

# Quarterly Disciplinary Review

July 2015

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 SEC decisions in FINRA cases). These summaries call attention to, and remind registered representatives and member 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.

## Borrowing From Customers, Engaging in Undisclosed Outside Business Activities, Submitting False Compliance Questionnaires and Disclosures, and Failing to Respond to a Request for Information and Documents

▶ FINRA settled a matter involving a registered representative who borrowed funds from customers, engaged in outside business activities without notifying the firm, submitted false compliance questionnaires and disclosures to the firm, and failed to respond to FINRA's request for information and documents. Between May 2009 and November 2012, the representative borrowed \$2.25 million from seven customers of his firm to purchase real estate in Hawaii and construct a rental property on the premises. All of the seven lenders were his customers at the time he borrowed the funds. The representative's firm had written procedures in place that prohibited representatives from borrowing funds from customers, with certain exceptions, which were not applicable to the circumstances surrounding the representative's loans. The representative's borrowing of funds from customers violated NASD Rule 2370\* (borrowing from or lending to customers), and FINRA Rules [3240](#) (borrowing from or lending to customers) and [2010](#) (ethical standards).

In May 2009, the representative purchased real estate in Hawaii, which he developed into a rental property and opened for business in May 2012. He was the sole owner and operator of the property and related real estate business. The representative failed to notify the firm of this outside business in violation of NASD Rule 3030† (outside business activities), and FINRA Rules [3270](#) (outside business activities) and [2010](#) (ethical standards).

Between 2009 and 2014, the representative submitted five compliance questionnaires to the firm. The questionnaires falsely stated that he did not borrow funds from any customer, and the questionnaires did not disclose his real estate or rental property businesses in response to specific questions related to outside business activities. During this same period, the representative also submitted false disclosures to the firm. The disclosures concerned two of

the seven loans related to the real estate investment and rental property construction in Hawaii. The disclosures falsely stated that the representative acquired the two loans to construct his personal residence, and the disclosures falsely represented that the representative did not own any interest in a rental property. By submitting false compliance questionnaires and disclosures to the firm, the representative violated FINRA Rule [2010](#) (ethical standards).

Finally, in February 2015, the representative failed to respond to FINRA's request for information and documents. The representative acknowledged receipt of FINRA's request, but stated that he would not provide FINRA with the requested information and documents or cooperate further with FINRA's investigation. His failure to provide the requested information and documents violated FINRA Rules [8210](#) (provision of information, testimony, and documents) and [2010](#) (ethical standards). FINRA barred the representative in all capacities in response to all of his violations.

### Making Unsuitable Recommendations and Improperly Permitting the Execution of Options Transactions

- ▶ FINRA settled a matter involving a registered representative who made recommendations of non-traditional exchange-traded funds (ETFs) to customers without having reasonable grounds to believe the recommendations were suitable, and improperly permitted the execution of options transactions in the account of a customer who was not approved for options activity.

Between October 2010 and October 2012, the representative recommended and executed purchase transactions of leveraged and inverse-leveraged ETFs in five customers' accounts. Although the ETFs were designed to achieve their objectives over the course of a single day only, the customers held the ETFs for much longer periods. In several instances, the ETFs remained in the customers' accounts for nearly two years, with an average holding period of more than nine months. The extended holding periods demonstrated that the representative failed to appreciate the nature of the ETFs at the time he recommended them. Specifically, the representative did not know that the ETFs were not designed to achieve their objectives for extended holding periods, and the representative did not have reasonable grounds to believe the recommendation of the ETFs to the five customers was suitable. The representative's unsuitable recommendations violated NASD Rule 2310<sup>†</sup> (suitability), and FINRA Rules [2111](#) (suitability) and [2010](#) (ethical standards).

During the same period, the representative was the only appropriately registered principal at the firm responsible for reviewing and approving options transactions. Between January 2011 and May 2012, the representative reviewed and approved 42 purchases and sales of options contracts another registered representative had effected, despite the fact that the customer account at issue was never approved for options transactions of any kind. Thus, the representative had violated FINRA Rules [2360](#) (options) and [2010](#) (ethical standards). For all of these violations, FINRA suspended the representative from association with all FINRA members in all capacities for 45 days, imposed a consecutive suspension from association with all FINRA members in all principal capacities for 30 days, and fined the representative \$15,000.

## Falsifying a Letter to a Prospective Customer, Forging a Colleague's Signature, and Improperly Using a Personal Email Account to Communicate With a Customer

- ▶ FINRA settled a matter involving a registered representative who falsified a letter, improperly affixed another firm employee's signature to the falsified letter, and improperly used his personal email account to transmit the falsified letter to a prospective customer. In March 2013, the representative requested that the firm's legal department prepare a "certificate letter" describing a potential investment in an offshore mutual fund to a prospective customer. The firm's legal department sent the certificate letter to the representative so he could transmit it to the customer. Rather than forward the certificate letter to the customer as the firm's legal department had prepared it, the representative added false information to it. Specifically, he added a statement to the certificate letter to report that no investor held more than 10 percent of the offshore mutual fund's assets.

When the representative added the statement to the certificate letter, he knew it was inaccurate. The firm previously denied the representative's request to include the statement because the firm knew that at least one shareholder held more than 10 percent of the offshore mutual fund's shares. Despite this fact, the representative added the false statement to the certificate letter to the prospective customer because he knew that the customer was only interested in investing in the mutual fund if no single investor owned more than 10 percent of its assets.

The representative not only added the false statement to the certificate letter to the prospective customer, he also affixed another employee's signature to the falsified certificate letter without that employee's knowledge, authorization or consent, and then transmitted the certificate letter to the prospective customer from his personal email account rather than the firm-issued email account.

By falsifying the certificate letter and forging another employee's signature on the letter, the representative violated FINRA Rule [2010](#) (ethical standards). The representative's falsification of the certificate letter and transmission of the letter by personal email to the prospective customer also caused his firm to maintain inaccurate books and records, and violated FINRA Rules [4511](#) (books and records) and [2010](#) (ethical standards). For this misconduct, FINRA barred the representative in all capacities.

## Engaging in Undisclosed Outside Business Activities and Willfully Failing to Disclose a State Tax Lien on a Form U4

- ▶ FINRA settled a matter involving a registered representative who engaged in undisclosed outside business activities and willfully failed to disclose a state tax lien on the Uniform Application for Securities Industry Registration (Form U4). In October 2009, the representative became a partner in an outside business that raised capital and debt for start-ups and existing businesses. The representative did not disclose his association with the capital-raising company to his firm when he joined the company as a partner in October 2009.

One year later, in October 2010, the representative provided the firm with a written request to participate in the capital-raising company as an outside business activity, but he stated that his involvement in the company would be limited to accounting and insurance services provided to prospective customers. Based on this representation, the firm approved the request in October 2010. In September 2011, the firm discovered that the representative was identified as a partner on the capital-raising company's website and determined the true nature of his outside business activities. The representative's involvement in the undisclosed outside business activities, and inaccurate depiction of the nature of the business when he requested the firm's approval of the activities, violated NASD Rule 3030<sup>+</sup> (outside business activities), and FINRA Rules [3270](#) (outside business activities) and [2010](#) (ethical standards).

The representative also failed to disclose that New York had subjected him to a state tax lien in January 2011 for \$564. The representative did not update the Form U4 to disclose the state tax lien, and consequently, willfully violated [Article V, Section 2 of FINRA's By-laws](#) (application for registration), and FINRA Rules [1122](#) (filing misleading information as to registration) and [2010](#) (ethical standards). For all of these violations, FINRA suspended the representative in all capacities for six months and fined him \$10,000. The representative is also statutorily disqualified.

### Failing to Respond to FINRA's Request for Information and Documents

- ▶ FINRA settled a matter involving a registered representative who failed to respond to FINRA's request for information and documents. In October 2014, FINRA initiated an investigation of the representative to determine whether he exceeded the scope of an approved outside business activity, engaged in an unapproved private securities transactions and failed to timely disclose several reportable financial events. FINRA staff asked the representative to provide information and documents in connection with the investigation. FINRA requested that the representative provide the information and documents on or before November 14, 2014.

Two weeks after the deadline, on December 2, 2014, the representative, through legal counsel, requested an extension of time to respond. FINRA staff granted the extension and gave the representative until December 16, 2014, to provide the response. The representative did not respond to FINRA's request by the extended deadline. Instead, the representative, through counsel, informed FINRA staff that he would not provide the requested information and documents at any time. The representative's failure to respond to FINRA's request for information and documents violated FINRA Rules [8210](#) (provision of information, testimony and documents) and [2010](#) (ethical standards). As a result, FINRA barred the representative in all capacities.

### Mismarking Solicited Order Tickets as Unsolicited

- ▶ FINRA settled a matter involving a registered representative who mismarked solicited order tickets as “unsolicited.” Between October 2009 and January 2013, the representative executed more than 8,000 trades. Although the representative solicited customers to execute the transactions, he marked the order tickets for approximately 76 percent of the 8,000 trades as unsolicited. The representative apparently mismarked the order tickets for the trades as unsolicited based on a mistaken belief that a trade was not solicited if he presented a customer with multiple trading ideas, and the customer made the ultimate decision as to which trades to execute.

By mismarking the order tickets for thousands of solicited trades as unsolicited, the representative caused his firm’s books and records to be inaccurate, in violation of NASD Rule 3110(a)<sup>5</sup> (books and records), and FINRA Rules [4511](#) (books and records) and [2010](#). For this misconduct, FINRA suspended the representative from association with any FINRA member firm in any capacity for 90 calendar days and fined him \$10,000.

### Check Kiting

- ▶ FINRA settled a matter involving an associated person who engaged in check kiting. Check kiting involves depositing checks with insufficient funds to cover them. Between April 2013 and May 2013, the associated person deposited three checks, totaling \$523, into his personal checking account. Following the deposit of the checks, he immediately withdrew \$523 from the account. The associated person knew the account was overdrawn and did not have sufficient funds to cover the checks that he had issued from the account. The three checks were later returned for insufficient funds because the account was overdrawn at the time each check was deposited.

The associated person’s actions clearly demonstrated check kiting, which violates FINRA Rule [2010](#) (ethical standards). For this misconduct, FINRA suspended the associated person from association with any FINRA member in any capacity for three months and fined him \$5,000.

### Executing Unauthorized Transactions in Municipal Securities Accounts

- ▶ FINRA settled a matter involving a registered representative who executed unauthorized transactions in municipal securities accounts. Between October 2012 and December 2012, the representative executed 15 unauthorized transactions in nine customers’ accounts by purchasing \$1 million of government bonds without the customers’ knowledge or consent. The representative earned nearly \$7,000 in commissions for the unauthorized transactions.

By executing unauthorized transactions in customer accounts, the representative violated [Municipal Securities Rulemaking Board \(MSRB\) Rule G-17](#) (conduct of municipal securities and municipal advisory activities), which requires that brokers, dealers, municipal securities dealers, and municipal advisors deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice. As a result, FINRA suspended the representative from associating with any FINRA member firm in any and all capacities for 18 months, fined him \$10,000 and ordered him to pay disgorgement equal to the commissions earned on the unauthorized transactions, plus interest.

\* NASD Rule 2370 has been superseded by FINRA Rule [3240](#), effective June 14, 2010.

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

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

§ NASD Rule 3110(a) has been superseded by FINRA Rule [4511](#), effective December 5, 2011.