

# Quarterly Disciplinary Review

January 2018

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.

## Creating Fictitious Correspondence on Firm Letterhead to Conceal Inaccurate Information Provided to a Customer

- ▶ FINRA settled a matter involving a registered representative who created fictitious letters to a former customer to conceal the fact that the representative had provided the customer with inaccurate information concerning a variable annuity contract that the representative had sold to that customer. In June 2014, the representative sold the variable annuity contract to the 74-year-old customer. In May 2016, the customer contacted the representative to ask him about certain features of the variable annuity contract, including whether the variable annuity contract carried a principal protection feature.

The representative knew or should have known that he had provided inaccurate information to the customer when he sold the variable annuity contract to the customer. Specifically, the representative knew that he had told the customer that the variable annuity contract offered both a principal protection feature and a guaranteed annual interest rate of 7 percent, neither of which were actual attributes of the variable annuity contract the customer had purchased.

Instead of informing the customer of the inaccurate information he had previously provided, the representative took steps to conceal his error. On two occasions, in June 2016 and September 2016, respectively, the representative used his member firm's letterhead to create two fictitious letters to the customer. The correspondence purported to show that the representative's member firm had investigated the insurance company that issued the variable annuity contract for unscrupulous and unfair sales practices. The second letter falsely stated that the representative's member firm had discovered numerous instances where the variable annuity contract issuer had provided false information to registered representatives. The representative sent the correspondence to the customer in an effort to conceal his earlier misstatements to the customer.



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The representative's creation of the fictitious correspondence to conceal his misstatements to the customer violated FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA barred the representative from association with any FINRA member in any capacity.

### Providing Firm Login Credentials to an Unauthorized Person and Making a False Statement During a Branch Audit

- ▶ FINRA settled a matter involving a registered representative who improperly provided an unauthorized individual with his login credentials, and, subsequently, made a false statement to a firm branch examiner concerning his sharing of the login credentials. At all relevant times, the representative's member firm maintained procedures that required associated persons to protect the firm's confidential customer information. Such confidential information included the customer's date of birth, Social Security number, net worth, financial account number and account balances. In order to protect the member firm's confidential customer information, the firm's procedures made clear that password sharing was strictly prohibited.

In June 2014, the representative provided an unauthorized individual, who was associated with a different FINRA member firm, with his computer login and password. This allowed that unauthorized person to access non-public personal customer information from the representative's member firm. Specifically, the unauthorized individual was able to access the date of birth, Social Security number, net worth, financial account number and account balances for each of the representative's 48 customers. The representative's member firm was unaware that the representative had provided his login credentials to an unauthorized individual. By improperly sharing his login and password information with an unauthorized individual, the representative provided that person with access to non-public personal customer information from the member firm, thus violating FINRA Rule [2010](#) (ethical standards).

During a 2015 branch audit, the representative also made a false statement to a branch examiner concerning his sharing of his login credentials. Specifically, when the member firm's branch examiner asked the representative if he had shared his login or password with another person, the representative answered "no," which was not true. The representative's false statement to the branch examiner violated FINRA Rule [2010](#) (ethical standards). For his misconduct, FINRA suspended the representative from associating with any FINRA member in any capacity for 45 business days and fined him \$10,000.

## Soliciting Loans From Customers, Making Misrepresentations on the Member Firm's Annual Certifications, and Failing to Disclose Outside Business Activities

- FINRA settled a matter involving a registered representative who accepted loans from customers, made misrepresentations on his member firm's annual certifications, and failed to disclose his outside business activities. In October 2013, the representative solicited a 71-year-old, unsophisticated customer for a \$20,000 loan. The customer did not have the funds for the loan readily available, so the representative assisted the customer in obtaining an early withdrawal from her annuity policy. The early withdrawal caused the customer to incur surrender charges and tax penalties totaling approximately \$4,400. The representative provided the customer with a note stating that the loan would be repaid over a 24-month period with interest rates ranging from 5 percent to 20 percent, depending on the duration of the term of the loan. The representative did not repay the loan.

In October 2013, the same month he borrowed funds from the first customer, the representative solicited a second customer for a loan. In this instance, the customer was 76 years old. The representative asked the customer to loan him \$10,000. The customer agreed and gave the representative a personal check for \$10,000. The representative prepared a loan document calling for the loan to be repaid in six months at an interest rate of 20 percent. Once again, the representative failed to repay the loan.

When the representative borrowed the funds from the customers, he obtained the loans in contravention of his member firm's procedures. The member firm's written procedures expressly prohibited its representatives from borrowing money or securities from customers. And the procedures did not provide any exception for borrowing arrangements between representatives and customers who, for example, were family members or friends of the representatives. By borrowing money from customers, in violation of his member firm's procedures, the representative violated FINRA Rules [3240](#) (borrowing from customers) and [2010](#) (ethical standards).

From 2013 through 2016, the representative's member firm required its representatives to complete annual certifications. The annual certifications required representatives to certify their understanding of certain prohibited practices, such as borrowing funds from customers, and that the representatives agree to abide by the member firm's procedures concerning those practices. In October 2013, one day after soliciting and accepting \$30,000 in loans from two customers, the representative certified on his annual certification for 2013 that he did not—and would not—engage in the prohibited practice of borrowing money or securities from customers. The representative's certification was not true, and he made the same false certification on the annual certifications that he completed for 2014 and 2015. The representative's false statements on his member firm's annual certifications violated FINRA Rule [2010](#) (ethical standards).

The representative also engaged in two outside business activities without disclosing them to his member firm. The first outside business activity, which occurred in 2013, involved the representative's establishment of a limited liability company. The representative served as a director and manager of the limited liability company, but he failed to disclose his activities in the limited liability company to his member firm for several years, from 2013 until the firm terminated his employment in 2016. The representative's undisclosed activities with the limited liability company violated FINRA Rules [3270](#) (outside business activities) and [2010](#) (ethical standards).

The second outside business activity involved the representative's sports officiating. Since 1969, the representative participated in a business involving sports officiating. The representative continues to participate in those activities to date. But the representative failed to disclose his participation in this outside business activity when he joined his member firm in 1992 or at any time prior to August 2008, when he reported the activity to his member firm. The Schedule C that the representative filed with his Internal Revenue Service (IRS) Form 1040 between 2013 and 2016 disclosed that the representative had earned \$1,300 to \$1,800 per year for his sports officiating activities. The representative's failure to disclose his sports officiating activities to his member firm violated NASD Rules 3030\* (from February 1992 to August 2008) and 2110† (from at least July 1996 to August 2008).

For all of these violations—soliciting loans from customers, making misrepresentations on the member firm's annual certifications, and failing to disclose outside business activities—FINRA suspended the representative from association with any FINRA member in any capacity for 18 months and fined him \$15,000.

### Improperly Using Customer Funds and Failing to Cooperate in FINRA's Investigation

- ▶ FINRA settled a matter involving a registered representative who failed to properly segregate customer funds, used customer funds to make unauthorized loans and commission payments to third parties, and failed to respond to FINRA's request for information and documents. In December 2011, a former registered representative—not the representative discussed in this settlement—solicited two individuals to invest \$25,000 in collectable medals. The representative that is the subject of the settlement sold the medals to the two customers.

The customers' investment in the medals was made through a business entity that the representative controlled, and the customers' invested funds were deposited into a bank account the representative owned and controlled. The customers intended for the representative to use the \$25,000 to purchase and store the medals for them. The representative, however, failed to provide the customers with any documentation of the sale, failed to physically separate the medals that had been purchased from his own holdings, and failed to adequately document the customers' holdings in his own records.

The representative also transferred portions of the invested funds from the customers' investment to the former registered representative who solicited the customers for the sale of the medals. The representative transferred the funds to the former registered representative as loans or commissions, but the representative failed to confirm with the customers that they had authorized the loan or commission payments. The representative's actions with the customers' invested funds constituted an improper use of customer funds and violated FINRA Rules [2150](#)(a) (improper use of customers' securities or funds) and [2010](#) (ethical standards).

Finally, the representative failed to cooperate in FINRA's investigation. In August 2017, FINRA requested that the representative provide information and documents to FINRA in connection with an investigation. The representative, through his counsel, informed FINRA that he would not provide the information or documents. The representative's failure to respond to FINRA's request for information and documents violated FINRA Rules [8210](#) (provision of information and testimony and inspection and copying of books) and [2010](#) (ethical standards). For improperly using customer funds and failing to cooperate in FINRA's investigation, FINRA barred the representative from association with any FINRA member in any capacity.

### Recommending Unsuitable Transactions to Customers

- FINRA settled a matter involving a registered representative who made unsuitable recommendations to two customers. From June 2007 to July 2011, the representative was the representative of record for a married couple while they were customers of his member firm. The couple was 72 years old and 64 years old, respectively, when they opened a joint trust account at the representative's member firm. When the representative serviced the couple's trust account, the representative communicated only with the husband.

In July 2011, the husband died. The surviving spouse, the wife, had little investment knowledge or experience, and had relied entirely on her husband to manage the couple's finances and investments prior to his death. The wife's investment objective was long-term capital appreciation, but the representative did not take any actions to assess the wife's changed circumstances after the death of her husband. Instead of speaking with the wife about her specific financial situation and needs, the representative relied on the account's prior investment objective of speculation for his investment recommendations. As a result, the representative continued to recommend short-term trading and the use of margin in the wife's account. The representative's investment recommendations were inconsistent with the wife's investment objective and risk tolerance, were unsuitable, and violated NASD Rule 2310<sup>†</sup> (suitability) and FINRA Rule [2010](#) (ethical standards).

The representative made an additional unsuitable recommendation to a second customer. The customer opened an account with the representative in 2008. The customer had minimal investing experience and wanted to identify investment opportunities that were not volatile and involved a limited amount of risk. From June 2009 to May 2010, the representative recommended that the customer purchase non-traditional exchange-traded funds (ETFs).

Although the prospectuses for the ETFs warned that the products were intended to be used as short-term trading vehicles for investors who sought “investment results for a single day only,” the ETFs remained in the customer’s account until June 2012, when the customer transferred the account from the representative’s member firm. The representative’s recommendation that the customer purchase non-traditional ETFs as long-term investments was inconsistent with the customer’s investment objective and risk tolerance, was unsuitable, and violated NASD Rule 2310<sup>†</sup> (suitability) and FINRA Rule [2010](#) (ethical standards). For making unsuitable recommendations to the two customers, FINRA suspended the representative from association with any FINRA member firm in any capacity for four months and fined him \$5,000.

### Causing Member Firm to Maintain Inaccurate Books and Records

- ▶ FINRA settled a matter involving a registered representative who negligently made, and caused his firm to maintain, inaccurate books and records with respect to 48 transactions. Between December 2012 and January 2015, the representative negligently caused his firm to maintain inaccurate records with respect to 48 transactions in which a customer liquidated a prospectus product. Prospectus products included open-end mutual funds, unit investment trusts, variable products, traded and non-traded real estate investment trusts, and structured products.

The representative’s member firm required that the representative submit an “Investment Switch/Exchange Disclosure Form” to liquidate prospectus products. The switch forms were maintained in the member firm’s records. The switch forms required that the representative include a narrative evaluation of the net investment advantage of the transaction to the customer. The switch forms reflected occasions where the representative’s customers exchanged products in different asset categories based on major market events and longer-term forecasts. The switch forms also required that the representative identify the total amount of new or additional sales charges, transfer fees, and other costs associated with the purchase of the new investment, in addition to the surrender charges, redemption fees and other costs associated with the liquidated investment. The representative caused 48 of the switch forms that he submitted to his member firm to contain inaccurate information about transaction costs. This generally occurred for one of three reasons:

- First, rather than rely on the prospectus to obtain the sales charge amount, and calculate the applicable rollover discount, the representative relied on unreliable methods, including rules of thumb, informal conversations with wholesalers and mistaken assumptions to prepare the switch forms. As a result, the representative incorrectly stated an erroneous sales charge on 46 switch forms.
- Second, on two occasions, the representative used a placeholder sales charge figure on the switch forms, but the representative neglected to correct the placeholder before submitting the form to his member firm. As a result, the representative incorrectly stated the sales charges on those two switch forms.
- Third, on 12 occasions, the representative failed to correctly account for deferred sales charges incurred on the products being liquidated. Prior to these transactions, the representative would query his firm's account view system to obtain the liquidation value of the product and compare it to the portfolio value provided by an outside service. If the two values were identical, the representative assumed there were no remaining deferred sales charges. This method proved inaccurate because the representative mistakenly queried portfolio values from his member firm's system, comparing them to the same portfolio values provided by the outside service. As a result, the representative incorrectly calculated that there were no remaining deferred sales charges on 12 switch forms.

The representative's inaccurate reporting on the switch forms violated FINRA Rules [4511](#) (books and records) and [2010](#) (ethical standards) because it caused his member firm to maintain inaccurate books and records. For this misconduct, FINRA suspended the representative from associating with any FINRA member firm in any capacity for 45 calendar days and fined him \$10,000.

### Maintaining and Using Pre-Signed and Altered Forms

- FINRA settled a matter involving a registered representative who maintained and utilized pre-signed and altered forms. Between May of 2012 and August 2015, the representative had three customers sign blank forms. The representative then made photocopies of the signed blank forms to effect transactions that the customers may later authorize. On a separate occasion, the representative, with the customer's authorization, submitted an altered, pre-signed form on which correction fluid had been used to correct an inaccurate bank account number.

By maintaining and using pre-signed and altered forms to conduct his member firm's business, the representative violated FINRA Rule [2010](#) (ethical standards), and caused his member firm to have inaccurate books and records, in violation of FINRA Rules [4511](#) (books and records) and [2010](#) (ethical standards). For this misconduct, FINRA imposed suspended the representative from association with any member firm in any capacity for three months and fined him \$5,000.

### Sharing Commissions With an Unregistered Person

- ▶ FINRA settled a matter involving a registered representative who shared his firm-paid commissions with an unregistered person. In January 2013, the representative entered into a referral marketing agreement with an individual who operated a retirement planning and investment management company. The individual was not associated with any FINRA member firm.

Under the terms of the referral marketing agreement, the unregistered person referred investors interested in alternative investments to the representative. Between January 2013 and June 2014, the representative paid the unregistered person approximately \$38,500 of his commissions that were generated by securities transactions resulting from these referrals. By sharing his commissions with an unregistered person, the representative violated NASD Rule 2420§ (dealing with non-members) and FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA imposed a censure and a \$12,500 fine.

### Purchasing Securities While in Knowing Possession of Material Nonpublic Information

- ▶ FINRA settled a matter with a registered representative who used an undisclosed outside brokerage account to purchase an issuer's securities while in possession of material, nonpublic information concerning the subject issuer. The subject issuer was a customer of the representative's member firm. In March 2017, while providing financial advisory services to the issuer, the representative obtained material, nonpublic information. The representative learned that the issuer was negotiating certain agreements that would permit another company to purchase a large equity stake in the issuer at a premium over the then-current market price for the issuer's shares. On March 20, 2017, while in possession of this information, the representative purchased call options to give him the right to buy shares of the issuer's stock.



The issuer publicly announced the equity purchase agreements with the other company about nine days later. Thereafter, the market price of the issuer's stock increased by more than 8 percent, and the representative exercised his options and closed out his position at a profit. The representative's purchase of the issuer's securities, while in possession of material, nonpublic information concerning the issuer, willfully violated Section 10(b) of the [Securities Exchange Act of 1934](#) (Exchange Act) (manipulative and deceptive devices), Exchange Act Rule 10b-5 (employment of manipulative and deceptive devices), and FINRA Rules [2020](#) (use of manipulative, deceptive or other fraudulent devices) and [2010](#) (ethical standards).

The representative's purchase of the issuer's securities and exercise of the call options also violated FINRA's rules in a second way. The representative traded the issuer's securities and options using a brokerage account that he held away from his member firm. The representative did not notify his member firm of the outside brokerage account or his trading in the account, and he did not notify the broker-dealer that maintained the outside brokerage account of his association with a FINRA member firm. The representative's failure to notify his member firm of his outside brokerage account, and failure to inform the other broker-dealer of his FINRA member firm affiliation, violated NASD Rule 3050<sup>‡</sup> (transactions for or by associated persons) and FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA barred the representative from association with any FINRA member in any capacity. The representative is also subject to statutory disqualification based on his willful violation of the Exchange Act.

\* NASD Rule 3030 has been superseded by FINRA Rule [3270](#), effective December 15, 2010.

† NASD Rule 2110 has been superseded by FINRA Rule [2010](#), effective December 15, 2008.

‡ NASD Rule 2310 has been superseded by FINRA Rule [2111](#), effective July 9, 2012.

§ NASD Rule 2420 has been superseded by FINRA Rule [2040](#), effective August 24, 2015.

‡ NASD Rule 3050 has been superseded by FINRA Rule [3210](#), effective April 3, 2017.