisor clients. Thus, Enforcement failed to prove the predicate for its fraud charge by a preponderance of the evidence.

Enforcement's fraudulent omission charge was premised entirely on Blair's OTR testimony that he did not disclose the two-tier pricing to his investment advisor clients. While that may have been a reasonable basis for filing the fraud charge, in light of the evidence adduced at the hearing, the Hearing Panel does not find Blair's investigative testimony sufficient to establish that Blair failed to disclose the two-tier price structure. As explained above, the two-tier structure was disclosed in the prospectus for the Cole REIT. At the hearing, Blair testified that, although he could not recall specifically discussing the two-tier pricing structure with his clients, he carefully reviewed the prospectus with each of them. Significantly, each of the clients who testified at the hearing confirmed that Blair reviewed the prospectus with them, that they were aware of the two-tier pricing, and that they elected to pay the higher price. Thus, they corroborated Blair's hearing testimony.

Enforcement argues that the Panel should reject both Blair's hearing testimony and the testimony of his clients as not credible. Enforcement challenges the clients' testimony because they expressed their loyalty to Blair, some of them were critical of or hostile to FINRA's investigation of Blair, and the wife of one client witness is employed by Blair.[56]

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[53] Tr. 59, 99-100, 144.

[54] Respondent Richard Blair's Pre-Hearing Br. 7-8. Prior to the hearing, Enforcement filed a Supplemental Pre-Hearing Brief arguing that Blair did not satisfy his disclosure obligations simply by furnishing the Cole REIT prospectus to his clients. None of the authorities cited by Enforcement, however, finds a fraudulent omission based solely on the failure to make a separate disclosure of information contained in a prospectus. Rather, the cases cited by Enforcement find that affirmative misrepresentations and omissions trigger a duty to disclose information even though it could be found within the prospectus. *See Robert A. Foster*, 51 S.E.C. 1211 (1994); *Ross Securities, Inc.*, 41 S.E.C. 509 (1963); *Dist. Bus. Conduct Comm. v. Klein*, No. C0194004, 1995 NASD Discip. LEXIS 222 (NBBC June 26, 1995), *aff'd*, 52 S.E.C. 1030 (1996); *Dep't of Mkt. Regulation v. Field*, No. CMS040202, 2008 FINRA Discip. LEXIS 63 (NAC Sept. 23, 2008). Enforcement did not allege that Blair made any misrepresentations or misstatements that triggered his obligation to disclose the two-tier pricing structure; rather, Enforcement argued that the disclosure obligation was triggered by Blair's fiduciary relationship to his investment advisor clients coupled with the conflict of interest posed by the two-tier pricing structure. Department of Enforcement's Pre-Hearing Br. 1. In light of the Panel's conclusion that Enforcement did not prove that Blair failed to disclose the two-tier pricing structure, the Panel finds it unnecessary to determine whether, in the circumstances cited by Enforcement, it would have been fraudulent for Blair to have omitted such a disclosure, even though the two-tier pricing structure was disclosed in the prospectus.

[55] Tr. 731.

[56] Tr. 637-38.

To the Panel, however, the clients appeared to truthfully recount their best recollections of their interactions with Blair at the time they purchased the Cole REIT. They did not appear to the Panel to have been rehearsed or to have given false accounts. The substance of their testimony and their demeanor provided the Panel with no reason to disbelieve them and to reject their accounts as fabricated. And although the five clients who testified constituted a small, and not necessarily representative, sample of the investment advisor clients who purchased the Cole REIT, Enforcement offered no evidence, apart from Blair's investigative testimony, from which the Panel could find that Blair failed to disclose the two-tier pricing structure to any or all of his other clients. Thus, Enforcement failed to meet its burden of proving by a preponderance of the evidence that Blair fraudulently omitted to inform his clients of the material fact that they could have purchased their shares of the Cole REIT at a discount. Accordingly, Enforcement's fraud charge must be dismissed.[57]

IV. Customer Complaints

A. Facts

In October 2010, Firm customers GD and AD, a married couple, filed a complaint with FINRA. The customers asserted that their "ability to retire financially secure has been virtually devastated," and charged that Blair engaged in "churning of variable annuities" and "unsuitable overconcentration of our retirement assets in high commission, high surrender penalty variable annuities all for his personal commission gain at our expense." The customers asked for "[c]ash restitution for the $79,374 losses due to unnecessary fees and surrender penalties," as well as unspecified "cash restitution" for other alleged losses. FINRA forwarded the complaint to Blair in January 2011, and he admitted receiving it then.[58]

In February 2011, JS and BS, another married couple, filed an on-line complaint with the SEC against the Firm and Blair. The customers alleged that Blair "surrendered annuities pre-mature resulting in surrender penalties. Richard D. Blair informed us that there would be minimal surrender fees and that a 'bonus' along with better investments would result in a better investment. Upon further investigation, We, the customer gained very little, if any, and the company and Richard D. Blair received a large amount in commission for the 'switches[.]'" The customers did not request any specific amount of damages, but stated that they had "requested

[57] The client witnesses' testimony raised a question as to how they concluded that it was in their best interest to pay a higher price, rather than paying a lower price and obtaining more shares. Blair testified that he would have raised the clients' investment advisor fees from one percent to two percent if he had not been able to collect commissions on the sales of the Cole REIT. Tr. 457-58. He also claimed that the clients would have paid "custodian fees" if they had purchased Cole REIT shares at the lower prices, and it appeared that he might have factored such fees into his purported conclusion that payment of the higher price, with a commission to the Firm, was in the clients' best interest. Tr. 469-73. Blair, however, could offer no coherent support for his contention that the clients would have paid custodian fees if they purchased at the lower price, and neither could his counsel in his closing argument. Tr. 713. It is possible that the clients' belief that purchasing at the higher price was influenced by inaccurate statements from Blair. In any event, the core of the fraud charge was that Blair failed to disclose the two-tier pricing system, and it was not proven.

[58] CX-124, at 5-6; Tr. 252-54.

several times for current [s]urrender penalties and bonuses to ensure that there would not be a loss of investment with each 'switch' [but] they could not provide the statements showing there was no 'loss' for us." The SEC forwarded this complaint to Blair in February 2011 and he acknowledged that he received it.[59]

B. Discussion

1. The Form U4 Filings

Blair acknowledged that he was aware that he was responsible for keeping his Form U4 information current.[60] Question 14I(3) of the Form U4 in effect at the relevant time asked:

> Within the past twenty-four (24) months, have you been the subject of an *investment-related*, consumer-initiated, written complaint, not otherwise reported under question 14I(2) above, which:
>
> (a) alleged that you were *involved* in one or more *sales practice violations* and contained a claim for compensatory damages of $5,000 or more (if no damage amount is alleged, the complaint must be reported unless the firm has made a good faith determination that the damages from the alleged conduct would be less than $5,000 …."[61]

Blair admitted that he was required to report the complaint filed by GD and AD on his Form U4 in response to this question. At the hearing, he conceded that the complaint met every one of the criteria set forth in question 14I(3): it was an investment-related, consumer-initiated, written complaint, not otherwise reported on his Form U4; it alleged he was involved in one or more sales practice violations; and it contained a claim for more than $5,000 in damages. He also admitted that, within 24 months after receiving the complaint of GD and AD, he filed 12 amendments to his Form U4, and electronically signed each amendment, without reporting the complaint on any of those filings.[62]

Blair admitted that the complaint filed by JS and BS also satisfied most of the reporting requirements set forth in question 14I(3) of the Form U4: it was investment-related, consumer-initiated, and not otherwise reported on his Form U4, and it alleged that he was involved in one or more sales practice violations. He admitted that he failed to disclose the complaint in the 12 amendments to his Form U4 that he filed in the 24 months after receiving the complaint. But he denied that he had an obligation to report the complaint on his Form U4.

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[59] CX-125; CX-126; Tr. 272-74.

[60] Tr. 251-52.

[61] CX-131, at 12. Italics in original. The italicized terms are further defined in the Form U-4. Blair admitted that the customer complaints filed by GD and AD and by JS and BS fell within those definitions. Tr. 257-60.

[62] Tr. 260-68; *see* CX-127-141 (Blair's CRD Record, CRD filing instructions, and Blair's CRD filings); Tr. 418-23.

First, Blair asserted that the surrender fees the customers complained about were not "damages" within the meaning of question 14I(3) of the Form U4, stating: "I don't see it saying anything about surrender charges on there."[63] However, the term "damages" is not used in a restrictive manner in the Form U4; it encompasses any claim for monetary relief.

Second, Blair claimed that he analyzed "everything, gains, surrender charges, bonuses, the length of time the client owned the account" and made a "good faith determination" that the damages from the conduct JS and BS complained about would be less than $5,000.[64] However, a FINRA examiner testified that an analysis of the transactions and the penalties and surrender fees JS and BS paid revealed that their damages exceeded $5,000.[65]

Blair's counsel focused on the customers' assertion that they "had gained very little, if any," from the annuity switches they complained of, suggesting that "very little" profit should not be equated with damages.[66] As the FINRA examiner testified, however, the fact that the customers complained that they had "gained very little" did not relieve Blair of his responsibility to conduct an analysis to make the "good faith determination" required by Question 14I(2)(a)[67] Blair's bald claim that he "made a good faith determination" that there were no damages is unsupported by any supporting evidence, and is contradicted by the analysis conducted by the FINRA examiner. On the basis of this evidence, the Panel concludes that Blair was required to disclose the complaint from JS and BS, as well as the complaint from GD and AD, on his Form U4.

By filing Form U4 amendments with false responses to question 14I(3), Blair violated FINRA Rule 1122, which provides: "No member or person associated with a member shall file with FINRA information with respect to membership or registration which is incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or fail to correct such filing after notice thereof." By violating Rule 1122, Blair also violated Rule 2010.

2. The NASD Rule 3070 Filings

During the relevant period, NASD Rule 3070 applied to FINRA members and required them to report certain statistical and summary information regarding customer complaints to FINRA.[68] In April 2011, Blair filed Rule 3070 reports for the two customer complaints discussed above, but incorrectly failed to indicate that the complaints were against him and the Firm, and failed to report the amount of money in dispute.

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[63] Tr. 279-80.

[64] Tr. 279-81.

[65] Tr. 427-29; CX-145.

[66] Tr. 432-36.

[67] Tr. 436.

[68] CX-142 (NASD Notice to Members 06-34, describing member reporting obligations under Rule 3070). FINRA Rule 4530 superseded NASD Rule 3070 after the events at issue in this proceeding. *See* Rule Conversion Chart at http://www.finra.org/RuleConversionChart; Tr. 423.

When he filed the report for GD and AD's complaint, under the heading "Complaint Info," Blair checked the box labeled "Other" when he should have checked the boxes labeled "Rep" and "Firm," because the customers alleged misconduct by him and the Firm. In addition, under the heading "Disputed Amount," Blair reported the amount as "0." He should have reported the amount as $79,374, the amount of losses alleged in the customers' complaint, or should have checked the box labeled "$5,000 or more/Cannot determine," because the customers sought other restitution without listing specific amounts.[69]

Blair's Rule 3070 report for JS and BS's complaint was similarly incorrect: the customers' allegations were directed at him and the Firm, requiring him to check the boxes labeled "Rep" and "Firm," but he checked the box labeled "Other."[70] And under the heading "Disputed Amount," Blair again incorrectly reported the amount as "0." Blair claims that he reported the amount correctly because the customers did not expressly claim a specific amount of damages.[71] The Panel rejects Blair's claim. He should have checked the box labeled "$5,000 or more/Cannot determine" because the customers' complaint related to surrender fees that exceeded $5,000.

By filing inaccurate reports regarding the customer complaints, Blair violated NASD Rule 3070 and FINRA Rule 2010.

V. Sanctions

A. Filing False or Inaccurate Amendments to Form U4

FINRA's Sanction Guidelines recommend a fine of $2,500 to $50,000 for filing false or inaccurate Form U4 amendments, as well as consideration of a suspension in any or all capacities for 5 to 30 business days.[72] In egregious cases, the Guidelines call for consideration of a longer suspension, for up to two years, or a bar.[73] The factors to consider in determining the appropriate sanctions for all false Form U4 violations include the "[n]ature and significance of the information at issue." The factors to consider in determining whether a Form U4 violation is egregious include whether the Form U4 amendment filing had false, inaccurate, or misleading information. The Sanction Guidelines also set forth Principal Considerations in Determining Sanctions. Those relevant to this case include relevant disciplinary history";[74] whether Blair relied on competent legal or accounting advice;[75] whether the misconduct consisted of numerous

[69] CX-124, at 6; CX-143, at 1; Tr. 269-71. *See* NASD Notice to Members 06-34 at 5 (July 2006), http://www .finra.org/industry/notices/06-34 ("Members must provide the amount of alleged compensatory damage [sic] in the complaint for sales practice complaints. If a specific amount is included in the complaint, it must be used.").

[70] CX-144, at 1; Tr. 282.

[71] CX-144, at 1; Tr. 279-81.

[72] FINRA Sanction Guidelines at 69 (2013), www.finra.org/sanctionguidelines.

[73] Guidelines at 70.

[74] Guidelines at 6 (Principal Consideration No. 1).

[75] Guidelines at 6 (Principal Consideration No. 7).

acts or a pattern of misconduct;[76] and whether the misconduct occurred over an extended period of time.[77] Applying these factors leads the Panel to conclude that Blair's misconduct was egregious.

Most significantly, Blair has an extensive disciplinary record:[78]

- In 1994, Blair was censured and fined for failing to give written notice to his employer firm that he was offering and selling fixed annuity contracts and similar insurance products to his customers.[79]

- In 2009, Blair and the Firm consented to a Securities and Exchange Commission order censuring them and ordering them to pay a $25,000 civil money penalty for making material misstatements and omissions concerning penalties and surrender charges when they recommended variable annuity product switches to customers, as a result of which the Firm received more than $200,000 in commissions.[80]

- In August 2013, Blair and the Firm consented to the entry of a Disciplinary Order and Undertaking by the Texas State Securities Board finding that Blair's sales of Cole REIT shares for $10.00, rather than $9.30 per share, constituted "inequitable practices in rendering services as an investment advisor representative," and that the Firm's receipt of seven percent commissions on those sales as well as assessing a one percent annual advisory fee on the clients' assets, including the Cole REIT, constituted "inequitable practices in rendering services as an investment advisor." Blair and the Firm were reprimanded and ordered, among other things, to pay a total of $83,000 to the Firm's investment advisor clients who had purchased the Cole REIT at $10.00 per share.[81]

- In February 2014, Blair and the Firm consented to another Disciplinary Order and Undertaking issued by the Texas State Securities Board, for failing to make the payments required by the prior Order in the time required. Blair and the Firm were reprimanded again and ordered to make supplemental payments to the

[76] Guidelines at 6 (Principal Consideration No. 8).

[77] Guidelines at 6 (Principal Consideration No. 9).

[78] CX-1, at 7-49; Tr. 231-49.

[79] CX-4, at 3.

[80] CX-5.

[81] CX-6. The Disciplinary Order and Undertaking includes findings that the Firm's investment advisor clients "qualified for the reduced share price of $9.30"; that "Blair sold the [Cole REIT] shares through [the Firm] as a participating dealer so that [the Firm] and Respondent Blair would receive the 7% sales commission"; and that "[h]ad Respondent Blair indicated on the subscription agreement that the [Cole REIT] shares would be sold through Respondent Blair as an investment advisor representative, of [the Firm], each client would have owned more shares for the same initial investment." Blair consented to the entry of the Disciplinary Order and Undertaking without any limitation on the use of those findings in proceedings such as this. CX-6, at 9, 15; Tr. 234.

clients to whom the Firm had not yet paid the full amount due under the prior Order.[82]

- Finally, in May 2012, FINRA accepted an Offer of Settlement from Blair and the Firm pursuant to which the Firm was censured and fined $7,500 and Blair was also censured and fined $7,500, in part for failing to make timely reports to FINRA of certain customer complaints and the settlement of a lawsuit brought by a non-customer, in violation of NASD Rule 3070 and FINRA Rule 2010.[83]

In addition to Blair's extensive disciplinary record, the Panel finds aggravating factors: the nature of the information that Blair failed to disclose on his Form U4; the number of false Form U4 amendments he filed; and the length of time encompassed by those filings. Information about customer complaints is plainly material to both existing and potential customers in deciding whether to begin or to continue a relationship with a registered representative. Had Blair disclosed the customer complaints, that information would have been available to other existing and potential customers. Blair filed a dozen Form U4 amendments over an 18-month period, from May 2011 to November 2012, without disclosing the customer complaints he had received.[84]

Finally, the Panel considered Blair's contention that he relied on advice from his consultants and lawyer in not reporting the complaint of customers BS and JS on his Form U4. However, Blair offered none of the details required to establish that he sought legal advice, received it, and reasonably relied on the advice he was given.[85] Therefore the Panel, as it must, rejects this claim.

Having considered these various factors and considerations, and having determined that Blair's filing of numerous false Form U4s was egregious, the Panel concludes that a four-month suspension in all capacities and a $10,000 fine are appropriate remedial sanctions for this violation.

Moreover, the Panel finds that Blair's failure to disclose the two customer complaints was willful. Blair admitted he was aware of the complaint filed by GD and AD and acknowledged that he was required to report it in his Form U4. He also admitted being aware of the complaint filed by JS and BS, but denied that he was required to report it. However, in finding Blair's violation willful, the Panel need not conclude that Blair intended to violate FINRA's rules, but rather only that he completed the Form U4 amendments, which he signed and submitted to FINRA, inaccurately stating that he had not received any reportable customer

[82] CX-7.

[83] CX-8.

[84] CX-129 – CX-141.

[85] Tr. 251-52; *see Leslie A. Arouh*, Exchange Act Release No. 62898, 2010 SEC LEXIS 2977, *52 (Sept. 13, 2010) (holding that an assertion of the defense of reliance on counsel requires a respondent to show full disclosure to counsel, seeking and obtaining legal advice, and reasonable reliance on the advice).

complaints.[86] Further, for the reasons set forth above, the inaccurate information was material.[87] In light of Blair's willful failure to disclose material information on his Form U4, he is subject to statutory disqualification.[88]

B. Filing Inaccurate Reports About Customer Complaints

For filing inaccurate reports under NASD Rule 3070, the Sanction Guidelines recommend a fine of $5,000 to $100,000 and consideration of a suspension of the responsible principal in all supervisory capacities for 10 to 30 days. In addition to the general considerations applicable to all violations, the principal considerations for filing inaccurate NASD Rule 3070 reports include whether the events reported inaccurately would have established a pattern of potential misconduct, and the number and type of incidents reported inaccurately.[89]

As with the Form U4 violations, the most significant aggravating factor for Blair's violations of Rule 3070 is his extensive disciplinary record, including a prior violation of Rule 3070. The Panel notes that Blair disclosed the customer complaints in his Rule 3070 filing, but he did so inaccurately. As explained above, the filings did not accurately report that the customer complaints were directed against the Firm and Blair personally. If they had, the filings would have disclosed the customer complaints against both Blair and the Firm to FINRA. Similarly, if Blair had correctly indicated that the disputed amount for the complaint by GD and AD was either the amount listed in the complaint or "$5,000 or more/Cannot determine," and that the disputed amount for the complaint by BS and JS was "$5,000 or more/Cannot determine," the filing might have alerted FINRA that the complaints should have been reported on Blair's Form U4.[90] On the other hand, the violations involved only two Rule 3070 submissions and two incidents.

Taking all of these circumstances into account, the Hearing Panel concludes that an additional fine of $7,500 suffices to accomplish FINRA's remedial goals.

VI. Conclusion

For willfully failing to disclose two customer complaints on his Form U4, in violation of FINRA Rules 1122 and 2010, Respondent is suspended in all capacities for four months and fined $10,000. Further, because the violations were willful and involved the failure to disclose

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[86] *Dep't of Enforcement v. Knight*, No. C10020060, 2004 NASD Discip. LEXIS 5, at *10 (NAC Apr. 27, 2004**)**; *Dep't of Enforcement v. Toth*, No. E9A2004001901, 2007 NASD Discip. LEXIS 25, *32 (NAC July 27, 2007).

[87] *See Knight*, 2004 NASD Discip. LEXIS 5, at *13 ("Because of the importance that the industry places on full and accurate disclosure of information required by the Form U4, we presume that essentially all the information that is reportable on the Form U4 is material.").

[88] *See* Section 3(a)(39)(F) of the Securities Exchange Act of 1934; Article III, Section 4 of FINRA's By-Laws; *see also Dep't of Enforcement v. Kraemer*, No. 2006006192901, 2009 FINRA Discip. LEXIS 39, at *15 (NAC Dec. 18, 2009) (stating that willful omission of material information on Form U4 results in statutory disqualification).

[89] Guidelines at 74.

[90] Tr. 424-25.

material information, Respondent is subject to statutory disqualification from becoming associated with any FINRA member. For inaccurately reporting information relating to the two customer complaints to FINRA, in violation of NASD Rule 3070 and FINRA Rule 2010, Respondent is fined an additional $7,500. In addition, Respondent is ordered to pay costs in the amount of $6,831.74, which includes an administrative fee of $750 and the cost of the hearing transcript.[91]

If this Decision becomes FINRA's final disciplinary action, Blair's suspension shall begin on May 4, 2015, and end on September 3, 2015. The fines shall be due and payable on a date set by FINRA but not sooner than 30 days after this becomes FINRA's final disciplinary action.

HEARING PANEL.

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By: Matthew Campbell
Hearing Officer

[91] The Hearing Panel has considered and rejects without discussion any other arguments made by the parties that are inconsistent with this Decision.