Quarterly Disciplinary Review

July 2016

FINRA publishes this quarterly review to provide firms with a sampling of recent disciplinary actions involving misconduct by registered representatives. The sample includes settled matters and decisions in litigated cases (National Adjudicatory Council (NAC) decisions and Securities and Exchange Commission (SEC) decisions in FINRA cases). These summaries call attention to, and remind registered representatives and firms of, specific conduct that violates FINRA rules and may result in disciplinary action. FINRA also provides detailed disciplinary information and decisions and a summary of monthly disciplinary actions on its website.

Improperly Providing a Pre-Publication Research Report to a Subject Company

- FINRA settled a matter involving a general securities principal who improperly caused a complete draft research report containing research rating, price target, and research summary information to be sent to the lead underwriter of an initial public offering (IPO). In June 2013, the principal's firm was a co-manager and co-underwriter of an IPO for an emerging growth company that had opened for trading earlier in the month. In connection with the offering, the firm prepared and issued two pre-deal research reports regarding the upcoming IPO. Before the publication of one of the reports, an officer of the subject company requested a copy of the draft report from a research analyst at the firm. The analyst declined to provide the officer with the report.

  Within a few hours, however, the officer emailed the principal to reiterate his request for the report. In response to the officer's request, the principal had at least two telephone conversations with the officer, discussed the request with the lead underwriter, and then ultimately asked the firm's research director to send the draft report to the lead underwriter. The principal also sent an email to the officer and the lead underwriter to inform them that the research director would send them the report the following day.

  The firm's research director sent the lead underwriter the complete draft of the research report as the principal had promised. The report contained a research rating, price target and research summary information, but it did not restrict the lead underwriter's use or dissemination of the report. The lead underwriter shared the draft research report with the officer of the subject company prior to the report's publication. After the officer reviewed the report, he contacted the lead underwriter and told the lead underwriter to inform the firm that its projections were conservative. The officer then asked the firm to participate in a telephone call before it published the report. Representatives of the firm participated in the telephone call, but the firm did not change the report after it was sent to the subject company.

Financial Industry Regulatory Authority

The principal caused the pre-publication draft research report to be sent to the lead underwriter without any restrictions and facilitated the provision of the report to the subject company, consequently violating FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the principal from associating with any firm in any capacity for 10 business days and fined him $7,500.

Churning, Making Unsuitable Recommendations, Engaging in Unauthorized Trading and Other Misconduct

- FINRA settled a matter involving a registered representative who churned customer accounts, engaged in excessive and unauthorized trading in customer accounts, made unsuitable recommendations to customers, failed to file Uniform Applications for Securities Industry Registration or Transfer, filed untimely and misleading Forms U4, and distributed inaccurate, unbalanced and materially misleading communications to customers.

Beginning in September 2012, the representative employed a short-term mutual fund trading strategy in the accounts of 11 customers. The customers were unsophisticated investors and, over many years, the representative had gained their trust with respect to trading and investing. All of the customers were living on fixed incomes. Seven of the customers were elderly. Four individuals were in their 80s and one individual was in his 90s. Six of the customers were widowed. According to the customers' new account forms, the 11 customers always followed the representative's investment recommendations. All of the customers sought investments with moderate risk, and an investment time horizon of at least four to six years and an investment holding period of at least one to three years (with most of the holding periods being longer).

Despite these facts, the representative made more than 150 separate purchases of mutual fund "A" shares and sold them for those customers after an average holding period of less than six months. Further, the representative consistently spread the mutual fund purchases across multiple fund families, and in so doing, failed to obtain breakpoint discounts for the customers. These short-term mutual fund trades were excessive and unsuitable, and cost the 11 customers over $150,000 in commissions.

In early 2014, the representative's firm placed him on heightened supervision because of this mutual fund trading. As a result, subsequent mutual fund sales by the representative required prior review and approval by the firm's compliance department. When his sales of mutual funds significantly decreased due to the heightened scrutiny, the representative increasingly employed a "swing trade" strategy in the accounts of the 11 customers. The swing trade strategy was based on "signals" the representative obtained from a website that used chart analysis to identify securities to purchase and sell within days. From October 2013 to December 2014, the representative placed thousands of swing trades for the 11 customers by buying securities and then selling them within days. Although some of the individual trades were profitable, the extremely frequent swing trading, combined with the commission costs, made it virtually certain that the customers would lose money over time. Indeed, the 11 customers lost over $770,000 in connection with the representative's swing trading in their accounts, while the representative earned $665,000 in commissions.

The representative's excessive short-term mutual fund trading and equity swing trading in the accounts of the 11 customers amounted to churning, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) (anti-fraud), Exchange Act Rule 10b-5 (anti-fraud), and FINRA Rules 2020 (anti-fraud) and 2010 (ethical standards). The representative's excessive short-term mutual fund trading and equity swing trading also was unsuitable and violated FINRA Rules 2111 (suitability) and 2010 (ethical standards). Finally, in 2,000 instances, the representative engaged in the excessive short-term mutual fund trading and equity swing trading without obtaining the requisite authorization from the customer prior to executing the trade. In so doing, the representative engaged in unauthorized trading and violated FINRA Rule 2010 (ethical standards).

The representative also failed to file Forms U4 and filed untimely, false and misleading Forms U4. The IRS filed a tax lien against the representative in April 2011. The representative was required to disclose the IRS lien within 30 days on his Form U4, but he did not disclose the lien until one year later, in March 2012.

Between June 2013 and January 2015, two homeowner's associations filed five liens against the representative for delinquent assessments. Although the liens were later satisfied, in the six Forms U4 he filed while the liens were unsatisfied, the representative falsely answered "no" on the Form U4 in response to questions concerning unsatisfied liens.

In August 2013, the representative entered into a compromise with a creditor for an unpaid bill. The representative never disclosed the compromise on his Form U4, as required. In the six Forms U4 he filed following the creditor compromise, the representative falsely answered "no" in response to questions concerning compromises with creditors in the last 10 years.

In November 2013, the representative had two state business tax liens levied against him. Despite the existence of the liens, the representative falsely answered "no" in response to questions on the Form U4 concerning unsatisfied liens. The representative ultimately reported the state business tax liens, but he did so nine months after they were entered against him and only after FINRA questioned him about them.

In December 2013, the representative established a corporation. Although the representative was both the owner and secretary of the corporation, he filed two Forms U4 in which he failed to disclose the corporation in response to questions concerning outside business activities.

In March 2014, the representative entered into a compromise with a creditor for unpaid credit card debt. The representative never disclosed the compromise on his Form U4. In the five Forms U4 he filed following the compromise, the representative falsely answered "no" in response to questions concerning compromises with creditors in the last 10 years. By failing to file Forms U4 and filing untimely, false, and misleading Forms U4, the representative willfully violated Article V, Section 2(c) of FINRA's By-Laws (application for registration) and FINRA Rules 1122 (filing of misleading information as to membership or registration) and 2010 (ethical standards).

Finally, the representative distributed inaccurate, unbalanced, and materially misleading communications to customers. In January 2015, the firm suspended the representative from trading securities. The representative never informed any of his customers that he had been suspended from trading, and that he was no longer their registered representative. Instead, the representative sent letters to 37 customers urging them to move their brokerage accounts from the firm to advisory accounts at an investment advisor affiliate of the firm where he could serve as their registered investment advisor. In the letter, the representative claimed he was changing from a brokerage practice to an advisory practice that would advantage customers through wider investment opportunities and asset-based fees. He failed to inform the customers that the firm had suspended him from trading securities and prohibited him from serving as their registered representative, and that the only means for him to continue to earn money through securities-related services was to move their accounts to advisory accounts. The representative's letter to the 37 customers violated FINRA Rules 2210 (communications with the public) and 2010 (ethical standards).

For all of this misconduct, FINRA barred the representative from associating with any firm in any capacity.

Failing to Update the Form U4 and Providing False Statements on Firm Compliance Questionnaires

- FINRA settled a matter involving a registered representative who willfully failed to update his Form U4 to report four federal tax liens, one state tax lien, two bankruptcy filings and two judgments; and misrepresented facts concerning the liens, bankruptcies and judgments on the firm's annual compliance questionnaires. During the relevant period, question 14-K on the Form U4 asked registered representatives to disclose whether they had made any compromises with creditors, filed a bankruptcy petition or have been the subject of an involuntary bankruptcy petition. Question 14-M asked registered representatives to disclose any unsatisfied judgment or lien.

  At all times, the representative had an obligation to keep his application current by filing amendments within 30 days of learning of facts that are required to be disclosed. Despite this obligation, between July 2010 and September 2014, the representative willfully failed to amend his Form U4 to disclose four federal tax liens recorded by the Internal Revenue Service (IRS), one state tax lien recorded by the Georgia Department of Revenue, the filing and discharge of two bankruptcy petitions, and two judgments entered against him. The representative's failure to update his Form U4 to disclose the liens, bankruptcies, and judgments against him violated Article V, Section 2(c) of FINRA's By-Laws (application for registration), and FINRA Rules 1122 (filing of misleading information as to membership or registration) and 2010 (ethical standards).

During this same period, the representative also submitted annual compliance questionnaires to his firm upon which he made false representations that his Form U4 was current with all the necessary disclosures relating to financial proceedings, including bankruptcies and unsatisfied liens. When the representative completed the questionnaires, however, he was aware of multiple unsatisfied tax liens and the filing of two bankruptcy petitions. The representative's false statements on the firm's questionnaires violated FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any firm in any capacity for six months and fined him $5,000.

Distributing and Causing the Distribution of Fraudulent Emails, and Engaging in a Securities Business While Net Capital Deficient

- FINRA settled a matter involving a general securities principal who distributed and caused the distribution of two emails that failed to disclose material information and caused a firm to engage in a securities business while net capital deficient. The primary business of the principal's firm was to assist companies with private placements and the raising of capital. As part of these efforts, the firm sent emails to potential investors describing various investment opportunities. In December 2010 and March 2011, respectively, the principal reviewed, approved, distributed and allowed the distribution of two separate emails to potential investors that contained material omissions concerning two issuers in need of capital.

  The principal distributed and allowed the distribution of the first email to 170 potential investors. Although the principal was responsible for the review and approval of the email before its distribution, the email failed to disclose that the principal, his family members, and the principal's limited partnership owned the issuer's stock and had provided the issuer with a loan; the principal was actively involved in the development and growth of the issuer; and the issuer was in imminent default on interest payments that were due on other promissory notes that it had issued.

  The principal distributed and allowed the distribution of the second email to at least 18 potential investors. As he had done in the first instance, the principal reviewed the draft email prior to its distribution. The second email failed to disclose that the principal and his family maintained an ownership interest in the issuer. The principal reviewed, approved, and distributed both emails even though he knew or should have known that the emails omitted material information. The principal's misconduct related to the dissemination of the emails violated FINRA Rule 2010 (ethical standards).

  The principal also caused the firm to conduct a securities business while net capital deficient. Between April and May 2010, the principal was registered as the firm's FINOP. As FINOP, the principal was responsible for ensuring the firm's compliance with its net capital requirements. Although the firm's minimum net capital requirement during that period was $5,000, for a nine-day period in May 2010, the firm operated with a net capital deficiency between $1,100 and $21,000. While the firm remained net capital deficient, individuals associated with the firm continued to conduct a securities business by exchanging emails with individuals outside of the firm concerning a variety of financing projects. The principal failed to take adequate steps to prevent the firm from conducting this business while it was net capital deficient. The principal therefore violated FINRA Rule 2010 (ethical standards).

For all of this misconduct, FINRA suspended the representative from associating with any firm in any capacity for six months and fined him $10,000.

Participating in Private Securities Transactions

- FINRA settled a matter involving a registered representative who participated in private securities transactions without providing written notice to, and obtaining approval from, his firm. On three occasions between October 2014 and February 2015, the representative used personal funds to purchase two privately held companies' shares; and, in January 2015, the representative solicited three of the firm's customers to participate in the investment with him. These transactions were outside the regular course and scope of the representative's employment with the firm, and the representative did not provide written notice to, or receive approval from, the firm to participate in any of the transactions. The representative therefore violated NASD Rule 3040* (private securities transactions) and FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any firm in any capacity for 15 business days and fined him $7,500.

Impersonating Customers as an Accommodation

- FINRA settled a matter involving a registered representative who impersonated customers as an accommodation. In three instances between November 2013 and July 2014, the representative impersonated three relatives on telephone calls to his firm's customer service department. The representative impersonated the individuals as an accommodation to help them obtain information concerning the premiums due for their term life insurance policies. During each of the telephone calls, the representative—who also was the insurance agent, beneficiary and payee for each of the relative's insurance policies—falsely represented himself as the policyholder in an effort to obtain premium amount information to pay the policy premiums. By engaging in this conduct, the representative violated FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any firm in any capacity for 30 calendar days and fined him $5,000.

Writing Fictitious Non-Variable Life Insurance Policies

- FINRA settled a matter involving a registered representative who wrote fictitious non-variable life insurance policies. Between August 2013 and July 2015, the representative wrote 43 fictitious non-variable life insurance policies for clients who did not exist in order to meet production goals with the firm's affiliated insurance company. The representative fabricated customer information on the policy applications and listed himself as the policy owner, payer and grandfather to the insured for each of the 43 policies. He paid the first premium for each of the 43 policies by personal check and received commission payments for each policy. After cancelling all 43 policies, which had not already lapsed, the insurance company refunded the premium payments to the representative less the commissions that he had been paid. The representative's conduct violated FINRA Rule 2010 (ethical standards). For this misconduct, FINRA barred the representative from associating with any firm in any capacity.

Converting Customer Funds

- FINRA settled a matter involving a registered representative who converted a customer's funds. In July 2014, the representative convinced an elderly customer to pay him $100,000. The representative told the 85-year-old customer that he would use the funds to establish an independent investment advisory firm through which he would repay the $100,000 debt by providing the customer with free investment advice over the next four years. The representative never established an independent investment advisory firm. Indeed, when the representative and customer executed the loan agreement for the funds, the representative was planning on retiring from the securities industry.

  Shortly after obtaining the $100,000 from the customer, the representative sold his securities business to another registered representative and left the securities industry. As part of the sale, the representative entered into a non-compete agreement that prevented him from providing investment advice to his former customers, including the customer from whom he had obtained the $100,000. The representative used the customer's $100,000 for his own personal use, including to pay off his daughter's student loan debt and his own credit card bills. He also used some of the funds to engage in securities trading on his own behalf. The representative has not repaid any of the funds obtained from the customer. The representative's conduct violated FINRA Rules 2150(a) (improper use of customers' funds) and 2010 (ethical standards). For this misconduct, FINRA barred the representative from associating with any firm in any capacity.

* NASD Rule 3040 has been superseded by FINRA Rule 3280, effective September 21, 2015.