BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Glenn Robert King, Marlboro, NJ, Respondent.	DECISION Complaint No. 2015044444801 Dated: July 20, 2017

Respondent excessively traded customer accounts and exercised discretion in customer accounts without written consent or approval. There is insufficient evidence to prove by a preponderance of the evidence that the respondent made fraudulent misrepresentations or omissions when he sold unit investment trusts to customers, or that he engaged in the unsuitable short-term trading of unit investment trusts and closed-end funds. Held, findings affirmed in part and reversed in part, sanctions affirmed in part and vacated in part.

Appearances

For the Complainant: Michael J. Newman, Esq., Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Pro Se

Decision

Glenn Robert King appeals a FINRA Hearing Officer's default decision issued on June 9, 2016. The Hearing Officer found that King: (1) willfully misrepresented and omitted material facts when he sold 44 unit investment trusts ("UITs") to seven customers (cause one); (2) excessively traded the accounts of four customers when he traded the customers' UITs and closed-end funds ("CEFs") on a short-term basis (quantitative suitability) (cause two); (3) made unsuitable recommendations to the same four customers when he recommended that they purchase UITs and CEFs as short-term trading vehicles (qualitative suitability) (cause three); and (4) exercised discretion in the accounts of the four customers without written consent or approval (cause four). The Hearing Officer barred King for the fraud and imposed an additional bar on him for the suitability violations. In light of the bars, the Hearing Officer declined to impose sanctions on King for the improper exercise of discretion.

After an independent review of the record, we affirm the Hearing Officer's findings of liability for the excessive trading (cause two) and improper exercise of discretion in customer accounts (cause four), but we reverse the Hearing Officer's findings of liability related to the fraud (cause one) and unsuitable recommendations (cause three). For sanctions, we bar King for the excessive trading. In light of this bar, we decline to impose sanctions on King for his improper discretionary trading. Because we have reversed the Hearing Officer's findings of liability for the fraud and unsuitable recommendations, we vacate the sanctions that the Hearing Officer imposed on King for these causes of action.

I. King's Background

In February 1992, King registered with FINRA when he associated with a member firm as a general securities representative. King has been registered almost continuously since his initial registration. During the periods relevant to the conduct in this case, April 2008 to March 2011 and January 2013 to December 2014, King was registered with Royal Alliance Associates, Inc. ("Royal Alliance") and Buckman, Buckman & Reid, Inc. ("Buckman Reid"), respectively. King joined Royal Alliance as a general securities representative in January 2005. He voluntarily terminated his association with the firm in June 2011. In January 2012, King registered with Buckman Reid as general securities representative. King voluntarily left Buckman Reid in June 2015. King has not registered with another FINRA member firm since he terminated his association with Buckman Reid.

II. Discussion

A. King Defaulted and Failed to Show Good Cause for His Failure to Participate in the Proceedings Below

The Hearing Officer determined that King defaulted. Consequently, as a threshold matter, we examine whether the Hearing Officer's entry of default against King was in accordance with FINRA's rules, and whether King has demonstrated good cause for his failure to participate in the proceedings before the Hearing Officer. On appeal, we affirm the Hearing Officer's entry of default against King, and we find that King has failed to demonstrate good cause for failing to participate in the proceedings before the Hearing Officer.[1]

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[1] When a respondent fails to demonstrate good cause for failing to participate in the proceedings before the Hearing Officer, we consider this matter on the basis of the written record, including the parties' briefs and any supplementary evidence that Enforcement may submit. *See Dep't of Enforcement v. Merhi*, Complaint No. E072004044201, 2007 NASD Discip. LEXIS 9, at *14 (NASD NAC Feb. 16, 2007). Under FINRA Rule 9344(a), we consider an appeal of a default decision on the basis of the record and other documents permitted under FINRA Rules 9346 and 9347, without the opportunity for oral argument, unless the respondent demonstrates good cause for failing to participate in the proceedings below.

1. Enforcement's First and Second Notices of the Complaint and King's Non-Compliant Response

FINRA's Department of Enforcement ("Enforcement") began investigating King after several of his customers at Royal Alliance filed written complaints against him based on his sales of UITs to them. When King joined Buckman Reid, Enforcement expanded its investigation. Enforcement's investigation focused on King's sales of UITs at Royal Alliance, his sales of UITs at Buckman Reid, and his sales of other long-term investment products, such as CEFs, at Buckman Reid. Enforcement's investigation led to the filing of the complaint against King.

Enforcement filed a four-count complaint against King in November 2015. Enforcement sent the complaint and first notice of complaint to King via certified and first-class mail to King's residential address in Marlboro, New Jersey, as listed in FINRA's Central Registration Depository, or "CRD"® ("CRD Address"). The United States Postal Service ("USPS") made three unsuccessful attempts to deliver the certified mailing to King. The USPS returned the certified mailing to FINRA with the notation, "Return to Sender, Unable to Forward," in January 2016. The first-class mailing of the complaint and first notice of complaint were not returned.

King's answer to the complaint was due on December 11, 2015. King did not file an answer or otherwise respond to the complaint. Consequently, on December 15, 2015, Enforcement served King with a second notice of complaint. Enforcement served King with the complaint, first notice of complaint, and second notice of complaint via certified and first-class mail at his CRD Address. The USPS made three unsuccessful attempts to deliver the certified mailing and returned it to FINRA as unclaimed in February 2016. The first-class mailing was not returned.

King's answer to the second notice of complaint was due on January 4, 2016, and, on that date, King submitted a one-paragraph, handwritten facsimile to Enforcement. King did not file the facsimile with the Office of Hearing Officers. He sent it only to Enforcement. Enforcement forwarded the document to the Hearing Officer. King's facsimile stated in its entirety:

> I gave answers to these clients listed here in person. All clients [sic] actions were done with permission and in (person most times). This letter does not mention any market conditions that was [sic] cause for rebalancing in these markets and conditions. Numbers do not reflect all the income they earned by buying income products, mutual funds, UITs, preferred stocks.

2. The Hearing Officer's First Order for a Compliant Answer to the Complaint

On January 5, 2016, the Hearing Officer issued an order directing King to file an answer that complied with the requirements of FINRA Rule 9215.[2] The order stated, "King's facsimile

[2] FINRA Rule 9215 states that, "an answer shall specifically admit, deny, or state that the [r]espondent does not have and is unable to obtain sufficient information to admit or deny, each allegation in the complaint," and that an answer should assert any affirmative defense on which the respondent intends to rely.

did not conform to the requirements of FINRA Rule 9215 for the form, content, and service of an [a]nswer in a FINRA disciplinary proceeding." The order specified, "[t]he facsimile that King submitted to Enforcement as his response contained a narrative that d[id] not specifically address the allegations in the [c]omplaint." Consequently, the order directed King to file a compliant answer that "contain[ed] numbered paragraphs corresponding to each [of the 138] numbered paragraph[s] in the [c]omplaint." The order added that King's answer should "be typewritten or printed in . . . typeface, and be plainly legible," and it required King to file a compliant answer with Enforcement and the Office of Hearing Officers, in accordance with FINRA's rules, on or before January 26, 2016. The order cautioned that King could be deemed in default if he failed to file an answer that complied with the requirements of FINRA Rule 9215 by the due date.

3. The Hearing Officer's Second Order for a Compliant Answer to the Complaint

On January 11, 2016, Enforcement received a two-page, typewritten facsimile from King. King did not file the document with the Office of Hearing Officers. Enforcement forwarded the facsimile to the Hearing Officer. The Hearing Officer determined that King's second facsimile, although typewritten, failed to satisfy the requirements of FINRA Rule 9215. On January 14, 2016, the Hearing Officer issued a second order directing King to file and serve a compliant answer. The Hearing Officer stated:

> Once again, King did not file the facsimile with the Office of Hearing Officers, and King's facsimile did not conform to the requirements of FINRA Rule 9215 in that it failed to include numbered paragraphs corresponding to each numbered paragraph in the [c]omplaint and did not admit, deny, or state that the [r]espondent does not have and is unable to obtain sufficient information to admit or deny [] each allegation in the [c]omplaint.

The second order for a compliant answer stressed that King should revise his submission by January 26, 2016, file it directly with the Office of Hearing Officers, and serve it on Enforcement. The second order also advised King that he could be deemed to be in default, and the allegations of the complaint would be considered admitted, if he failed to comply with the order.

4. King Fails to Attend the Hearing Officer's Mandated Pre-Hearing Conference

King filed nothing in response to the Hearing Officer's second order for a compliant answer. Accordingly, on February 2, 2016, the Hearing Officer issued an order directing Enforcement to file, and serve on King, a motion for entry of a default decision. The Hearing Officer's order stated that Enforcement should file the motion on or before March 2, 2016.

On February 12, 2016, the Office of Hearing Officers received a hand-written letter from King. King's letter, which was dated February 3, 2016, attached the two-page, typewritten facsimile that King had submitted to Enforcement on January 11, 2016. King's letter stated, "[h]ere is a copy of my response [presumably referring to the two-page, typewritten facsimile from January 11, 2016]. I sent it to FINRA . . . . I do not have a lawyer. I responded to the letter I was given. I don't understand what else I am supposed to do."

The Hearing Officer found that King's submission, which the Office of Hearing Officers received on February 12, 2016, did not comply with the requirements of an answer under FINRA Rule 9215, and the Hearing Officer refused to accept the document. Nevertheless, on February 17, 2016, the Hearing Officer stayed the prior order directing Enforcement to file a motion for entry of a default decision against King.[3] The Hearing Officer explained, "[i]n light of King's efforts to communicate with the Office of Hearing Officers . . . the Hearing Officer hereby stays the February 2, 2016 Order Governing Motion for Entry of Default Decision."

The Hearing Officer's order also scheduled a telephonic pre-hearing conference for March 8, 2016. The Hearing Officer explained that, during the pre-hearing conference, King should have a copy of the complaint available, and that he should be prepared to provide an answer of "admit, "deny," or insufficient information to admit or deny for each paragraph of the complaint. The Hearing Officer's order emphasized that, "a failure to appear at the [c]onference . . . may be deemed a default." On March 8, 2016, the Hearing Officer and Enforcement participated in the pre-hearing conference. King did not.

5. Enforcement's Motion for Entry of a Default Decision Against King

Because King failed to attend the Hearing Officer's required pre-hearing conference, on April 13, 2016, Enforcement filed a motion for entry of a default decision against King. Enforcement's motion requested that the Hearing Officer issue a default decision deeming the allegations of the complaint admitted, enter findings of liability consistent with the complaint's allegations, and impose sanctions on King for the alleged misconduct.

Enforcement supported the motion with a declaration from counsel. Enforcement counsel's declaration detailed FINRA's jurisdiction over King, summarized the evidentiary support for the allegations against King outlined in the complaint, detailed Enforcement's service of the first and second notice on King, and explained how the procedural history of the case favored finding that King defaulted.[4] King did not respond to Enforcement's motion.

6. The Hearing Officer's Default Decision Against King, and King's Appeal to the NAC

On June 9, 2016, the Hearing Officer issued the default decision that is the subject of King's appeal. The Hearing Officer found that Enforcement's service of the default motion was proper and outlined the extensive procedural history of the case. The Hearing Officer summarized, "[t]o date, [King] . . . has not filed a . . . compliant answer to the [c]omplaint." The Hearing Officer considered the allegations in the complaint admitted, barred King for the fraud (cause one), and imposed a second bar for the suitability violations (causes two and three). The

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[3] The Hearing Officer served the order on King via overnight courier and first-class mail.

[4] No independent evidence of King's alleged misconduct accompanied Enforcement's default motion or Enforcement's counsel's declaration.

Hearing Officer declined to assess sanctions against King for his improper exercise of discretion in customer accounts (cause four).

On June 20, 2016, King timely filed an appeal with us pursuant to FINRA Rule 9311. On August 8, 2016, after the Hearing Officer certified the record in this case, the subcommittee of the National Adjudicatory Council empanelled to consider King's appeal (the "NAC Subcommittee") ordered Enforcement to supplement the record pursuant to FINRA Rule 9346(f). Specifically, the NAC Subcommittee ordered Enforcement to provide evidence supporting the allegations and contentions detailed in the complaint.

FINRA Rule 9346(f) states that the NAC Subcommittee "may order that the record be supplemented with such additional evidence as it may deem relevant." Although FINRA Rule 9269(a)(2) permits a Hearing Officer to deem the allegations against a defaulting respondent admitted, the Securities and Exchange Commission ("Commission") nevertheless requires that the record contain sufficient independent evidence to support FINRA's findings and enable the Commission to discharge its statutory review functions under Section 19 of the Securities Exchange Act of 1934 ("Exchange Act"). *See, e.g.*, *David Kristian Evansen*, Exchange Act Release No. 75531, 2015 SEC LEXIS 3080, at *51 (July 27, 2015) (stating, in connection with a default decision, that "the NAC order to supplement the record demonstrated that FINRA's procedures . . . seem to have worked as intended and confirm that the NAC conducted a de novo review of the evidence and Evansen's arguments"). Enforcement filed the requested supplementary evidence.

7. King Defaulted, and, on Appeal, He Fails to Demonstrate Good Cause for Failing to Participate in the Proceedings Below

FINRA Rule 9269(a)(1) authorizes a Hearing Officer to:

> [I]ssue a default decision against a [r]espondent that fails to answer the complaint within the time afforded under [FINRA] Rule 9215, or a [p]arty that fails to appear at a pre-hearing conference held pursuant to [FINRA] Rule 9241 of which the [p]arty has due notice, or a [p]arty that fails to appear [at] any hearing that a [p]arty is required to attend under the [FINRA] Rule 9200 Series of which the [p]arty has due notice.

Enforcement twice served King with the complaint and notice of the complaint in compliance with FINRA's rules. King did not file a compliant answer, despite the Hearing Officer's issuance of two orders instructing him to do so. In addition, when the Hearing Officer scheduled a telephonic pre-hearing conference to facilitate King's participation in the disciplinary proceeding by allowing King to provide an oral "answer" to each allegation of the complaint, King failed to appear for the conference. Based on these facts, we conclude that the Hearing Officer properly exercised discretion and issued a default decision against King. *See Dep't of Enforcement v. Evansen*, Complaint No. 2010023724601, 2014 FINRA Discip. LEXIS 10, at *19-21 (FINRA NAC June 3, 2014) (finding that the Hearing Officer properly issued a default decision against the respondent when Enforcement served the respondent with the complaint in compliance with FINRA's rules, and the respondent failed to file an answer to the complaint), *aff'd*, 2015 SEC LEXIS 3080, at *51 (July 27, 2015).

The record similarly establishes that King has not demonstrated good cause for his failure to participate in the proceedings before the Hearing Officer. King ignored Enforcement's first notice of complaint. He submitted a short and unclear statement in response to the second notice of complaint. When the Hearing Officer instructed King to clarify his response to comply with FINRA's rule for the filing of an answer, King offered a two-page, typewritten response that did not directly address the allegations of the complaint. When the Hearing Officer confronted him about his non-compliant answer, King professed ignorance and requested assistance. And when the Hearing Officer offered assistance and an alternative manner for King to respond to the complaint and participate in the disciplinary proceeding, King did not appear. We therefore find that King failed to establish good cause for his failure participate in the proceedings below. *See Evansen*, 2014 FINRA Discip. LEXIS 10, at *20-21.

B. King Excessively Traded Four Customers' UITs and CEFs (Quantitative Suitability)

The Hearing Officer found that, between January 2013 and December 2014, while he was associated with Buckman Reid, King excessively traded the UITs and CEFs of four customers – LA and RA, a married couple who maintained individual and joint accounts with King at Buckman Reid, JE, and CM.[5] The Hearing Officer concluded that King's excessive trading violated FINRA's suitability rule, FINRA Rule 2111,[6] and FINRA's ethical standards rule, FINRA Rule 2010.[7] We affirm the Hearing Officer's findings of liability.

[5] The supplementary evidence that Enforcement submitted contains documentary and testimonial evidence concerning the four customers and King's trading activities in the four customers' accounts, including customer complaints filed with the Commission, FINRA, and Buckman Reid, correspondence between the customers and Buckman Reid and King, account statements, new account forms, trade blotters, trade confirmation statements, and trade review or trade exception reports. Enforcement's supplementary evidence also contains on-the-record testimony that King provided to FINRA in June 2012, February 2015, and April 2015, and testimony provided to FINRA by King's business partner in August 2012.

[6] The conduct rules that apply are those that existed at the time of the conduct at issue.

[7] A violation of FINRA's suitability rule constitutes conduct that is inconsistent with high standards of commercial honor and just and equitable principles of trade, and, consequently, violates FINRA Rule 2010. *See Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *3 n.2 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

1. FINRA Rule 2111

FINRA Rule 2111 states:

> A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile.

The supplementary material to FINRA Rule 2111 explains that the rule has three components – quantitative suitability, reasonable-basis suitability, and customer-specific suitability. *See* FINRA Rule 2111.05 (Components of Suitability Obligations). In this case, only quantitative suitability and reasonable-basis suitability are at issue.[8]

2. UITs (Unit Investment Trusts)

The allegations of this case focus on King's recommendations, purchases, sales, and in-and-out trading of UITs and CEFs. A UIT is one of three types of investment companies.[9] The other two types are CEFs and mutual funds. The traditional and distinguishing characteristics of UITs are as follows:

- UITs typically issue redeemable securities (or "units"), like a mutual fund, which means that the UIT will buy back an investor's "units," at the investor's request, at their approximate net asset value (or "NAV").

- UITs typically will make a one-time "public offering" of only a specific, fixed number of units. Many UIT sponsors, however, will maintain a secondary market, which allows owners of UIT units to sell them back to the sponsors and allows other investors to buy UIT units from the sponsors.

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[8] The Hearing Officer found that King's short-term trading in UITs and CEFs lacked customer-specific suitability. But Enforcement's complaint made no such allegation. The only two counts of the complaint related to suitability were causes two and three. The second cause concerned King's excessive trading, and the third cause stated, "King did not have a reasonable basis to believe that [the UIT and CEF purchases, sales, and in-and-out trades] were suitable for any investor." We set aside the Hearing Officer's determination that King's short-term trading of UITs and CEFs lacked customer-specific suitability.

[9] "An 'investment company' is a company (corporation, business trust, partnership, or limited liability company) that issues securities and is primarily engaged in the business of investing in securities." US Securities and Exchange Commission, https://www.sec.gov/fast-answers/answersmfinvcohtm.html (last visited May 4, 2017). "An investment company invests the money it receives from investors on a collective basis, and each investor shares in the profits and losses in proportion to the investor's interest in the investment company." *Id.*

- UITs will have a termination date that is established when the UIT is created (although some may terminate more than fifty years after they are created). When a UIT terminates, any remaining investment portfolio securities are sold and the proceeds are paid to the investors.

- UITs do not actively trade their investment portfolio. That is, a UIT buys a relatively fixed portfolio of securities (for example, 5, 10, or 20 specific stocks or bonds), and holds them with little or no change for the life of the UIT. Because the investment portfolio of a UIT generally is fixed, investors know more or less what they are investing in for the duration of their investment. Investors will find the portfolio securities held by the UIT listed in its prospectus.[10]

The Commission advises investors who invest in UITs to "[k]eep in mind that just because a UIT had excellent performance last year does not necessarily mean that it will duplicate that performance . . . . [M]arket conditions can change, and this year's winning UIT could be next year's loser."[11] The Commission also notes that UITs are regulated under the Investment Company Act of 1940 ("Investment Company Act"), and that investors should consult a specific UIT's prospectus to obtain a particular UIT's risk factors, projected dissolution date, liquidity, fees, expenses, and commissions.[12]

3. CEFs (Closed-End Funds)

CEFs, or closed-end funds, are a second type of investment company. The Commission lists the following traditional and distinguishing characteristics of CEFs:

- CEFs generally do not continuously offer their shares for sale. Rather, they sell a fixed number of shares at one time (in an initial public offering), after which the shares typically trade on a secondary market. The price of a CEF's shares that trade on a secondary market after their initial public offering is determined by the market and may be greater or less than the shares' NAV.

- Investment advisers generally manage the investment portfolios of CEFs.

- The shares of CEFs generally are not redeemable. That is, CEFs are not required to buy shares back from investors upon request. Some CEFs, commonly referred to as interval funds, offer to repurchase their shares at specified intervals.

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10 US Securities and Exchange Commission, https://www.sec.gov/fast-answers/answersuithtm.html (last visited July 19, 2017).

11 *See id.*

12 *See id.*

- CEFs are permitted to invest in a greater amount of "illiquid" securities than are mutual funds.[13]

The Commission explains that there are many types of CEFs, and that the different types of CEFs have varying investment objectives, strategies, investment portfolios, risks, volatility, fees, and expenses.[14] Similar to the warnings that the Commission provided with UITs, the Commission advises purchasers of CEFs that there is no connection between a CEF's current and future performance, and that individuals who invest in CEFs should consult the product's prospectus for CEF-specific information.[15]

4. King's Periods of Heightened Supervision at Royal Alliance and Buckman Reid

The allegations of this case relate to King's conduct during two distinct periods, from April 2008 to March 2011, while he was registered with Royal Alliance, and from January 2013 to December 2014, when he was associated with Buckman Reid. During his tenure at each firm, King was subject to heightened supervision. Each period of heightened supervision resulted from red flags raised by King's sales of UITs.

a. King's Heightened Supervision at Royal Alliance

The supplementary evidence that Enforcement provided contains narratives and documents that Royal Alliance provided to FINRA. Royal Alliance states that the first issue involving King's sales of UITs came to the firm's attention in June 2009. King's name appeared on a routine review report of Royal Alliance's surveillance of UIT rollovers. The Regional Supervision Manager for King's area contacted King's supervisors and King about "potential 'red flags' on actively traded UITs."

Royal Alliance continued reviewing King's UIT sales throughout 2009. In August 2009, additional concerns about King's sales of UITs began to percolate. The Supervision Regional Vice President contacted the supervisors of King's branch office to explain that she had initiated a secondary "inquiry . . . focused on [the] overall investment strategy for the noted UIT transactions, and [that she] sought an explanation for the transactions." At the end of this second inquiry, Royal Alliance instituted "enhanced procedures" for the "handling of UIT trades going forward."

As Royal Alliance states, "[d]espite the additional procedures put into place, surveillance reports for King [and others in his branch office] in April and August 2010 identified new possible short-term trading and [] UIT issues." In April 2010, Royal Alliance's Field

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13 US Securities and Exchange Commission, https://www.sec.gov/fast-answers/answersmfclosehtm.html (last visited July 19, 2017).

14 *See id.*

15 *See id.*

Supervision Department prepared a "UIT Analysis" of King's trading activities for a one-year period – March 2009 to February 2010. The analysis stated that King had earned commissions of $441,596, of which $328,332 (74 percent) came from UIT trading. The analysis highlighted "potential issues" connected to King's UIT trading activities, including "short term trading of UITs," "switching [and] swapping of products with similar objectives," "order designation" (i.e., the marking of trade orders as solicited versus unsolicited), and "rep earnings vs. client income." The analysis also listed the "top 10 commission earning accounts for [] King," and, among the accounts, noted the accounts of JE and CM, two of the customers discussed below.

In August 2010, Royal Alliance's Field Supervision Department performed a UIT analysis for all representatives in King's branch office.[16] The analysis covered the one-year period from July 2009 to June 2010. During that period, King was the highest commission-earner for the branch office ($474,901), and his commissions comprised 35 percent of all commissions ($1.36 million) earned in the branch. Sales of UITs at King's branch office also dwarfed all other investment products. Commissions for the sale of UITs for that period totaled $1.1 million, while the next highest commission-earning investment product, mutual funds, grossed commissions of $185,960. Commissions from the sales of UITs in the branch office comprised 80 percent ($1.1 million) of all commissions earned ($1.36 million) at the branch, and King's UIT sales ($328,332) singlehandedly accounted for 30 percent of that amount. As a result of the April 2010 and August 2010 reports related to King's and the other branch office representatives' sales of UITs, the Supervision Regional Vice President and the supervisors of King's branch office "decided . . . that certain new requirements would be instituted regarding UIT sales at [King's] branch [office]."

In early-December 2010, Royal Alliance's Supervision Regional Vice President met with King's branch officer supervisors, "and it appeared that the procedures were being followed." Nevertheless, in January 2011, Royal Alliance began requiring that King's branch supervisors approve all future UIT sales, and that all UITs be held to maturity.[17] Royal Alliance advised the representative's in King's branch office that it would reverse the commissions of any representative who sold a UIT prior to maturity. Royal Alliance similarly warned that it would reverse the commissions of any representative in King's branch office who sold a "new" UIT to a customer with an account identified as "active," if the selling representative failed to document follow-up conversations with the customer.

Royal Alliance's narrative related to King's periods of heightened supervision at the firm explained that the first customer complaints involving King's sales of UITs arrived in February 2011. The narrative notes, "[a]s you are aware, in the spring of 2011, the [f]irm received and reviewed a number of . . . customer complaints involving [] King . . . ." Royal Alliance's receipt of these customer complaints sparked the firm's compliance department, once again, to send letters to the UIT customers of King's branch office. The letters provided an overview of UITs

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[16] There were seven representatives located in King's branch office, including King.

[17] The record does not explain the circumstances that gave rise to the additional requirements that Royal Alliance instituted in January 2011.

and invited the customers to call a special supervision telephone number to inquire about their accounts.

Royal Alliance issued a letter of warning to King in April 2011. In June 2011, King resigned from the firm.

b. King's Heightened Supervision at Buckman Reid

Between June 2011, when King left Royal Alliance, and January 2012, when he joined Buckman Reid, King was registered with two FINRA member firms. At some point during this period (June 2011 to January 2012), the New Jersey Bureau of Securities ordered that King be placed under heightened supervision.[18] The heightened supervision followed King to Buckman Reid, and, from January 2012 to March 2014, while registered with Buckman Reid, King was prohibited from soliciting any new customer who had a net worth of less than $1 million.[19]

In March 2014, King and his compliance manager at Buckman Reid requested that the New Jersey Bureau of Securities remove King's heightened supervision restrictions, and the New Jersey Bureau of Securities did so. During his on-the-record testimony, King summarized his pre-restriction and post-restriction UIT sales activities as follows:

> Before the restriction . . . I wouldn't do a UIT because I didn't want to have to mess with any conflict of interest or anything until everything was cleared . . . . Because you guys [FINRA] were questioning UITs like a bad investment, so I stuck with mutual funds, [CEFs], those type of investments until everything I knew was settled and cleared . . . . [, and then] I started selling them again this year.

With the restrictions of the New Jersey Bureau of Securities lifted, King increased his trading of UITs and CEFs in customer accounts, including the accounts of LA, RA, JE, and CM.

5. King's Excessive Trading

King's UIT and CEF trading activities in LA's, RA's, JE's, and CM's accounts violated FINRA's requirement of quantitative suitability. Quantitative suitability requires that an associated person has a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile. *See* FINRA Rule 2111.05(c).

King violated this quantitative suitability requirement by excessively trading LA's, RA's, JE's, and CM's accounts. Excessive trading occurs when a registered representative has: (1)

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[18] The only information concerning the New Jersey Bureau of Securities' period of heightened supervision comes from King's on-the-record testimony.

[19] It is unclear from the record, but King also may have had to submit his sales presentations and trade tickets to his supervisor at Buckman Reid.

"control over the trading in an account," and (2) "the level of trading in that account is inconsistent with the customer's objectives and financial situation." *Cody*, 2011 SEC LEXIS 1862, at *40-41. As explained below, King controlled LA's, RA's, JE's, and CM's accounts, and he traded the customers' accounts in a manner that was at odds with their investment objectives, economic situation, and financial needs. *See id.* at *40-55.

a. King Had De Facto Control over the Four Customers' Accounts

The "element [of control] is satisfied if the broker has either discretionary authority or *de facto* control over the [customer's] account." *Dep't of Enforcement v. Medeck*, Complaint No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *34 (FINRA NAC July 30, 2009). The second type of control, "de facto control," "may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions," or when "the customers were not consulted, nor typically even made aware of, the particular trades executed in their account until well after the fact." *Cody*, 2011 SEC LEXIS 1862, at *41.

King improperly exercised discretion in LA's, RA's, JE's, and CM's accounts, and it is this improper exercise of discretion that demonstrates King's de facto control over the accounts. *See infra* Part II.C. Although LA, RA, JE, and CM never gave King discretion, either verbally or in writing, to trade in their accounts, King nevertheless traded in the customers' account as if he had discretion. King made the investment decisions in the accounts, including what to buy and sell, the quantities of units (UITs) or shares (CEFs) to trade, and when each transaction would occur. King controlled the volume and frequency of transactions in LA's, RA's, JE's, and CM's accounts, and, consequently, maintained de facto control over accounts.[20] *See Dep't of Enforcement v. Cody*, Complaint No. 2005003188901, 2010 FINRA Discip. LEXIS 8, at *35 (FINRA NAC May 10, 2010), *aff'd*, 2011 SEC LEXIS 1862, at *1 (May 27, 2011).

[20] A violation of the suitability rule also requires proof of a "recommendation." *See Medeck*, 2009 FINRA Discip. LEXIS 7, at *35 n.14. King's improper exercise of discretion in LA's, RA's, JE's, and CM's accounts also satisfies the recommendation requirement of the suitability rule. *See id.* ("[W]here the broker has discretionary authority (or engages in unauthorized trading), the transactions are deemed to have been implicitly recommended for purposes of the suitability rule.").

b. King's Trading Activity in the Customers' Accounts Was Excessive

There is no single test to determine whether the trading activity in an account was excessive, but factors such as the cost-to-equity ratio,[21] the presence of in-and-out trading,[22] the turnover rate,[23] and the number and frequency of trades may provide a basis for a finding of excessive trading. *See Cody*, 2010 FINRA Discip. LEXIS 8, at *33; *Medeck*, 2009 FINRA Discip. LEXIS 7, at *43. Although these factors "introduce some measure of objectivity or certainty into the [excessive trading] analysis[,] . . . assessment of the level of trading . . . does not rest on any magical per annum percentage, however calculated." *Cody*, 2010 FINRA Discip. LEXIS 8, at *33.

The turnover rates and cost-to-equity ratios, King's in-and-out trading of the customers' UITs and CEFs, the frequency and quantity of King's trading in the customers' accounts, and the

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[21] The cost-to-equity ratio represents "the percentage of return on the customer's average net equity needed to pay broker-dealer commissions and other expenses." *Pinchas*, 54 S.E.C. at 340. "[A] cost-to-equity ratio in excess of 20 . . . indicates excessive trading," but cost-to-equity ratios ranging from 12.1 to 18 also have been found to be excessive. *Id.*; *see Thomas F. Bandyk*, Exchange Act Release No. 35415, 1995 SEC LEXIS 481, at *2-3 (Feb. 24, 1995) ("[respondent's] excessive trading yielded . . . annualized [cost-to-]equity ratio[s] ranging between 12.1 . . . and 18.0").

[22] The term "in-and-out" trading denotes the sale of all or part of a customer's portfolio, with the money reinvested in other securities, followed by the sale of the newly acquired securities. *Cody*, 2011 SEC LEXIS 1862, at *47 n.39. In-and-out trading is a "hallmark of excessive trading." *Id.* In-and-out trading is "a practice extremely difficult for a broker to justify and can, *by itself*, provide a basis for finding excessive trading." *Pinchas*, 54 S.E.C. at 339 (emphasis added).

[23] "A turnover rate measures the turnover in an account, which is the number of times during a given period that the securities are replaced by new securities." *First Allied Secs., Inc.*, Exchange Act Release No. 61655, 2010 SEC LEXIS 1253, at *12 n.2 (Mar. 5, 2010). The turnover rate is calculated by "dividing the aggregate amount of purchases in an account by the average monthly investment." *Rafael Pinchas*, 54 S.E.C. 331, 339-40 n.14 (1999).

"Turnover rates between three and five have triggered liability for excessive trading, and it has been generally recognized that an annual turnover rate of greater than six evidences excessive trading." *Jack H. Stein*, 56 S.E.C. 108, 118-19 (2003); *see also Sandra K. Simpson*, 55 S.E.C. 766, 794 (2002) (finding excessive trading in account of elderly retiree with conservative investment objectives and annualized turnover rate of 2.1); *J. Stephen Stout*, 54 S.E.C. 888, 894 n.18 (2000) (as a "rule of thumb, . . . a turnover rate of two may be considered suggestive of excessive trading for a conservative investor"); *Donald A. Roche*, 53 S.E.C. 17, 21 (1997) (finding account with turnover rate of 3.3 was excessively traded for conservative investor); *Gerald E. Donnelly*, 52 S.E.C. 600, 602 n.11 (1996) ("an annualized turnover rate of between two and four percent is presumptive of churning").

transaction costs incurred as a result of King's trading activities demonstrate that King excessively traded LA's, RA's, JE's, and CM's accounts. As explained below, UITs and CEFs are long-term investments, and King's short-term trading of the products was excessive and lacked reasonable-basis suitability.

i. King's Trading in LA's IRA

Enforcement's complaint focuses on King's trading in LA's individual retirement account (IRA) between January 2014 and December 2014. In January 2014, LA was 66 years old and retired. LA had an annual income of $50,000 to $99,000, a net worth between $250,000 and $499,999, and annual liquidity needs of $10,000 to $49,999. LA described her risk tolerance as "minimal risk,"[24] her investment objective as "preservation of principal/income,"[25] her investment experience as "limited," and her investment time horizon as four to six years.[26] LA's IRA maintained an average monthly balance of approximately $158,000.

The frequency and quantity of King's trading in LA's IRA was at odds with her investment objectives, economic situation, and financial needs. Over the 12-month period, King effected 32 purchases and sales of UITs and CEFs in LA's IRA. Purchases of these securities totaled more than $772,000 and generated more than $25,000 in commissions.[27] King effected these trades on 25 different days, often made multiple trades in a single day, and engaged in in-and-out trading of several UITs and CEFs. There were at least 16 instances in which King sold a UIT or CEF within six months of purchase, and then used the proceeds to buy another UIT or CEF. The holding periods for the UITs and CEFs that King purchased in LA's IRA ranged from 18 to 170 days, with an average holding period of 65 days. King's trading in LA's IRA yielded

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[24] The "minimal risk" category was the most conservative designation on Buckman Reid's risk tolerance scale. The category applied to investors who "[m]ay not have income or returns [and] may not keep up w[ith] inflation."

[25] The "preservation of principal/income" category was the most conservative designation on Buckman Reid's investment objective scale. Preservation of principal/income "focus[es] . . . on [the] preservation of principal and income. *Very conservative*. Note: For [a]dvisory accounts, the investment objective for this category is income."

[26] In January 2014, LA listed her risk tolerance as "low risk," and she stated that her investment objective was "balanced growth." Buckman Reid described investors with a "low risk" tolerance as individuals "[c]apable of sustaining modest loss of principal . . . [and] some volatility." "Balanced/Conservative Growth – Focus[es] . . . on generating current income and/or long-term capital growth. *Conservative*." Between January 2014 and February 2014, LA's risk tolerance and investment objective were downgraded to minimal risk and preservation of principal/income, as described above. LA's risk tolerance and investment objective remained in these more conservative categories for the remainder of 2014. The record does not disclose the reason for these changes to LA's account.

[27] For convenience, we use the term "commissions" to refer to UIT sales charges and fees and broker-dealer commissions.

an annualized turnover rate of 4.89, and an annualized cost-to-equity ratio of 16.08, meaning, at a minimum, that LA's IRA needed to have returns of more than 16 percent to cover the commissions and the account's maintenance fees and expenses. LA lost more than $25,000 in her IRA account as a result of King's excessive trading.

ii. King's Trading in RA's IRA

RA is LA's spouse. Enforcement's complaint focuses on King's trading in RA's IRA between January 2014 and December 2014. According to Buckman Reid's records, RA was retired, and he had an annual income of $50,000 to $99,000, a net worth between $500,000 and $999,999, and annual liquidity needs of $10,000 to $49,999. RA described his risk tolerance as "minimal risk," his investment objective as "preservation of principal/income," and his investment time horizon as four to six years.[28] RA's IRA maintained an average monthly balance of approximately $89,000.

The frequency and quantity of King's trading in RA's IRA was at odds with his investment objectives, economic situation, and financial needs. Over the 12-month period, King effected 25 purchases and sales of UITs and CEFs in RA's IRA. Purchases of these securities totaled nearly $457,000 and generated more than $14,000 in commissions. King often made multiple trades in a single day, and engaged in in-and-out trading of several UITs and CEFs. There were approximately 12 instances in which King sold a UIT or CEF within four months of purchase, and then used the proceeds to buy another UIT or CEF. The holding periods for the UITs and CEFs that King purchased in RA's IRA ranged from 24 to 128 days, with an average holding period of 69 days. King's trading in RA's IRA yielded an annualized turnover rate of 5.12, and an annualized cost-to-equity ratio of 16.58. RA lost nearly $12,000 in his IRA account as a result of King's excessive trading.

iii. King's Trading in LA's and RA's Joint Account

King's excessive trading was not limited to LA's and RA's IRAs. It carried over into their joint brokerage account. Between January 2014 and December 2014, LA's and RA's joint account maintained an average monthly balance of approximately $152,000.

The frequency and quantity of King's trading in LA's and RA's joint account was at odds with the couples' investment objectives, economic situation, and financial needs. King effected 33 purchases and sales of UITs and CEFs in LA's and RA's joint account. Purchases of these securities totaled more than $800,000 and generated more than $25,000 in commissions. King effected these trades on 27 different days, often made multiple trades in a single day, and engaged in in-and-out trading of several UITs and CEFs. There were approximately 16 instances in which King sold a UIT or CEF within four months of purchase, and then used the proceeds to

[28] Similar to the case with his wife, between January 2014 and February 2014, RA's risk tolerance was downgraded from low risk to minimal risk, and his investment objective was lowered from balanced growth to preservation of principal/income. RA's risk tolerance and investment objective remained in the more conservative categories for the remainder of 2014. The record does not disclose the reason for the changes.

buy another UIT or CEF. The holding periods for the UITs and CEFs that King purchased in LA's and RA's joint account ranged from 8 to 99 days, with an average holding period of 67 days. King's trading in LA's and RA's joint account yielded an annualized turnover rate of 5.26, and an annualized cost-to-equity ratio of 16.77. LA's and RA's joint account lost more than $27,000 as a result of King's excessive trading.

iv. King's Trading in JE's IRA

Enforcement's complaint focuses on King's trading in JE's IRA between January 2014 and December 2014. According to Buckman Reid's records, JE had an annual income of $100,000 to $199,000, a net worth between $100,000 and $249,999, and annual liquidity needs of less than $1,000 (JE was still working at that time). JE described his risk tolerance as "moderate risk,"[29] his investment objective as "growth,"[30] and his investment time horizon as nine to 11 years. JE's IRA maintained an average monthly balance of approximately $180,000.

The frequency and quantity of King's trading in JE's IRA was at odds with his investment objectives, economic situation, and financial needs. Over the 12-month period, King effected 50 purchases and sales of UITs and CEFs in JE's IRA. Purchases of these securities totaled nearly $1.3 million and generated more than $38,000 in commissions. King effected these trades on 33 different days, often made multiple trades in a single day, and engaged in in-and-out trading of several UITs and CEFs. There were approximately 20 instances in which King sold a UIT or CEF within five months of purchase, and then used the proceeds to buy another UIT or CEF. The holding periods for the UITs and CEFs that King purchased in JE's IRA ranged from 16 to 135 days, with an average holding period of 54 days. King's trading in JE's IRA yielded an annualized turnover rate of 7.07, and an annualized cost-to-equity ratio of 21.42. JE lost more than $42,000 in his IRA account as a result of King's excessive trading.

v. King's Trading in CM's IRA

Our analysis focuses on King's trading in CM's IRA between January 2013 and December 2013.[31] In January 2013, CM was 58 years old and retired. CM had an annual income of less than $50,000, a net worth between $250,000 and $499,999, and annual liquidity needs of less than $1,000. CM described his risk tolerance as "moderate risk," his investment

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[29] The "moderate risk" category applied to investors who "[c]an withstand volatility [and] can sustain [the] loss of a portion of [his or her] principal."

[30] The "growth" investment objective "focus[es] . . . on generating long-term capital growth. *Moderate*."

[31] Enforcement's complaint focused on King's trading in CM's IRA between January 2013 and June 2014, an 18-month period. Enforcement provided specific trades for the entire period, but Enforcement neglected to provide substantiating trade data or analytics for the period between January 2014 and June 2014. As a consequence, we have limited our review to the one-year period from January 2013 to December 2013, and we have adjusted our figures and calculations accordingly.

objective as "growth," his investment experience as "average," and his investment time horizon as nine to 11 years. CM's IRA maintained an average monthly balance of approximately $144,000.

The frequency and quantity of King's trading in CM's IRA was at odds with his investment objectives, economic situation, and financial needs. Over the 12-month period, King effected 27 purchases and sales of UITs and CEFs in CM's IRA. Purchases of these securities totaled more than $470,000 and generated more than $18,000 in commissions. King often made multiple trades in a single day, and he engaged in in-and-out trading of several UITs and CEFs. There were at least 14 instances in which King sold a UIT or CEF within nine months of purchase, and then used the proceeds to buy another UIT or CEF. The holding periods for the UITs and CEFs that King purchased in CM's IRA ranged from 54 to 256 days, with an average holding period of 123 days. King's trading in CM's IRA yielded an annualized turnover rate of 3.27, and an annualized cost-to-equity ratio of 12.57.

On December 9, 2013, CM wrote to King about King's trading in his IRA. CM wrote:

> Enough already! What is with all this buying and selling? YTD my account has seen $461,945 in redemptions and sales. That is [four] times the account value! And what do I have to show for it? My account value has dropped some !!!$50,000!!! since May . . . . Effective immediately, you DO NOT have my authorization to do anything to my account, except to cash everything out when I am ready to transfer the money to another institution.

Between January 2013 and December 2013, CM lost more than $43,000 in his IRA account as a result of King's excessive trading.

* * *

CM's observations about King's trading in his IRA strike at the heart of King's misconduct. Between January 2013 and December 2014, King excessively traded LA's, RA's, JE's, and CM's UITs and CEFs. King frequently traded the customers' long-term investments on a short-term basis, and he did so in the accounts of customers who were retired or nearing retirement and had minimal to moderate risk tolerances and conservative investment objectives that ranged from income (preservation of principal) to growth (long-term capital growth).

The resulting annualized turnover rates (between 3.27 and 7.07) and annualized cost-to-equity ratios (between 12.57 and 21.42) support King's liability for the excessive trading violation. Although these ratios may be lower than some other excessive trading cases,[32] we understand that these numbers must be viewed in the context of the long-term investments that King traded. Moreover, we are mindful of the fact that excessive trading analyses do not rest on

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[32] *See, e.g.*, *Peter C. Bucchieri*, 52 S.E.C. 800, 801-03 (1996) (finding excessive trading where cost-to-equity ratios were 21.8 percent, 24.9 percent, 22.4 percent, and 25.6 percent); *Michael David Sweeney*, 50 S.E.C. 761, 763-65 (1991) (finding excessive trading where cost-to-equity ratios were 22 percent, 27 percent, 36 percent, and 44 percent).

fixed percentages, that turnover rates between three and five have triggered liability for excessive trading, that a turnover rate of two may be indicative of excessive trading for a conservative investor, and that cost-to-equity ratios between 12.1 and 18 have supported excessive trading findings. *Stein*, 56 S.E.C. at 118-19 (turnover rates of three to five have triggered excessive trading liability); *Simpson*, 55 S.E.C. at 794 (turnover rate of 2.1 was excessive for an elderly retiree with conservative investment objectives); *Bandyk*, 1995 SEC LEXIS 481, at *2-3 (cost-to-equity ratios between 12.1 and 18 resulted in finding of excessive trading). Finally, we note that King's trading in LA's, RA's, JE's, and CM's accounts was marred by in-and-out trading, and that in-and-out trading is the "hallmark of excessive trading" and may, "by itself, provide a basis for finding excessive trading."[33] *Cody*, 2011 SEC LEXIS 1862, at *47 n.39; *Pinchas*, 54 S.E.C. at 339.

On appeal, King argues that his trading activities in LA's, RA's, JE's, and CM's accounts were in response to volatile market conditions. King's argument reinforces the unsuitable nature of his recommendations. By his own estimation, King's trading was not focused on the customers' investment objectives, economic situation, and financial needs, as it should have been; rather, King was concentrated on the market and its fluctuations. Simply put, market conditions, volatile or otherwise, do not provide any justification for the fact that King excessively traded LA's, RA's, JE's, and CM's accounts and traded in the customers' accounts without regard for their investment objectives, economic situation, and financial needs.[34]

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[33] Enforcement argues that King's in-and-out trading, or switching, of the customers' UITs and CEFs is analogous to the Commission's and FINRA's mutual fund switching cases, and that his trading activities "creates a rebuttable presumption of unsuitability." *Dep't of Enforcement v. Wilson*, Complaint No. 2007009403801, 2011 FINRA Discip. LEXIS 67, at *17 (FINRA NAC Dec. 28, 2011); *see also Kenneth C. Krull*, 53 S.E.C. 1101, 1104 (1998) ("Mutual fund shares generally are suitable only as long-term investments and cannot be regarded as a proper vehicle for short-term trading . . . ."), *aff'd*, 248 F.3d 907 (9th Cir. 2001); *Dep't of Enforcement v. Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *67-68 (FINRA NAC Dec. 20, 2007) ("A pattern of switches . . . where there is no indication of a change in the investment objectives of the customers . . . is not reconcilable with the concept of suitability[, and] [w]here such a pattern is established, it is incumbent upon the registered representative that recommended such switches to demonstrate the unusual circumstances which justified what is a clear departure from the manner in which mutual fund investments are normally made."), *aff'd*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *1 (Jan. 30, 2009), *aff'd*, 416 App'x 142 (3d Cir. 2010). While we are inclined to agree with Enforcement's argument, an appeal of a Hearing Officer's default decision, with the limited record that such a case presents, is not the proper place for that determination to be made. We therefore decline to reach the issue of whether a registered representative's in-and-out trading, or switching, of UITs and CEFs creates a rebuttable presumption of unsuitability.

[34] King also suggests that he did not violate FINRA's rules because Royal Alliance, Buckman Reid, and the New Jersey Bureau of Securities did not find that he engaged in misconduct. King's argument is factually and legally flawed. As an initial matter, King's argument ignores the salient fact that each of these entities placed King on heightened supervision based on his sales of UITs to customers. Moreover, Royal Alliance's, Buckman Reid's, and the New Jersey Bureau of Securities' investigations of King's trading activities have

[Footnote continued on next page]

When King traded LA's, RA's, JE's, and CM's UITs and CEFs, he did not have reasonable grounds for believing that the transactions were suitable for the customers in light of the size, frequency, and nature of the transactions, and each customer's investment objectives, economic situation, and financial needs. In fact, many of King's purchases and sales of UITs and CEFs in LA's, RA's, JE's, and CM's accounts generated commissions, but resulted in customer losses. King's trading activities garnered $120,000 in gross commissions, while LA, RA, JE, and CM lost $149,000. Based on these facts, we conclude that King excessively traded LA's, RA's, JE's, and CM's accounts, King's excessive trading was quantitatively unsuitable, and King violated FINRA Rules 2111 and 2010, as alleged in the second cause of the complaint.

C. King Exercised Discretion in Four Customer Accounts Without Written Consent or Approval

The Hearing Officer found that King exercised discretionary trading authority in LA's, RA's, JE's, and CM's accounts, and that he did so without the required prior written authorization and firm approval. We affirm the Hearing Officer's findings.

1. NASD Rule 2510(b)

NASD Rule 2510(b) prohibits a registered representative from exercising discretionary authority in a customer's account unless the customer has given prior written authorization to the representative, and the representative's member firm has accepted the account as discretionary and evidenced that acceptance in writing.[35] Compliance with the requirements of NASD Rule 2510(b), among other FINRA rules, ensures effective supervision of sales practices at member firms by providing the firm with a meaningful opportunity to "review all discretionary accounts at frequent intervals in order to detect and prevent transactions which are excessive in size or frequency in view of the financial resources and character of the account." NASD Rule 2510(c).

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no bearing on FINRA's regulatory responsibility or disciplinary proceeding. *See Dep't of Enforcement v. McGee*, Complaint No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *54 n.28 (FINRA NAC Jul. 18, 2016), *aff'd*, Exchange Act Release No. 80314, 2017 SEC LEXIS 987, at *25-26 (Mar. 27, 2017). FINRA "is not bound by" another adjudicator's investigation or findings. *Dep't of Enforcement v. Taylor*, Complaint No. C8A050027, 2007 NASD Discip. LEXIS 11, *29 n.15 (NASD NAC Feb. 27, 2007). Rather, FINRA's investigations and disciplinary actions are independent of other investigations or adjudications. *See id.* In this case, we have been tasked with determining whether King's purchases, sales, and trading of LA's, RA's, JE's, and CM's UITs and CEFs violated FINRA's suitability rules. We have made that determination.

[35] A violation of NASD Rule 2510(b) constitutes a violation of FINRA Rule 2010. *See Wilson*, 2011 FINRA Discip. LEXIS 67, at *31 n.21.

2. King's Improper Exercise of Discretion in Customer Accounts

There is no dispute that, from January 2013 to December 2014, King exercised discretion in LA's, RA's, JE's, and CM's accounts, that King did not obtain written authority from the customers before exercising discretion, and that Buckman Reid did not accept any of the customers' accounts as discretionary. Despite the presence of these established facts, King argues that he did not violate FINRA's prohibition on the exercise of discretion because he met with customers in person and obtained oral authorization from customers to exercise discretion.[36]

Even if King's representations are true, a customer's oral grant of discretionary authority does not satisfy the requirements of NASD Rule 2510(b). *See Michael Pino*, Exchange Act Release No. 74903, 2015 SEC LEXIS 1811, at *17-18 (May 7, 2015) (finding that the respondent violated NASD Rule 2510(b) when he did not have customer written authorization and permission from firm to effect trades); *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *27-28 (July 2, 2013), *aff'd sub nom., Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014) (finding that respondent violated NASD Rule 2510(b) when the customer granted oral authority for discretionary trading, but did not grant written authority).[37]

NASD Rule 2510(b) is unequivocal. In order for a registered representative to exercise discretion in a customer's account, the representative must obtain "*written authorization*" from the customer to exercise discretion, and the firm's acceptance of the customer's account as discretionary should be "evidenced *in writing*." NASD Rule 2510(b) (emphasis added). Based on these facts, we find that King violated NASD Rule 2510(b) and FINRA Rule 2010, as alleged in the fourth cause of the complaint.[38] *Cf. Protective Group Sec. Corp*., 51 S.E.C. 1233, 1240 (1994) (finding liability for discretionary trading without written authorization after representative admitted making discretionary trades in customer accounts and had obtained oral authorization prior to the trades as well as written ratification subsequent to the trades).

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[36] King testified to these facts during his on-the-record testimony. King's testimony focused on his general practice concerning his exercise of discretion in customer accounts. King did not provide any specific testimony about whether LA, RA, JE, or CM gave him oral discretionary authority to trade in their accounts.

[37] King's argument also ignores the second requirement of NASD Rule 2510(b) (i.e., the member firm's written acceptance of the customer's account as a discretionary account).

[38] As part of this violation, the Hearing Officer found that Buckman Reid "prohibited the use of discretion by its representatives." But the record does not contain a copy of Buckman Reid's procedures. Consequently, we are not in a position to verify this fact, and we set aside this finding. Nevertheless, we find that there is sufficient evidence, including King's own testimony, to prove by a preponderance of the evidence that King improperly exercised discretion in LA's, RA's, JE's, and CM's accounts, and, in so doing, violated NASD Rule 2510(b).

D. There Is Insufficient Evidence to Determine Whether King Engaged in Fraud

The Hearing Officer found that King sold 44 UITs to seven of his customers at Royal Alliance, and that King made misrepresentations and omissions when he made the sales. Specifically, the Hearing Officer determined that King: (1) misrepresented to the customers that they were investing in safe, no-risk bonds (not UITs); (2) misrepresented that these "bonds" paid a fixed rate of return and guaranteed the return of the investor's principal with interest at maturity; (3) misrepresented that he would not charge commissions on the customers' purchases of UITs; (4) omitted information related to the features and risks of UITs when he solicited the customers to purchase the UITs; and (5) failed to disclose the sales charges, costs, and commissions associated with the customers' purchases of UITs. The Hearing Officer concluded that King's misrepresentations and omissions were material, that King made the misrepresentations and omissions in connection with the purchase or sale of a security, and that King acted with scienter. The Hearing Officer found that King engaged in fraud, and that his fraud constituted a willful violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110. We reverse the Hearing Officer's findings.

To establish that King violated the antifraud provisions of the Exchange Act and FINRA's rules, as charged, Enforcement must prove that King "made a material misrepresentation (or a material omission if [he] had a duty to speak)," King made the material misrepresentation or omission "in connection with the purchase or sale of a security," and King "act[ed] with scienter."[39] *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996), *aff'd*, 522 U.S. 812 (1997). Our review of the evidence, however, leaves us unable to ascertain sufficient information about the transactions at issue.

For example, Enforcement identified the seven customers from the complaint, but Enforcement failed to link the seven customers to 44 UIT transactions (even accounting for transactions in accounts that the customers may have held with spouses or other individuals). In addition, despite the many UITs and CEFs identified in the record (on customer account statements, trade blotters, trade confirmations, etc.), the supplementary evidence that Enforcement submitted contains only one prospectus, a prospectus for a UIT listed as the "New Jersey Municipal Income Closed-End Portfolio, Series 23 FT 2368." Because UITs are sold by prospectus, and the prospectus contains UIT-specific information concerning the product's risks, dissolution, liquidity, fees, expenses, and commissions, the lack of prospectuses in the record leaves us unable to examine the characteristics of the UITs that King sold to the seven customers. As a consequence, we were not able to assess whether King misrepresented or omitted material facts about the UITs' features, fees, and risks when he sold them.[40]

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[39] Liability under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 also requires proof of a jurisdictional element (i.e., that King used "means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange"). 17 C.F.R. § 240.10b-5.

[40] To illustrate further, we note that Enforcement alleged, and the Hearing Officer found, that King misrepresented that the seven customers purchased "bonds." And while we

[Footnote continued on next page]

Accordingly, we reverse the Hearing Officer's findings that King engaged in fraud, and we dismiss cause one of the complaint.

E. There Is Insufficient Evidence to Determine Whether King's Short-Term Trading of UITs and CEFs Lacked Reasonable-Basis Suitability (Qualitative Suitability)

The Hearing Officer also found that King's short-term trading of LA's, RA's JE's, and CM's UITs and CEFs lacked reasonable-basis suitability, and that King violated FINRA Rules 2111 and 2010. Reasonable-basis suitability requires a showing that a registered representative has a reasonable basis to believe, based on reasonable diligence, that his or her recommendation is suitable for at least *some* investors. *See* FINRA Rule 2111.05(a). The record fails to support this violation. Specifically, Enforcement did not prove that King's short-term selling of UITs and CEFs would not be suitable for any investor, particularly an investor who may want to speculate. We therefore reverse the Hearing Officer's findings of liability for cause three of the complaint.

III. Sanctions

In the proceedings below, the Hearing Officer barred King for fraud, combined King's excessive trading and reasonable-basis suitability violations to impose a second bar, and declined to impose sanctions on King for his improper exercise of discretionary authority. On appeal, we bar King for excessively trading LA's, RA's, JE's, and CM's accounts. In light of the bar, we decline to impose sanctions on King for his improper exercise of discretion in customer accounts. We vacate the sanctions that the Hearing Officer imposed on King for the fraud and reasonable-basis suitability violation because we have reversed those findings.

A. Excessive Trading (Quantitative Suitability)

For cases involving unsuitable recommendations, FINRA's Sanction Guidelines ("Guidelines") advise adjudicators to consider a fine of $2,500 to $110,000 and a suspension of the individual in any or all capacities for a period of 10 business days to two years.[41] Where

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[cont'd]

acknowledge that UITs and bonds are different products, and that they have varying risks, characteristics, and fees, we note that the only prospectus in the record, the "New Jersey Municipal Income Closed-End Portfolio, Series 23 FT 2368," states that the UIT "invest[s] primarily in tax-exempt New Jersey municipal bonds."

[41] *FINRA Sanction Guidelines* 95 (2017) (Suitability – Unsuitable Recommendations), http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf [hereinafter *Guidelines*]. For each violation discussed in this decision, we applied the applicable Guidelines in place at the time of this decision and examined the specific Guidelines related to each violation. *See id.* at 9. We also consulted the General Principles Applicable to All Sanction Determinations and Principal Considerations in Determining Sanctions, which adjudicators consult in every disciplinary case. *See id.* at 2-8.

aggravating factors predominate, however, the Guidelines recommend that adjudicators strongly consider barring the individual.[42] Aggravating factors predominate King's excessive trading.

Over a two-year period, King effected a total of 167 trades in LA's, RA's, JE's, and CM's retirement accounts, purchasing more than $3.7 million in UITs and CEFs.[43] King brazenly traded UITs and CEFs in-and-out of the customers' accounts, racking up $149,000 in customer losses, while he generated gross commissions of $120,000.[44]

King's trading in LA's, RA's, JE's, and CM's accounts was not just risky, but extremely so.[45] Three of the four customers were retired, living on fixed incomes. All four customers had minimal to moderate risk tolerances and generally conservative investment objectives that ranged from income (preservation of principal) to growth (long-term capital growth). They did not want to assume the high degree of risk that King's rampant trading introduced into their retirement accounts. King's excessive trading and unsuitable recommendations demonstrated a gross indifference to LA's, RA's, JE's, and CM's investment objectives, economic situation, and financial needs.

Finally, as we consider the appropriate sanctions for King's suitability violations, we note that King had been put on notice that his UIT sales practices were, at a minimum, questionable, and that he should exercise caution when he recommended that a customer purchase, sell, or trade the product. Between June 2009 and March 2014, Royal Alliance, Buckman Reid, and the New Jersey Bureau of Securities each placed King under a period of heightened supervision based on his sales of UITs.[46] Despite the cautious trading that their increased oversight should have produced, King seemingly set caution aside to excessively trade in LA's, RA's, JE's, and CM's accounts. From as early as June 2009, Royal Alliance noted the troubling hallmarks of King's trading in UITs – "short term trading of UITs," "switching [and] swapping of products with similar objectives," and "rep earnings vs. client income." But, as the misconduct discussed in this decision suggests, King's troubling behavior persisted. Based on the record before us, we

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42 *See id.* at 95 (Suitability – Unsuitable Recommendations).

43 *See id.* at 7 (Principal Considerations in Determining Sanctions, Nos. 8, 9) (considering whether respondent engaged in numerous acts and whether the misconduct occurred over an extended period of time).

44 *See id.* at 7, 8 (Principal Considerations in Determining Sanctions, Nos. 11, 17) (considering whether respondent's misconduct resulted in injury to the investing public or respondent's monetary gain).

45 *See id.* at 8 (Principal Considerations in Determining Sanctions, No. 13) (considering whether the respondent's misconduct was the result of an intentional act, recklessness, or negligence).

46 *See id.* at 8 (Principal Considerations in Determining Sanctions, No. 15) (considering whether the respondent engaged in the misconduct notwithstanding prior warnings from regulators).

conclude that Royal Alliance's, Buckman Reid's, and the New Jersey Bureau of Securities' periods of heightened supervision had little (or no) deterrent effect on King's conduct, and that a bar is necessary to protect the investing public from King's risky trading practices.

B. Improper Discretionary Trading

For cases involving the exercise of discretion without a customer's written authority, the Guidelines recommend a fine of $2,500 to $15,000.[47] Where aggravating factors predominate, the Guidelines recommend that adjudicators suspend an individual respondent in any or all capacities for *at least* 10 to 30 business days.[48] In the assessment of sanctions, the Guidelines advise adjudicators to consider: (1) whether the customer's grant of discretion was express or implied; (2) whether firm's policies or procedures prohibited discretionary trading; (3) whether the firm prohibited the respondent from exercising discretion in customer accounts; and (4) whether the respondent's exercise of discretion went beyond time and price discretion.[49] The application of these factors suggest that aggravating factors predominate King's improper exercise of discretion, and that the assessment of sanctions should be toward the upper-end of the Guidelines' range.

As an initial matter, none of the four customers expressly or implicitly authorized King to exercise discretion in their accounts. Second, while we are not able to ascertain whether Buckman Reid's procedures prohibited all of its registered representatives from exercising discretion in customer accounts, the record supports that Buckman Reid prohibited King from exercising discretion in customer accounts, from January 2012, when he joined the firm, to March 2014, when the New Jersey Bureau of Securities removed King's heightened supervision restrictions. Accordingly, as we reviewed the evidence, we determined that King flouted the trading safeguards that the New Jersey Bureau of Securities and Buckman Reid had in place,[50] and that King's exercise of discretion in LA's, RA's, JE's, and CM's accounts from January 2013 to March 2014 was egregious. Finally, we find that King's discretionary trading went well-beyond the confines of time and price discretion. King purchased, sold, and traded in the customers' accounts indiscriminately – he traded the UITs and CEFs that he wanted, traded them when he wanted, and traded them in the quantities that he wanted.

"[D]iscretionary trading in a customer's account is a practice that is inherently susceptible to abuse."[51] It can lead to any number of ancillary violations, including the excessive

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47 *Id.* at 86 (Discretion—Exercise of Discretion Without Customer's Written Authority).

48 *Id.* (emphasis added).

49 *Id.*

50 *See id.* at 8 (Principal Considerations in Determining Sanctions, No. 15) (considering whether the respondent engaged in the misconduct notwithstanding prior warnings from regulators).

51 *Murphy*, 2013 SEC LEXIS 1933, at *27.

trading that occurred here.[52] In light of the potential for abuse, FINRA's rules require that the authorization for the exercise of discretionary power in a customer's account be in writing to ensure "that the trading is being done with the consent of the customer and to alert the firm that extra oversight of the sales representative's handling of the account may be necessary to protect against improper or unsuitable trading."[53] King's exercise of discretion without written customer authorization and written firm acceptance thwarted the customer protections that NASD Rule 2510(b) provides and evaded Buckman Reid's much-needed supervision of his trading activities. In light of these factors, we find that a fine of $15,000 and a one-year suspension in all capacities are appropriate sanctions to deter King, and other similarly situated individuals, from disregarding their firms' safeguards and improperly exercising discretion in customer accounts. We decline to impose these sanctions in light of the bar that we have imposed for King's suitability violations.

IV. Conclusion

We affirm the Hearing Officer's findings that King excessively traded the accounts of four customers (quantitative suitability), in violation of FINRA Rules 2111 and 2010 (cause two), and that he exercised discretion in the accounts of four customers without written consent or approval, in violation of NASD Rule 2510(b) and FINRA Rule 2010 (cause four). We reverse the Hearing Officer's findings that King engaged in fraud, in violation of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110 (cause one), and that he made unsuitable recommendations to four customers (qualitative suitability), in violation of FINRA Rules 2111 and 2010 (cause three).

We bar King for the excessive trading. We decline to impose additional sanctions on King for the improper exercise of discretion in customer accounts. We vacate the sanctions that the Hearing Officer imposed on King for the fraud and unsuitable recommendations. The bar that we have imposed is effective as of the date of this decision.

On behalf of the National Adjudicatory Council,

Jennifer Piorko Mitchell,
Vice President and Deputy Corporate Secretary

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[52] *See Dep't of Enforcement v. Griffith*, Complaint No. 2010025350001, 2015 FINRA Discip. LEXIS 55, at *13-14 (FINRA NAC Dec. 22, 2015).

[53] *William J. Murphy*, 54 S.E.C. 303, 307 (1999); *see also Wilson*, 2011 FINRA Discip. LEXIS 67, at *30-31 (explaining that compliance with the requirements of NASD Rule 2510(b) is "an additional means of ensuring effective supervision of sales practices at securities firms").