

# Quarterly Disciplinary Review

April 2012

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.

## Unsuitable Switches, Exercising Discretion Without Approval and Providing Inaccurate Information

- ▶ FINRA settled a matter involving a registered representative who recommended unsuitable investments to customers, exercised discretionary authority in customer accounts without firm approval, and provided his firm with incomplete and incorrect information regarding his customers' mutual fund and variable annuity switches.

During a two-year period, the registered representative excessively traded seven customers' mutual fund investments. The seven customers were unsophisticated, retired senior investors, ranging in age from 66 to 93 years, with annual incomes between \$30,000 and \$55,000, and had liquid net worth ranging from \$50,000 to \$556,000. During this period, the registered representative recommended to his customers approximately 484 short-term mutual fund switches that involved average holding periods of 50 to 74 days. Notwithstanding the short-term nature of the recommended trading, he also recommended that his customers purchase only class A and B mutual fund shares, which were designed for long-term investors. The registered representative also failed to explain to his customers the available cost-saving options with respect to purchasing class C shares. As a result of the registered representative's recommendations, his customers incurred \$147,546 in unnecessary costs, and the registered representative derived \$120,177 in commissions. FINRA concluded that the representative's recommendations were unsuitable and violated NASD Rules 2310\* (recommendations to customers) and 2110\*\* (ethical standards), and NASD IM-2310-2\* (fair dealing with customers).

During the same two-year period, the registered representative exercised discretion in the seven customers' accounts without having obtained the customers' prior written authority and the firm's prior approval. FINRA found that this conduct violated NASD Rules [2510](#) (discretionary accounts) and 2110\*\* (ethical standards).

During a separate five-month period, the registered representative made unsuitable variable annuity switch recommendations to three other customers. The three customers were elderly retirees with modest incomes. As a result of the registered representative's recommendations, two of the customers held their variable annuities for only nine months and the other held his variable annuity for 27 months, and the three customers together incurred \$27,168 in surrender charges. In light of the customers' financial objectives and resources, FINRA found that the registered representative's variable annuity switch recommendations were unsuitable and violated NASD Rules 2310<sup>D</sup> (recommendations to customers) and 2110\*\* (ethical standards), and NASD IM-2310-2\* (fair dealing with customers).

Additionally, the registered representative was responsible for more than 50 inaccurate mutual fund and variable annuity disclosure forms. The registered representative failed to include information on disclosure forms that he provided to his customers. For example, he failed to include information regarding front-end load charges, contingent deferred sales charges and surrender time periods. The registered representative also pre-dated customer signature lines on the disclosure forms and added fee and expense information to the forms after the customers signed them. In addition, the registered representative included inaccurate information on the disclosure forms about the reasons for the customers' variable annuity exchanges. FINRA concluded that this conduct violated NASD Rules 3110# (books and records) and 2110\*\* (ethical standards).

In light of the violations, FINRA suspended the representative in all capacities for two years, ordered that he requalify as a Series 7 registered representative, fined him \$25,000 and ordered that he pay restitution to his customers in the total amount of \$166,914 plus interest.

### Unsuitable Switches, Unauthorized Trading, Exercising Discretion Without Approval and Making False Representations

- ▶ FINRA's National Adjudicatory Council (NAC) found that a registered representative recommended to customers unsuitable mutual fund switch transactions, engaged in unauthorized trading and unapproved discretionary trading, and caused his firm's books and records to be inaccurate. The registered representative recommended unsuitable mutual fund switch transactions in 12 customers' accounts. The NAC found that the recommendations subjected the customers to fees and longer holding periods or denied them lower operating expenses. The NAC specifically found that the switch transactions caused the representative's customers to incur more than \$84,000 in contingent deferred sales charges and lose the benefits associated with holding class A shares for certain time periods. The NAC rejected the representative's argument that the recommendations were suitable because the customers agreed to them, and concluded that the representative's conduct violated NASD Rules 2310\* (recommendations to customers) and 2110\*\* (ethical standards), and NASD IM-2310-2\* (fair dealing with customers).

The NAC also found that the registered representative engaged in unauthorized trading and that he exercised discretion in customer accounts without the firm's and customers' approval. The NAC concluded that the representative engaged in numerous mutual fund switches in three customer accounts without the customers' permission. The NAC rejected the representative's argument that the customers' testimony was unreliable, and found that his conduct violated NASD Rule 2110\*\* (ethical standards) and NASD IM 2310-2\* (fair dealing with customers). The NAC further found that the registered representative exercised discretion in eight customer accounts without customer or firm approval. The NAC noted that, during the relevant period, the representative's firm prohibited registered representatives from discretionary trading. The NAC found that the representative's conduct violated NASD Rules 2110\*\* (ethical standards) and [2510](#) (discretionary accounts).

In addition, the NAC found that the representative caused his firm to make inaccurate entries in the firm's mutual fund switch log by misrepresenting the reasons for his customers' switches. The NAC further found that the registered representative falsely represented on firm records that certain mutual fund switch transactions were unsolicited when they were in fact solicited. The NAC concluded that the representative's conduct violated NASD Rules 3110# (books and records) and 2110\*\* (ethical standards).

The NAC barred the representative in all capacities for recommending unsuitable trades and imposed an additional bar for engaging in unauthorized trading.

### Trading Securities Based on Material Non-Public Information

- ▶ FINRA settled a matter involving a registered representative who improperly traded securities based on material, non-public information. The representative received material, non-public information about two issuers, and he knew when he received the information that it had been misappropriated. He nonetheless used the information when deciding to purchase and sell the securities of those issuers in accounts he controlled, and he derived illegal profits from the trades.

FINRA found that the representative's conduct violated Section 10(b) of the [Exchange Act](#) (fraud), Exchange Act Rule [10b-5](#) (fraud), and NASD Rules 2120† (fraud) and 2110\*\* (ethical standards). For these violations, FINRA barred the registered representative from associating with any member firm in any capacity.

### Converting Customer Funds, Providing Customers With False Account Statements and Failing to Disclose Outside Business Activities

- ▶ FINRA settled a matter involving a registered person who converted customer trust funds. The registered representative had been appointed by an individual as trustee for two trusts established to provide living expenses and medical care for the individual's disabled child. On behalf of the trusts, the registered representative established several

checking accounts, opened a brokerage account at his firm in the name of one trust, and acquired three life insurance policies on behalf of the other trust. He served as representative of record for the brokerage account and agent of record for the life insurance policies.

During a nine-year period, the registered representative wrongfully and without authorization disbursed funds to himself from one trust's checking accounts and brokerage account, and he used those funds for his own benefit. During a six-year period, the registered representative wrongfully and without authorization disbursed funds to himself from the second trust's three life insurance policies, and he used the funds for his own benefit. FINRA concluded that the representative's conduct constituted conversion of funds and violated FINRA Rule [2010](#) (ethical standards), and NASD Rules 2330(a) † and 2110\*\* (ethical standards).

FINRA further found that the representative provided the parents of the disabled child for whom the trusts were established with fabricated account statements and correspondence that grossly overstated the value of the trusts' assets. For example, the representative reported that one trust held assets of more than \$585,000 when in fact it held assets of approximately \$180. FINRA concluded that the representative's conduct violated FINRA Rule [2010](#) (ethical standards) and NASD Rule 2110\*\* (ethical standards). FINRA also found that, for a period of approximately 10 years, the representative failed to provide written notice to his firm that he served as trustee to the two trusts and that he had received compensation of approximately \$2,000 per year for serving as trustee. FINRA further found that the representative had falsely answered "no" on firm questionnaires that specifically asked whether he received compensation from any outside sources. FINRA concluded that the representative's activities violated NASD Rules 3030<sup>§</sup> (outside business activities) and 2110\*\* (ethical standards), and FINRA Rule [2010](#) (ethical standards).

In light of the foregoing, FINRA barred the representative from associating with any member firm in any capacity.

### Misusing Non-Customer Funds, Failing to Respond to FINRA Information Requests and Failing to Disclose Liens

- ▶ FINRA settled a matter involving a registered representative who, during a period of five years, misappropriated two individuals' funds for his own use. One individual tendered a check for \$175,000 to the registered representative to open a brokerage account. The representative never opened the account and instead deposited the check into his personal bank account. In order to conceal his misconduct, the registered representative sent the individual fabricated account statements and made regular cash distributions to the individual. The individual later gifted the brokerage account that he believed he had funded to another individual. The registered representative continued

to misappropriate funds and provided the second individual with similar fabricated account statements. FINRA concluded that the representative's conduct violated NASD Rule 2110\*\* (ethical standards). FINRA sent a Rule 8210 request for information to the registered person to inquire into his possible misappropriation of customer and non-customer funds. After FINRA granted the representative two extensions of time, the representative refused to respond to FINRA's requests. FINRA found that the registered representative violated FINRA Rules [8210](#) (requests for information) and [2010](#) (ethical standards).

In addition, FINRA found that the representative failed to disclose a tax lien and a judgment lien. In September 2007, the United States Internal Revenue Service filed a tax lien of approximately \$93,000 against the representative, which remained unsatisfied. In May 2008, the representative answered "no" on the Form U4 to the question of whether he had any unsatisfied judgments or liens against him. Similarly, in February 2008, a state court entered a \$300 judgment against the representative, and in August 2008, the court issued a judgment lien against the representative. While the judgment remained unsatisfied, the representative never amended his Form U4 to disclose the lien. FINRA concluded that the registered representative's conduct violated NASD Rule 2110\*\* (ethical standards), IM-1000-1¥ (misleading membership and registration information), and FINRA Rules [1122](#) (misleading membership and registration information) and [2010](#) (ethical standards).

In light of the foregoing violations, FINRA barred the registered representative from associating with any member firm in any capacity.

### Private Securities Transactions

- ▶ FINRA settled a matter involving a registered representative who engaged in private securities transactions without obtaining prior firm approval. The representative referred 14 individuals, some of whom were his clients, to an unrelated entity, which initially claimed to offer foreign exchange opportunities, but later claimed to offer investments in a hedge fund. The individuals invested a total of \$750,000, and the entity promised returns of 12 percent per year for two years. The representative received \$8,600 for the referrals. FINRA concluded that the proposed investments were securities and that the representative failed to provide his firm with prior written notice and obtain the firm's prior approval. FINRA concluded that the representative's conduct violated NASD Rules 2110\*\* (ethical standards) and [3040](#) (private securities transactions). As such, FINRA suspended the registered representative in all capacities for 18 months and fined him \$15,000.

## Engaging in Private Securities Transactions and Improperly Borrowing Money From a Customer

- ▶ FINRA settled a matter involving a registered representative who engaged in private securities transactions without firm approval and improperly borrowed funds from a customer. During a two-year period, the representative sold \$1,712,500 in notes and debentures, both of which were securities, to 32 customers through private placements away from his firm. The representative received \$171,000 in commissions for the sales. The representative failed to provide his firm with prior written notice and obtain the firm's prior written approval. FINRA concluded that the representative's conduct violated NASD Rules 2110\*\* (ethical standards) and [3040](#) (private securities transactions).

In November 2008, the same representative borrowed \$10,000 from one customer and \$5,000 from another. He executed a promissory note for repayment of the \$10,000 loan but failed to abide by the terms of the note. After the lending customer filed an action against the representative in May 2011, the representative repaid the note with interest. The representative never documented the \$5,000 loan in writing and did not have terms for repayment. He repaid the \$5,000 loan in May 2011. The representative did not disclose either loan to this member firm, and the firm's policies prohibited loans from customers without prior firm approval. FINRA concluded that the representative's conduct violated NASD Rules 2370<sup>Ω</sup> (borrowing from or lending to customers) and 2110\*\* (ethical standards).

FINRA suspended the registered representative from associating with any member firm in any capacity for two years and fined him \$181,000.

\* NASD Rule 2310 and IM-2310-2 are superseded by FINRA Rule [2111](#), effective July 9, 2012.

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

# NASD Rule 3110(a) has been superseded by FINRA Rule [4511](#), effective December 5, 2011. NASD Rule 3110(c) has been superseded by FINRA Rule [4512](#), effective December 5, 2011. NASD Rule 3110(d) and (e) have been superseded by FINRA Rule [4513](#), effective December 5, 2011. NASD Rule 3110(f) has been superseded by FINRA Rule [2268](#), effective December 5, 2011. NASD Rule 3110(g) has been superseded by FINRA Rule [4514](#), effective December 5, 2011. NASD Rule 3110(h) has been superseded by FINRA Rule [7440](#), effective December 5, 2011. NASD Rule 3110(j) has been superseded by FINRA Rule [4515](#), effective December 5, 2011.

† NASD Rule 2120 has been superseded by FINRA Rule [2020](#), effective December 15, 2008.

† NASD Rule 2330(a), (e) and (f) has been superseded by FINRA Rule [2150](#), effective December 14, 2009.

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

¥ IM 1000-1 has been superseded by FINRA Rule [1122](#), effective August 17, 2009.

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