

Quarterly Disciplinary Review

April 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.

Failing to Supervise

- ▶ FINRA settled a matter involving a general securities principal who inadequately supervised a registered representative who engaged in unsuitable trading in the individual retirement account (IRA) of one customer and improperly exercised discretion in the accounts of three customers. Between January 2011 and January 2012, the principal's firm assigned him to supervise the activities of a representative, and the representative engaged in several sales practice violations while under the principal's supervision.

For example, the registered representative recommended that a retired customer, with a degenerative eye disease that prevented him from working, invest more than \$100,000 in a speculative oil and gas exploration company based in Oklahoma. The representative also recommended that the same customer purchase two closed-end mutual funds that incurred substantial risk in pursuit of an annual yield exceeding 10 percent. Finally, the representative exercised discretion without written authorization in three customers' accounts by executing approximately 229 discretionary trades in the customers' accounts. The representative engaged in this misconduct while he was under the principal's supervision.

The principal's supervision of the registered representative was inadequate because he failed to establish and maintain a supervisory system designed to ensure that the transactions executed in the representative's customer accounts were suitable. The principal also failed to supervise the representative's sales practices, failed to detect the representative's unsuitable purchases of high-risk securities, and failed to monitor the representative's use of discretion in customer accounts. The principal's supervisory failures violated NASD Rule 3010(a)* (supervisory system) and FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA suspended the principal from associating with any firm in any principal capacity for 45 days and fined him \$5,000.

Converting Customer Funds and Forging Customer Signatures

- ▶ FINRA settled a matter involving a registered representative who converted customer funds and forged customer signatures. Between January 2007 and April 2014, while associated with a firm, the representative served as the trustee of an estate customer's testamentary trust. The estate customer established the trust for the benefit of the son and grandchildren of the decedent. The representative's duties as trustee of the trust included paying tax and legal bills, signing tax returns, and distributing funds to the trust's beneficiaries. The representative did not keep any records of the time he spent on trust-related matters or the tasks he performed as trustee, but on firm compliance questionnaires, he estimated that he spent no more than approximately 43 hours per year on trust-related activities.

Although the document governing the trust was silent on the amount of compensation to be paid to the trustee, the representative determined the amount of his own compensation for his trustee-related services; and, for the seven-year period that the representative served as trustee, he paid himself nearly \$200,000. In 2012, for example, the representative paid himself more than \$30,000; and in 2013, he paid himself more than \$40,000. And, in 2014, although the representative resigned as trustee in May of that year, he paid himself more than \$40,000. The representative converted at least \$110,000 in funds belonging to the estate customer by paying himself trustee fees that were excessive and inconsistent with the limited nature of his duties as trustee.

The representative refunded approximately \$110,000 to the estate customer and resigned as trustee, but he did not do so until the firm commenced an investigation into his administration of the trust. The representative's conversion of the estate customer's funds violated NASD Rule 2110[†] (ethical standards) for conduct occurring before December 15, 2008; NASD Rule 2330(a)[‡] (improper use of customers' securities or funds) for conduct occurring before December 14, 2009; FINRA Rule [2150\(a\)](#) (improper use of customers' securities or funds) for conduct occurring on or after December 14, 2009; and FINRA Rule [2010](#) (ethical standards) for conduct occurring on or after December 15, 2008.

During the seven years the representative served as the estate customer's trustee, he also forged the signature of a co-executor on at least 12 checks made payable to the estate and used a portion of those funds for personal expenses. The representative arranged for 19 checks made payable to the estate to be issued from the estate's brokerage account at the firm. The checks, which totaled \$247,000, were made payable to the estate in the name of the representative as an executor of the estate, and a second individual, the estate's co-executor. The representative endorsed 12 of the 19 checks, totaling \$170,000, by signing his own name and forging the co-executor's signature. The representative endorsed the remaining seven checks "for deposit only." The representative deposited the checks into the estate's bank account held outside of the firm and used the funds to pay for personal expenses such as his credit card bills and home loan.

The representative's forgery and conversion of the estate's checks violated NASD Rule 2110[†] (ethical standards) for conduct occurring before December 15, 2008; and FINRA Rule [2010](#) (ethical standards) for conduct occurring on or after December 15, 2008. For converting customer funds and forging customer signatures, FINRA barred the representative from associating with any firm in any capacity.

Participating in Private Securities Transactions and Engaging in Undisclosed Outside Business Activities

- ▶ FINRA settled a matter involving a registered representative who participated in private securities transactions and engaged in outside business activities without providing prior written notice to his firm. Between August 2008 and August 2011, while he was registered with a firm, the representative recommended that four customers invest in two companies that specialized in the production and development of renewable energy. The representative, who was a consultant for both energy companies, provided the customers with promotional materials about the companies. After the representative solicited the customers, each of them invested in the energy companies, collectively investing a total of \$255,000.

On a second occasion, in December 2008, the representative recommended that a customer invest in a gold mining company, for which the representative's son served as the CEO. The representative provided this customer with promotional materials, and the customer invested \$26,000 in the gold mining company. The representative did not provide his firm with any written notice of his participation in the customers' purchase of the interests in the energy or gold mining companies. His participation in the private securities transactions violated NASD Rule 3040** (private securities transactions); NASD Rule 2110[†] (ethical standards) for conduct occurring before December 15, 2008; and FINRA Rule [2010](#) (ethical standards) for conduct occurring on or after December 15, 2008.

The representative also engaged in an undisclosed outside business activity. Between December 2008 and August 2011, he purchased gold and silver coins from the U.S. Department of the Treasury, and he sold them to the four customers. The representative failed to provide any notice of this outside business activity to his firm. The representative's undisclosed outside business activity violated NASD Rule 3030[§] (outside business activities) for conduct occurring before December 15, 2010; NASD Rule 2110[†] (ethical standards) for conduct occurring before December 15, 2008; FINRA Rule [3270](#) (outside business activities) for conduct occurring on and after December 15, 2010; and FINRA Rule [2010](#) (ethical standards) for conduct occurring on or after December 15, 2008. For participating in private securities transactions and engaging in undisclosed outside business activities, FINRA suspended the representative from association with any firm in any capacity for seven months and fined him \$15,000.

Borrowing Funds From Customers, Engaging in Undisclosed Outside Business Activities and Submitting False Compliance Questionnaires

- ▶ FINRA settled a matter involving a registered representative who borrowed funds from a customer without prior written permission from the firm, engaged in undisclosed outside business activities, and submitted false compliance questionnaires to the firm concerning the loan and outside business activities. In July 2009, while associated with a firm, the representative purchased a parcel of farm land from one of his customers. To purchase the land, he executed a promissory note for approximately \$250,000 in favor of the customer. The promissory note included an interest rate and a repayment schedule. The amortization schedule for the promissory note detailed the amount due on the “loan” to the representative.

Thereafter, in 2012, the representative and the customer agreed to build a riding arena on the farm land. Because the representative was unable to contribute to the \$40,000 cost of building the arena, the customer paid for it himself. In conjunction with the transaction, the representative executed a repayment agreement pursuant to which both parties acknowledged that the representative was indebted to the customer for an additional \$20,000 for his share of the cost of building the riding arena. The repayment agreement also set forth the interest rate and timeline for repayment of the loan.

Between 2012 and 2013, the representative gained employment with another firm. While the representative was registered at the new firm, he and the customer executed a replacement promissory note for the outstanding amount due under the 2009 promissory note. The replacement promissory note reflected a change in the title-owner of the farm from the customer to a limited liability company the customer had formed. The customer listed the representative as a member of the limited liability company holding title to the farm. The representative did not inform or obtain prior written approval from either firm for the loans or loan modification. Consequently, the representative violated NASD Rule 2370¹¹ (borrowing from or lending to customers) for conduct occurring before June 14, 2010; FINRA Rule [3240](#) (borrowing from or lending to customers) for conduct occurring on or after June 14, 2010; and FINRA Rule [2010](#) (ethical standards).

During this same period, the representative was actively involved in the management of the farm with the customer. The representative expected to receive compensation in connection with his activities on the farm, including funds for renting portions of the property and selling timber on it. The representative and customer formed a partnership and opened a bank account in the name of the partnership to account for the revenue and expenses that the farm had generated. Despite these actions, the representative did not disclose his farm-related activities to either of the firms that employed him during this period. The representative’s undisclosed outside business activities violated NASD Rule 3030⁵ (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).

The representative also submitted five annual compliance questionnaires between January 2010 and March 2014, while he was engaged in the farm-related business. In each questionnaire, the representative was asked if he borrowed from or loaned money to any of his customers that had not been reported to the firm's compliance department; and each time, he answered "no," which was not true. On three of the five compliance questionnaires, the representative was also asked if he was engaged in any outside business activities that had not been previously disclosed to the firm, or if he had any additional outside business activities to disclose that were not previously disclosed. The representative falsely answered "no" to these questions as well. The representative's false responses on the compliance questionnaires violated FINRA Rule [2010](#) (ethical standards). As a result of all of his activities, FINRA suspended the representative from associating with any firm in any capacity for nine months and fined him \$15,000.

Purchasing Shares in an Initial Public Offering While Registered With a Firm

- ▶ FINRA settled a matter involving a registered representative who purchased shares in two initial public offerings (IPO) while registered with a firm. In November 2010, the representative purchased shares of a car company's IPO through a disclosed personal brokerage account that he maintained at another broker-dealer. The representative sold the shares four days later, earning approximately \$1,000 in profits.

The representative engaged in similar misconduct two years later. In May 2012, the representative purchased shares of a technology company during its IPO. As he did previously, the representative purchased the shares through his disclosed personal brokerage account. The representative sold the shares at a loss four months later. The representative's purchase and sale of the car and technology companies' newly issued IPO shares violated FINRA Rule [5130](#) (restrictions on the purchase and sale of initial equity public offerings) and FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA fined the representative \$5,000 and ordered him to pay nearly \$1,000 in disgorgement.

Intentionally Inputting Inaccurate Information Into an Internal Firm System

- ▶ FINRA settled a matter involving a registered representative who intentionally input inaccurate information into an internal firm system relating to electronic trading of foreign currency exchange transactions. Between March 2013 and March 2014, the representative was responsible for entering foreign exchange currency transaction information into the firm's internal system. The firm used the system to track sales revenue and trading profits and losses for foreign currency transactions. Whenever entering information into the system, the representative was expected to accurately transfer information from the trading platform the firm used to book the transactions. The representative, however, intentionally input information that was different from what had been recorded for the original booking of hundreds of electronically traded foreign currency exchange transactions at the firm. The representative did so to inflate the amount of sales revenue attributed to his foreign exchange currency transactions.

Although the representative's entry of inaccurate information did not affect any of the firm's customers, or materially impact the firm's overall profit-and-loss statement, the representative's conduct was unethical and violated FINRA Rule [2010](#) (ethical standards). For his actions, FINRA suspended the representative from associating with any firm in any capacity for three months and fined him \$7,500.

Misappropriating Funds

- ▶ FINRA settled a matter involving a registered representative who misappropriated funds by obtaining double payment on three firm paychecks. In January and February 2015, the representative misappropriated funds by depositing three paychecks via a mobile application and also cashing the physical copies of those same checks.

The representative previously received paychecks from the firm via direct deposit to his checking account; however, in January 2015, the representative notified the firm that he had closed his checking account and wanted to receive physical paychecks going forward. The firm issued the representative physical paychecks, totaling more than \$5,000, on three dates in January and February 2015. For each paycheck, the representative first deposited the check into his checking account via a mobile application on his cellphone and then cashed the same check at a check-cashing center. Through this strategy, the representative received double payment from each of the three paychecks. Because each paycheck had already been deposited and paid, the paychecks were returned unpaid to the check-cashing centers, resulting in losses to the check-cashing centers. The representative's misappropriation of the funds violated FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA barred the representative from association with any firm in any capacity.

Misappropriating Funds and Failing to Appear for On-the-Record Testimony

- ▶ FINRA settled a matter involving a registered representative who misappropriated funds from a property owners' association, for which he served as treasurer, and failed to appear for on-the-record testimony. Beginning in 2009, the representative was the association's treasurer and served on its Board of Directors. The representative's position as treasurer afforded him access to the association's check book and bank accounts. In July 2013, while serving as treasurer, he misappropriated nearly \$20,000 by forging another association board member's name on a check made payable to the representative. By misappropriating funds from the association, the representative violated FINRA Rule [2010](#) (ethical standards).

In September 2015, FINRA staff sent the representative a request to appear for on-the-record testimony concerning his activities with the association. In a telephone call with FINRA staff, the representative, through counsel, stated that he would not appear. The representative's counsel also provided written confirmation to FINRA staff of the representative's refusal to appear. By refusing to appear for on-the-record testimony, the representative violated FINRA Rule [8210](#) (provision of information, testimony, and documents) and FINRA Rule [2010](#) (ethical standards). For misappropriating funds and failing to appear for on-the-record testimony, FINRA barred the representative from association with any firm in any capacity.

- * NASD Rule 3010(a) has been superseded by FINRA Rule [3110\(a\)](#), effective December 1, 2014.
- ** NASD Rule 3040 has been superseded by FINRA Rule [3280](#), effective September 21, 2015.
- † NASD Rule 2110 has been superseded by FINRA Rule [2010](#), effective December 15, 2008.
- ‡ NASD Rule 2330(2) has been superseded by FINRA Rule [2150\(a\)](#), effective December 14, 2009.
- § NASD Rule 3030 has been superseded by FINRA Rule [3270](#), effective December 15, 2010.
- || NASD Rule 2370 has been superseded by FINRA Rule [3240](#), effective June 14, 2010.