Quarterly Disciplinary Review

October 2017

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.

Executing an Inaccurately Dated and False Compliance and Supervisory Processes Certification

- FINRA settled a matter involving a registered representative who signed a compliance and supervisory processes certification that was inaccurately dated and that he should have known contained false statements. FINRA Rule 3130 requires that each member firm have its chief executive or equivalent officer certify, no later than the anniversary date of the previous year's certification, that it has processes in place to establish, maintain, review, test, and modify its written compliance policies and supervision procedures, and that the chief executive officer has conducted one or more meetings with the chief compliance officer in the preceding 12 months to discuss this process.

  The representative's firm submitted its prior FINRA Rule 3130 certification to FINRA on March 31, 2012. Accordingly, FINRA required that the firm make a new certification by March 31, 2013. For the annual period ending March 31, 2013, the firm did not test its supervisory procedures because the firm anticipated that it would complete the sale of its assets in mid-2012 and withdraw from FINRA membership before the end of the year. But the firm took longer than anticipated to complete the shuttering process, and its withdrawal from FINRA membership was not accepted until April 1, 2013.

  On March 1, 2013, FINRA's Department of Enforcement asked the firm to provide all documents related to its annual testing and certification of its compliance and supervisory processes. On April 26, 2013, after the firm had withdrawn from FINRA membership, an employee of the firm asked the representative to sign a compliance and supervisory processes certification for the annual period ending March 31, 2013. When the employee sought the representative's signature on the certification, the employee inaccurately informed the representative that the representative had signed the original version of the certification on March 31, 2013, but that he (the employee) could not locate it. The representative

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signed the compliance and supervisory processes certification and dated it for March 31, 2013, which made it appear that the representative had signed the certification by the deadline that FINRA Rule 3130 required.

The compliance and supervisory processes certification that the representative signed also inaccurately stated that the firm had processes in place to test its procedures on a periodic basis, and that the testing for the prior year had been evidenced in a written report. The representative should have known that the firm had not conducted its annual testing because the representative was the one who had approved the firm's cancellation of its annual testing in mid-2012. Similarly, the representative should have known that the firm had not prepared the reports, and that he had not reviewed them. The representative, however, failed to appropriately review the certification that he was signing, and he failed to act reasonably to ensure that the statements contained in the certification were true.

By executing an inaccurately dated and false compliance and supervisory processes certification, the representative violated FINRA Rules 3130 (annual certification of compliance and supervisory processes) and 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any capacity for 45 days and fined him $15,000.

Misplacing Customer Funds and Borrowing Funds From a Customer Without Prior Firm Approval

- FINRA settled a matter involving a registered representative who misplaced funds he received from a customer to open a retirement account, and borrowed funds from a customer without prior firm approval. In September 2013, the representative met with a customer—who also was a longtime personal friend—to complete the paperwork necessary for the customer to open an individual retirement account. The customer gave the representative $5,000 in cash to fund the account. The representative accepted the funds even though he knew it was against his firm's policy to accept cash from a customer. The representative placed the cash and accompanying paperwork in the trunk of his car and returned to his office. The representative failed to promptly open the account, and when he later attempted to locate the funds, he could not find them. Rather than promptly address the situation of the misplaced funds, the representative waited until the customer complained to bring the matter to his firm's attention. The firm terminated the representative and repaid the customer. By failing to apply the $5,000 to the customer's retirement account, the representative misused customer funds and violated FINRA Rules 2150(a) (improper use of customers' securities or funds) and 2010 (ethical standards).

The representative also improperly borrowed funds from a separate customer three years earlier. In September 2010, the representative borrowed $3,000 from a customer who also was the representative's personal friend. The representative did not notify or seek approval from the firm prior to accepting the loan, and he failed to disclose the loan on his annual compliance questionnaire for 2010. The representative repaid the customer; however, there was a dispute between the customer and the representative regarding the total amount owed on the loan. The representative disclosed the loan to the firm one year later—in September 2011—after he was unable to resolve the disagreement with the customer over the repayment amount. By borrowing funds from a customer without seeking or obtaining the firm's prior approval, the representative violated FINRA Rules 3240 (borrowing from or lending to customers) and 2010 (ethical standards). For misplacing customer funds and borrowing funds from a customer without firm approval, FINRA suspended the representative from associating with any FINRA member firm in any capacity for two years and fined him $12,500.

Concealing the Receipt of Funds From a Customer, Using Text Messages to Communicate With Customers, and Recommending an Unsuitable Transaction to a Customer

- FINRA settled a matter involving a registered representative who concealed the improper receipt of funds from a customer, improperly used text messages to communicate with customers, falsely attested that he did not use text messaging with customers, and recommended an unsuitable transaction to a customer. Between 2007 and 2012, the representative was a married couple's broker of record. In late 2012, the husband died, and his widow became the sole point of contact on their account. The widow, an unsophisticated investor who had not held a job in almost 20 years, opened two additional accounts with the representative soon after her husband's death.

  In July 2014, the widow contacted the representative about providing him with funds to allow him to benefit by sharing in the profits in her account at the firm. On the same date, the widow wrote the representative a check for $2,500 drawn from her cash management account at the firm. The representative immediately contacted the widow because he was concerned that the firm would learn of the deposit, which he knew to be prohibited. In order to avoid the firm's detection, the representative provided the widow with his personal banking account details for an account he held at another financial institution. He informed the widow that she could directly deposit funds related to the purported profits into his personal checking account. As a result, between July and November 2014, the widow deposited nine checks totaling $29,000 into the representative's personal bank account. The funds the representative received were purportedly a share of the profits from the widow's account. The representative knew he was prohibited from accepting such payments, but he nevertheless used his share of the purported profits for personal expenses. By sharing in the profits of a customer account, the representative violated FINRA Rules 2150 (improper use of customers' securities or funds) and 2010 (ethical standards).

From 2012 until his resignation from the firm in 2016, the representative used his personal cell phone to send text messages to the widow, in addition to other customers. The representative was prohibited from text messaging with customers unless it was done through a platform the firm had approved. Moreover, in 2015, the representative submitted an annual attestation to the firm that certified that the representative had not used text messaging with any customer in the prior 12 months. The representative's attestation was false. As a result, the representative prevented the firm from discharging its supervisory responsibilities with respect to the representative's text messages. By using text messaging with customers in contravention of his firm's policies and falsely attesting the he did not use text messaging with customers, the representative violated FINRA Rule 2010 (ethical standards).

In addition, in January 2015, the representative recommended that the widow purchase units of a nontraditional, leveraged crude oil exchange-traded fund (ETFs) even though he did not have a reasonable basis to do so. Specifically, the representative did not receive training on nontraditional ETFs, failed to account for the compounding of risk associated with holding nontraditional ETFs overnight, and failed to appreciate that ETFs are designed to achieve their stated objectives within a single trading day. The representative did not understand that holding ETFs in the long-term could cause a customer to experience significant losses.

On the representative's recommendation, the widow purchased 5,000 units of a nontraditional, leveraged crude oil ETF. The widow paid more than $40,000 for the units. The representative did not liquidate the widow's position for eight months, until August 2015, by which time the widow had experienced losses. By making an unsuitable recommendation to the widow, the representative violated FINRA Rules 2111 (suitability) and 2010 (ethical standards). For all of these violations, FINRA barred the representative from association with any FINRA member in any capacity.

Participating in Private Securities Transactions, Making Unsuitable Recommendations, and Engaging in Undisclosed Outside Business Activities

- FINRA settled a matter involving a registered representative who participated in private securities transactions, made unsuitable recommendations to customers and engaged in undisclosed outside business activities. In June 2010, the representative recommended that two customers consider making investments in a software development company. The representative knew the software development company was selling securities that would allow the purchasers of its securities to participate in a bridge loan to the company. The representative referred two customers to the software development company's management, and the customers subsequently each invested $100,000 in the company. In return for the referral, the software development company paid the representative fees totaling $32,000. The securities the software development company issued did not perform well, and the representative's customers lost their entire investment.

The software development company's securities were not offered through the firm. Prior to recommending that his customers invest in the software development company's securities, the representative did not disclose to the firm, in writing or otherwise, his involvement in recommending the securities or his receipt of compensation for referring the customers to the company. Furthermore, before recommending that his customers consider investing in the software development company, the representative conducted virtually no inquiry into the company, its business model, its finances, its management, or its intended use of the proceeds generated through the sale of its securities.

By participating in the two customers' investments in the software development company for compensation without providing prior written notice to the firm, the representative violated NASD Rule 3040* (private securities transactions) and FINRA Rule 2010 (ethical standards). By recommending that the two customers invest in the software development company without first undertaking reasonable diligence to understand the company or its securities, the representative violated NASD Rule 2310† (suitability), NASD IM-2310-2‡ (fair dealing with customers) and FINRA Rule 2010 (ethical standards).

In mid-2010, a trader with whom the representative had a prior business relationship established his own company to provide investors with separately managed commodities and futures trading accounts. The trader's company, a commodities and futures trading entity, was registered with the National Futures Association and maintained its accounts with a commodities and futures dealer. Beginning in November 2010, the representative began actively marketing the commodities and futures trading entity's managed commodities and futures accounts to his customers and other potential investors. Between November 2010 and December 2012, the representative referred 28 individuals to the commodities and futures trading entity. Those individuals collectively invested more than $1.8 million in accounts managed by the commodities and futures trading entity. In addition to referring the investors to the commodities and futures trading entity, the representative also assisted the investors in completing the paperwork required to establish their accounts with the commodities and futures trading entity and the commodities and futures dealer that monitored the performance of those accounts. The representative received more than $70,000 from the commodities and futures trading entity in return for his referrals. Nearly all of the investors the representative referred to the commodities and futures trading entity lost money on their investments. The representative did not disclose his outside business relationship with the commodities and futures trading entity to his member firm.

By engaging in an undisclosed outside business relationship with the commodities and futures trading entity without providing written notice to his member firm, the representative violated NASD Rule 3030§ (outside business activities) for conduct occurring before December 15, 2010; FINRA Rule 3270 (outside business activities) for conduct occurring on or after December 15, 2010; and FINRA Rule 2010 (ethical standards). For all of these violations, FINRA barred the representative from association with any FINRA member in any capacity.

Serving as a Firm's Chief Administrative Officer Without the Appropriate Registration

- FINRA settled a matter involving a registered representative who served as a firm's Chief Administrative Officer without obtaining his qualifications as a general securities principal. In April 2013, the firm hired the representative as its Chief Administrative Officer. When the representative joined the firm, he held licenses as a general securities representative (Series 7) and as a state securities agent (Series 63).

  From April 2013, when the representative began serving as the firm's Chief Administrative Officer, until May 2014, when he stopped serving in that capacity, the representative was responsible for supervising the firm's operations support functions, which included the firm's back office, control unit and information technology departments; and its administration support function, which included the firm's credit and compliance departments. As a result, the firm's Chief Compliance Officer reported directly to the representative. As Chief Administrative Officer, the representative also approved the travel and entertainment expenses for any employee in his area of authority, carried out any powers that the firm's Chief Executive Officer delegated to him, and engaged in any of the powers of his subordinated officers subject to governing regulatory qualifications.

  Consistent with his title and responsibilities, the firm applied to register the representative as a general securities principal. But the representative did not obtain his license as a general securities principal until March 2014, nearly one year after being hired to serve as the firm's Chief Administrative Officer. By failing to qualify as a general securities principal within 90 days of his association with the firm, and by continuing to function as a general securities principal without having successfully passed the appropriate qualification examination, the representative violated NASD Rule 1021[Ð] (registration requirements) and FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any capacity 15 business days and fined him $5,000.

Failing to Reasonably Supervise the Offer and Sale of Mortgage-Backed Securities

- FINRA settled a matter involving a registered representative who failed to reasonably supervise his salespersons' offers and sales of mortgage-backed securities. Between 2008 and 2010, the representative was co-head of mortgage-backed securities trading at the firm. As the co-head of this group, the representative had shared responsibilities for sales, trading and supervision of the firm's mortgage-backed securities desk. In four instances, the representative failed to prevent a false statement from being made, or failed to correct a false statement that had been made, to customers in connection with a sale or offer of a mortgage-backed security.

In two instances, a salesperson on the firm's mortgage-backed securities desk sent an email to the representative saying that he intended to make a statement to customers, or intended to direct another employee to make a statement to customers, that the salesperson and the representative knew, or should have known, was false. On these two occasions, the firm acted as an intermediary—buying bonds from a customer at one price and selling them to another customer at a higher price. The salesperson's misrepresentation concerned the firm's cost basis for purchasing the bonds, which would have had the effect of increasing the firm's profitability in the transaction. The representative responded to the salesperson's emails, but the representative did not instruct the salesperson not to make the false statement. Nor did the representative order the salesperson to correct the false statement once it had been made. The misrepresentations reflected in the emails between the salesperson and the representative were communicated to the customers—and one transaction resulted from them.

In a third instance, a salesperson on the mortgage-backed securities desk communicated an inaccurate transaction price to a customer in an attempt to induce the customer to purchase the bonds at a higher price. The misrepresentation concerning the transaction price did not result in a trade. In the fourth, and final, instance, a salesperson told a customer that the firm had an order from another customer to sell bonds when, in fact, the bonds were held in the firm's inventory. This resulted in a transaction. In both of these instances, the representative knew, or should have known, that a misrepresentation was made to a customer based on emails that the representative had received. Although the representative received the emails, he did not correct the misrepresentations.

As a supervisor, the representative had an obligation to prevent or correct the misrepresentations that the salespersons on the firm's mortgage-backed securities desk had made to the customers. In the four instances cited, the representative did not take any action, and, consequently, did not reasonably supervise the salespersons' offer or sale of mortgage-backed securities to customers. By failing to reasonably supervise the salespersons' sales solicitations, the representative violated NASD Rule 3010[¶] (supervision) and FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any principal capacity for three months, fined him $30,000, and ordered him to requalify by examination as a general securities principal.

Placing an Unauthorized Trade in a Customer's Account

- FINRA settled a matter involving a registered representative who placed an unauthorized trade in a customer's account. In mid-2011, the representative began servicing the account of a corporate entity. The representative did not have discretionary authority for any of the entity's accounts.

  In September 2014, the representative placed a $5 million trade in the entity's account without informing the two individuals with authority to place trades in the account. Later that same month, one of the individuals with trading authority over the entity's account questioned the representative about the trading activity in the account, but the representative concealed the unauthorized trade.

  In October 2014, the firm began questioning the representative about the trade. The representative initially concealed the fact that the trade was unauthorized, but he later admitted to the firm that the trade was not authorized by either of the individuals with trading authority over the entity's account. The firm reversed the trade.

  By placing an unauthorized trade in a customer's account, the representative violated FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any capacity for nine months and fined him $15,000.

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

† NASD Rule 2310 has been superseded by FINRA Rule 2111, effective July 9, 2012.

‡ NASD IM-2310-2 has been superseded by FINRA Rule 2111, effective July 9, 2012.

§ NASD Rule 3030 has been superseded by FINRA Rule 3270, effective December 15, 2010.

Đ The SEC has approved FINRA Rule 1210, but its effective date has not yet been determined as of October 1, 2017. Upon effectiveness, FINRA Rule 1210 will supersede NASD Rule 1210.

¶ NASD Rule 3010 has been superseded by FINRA Rule 3110, effective December 1, 2014.