FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. MEGURDITCH PATATIAN (CRD No. 4047060), Respondent.	Disciplinary Proceeding No. 2018057235801 Hearing Officer–DDM **EXTENDED HEARING PANEL DECISION** June 10, 2022

Respondent Megurditch Patatian made unsuitable recommendations to his customers for REIT purchases, variable annuity surrenders, and variable annuity exchanges. To obtain approval of the REIT purchases, he overstated his customers' financial information and investment experience, causing his firm to create and maintain inaccurate books and records. He also impersonated a customer in a telephone call with an insurance company.

Patatian is barred from associating with any FINRA member in any capacity for these violations. He is also ordered to disgorge the commissions from his unsuitable recommendations, pay restitution to customers who sold their REITs at a loss, and offer rescission to the customers who have not sold their REITs.

Appearances

For the Complainant: Brody Weichbrodt, Esq., John-Michael Seibler, Esq., and Jessica Zetwick-Skryzhynskyy, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Jeffrey Kob, Esq., Jeffrey Kob Law

DECISION

I. Introduction

Respondent Megurditch Patatian recommended that 59 of his customers invest $7.86 million in non-traded real estate investments trusts ("REITs"). FINRA's Department of Enforcement alleges that Patatian committed several FINRA Rule violations in making those recommendations. Enforcement also alleges that Patatian made unsuitable recommendations for variable annuity surrenders and exchanges and impersonated a customer.

The Complaint contains five causes of action. First, Enforcement contends that Patatian's recommendations to his customers to purchase non-traded REITs were unsuitable, violating FINRA Rules 2111 and 2010. Second, Enforcement asserts that Patatian made five unsuitable recommendations to customers to surrender their variable annuities to invest in non-traded REITs, in violation of FINRA Rules 2111 and 2010. Third, Enforcement contends that Patatian made six unsuitable recommendations to customers to exchange their variable annuities, violating FINRA Rules 2330(b) and 2010. Fourth, Enforcement alleges that Patatian impersonated a customer in a telephone call with an insurance company, violating FINRA Rule 2010. Fifth, Enforcement asserts that Patatian created inaccurate forms to facilitate his sale of non-traded REITs, causing his firm to create and maintain inaccurate books and records, in violation of FINRA Rules 4511 and 2010.

After a seven-day hearing, we find that Enforcement proved each cause of action. Because Patatian's actions were egregious, we impose a bar. We order Patatian to provide restitution of $262,958.73 plus interest to his 20 customers who sold their REITs at a loss, and to offer rescission to the customers who still hold their REITs. We also order that Patatian disgorge $458,418.07 in commissions he earned from his unsuitable non-traded REIT recommendations.

II. Findings of Fact

A. Patatian's Background in the Securities Industry

Patatian registered with FINRA in 1999, and worked with three different FINRA member firms before joining Western International Securities ("Western") in 2013.[1] One of those firms was CUSO Financial Services, L.P. ("CUSO").[2] Patatian was registered with CUSO until March 2013, when the firm filed a Uniform Termination Notice for Securities Industry Registration (Form U5) for Patatian stating that he resigned after "fail[ing] to follow firm policy with regards to firm transaction documentation."[3]

About a month later, Patatian joined Western. He associated with Western until April 2020, when Western filed a Form U5 stating that Patatian resigned "after the firm questioned the integrity of a client signed document."[4] Patatian is not currently associated with a FINRA member firm.[5]

[1] Joint Stipulations ("Stip.") ¶¶ 1, 4.

[2] Stip. ¶ 3.

[3] Stip. ¶ 3.

[4] Stip. ¶ 6.

[5] While Patatian is no longer associated with a FINRA member firm, the parties agree that FINRA has jurisdiction over him for purposes of this proceeding. Stip. ¶ 7.

B. FINRA's 2013 Investigation and Closing Letter

Prompted by CUSO's Form U5 filing, FINRA opened an investigation in May 2013 into Patatian's resignation from CUSO.[6] As part of this investigation ("the 2013 investigation"), FINRA sent multiple investigative requests to CUSO,[7] Western,[8] and Patatian.[9] FINRA also took Patatian's on-the-record testimony ("OTR") in 2015.[10] FINRA's 2013 investigation covered various topics, including Patatian's possible use of non-public personal information for CUSO customers,[11] his outgoing correspondence,[12] his mutual fund and variable annuity sales practices,[13] and his REIT sales practices.[14]

The 2013 investigation continued until January 31, 2018, when an Enforcement attorney informed Patatian in a letter that Enforcement had determined not to take disciplinary action against him "with regard to [his] conduct while registered with [CUSO] based on the information currently in our possession."[15] This letter ("the Closing Letter") contained two important caveats. First, Enforcement cautioned that the decision not to charge Patatian "should not in any way be construed as indicating that you have been exonerated of any wrongdoing or that no wrongdoing may have occurred."[16] Second, Enforcement "reserve[d] the right to re-open this investigation" or "use any information obtained in this matter in connection with this or any other matter." As a result, the Closing Letter stated, "the staff cannot provide any assurance that no action will ultimately result from any further review of any such information at a future date."[17]

After Enforcement closed the 2013 investigation, it opened another investigation of Patatian. The FINRA attorney who signed the Closing Letter testified that Enforcement decided to open another investigation into Patatian because the 2013 investigation focused on Patatian's conduct at CUSO Financial Services.[18] "And based on what we learned during the 2013 matter," she testified, "[we] finished that one out, closed it, and then moved on . . . with a new matter

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[6] Hearing Transcript ("Tr.") 1690, 1699; Respondent's Exhibit ("RX-") 524B.

[7] *See* RX-524; RX-524B; RX-525; RX-530; RX-532; RX-538.

[8] RX-526; RX-528.

[9] RX-528.

[10] *See* Complainant's Exhibit ("CX-") 235.

[11] RX-526; RX-527; Tr. 1701.

[12] RX-532.

[13] RX-529.

[14] RX-530; RX-537; Tr. 1707.

[15] RX-540.

[16] RX-540.

[17] RX-540.

[18] Tr. 1744.

specifically looking at Mr. Patatian's conduct at Western[.]"[19] In this investigation ("the 2018 investigation"), Enforcement took another OTR of Patatian over two days, on April 30 and May 1, 2020 (collectively, the "2020 OTR").[20]

C. Patatian's 2020 OTR and Credibility

Much of Patatian's testimony at the hearing conflicted directly with his prior, sworn testimony during his 2020 OTR. This decision discusses the specific discrepancies between Patatian's testimony at the hearing and his testimony at the 2020 OTR. We also discuss other aspects of his credibility where appropriate.

At the hearing, Patatian essentially disavowed his 2020 OTR testimony, describing some of his answers as "pretty outlandish."[21] Some of his 2020 OTR testimony clearly acknowledged wrongdoing. But Patatian was unpersuasive that the Panel should believe his testimony at the hearing instead of his 2020 OTR testimony.

Patatian testified at the hearing that he did not prepare before his 2020 OTR. As he put it, he came in "cold turkey."[22] He also testified at the hearing that he thought "he was in the clear" because of the Closing Letter.[23] Patatian thought he was "cooperating with FINRA"[24] in an investigation into Western, he testified, like a "whistleblower."[25] He also questioned his "state of mind" during the 2020 OTR, testifying that he had "suffered a lot of psychological damage because of all this negative stuff that happened as a result of the REITs."[26]

Patatian similarly tried to distance himself from his 2020 OTR testimony shortly before Enforcement filed the Complaint. In an email to Enforcement, Patatian claimed that he "did not understand and was not informed that [he] could have an attorney representing [him]" during his 2020 OTR testimony.[27] "Because I did not have an attorney present," Patatian wrote, "no one read me my Miranda rights, [so] I do not want my testimony to be used against me and believe it should be inadmissible."[28]

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[19] Tr. 1745.

[20] *See* CX-236; CX-237.

[21] Tr. 1769.

[22] Tr. 1768.

[23] Tr. 147.

[24] Tr. 147.

[25] Tr. 1766.

[26] Tr. 205.

[27] CX-17, at 1.

[28] CX-17, at 1.

But in that same email, Patatian acknowledged that he was "fully forthcoming and transparent" and testified "in the spirit of being truthful and cooperative" in his 2020 OTR.[29] Enforcement told him, in writing when it scheduled the 2020 OTR, that he had a right to an attorney during his OTR.[30] Enforcement also advised him during his 2020 OTR that he could be represented by an attorney.[31] Yet he said that he was willing to testify without one.[32]

In short, Patatian failed to explain why the Panel should believe his testimony at the hearing when it conflicted with his 2020 OTR testimony. Given that he thought he was cooperating in an investigation against Western, he had an incentive to testify truthfully during the 2020 OTR. His 2020 OTR testimony also aligns with the testimony of his customers, as well as relevant documents. And his 2020 OTR testimony is more plausible than the contradictory testimony he offered at the hearing. His testimony at the hearing seemed borne of expedience and a desire to avoid the consequences of his actions rather than accept responsibility for them.

D. Patatian Starts to Sell REITs at Western

At CUSO, Patatian developed a customer base that mostly consisted of retirees who had worked for a California utility, the Department of Water and Power ("DWP").[33] Patatian mostly recommended that his DWP customers invest in mutual funds and variable annuities at CUSO.[34] When Patatian left CUSO to join Western, many of his DWP customers followed him to his new firm.[35] Once he joined Western, and for the first time in his career, Patatian started to sell REITs.[36]

Before joining Western, Patatian was, in his words, "unfamiliar" and "inexperienced" with REITs.[37] During the 2018 investigation, Patatian told Enforcement that he "resisted selling any [REITs] for the first year and a half to two years" he worked at Western.[38] In fact, though, just two months into his tenure at Western, Patatian sold a non-traded REIT to a customer.[39]

After that, non-traded REITs became nearly his entire business. From April 2013 through March 2017, Patatian sold more than $7.8 million in non-traded REITs to 59 customers in 81

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[29] CX-17, at 1.

[30] CX-233, at 6-7.

[31] CX-236, at 4.

[32] CX-236, at 4.

[33] Stip. ¶ 5.

[34] Tr. 102-03.

[35] Stip. ¶ 5; Tr. 137-38.

[36] Tr. 196.

[37] Tr. 196-97.

[38] CX-17.

[39] CX-193; CX-1.

recommended transactions.[40] His customers ranged in age from 23 years old to 91 years old at the time of their purchases.[41] A third of his customers were at least 65 years old when they bought their REITs.[42] Almost all of his commissions in 2013, 2014, and 2015 came from non-traded REIT sales, and more than half of his commissions in 2016 were attributable to non-traded REITs.[43] Between April 2013 and March 2017, Patatian earned more than $450,000 in commissions from his non-traded REIT sales.[44]

E. The REITs Sold by Patatian

REITs "pool the capital of numerous investors to purchase a portfolio of properties – from office buildings to hotels and apartments, even timber-producing land – which the typical investor might not otherwise be able to purchase individually."[45] There are generally two types of public REITs: those that trade on a national securities exchange, and those that do not.[46] REITs that do not trade on a national securities exchange, known as non-traded REITs, "are generally illiquid, often for periods of eight years or more."[47] Further, issuers of non-traded REITs often restrict the ability of investors to redeem their shares early,[48] and sometimes only at a discount.[49] As a result, to sell or redeem their shares, investors generally have to wait until a so-called "liquidity event," when the non-traded REIT lists its shares on an exchange or sells its assets.[50]

There are other risks to investing in non-traded REITs. The REIT's Board of Directors decides the cash distributions – not just the amount of the distributions, but whether to make them at all.[51] And the distributions may consist of borrowed funds or the return of investor capital.[52] Even if there is a liquidity event, then, the value of an investment in a non-traded REIT may have declined or disappeared altogether.[53]

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[40] Stip. ¶¶ 8, 11.

[41] Exhibit ("Exh.") A to Complaint ("Compl."); Tr. 1541.

[42] Tr. 1541.

[43] CX-5.

[44] Stip. ¶ 9.

[45] CX-19, at 1.

[46] CX-19, at 1.

[47] CX-19, at 3.

[48] CX-19, at 3.

[49] CX-23, at 1.

[50] CX-23, at 1.

[51] CX-20, at 2.

[52] CX-20, at 2.

[53] CX-19, at 4-5; CX-20, at 2.

These risks are general to non-traded REITs. But they also applied specifically to the REITs sold by Patatian. As an example, the prospectus for one non-traded REIT sold by Patatian disclosed that "there is no public trading market for our shares and there may never be one; therefore, it will be difficult to sell your shares."[54] As a result, the prospectus cautioned, "[y]ou should purchase the shares only as a long-term investment because of the illiquid nature of the shares."[55] Along with liquidity risks, the prospectus cautioned that "there is no guarantee of any return on your investment, and you may lose all or a portion of your investment."[56] The prospectus therefore stated that "you should purchase these securities only if you can afford a complete loss of your investment."[57] These and similar warnings appeared in the prospectuses for each of the non-traded REITs sold by Patatian.[58]

Because non-traded REITs are complex and risky, several states limit how much a customer may invest in them. One such state is California, where Patatian's customers lived.[59] When Patatian sold non-traded REITs to his customers, California limited investors' maximum investment in a non-traded REIT to 10 percent of their net worth, exclusive of their homes, home furnishings, and automobiles.[60] Patatian was aware of California's investment limitation, [61] and Western and the REIT sponsor tracked it in applications to purchase REITs.[62]

The non-traded REITs sold by Patatian were sponsored or co-sponsored by the American Realty Capital ("ARC") group of companies or an ARC subsidiary, Cole Capital.[63] Starting in October 2014, ARC made a series of disclosures that harmed the value and liquidity of the REITs sold by Patatian.[64] Most notably, ARC disclosed significant accounting problems that ultimately led to criminal charges.[65] As of the hearing, some of the non-traded REITs sold by Patatian remained essentially illiquid, with no public trading market for their shares.[66]

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[54] CX-43, at 42.

[55] CX-43, at 42.

[56] CX-43, at 16.

[57] CX-43, at 16.

[58] *See* CX-43 – CX-48.

[59] Stip. ¶ 11.

[60] *See, e.g.*, CX-43, at 4.

[61] Tr. 294-95.

[62] *See, e.g.*, CX-56, at 5.

[63] *See, e.g.*, CX-46 at 10; Tr. 1497.

[64] CX-1.

[65] Tr. 1495.

[66] CX-7.

F. Patatian Failed to Understand Non-Traded REITs

Patatian testified at the hearing that, because he was unfamiliar with REITs before he joined Western, he approached them with a "level of apprehension and caution."[67] At the hearing, he testified that he "did online trainings, read whatever [he] could get [his] hands on to do [his] homework, to do [his] research . . ."[68] He also testified that he reviewed regulatory alerts and prospectuses for the non-traded REITs before he started to recommend them to clients.[69] "I did research, extensive research about REITs," Patatian testified, "and I would have tried my best to catch everything."[70] This "extensive research" simply continued the "due diligence" that he had started while he was still at CUSO, Patatian testified.[71]

During his 2020 OTR, however, Patatian described his efforts to understand REITs very differently. Before joining Western, Patatian testified in his 2020 OTR, REITs were "not an area of interest" and the "last thing [he] was interested in."[72] He denied that he had any meaningful training while at Western.[73] Instead, he testified, he attended "due diligence" trips sponsored by ARC that were "just like pumping up their product," and "just a payoff, like a bonus, it was greasing the wheel."[74] He described the non-traded REITs he sold to customers as a "black box" and admitted repeatedly that he did not know how they worked.[75] Indeed, he admitted that he would not have recommended the non-traded REITs to his customers if he knew how they functioned.[76]

At his 2020 OTR, Patatian was asked why he changed his mind about recommending non-traded REITs to his customers. "It's not liquid," he replied, and the commissions and fees were so high that "it's impossible that it's going to end up being favorable to the client."[77] He said he would "never, ever do it again," and elaborated on why:

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[67] Tr. 197.

[68] Tr. 198.

[69] Tr. 207.

[70] Tr. 227.

[71] Tr. 198.

[72] CX-236, at 27; Tr. 200-01.

[73] CX-236, at 44-45; Tr. 203-04.

[74] CX-236, at 38; Tr. 222.

[75] CX-236, at 40; Tr. 223-24.

[76] CX-236, at 49; Tr. 248.

[77] CX-236, at 50; Tr. 257.

> Like I didn't know. I was too stupid to really understand what it was really all about, and I guess I was guilty of looking away. And I mean, if I really had dug deep and learned all the gory details, it would have been retarded for me, but I was looking away hoping for the best. And if I could have just got in there, be in there for two, three years max, get the money back, I got seven percent, the client made money, and just get away with it.[78]

Despite his hopes, Patatian acknowledged, "it didn't happen like that at all."[79] Instead, he admitted, "[i]t was a disaster."[80]

Patatian's communications with his clients corroborate his 2020 OTR testimony that he did not understand the risks of investing in non-traded REITs. In the first sentence of an October 2015 email to a customer, for example, he wrote that "[t]he REITS (Real Investment Trusts) are low risk."[81] In the same email, he described them as "very stable."[82] Several customers testified that Patatian either failed to tell them the REITs were risky[83] or assured them that there was not much risk in investing in the REITs.[84]

At the hearing, it was clear that Patatian did not fully understand what he had sold to his customers. He was confronted about the warning, on the front page of the ARC prospectus, that "investing in our common stock involves a high degree of risk."[85] Patatian denied at the hearing, though, that this risk warning applied to his recommendations. "I wasn't trying to invest in the common stock," he testified.[86] Instead, Patatian testified, he "was investing in real estate that was going to provide consistent income streams for the clients long-term."[87] He persisted in this misunderstanding even after he was shown relevant parts of the prospectus several times. "I wasn't trying to buy speculative investments, I was buying real estate," he testified. "I was trying to get the clients into real estate."[88]

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[78] CX-236, at 51; Tr. 258.

[79] CX-236, at 51; Tr. 258.

[80] CX-236, at 51; Tr. 258.

[81] CX-27a.

[82] CX-27a.

[83] Tr. 975, 1097, 1231, 1423.

[84] Tr. 1353.

[85] CX-44; Tr. 265.

[86] Tr. 265. Common stock is, nevertheless, what his customers purchased. *See* CX-44, at 1 (numerous references to investing in "common stock" of American Realty Capital Trust V, Inc.).

[87] Tr. 266.

[88] Tr. 273. *See also* Tr. 267 ("We were investing in a trust that was going to buy real estate . . . that could ultimately potentially get listed and turn into a common stock.").

G. Patatian Overstated His Customers' Investment Experience and Liquid Net Worth

Patatian also created and submitted inaccurate paperwork at Western so that his customers could purchase non-traded REITs. This paperwork consisted of two types of documents. First, there were new account forms, which Patatian needed to submit for the customers who followed him from CUSO.[89] Second, for customers who invested in a non-traded REIT or Direct Participation Program ("DPP"), Patatian had to submit a Client Disclosure Form. Once Patatian filled out these forms, they became part of Western's books and records.[90]

Western's new account forms required information about a customer's investment experience.[91] The form asked for each customer's total number of years investing, and the number of years investing in stocks, bonds, mutual funds, and other instruments.[92] Patatian overstated the investment experience for customers on this form. Patatian used the number of years that each customer worked at DWP as a proxy for that customer's investment experience. If a customer worked at DWP for 25 years, for example, Patatian would report that the customer had 25 years of experience in investing overall, and 25 years of investing experience in stocks, bonds, and mutual funds. At his 2020 OTR, Patatian summarized his practice for recording a DWP customer's investment experience:

> I would ask them how many years you were at the department and I would write that number in the boxes. Right or wrong, that's how I would do it.[93]

Patatian testified at the hearing that he did this because his DWP customers invested in DWP's deferred compensation plan and had to choose bond and stock funds within that plan.[94] But Patatian conceded that the customers were choosing asset classes within the plan, and that the customers may have never selected an individual stock or bond.[95] And the customers who testified at the hearing stated that they had never invested in stocks or bonds when they opened their accounts at Western.[96] Indeed, one customer expressed confusion about the difference between a mutual fund and a money-market fund.[97]

Patatian engaged in a similar practice with the Client Disclosure Forms. Those forms contained a "Client Information" section. This section included fields for the purchase amount of

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[89] Tr. 298; *see, e.g.*, CX-53.

[90] Tr. 314.

[91] *See, e.g.*, CX-53.

[92] *See, e.g.*, CX-53.

[93] CX-236, at 78; Tr. 310.

[94] Tr. 306-07.

[95] Tr. 306.

[96] Tr. 1185, 1091-92, 1349, 1419.

[97] Tr. 1093-94.

the REIT or DPP, the customer's "estimated liquidated net worth (excluding home(s), auto)," the percentage of the customer's "estimated net worth" represented by the purchase, and the percentage of the customer's liquid net worth represented by all REITs and DPP.[98] Customers also had to acknowledge in the Client Disclosure Form that they had "the financial status, including net worth and annual gross income, that meets the suitability standards of the Issuer or [their] state of residence."[99]

Patatian overstated his customers' net worth and liquid net worth in the Client Disclosure Forms. This financial information was relevant to Western in its review of whether a REIT purchase was suitable.[100] It was also relevant because of California's limit on how much a customer could invest in REITs.[101]

Again, Patatian was candid in his 2020 OTR about how he completed the Client Disclosure Forms, particularly about his customers' net worth. At Western, Patatian claimed, he was "coached and instructed about how to maneuver and negotiate" California's investment limitations on the Client Disclosure Form.[102] He elaborated on how he backed into a customer's net worth for the Client Disclosure Form to stay under California's 10 percent cap:

> I mean, if you wanted to invest two hundred thousand into a REIT, you had to make a client's net worth at least $2 million. If you say a client's net worth is a million five, that's going to be above the ten percent, so we are going to have an issue. So the easiest workaround or easiest solution right up front is to make a client's net worth above the number you want to invest, you want to make the investment for.[103]

At his 2020 OTR, Patatian compared this practice to "mak[ing] the numbers fit into a puzzle."[104]

At the hearing, Patatian backtracked on this admission. He claimed that, unlike others in his office, he never inflated his customers' net worth for REIT sales.[105] Instead, Patatian said, to be accurate and comprehensive, he included the present value of his customers' future DWP pensions when calculating their net worth.[106] As an example, Patatian testified, one of his customers had a pension that would generate future monthly payments of $8,000 to $10,000 for

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[98] *See*, *e.g.*, CX-56, at 1.

[99] Stip. ¶ 10; Tr. 312; *see, e.g.*, CX-56.

[100] Tr. 766-67.

[101] See, *e.g.*, CX-43, at 4.

[102] CX-236, at 29-30.

[103] CX-236, at 29-30; Tr. 319-20.

[104] CX-236, at 91.

[105] Tr. 320-21.

[106] Tr. 320.

the customer's lifetime.[107] Patatian said that he included the present value of the lifetime payments from that pension when determining that customer's net worth when he was at CUSO and Western.[108]

But Patatian conceded that he did not use the same method to value his customer's Social Security payments for a net worth calculation, although had he believed it was proper to do this, he could have.[109] Further, his testimony was contradicted by his documents. Patatian often reported far greater liquid net worth for a customer in the Client Disclosure Form than when he reported the same customer's net worth exclusive of home and personal property ("Net Worth Exclusive") in the new account form.

There are several examples of this. In a new account form dated May 15, 2013, Patatian listed Customer CA's Net Worth Exclusive as $2 million.[110] But when CA bought a non-traded REIT less than a year later, Patatian wrote on the Client Disclosure Form that CA's "liquidate [sic] net worth (excluding home(s), auto)" was $2.5 million – or $500,000 more than the prior estimate of his entire net worth exclusive.[111] When asked how CA's liquid net worth could increase more than $500,000 from his Net Worth Exclusive in less than a year, Patatian testified that "it could have been a clerical error."[112]

As another example, Customer CN's new account form listed her Net Worth Exclusive as $2 million and her liquid assets as $500,000 in June 2013.[113] When she bought a REIT almost exactly one month later, Patatian listed her liquid net worth as $3 million in the Client Disclosure Form.[114] And as yet another example, Patatian listed Customer JO's Net Worth Exclusive as $2.5 million in her new account form dated July 19, 2013,[115] and then listed her liquid net worth as $4 million in her Client Disclosure Form, dated May 2014.[116] Again, Patatian tried to attribute these significant differences to possible "clerical error[s]."[117] Given these documents, however, along with the testimony of certain customers addressed below, Patatian's testimony at the hearing about his methodology is simply not credible.

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[107] Tr. 338.

[108] Tr. 338, 1788-89.

[109] Tr. 337.

[110] CX-53.

[111] CX-56.

[112] Tr. 342.

[113] CX-116.

[114] CX-120.

[115] CX-125.

[116] CX-127.

[117] Tr. 474.

H. Patatian's Strategy for Selling Non-Traded REITs

At the hearing, Patatian described his "strategy" in recommending non-traded REITs to his clients.[118] He described a multi-week process. First, he called a customer on the phone, and in a 10- or 15-minute conversation would "just give a preliminary throw the idea out there."[119] After two weeks, he called the customer again, and talked "in depth about the virtue and merits of the product."[120] He claimed he sent each customer a prospectus for the REIT so the customers could conduct their own research.[121] After another two or three weeks, Patatian testified, he scheduled a third meeting, where he "would present the product in detail."[122]

He never let a customer sign anything at that meeting, Patatian claimed.[123] Instead, he "always let them walk away," and gave them a brochure and prospectus so they could research the potential investment.[124] He testified that he encouraged his customers to talk to an attorney, accountant, or other financial advisors about the potential investment.[125] Two weeks later, Patatian testified, he would meet with the customer again.[126] Only then, Patatian claimed, would he let the customer sign anything.[127]

And Patatian insisted that he never submitted documents to Western that he had filled in after the customer signed them in blank.[128] He wanted his customers to know the risks of investing in a non-traded REIT, he claimed. "I wanted them to know that it was nonliquid, I wanted them to know that it could be long-term, I wanted them to understand those disclosures," he testified.[129]

We find that Patatian's description of his sales practices is not credible. It conflicts with the testimony of four of his customers, and the son of a deceased customer. They described their experience with Patatian consistently, credibly, and with specificity. They each testified that Patatian pushed them to invest in non-traded REITs. They each testified that he gave them little or no documentation about their investment when he recommended it. They each testified that they had no understanding of how REITs worked, and that Patatian did not describe the

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[118] Tr. 1769-70.

[119] Tr. 1769-70.

[120] Tr. 1769-70.

[121] Tr. 1769-70.

[122] Tr. 1770.

[123] Tr. 1770.

[124] Tr. 1770.

[125] Tr. 1770.

[126] Tr. 1770.

[127] Tr. 1771.

[128] Tr. 1773.

[129] Tr. 1773-7.

investment in any meaningful detail. They each testified that Patatian explained none of the features or risks of investing in non-traded REITs. Three customers testified that they signed blank forms that Patatian filled in later. Another customer testified that she signed a form that she did not review, and that she signed another form because Patatian told her that the information on the form did not matter.

I. Six REIT Customers

Enforcement alleged that Patatian recommended non-traded REITs to six customers for whom the investments were unsuitable given their best interests and financial situations. Four of the customers testified at the hearing, including a customer who bought a non-traded REIT jointly with her spouse. Another customer was deceased, so her son testified about her purchase of a non-traded REIT from Patatian.

1. CN

CN is a 77-year-old retiree who worked as an electrician for DWP.[130] After CN retired, she met Patatian at a DWP credit union branch and he became her financial advisor at CUSO in 2006.[131] At CUSO, she invested in variable annuities.[132] She became "a little disturbed," she testified, when Patatian told her that she was limited in the amount of money she could withdraw from her variable annuity without penalty.[133] She questioned him about why he recommended that she buy a variable annuity when she "wanted to be able to get my hands on [her money] at any time."[134]

After Patatian left CUSO for Western, he started talking with CN about a possible "real estate investment," she testified.[135] According to CN, Patatian "described it as a real estate investment where they build strip malls and they have like CVSes on the corner" and "they lease it for a couple of years and then they sell it and that's when I would make my money."[136] After conversations with Patatian about this investment,[137] CN opened an account with him at Western on June 4, 2013, to purchase a non-traded REIT.[138]

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[130] Tr. 1066-67.

[131] Tr. 1068-69.

[132] Tr. 1069-70.

[133] Tr. 1074.

[134] Tr. 1074-75.

[135] Tr. 1076.

[136] Tr. 1077.

[137] Tr. 1077.

[138] CX-116.

CN testified that she was not willing to take a lot of risk and that her investment "could take up to four or five years."[139] Even so, her new account form showed that she had a "moderate" risk profile and an investment time horizon of more than 10 years.[140] She had "zero" investing experience in 2013,[141] and had never bought a stock or bond.[142] Indeed, at the hearing, she expressed confusion about the difference between a money-market fund and a mutual fund.[143] Yet according to the new account form she had 25 years of experience investing in stocks, bonds, and mutual funds.[144]

There were other inaccuracies in how CN's financial situation was depicted on Western's new account form. She testified that her Net Worth Exclusive was around $600,000 in 2013.[145] According to the new account form, though, that figure was $2.1 million.[146] Her liquid assets were $150,000, she testified,[147] rather than the $500,000 listed on the new account form.[148]

These discrepancies have an explanation: Patatian filled out the form, and CN signed it without reviewing it.[149] CN considered Patatian a friend,[150] and she did not review the form before signing it because she trusted him.[151] And because she trusted him, she did not discuss with him any of the information he reported on the form about her financial information or investment experience.[152] They did not discuss the risks or potential of loss from investing in a non-traded REIT.[153] In fact, it was unclear whether CN realized she was not investing directly in real estate.[154] "I don't even know what REIT is," she testified.[155]

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[139] Tr. 1083-84.

[140] CX-116, at 1.

[141] Tr. 1091.

[142] Tr. 1092.

[143] Tr. 1093-94.

[144] CX-116, at 1.

[145] Tr. 1090.

[146] CX-116, at 1.

[147] Tr. 1090-91.

[148] CX-116, at 1.

[149] Tr. 1094.

[150] Tr. 1120.

[151] Tr. 1095.

[152] Tr. 1095.

[153] Tr. 1097-98.

[154] Tr. 1097.

[155] Tr. 1108.

To fund her purchase of a non-traded REIT, CN surrendered the variable annuity she had bought through Patatian at CUSO.[156] This generated about $60,000 in proceeds.[157] To purchase the non-traded REIT, CN signed a Client Disclosure Form on July 3, 2013 – less than a month after she opened her account at Western.[158] As with the new account form, Patatian filled out the Client Disclosure Form in front of her.[159] He wrote that her estimated liquid net worth, exclusive of her home and auto, was $3 million[160] – almost a million dollars more than what he had listed in the new account form. When CN questioned Patatian about her inaccurate liquid net worth, she testified, "his answer was it doesn't matter; they don't check anyway."[161] So she signed the Client Disclosure Form.[162]

Similarly, with risk disclosures and client acknowledgments in the Client Disclosure Form, Patatian told CN where to write her initials, and she did so without reading the disclosures or discussing any risks with Patatian.[163] She acknowledged on the Client Disclosure Form, for example, that she "read and carefully reviewed the prospectus" for the non-traded REIT.[164] But at the hearing, she testified credibly that she did not know what a prospectus is, and she did not review any documents before making her investment.[165]

After CN invested in the non-traded REIT, she testified, she received monthly dividends.[166] Later she learned that these dividends simply represented a return of her principal investment.[167] In November 2021, she testified, she sold her shares in the non-traded REIT at a substantial loss.[168]

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[156] CX-119; Tr. 1101.

[157] CX-119.

[158] CX-120.

[159] Tr. 1104.

[160] CX-120.

[161] Tr. 1105.

[162] Tr. 1105.

[163] Tr. 113.

[164] CX-120, at 1.

[165] Tr. 1107-08.

[166] Tr. 1114.

[167] Tr. 1114-15.

[168] Tr. 1119-20.

2. JO

JO has worked as a supervisor at DWP for 36 years.[169] She is also a mother of four, including two minors.[170] She became Patatian's customer in 2006 when he was with CUSO.[171] She invested about $300,000 into a variable annuity, with conservative investments in the subaccounts.[172]

Shortly after Patatian left CUSO for Western, he called JO about opening an account at Western.[173] When they met, JO told Patatian that she was going through a divorce and did not know where she would live, so she needed her money "safe and accessible."[174] She was also undergoing chemotherapy.[175] So when Patatian recommended investing in commercial real estate, JO told him that was too risky for her and she was not interested in real estate.[176]

At a meeting with Patatian, JO signed a Western new account form dated July 19, 2013.[177] The form was blank, except for some typed background information about her name, address, and contract information.[178] JO signed the otherwise blank form, she testified, because she trusted Patatian.[179]

So while her "return objective" was listed as "growth," and her "risk profile" was listed as "moderate" on the new account form,[180] in reality JO's goal was to have her money "safe and accessible"[181] and her risk tolerance was "[n]one, or extremely conservative."[182] And while her account form showed that her investment time horizon was more than 10 years, JO was unwilling to tie her money up for even a short time.[183]

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[169] Tr. 1396-97.

[170] Tr. 1397.

[171] Tr. 1399-1400.

[172] Tr. 460.

[173] Tr. 1402-04.

[174] Tr. 1404.

[175] Tr. 1405.

[176] Tr. 1405-06.

[177] Tr. 1407-08; CX-125.

[178] Tr. 1408; CX-125, at 1.

[179] Tr. 1409-10.

[180] CX-125, at 1.

[181] Tr. 1410.

[182] Tr. 1411.

[183] Tr. 1411-12.

Similarly, JO's actual financial condition differed from what was listed on the new account form. While the value of her assets was less than $1 million, including her pension, the new account form listed her assets as $3 million, and her Net Worth Exclusive as $2.5 million.[184] Moreover, she did not have 20 years of investing experience in stocks, bonds, and mutual funds, as the new account form stated.[185] JO did not discuss this financial information with Patatian when she signed the form.[186]

About ten months later, in May 2014, JO followed Patatian's recommendation to surrender her variable annuity.[187] Patatian used the proceeds of the surrender – about $360,000 – to purchase a non-traded REIT for JO.[188] As with the new account form, JO signed a blank Client Disclosure Form.[189] On the Client Disclosure Form, JO's liquid net worth was listed incorrectly as $4 million.[190] JO had no discussions with Patatian about her liquid net worth when she signed the Client Disclosure Form.[191] And she had no discussions with Patatian about any of the risks or disclosures associated with investing in REITs listed in the Client Disclosure Form.[192] As with the new account form, JO testified, she signed the blank Client Disclosure Form because she trusted Patatian.[193]

JO testified that she did not realize that she had bought a REIT until about a month later, when she received literature from the issuer in the mail.[194] When she realized her investment was in a non-traded REIT, JO told Patatian that she was unhappy because she wanted her money safe and accessible.[195] Patatian told her that she would have to wait a year before trying to get back her investment.[196] After a year, JO called and texted Patatian repeatedly to get her investment back, to no avail.[197] Finally, after contacting a Western manager, JO managed to sell her non-traded REIT in July 2015 for around $307,000.[198]

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[184] Tr. 1413-14, 1416; CX-125, at 1.

[185] Tr. 1418-19.

[186] Tr. 1417.

[187] Tr. 1424-25; CX-126.

[188] CX-127.

[189] Tr. 1429.

[190] CX-127, at 1; Tr. 1434.

[191] Tr. 1430.

[192] Tr. 1430-33.

[193] Tr. 1434.

[194] Tr. 1421.

[195] Tr. 1423.

[196] Tr. 1424.

[197] Tr. 1436-37.

[198] Tr. 1441, 1462-63; CX-130; CX-131.

According to Patatian, JO wanted to sell her variable annuity and invest in a non-traded REIT because she wanted an income stream.[199] After he recommended the REIT to her, though, her life circumstances changed, he testified.[200] She developed cancer after his recommendation, he testified, and she wanted money to purchase a property.[201] But Patatian did not explain why, if JO wanted an income stream, he recommended that she invest in a non-traded REIT.

3. RC

RC is a 73-year-old retiree.[202] He lives in Manhattan Beach, California.[203] He worked as a security guard for DWP for 20 years, until his retirement in 2019.[204]

RC became Patatian's client in 2007, when he invested around $77,000 in a variable annuity as part of his retirement planning.[205] RC had saved this money from working overtime in double-shifts at DWP.[206] Prior to purchasing this variable annuity, RC had no investing experience.[207]

After he left CUSO for Western, Patatian called RC and told him there was a "fantastic deal" that would be "perfect" for RC's retirement planning.[208] Because it was such a "fantastic investment," Patatian told RC, he'd "have to act fast."[209] At a meeting in RC's home on July 1, 2014, Patatian gave RC a new account form that was blank except for his contact information and basic biographical information.[210] This mostly-blank account form, with an arrow directing where RC needed to sign, was introduced into evidence at the hearing.[211]

RC signed the new account form at that meeting, even though the sections about his investment objectives and financial information were blank. He considered Patatian a friend.[212]

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[199] Tr. 1793.

[200] Tr. 1794.

[201] Tr. 1795.

[202] Tr. 1175.

[203] Tr. 1175.

[204] Tr. 1177.

[205] Tr. 1178, 1182; CX-69.

[206] Tr. 1182-83.

[207] Tr. 1185.

[208] Tr. 1187.

[209] Tr. 1189.

[210] CX-70a.

[211] CX-70a.

[212] Tr. 1206.

"I trusted him a hundred percent," RC testified. "I would not even bother to read what it was in there."[213]

Patatian filled out the rest of the new account form after RC signed it.[214] So even though RC said that his "main concern was to have money for retirement"[215] and he was unwilling to take any risk,[216] the new account form listed his risk profile as moderate and his investment time horizon as longer than 10 years.[217] The new account form also overstated his investing experience,[218] liquid assets,[219] annual income,[220] and Net Worth Exclusive.[221]

Three weeks later, RC invested around $95,000 in a non-traded REIT.[222] This represented all the proceeds from his variable annuity.[223] RC signed the Client Disclosure Form without reviewing it because, as with the new account form, RC "trusted [Patatian] a hundred percent."[224] Patatian "just told [him] where to sign and where to put [his] initials."[225] So in the Client Disclosure Form, Patatian listed RC's liquid net worth as more than three times the amount of liquid assets listed in the new account form of only three weeks before.[226] RC testified that he had no discussion with Patatian about the features of the product or disclaimers outlined in the Client Disclosure Form.[227]

RC described the performance of the REIT as "lousy, very awful" because the issuer stopped paying dividends in July 2020 and he could not sell it.[228] In 2017 and then again in 2018, RC received offers to purchase his investment at 40 percent of his purchase price per share.[229]

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[213] Tr. 1206.

[214] Tr. 1207; CX-70.

[215] Tr. 1208.

[216] Tr. 1210.

[217] CX-70.

[218] Tr. 1221-22.

[219] Tr. 1220.

[220] Tr. 1212-13.

[221] Tr. 1219.

[222] CX-71.

[223] Tr. 1226.

[224] Tr. 1229.

[225] Tr. 1229.

[226] CX-71, at 1.

[227] Tr. 1230-34.

[228] Tr. 1236, 1238.

[229] Tr. 1237.

Western denied his request that the firm return his money[230] and the issuer of the REIT refused to return his investment.[231] As of the hearing, his investment remained illiquid.[232] He testified that he had to work five more years to accumulate extra money because he could not sell his investment.[233]

At the hearing, Patatian described RC as "a pain in the ass."[234] Patatian also said that RC, who took online courses at an unaccredited law school over six or seven months,[235] thinks "he's like this genius lawyer, he's this brilliant legal mind, and he's smarter than everybody else."[236] Patatian tried to explain why RC managed to produce a signed blank form at the hearing. Patatian testified that he sent RC blank forms "for him to analyze and to read line by line" before they met.[237] During the meeting at RC's home, Patatian and RC were going through the form "line by line."[238] According to Patatian, halfway through their meeting, RC asked if he could make a copy of the blank forms.[239] "I didn't think anything of it at the time," Patatian testified, "and I said, yeah, sure."[240] So RC made a copy halfway through their meeting, Patatian claimed.[241] The paperwork was complete when RC signed it, Patatian testified, and "if I could go back I'd tell him no, no, no, you're not copying anything until we're done."[242]

Again, however, Patatian's hearing testimony contradicted his 2020 OTR testimony. During his 2020 OTR, Patatian was asked whether he asked RC to sign a blank form and send it back to him. His answer: "I probably could have, yes."[243] When asked why, he said, "So we could get the account open."[244] At the hearing, he dismissed his 2020 OTR testimony about the blank form by saying that he was "mistaken" and "didn't remember everything right at that point."[245]

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[230] Tr. 1243-45.

[231] Tr. 1240-41.

[232] Tr. 1242.

[233] Tr. 1247.

[234] Tr. 1771.

[235] Tr. 1283-84.

[236] Tr. 1771.

[237] Tr. 1772.

[238] Tr. 1772.

[239] Tr. 1772.

[240] Tr. 1772.

[241] Tr. 1773.

[242] Tr. 1773.

[243] Tr. 1831.

[244] Tr. 1831.

[245] Tr. 1832.

4. JD and WD

JD and WD are a married couple who became Patatian's customers at CUSO in 2008.[246] WD testified at the hearing. She is 67-years old and runs a family lighting business.[247]

JD and WD opened an account with Patatian at Western in April 2013.[248] JD and WD wanted to invest the proceeds from the variable annuity they had bought from Patatian at CUSO.[249] They told Patatian repeatedly that they did not want a long-term investment and wanted to keep their money liquid.[250] Patatian told them "he had something that would get five or six percent again."[251] He also told them that they "would only need to invest for a year and that [they] could have [their] money at any time."[252]

When they met with Patatian at their office, they were rushing to leave because their business had closed.[253] After assuring JD and WD that they could access their money after one year, he had them sign blank forms.[254] Patatian took the forms with him when he left.[255]

JD and WD signed a blank Western new account form on April 18, 2013.[256] According to the new account form, their risk profile was moderate, when in reality it was conservative.[257] Their investment time horizon was "very short," though the new account form stated it was greater than ten years.[258] They had little to no investing experience, despite the 25 years of investing experience listed on the new account form.[259]

Similarly, the new account form listed JD and WD's annual income as $200,000, when it was only about $150,000.[260] Their assets were substantially less than the $3 million listed on the

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[246] CX-80.

[247] Tr. 1324.

[248] CX-83.

[249] Tr. 1332.

[250] Tr. 1334, 1335.

[251] Tr. 1334.

[252] Tr. 1334.

[253] Tr. 1336.

[254] Tr. 1336.

[255] Tr. 1337.

[256] CX-83.

[257] Tr. 1340-41.

[258] Tr. 1341.

[259] Tr. 1349.

[260] Tr. 1342.

new account form.[261] And their Net Worth Exclusive and liquid assets were also substantially overstated on the new account form.[262]

Patatian recommended that JD and WD buy a REIT. At the time, JD and WD "had no idea what a REIT was[.]"[263] In fact, WD testified, she thought she was investing directly into a real estate property.[264] Patatian told them there was little risk in the investment. "He said that we could take our money out after a year," WD testified. "[Y]ou get five percent, they're going to sell the property, and then you can get it out sooner."[265] Patatian assured them that they would get their "whole value back."[266] So in July 2014, JD and WD invested around $45,000 from their annuity into a non-traded REIT.[267]

As with the Western new account form, JD and WD signed a blank Client Disclosure Form.[268] WD signed a blank form without reading it, she testified, because she was in a hurry and trusted Patatian.[269] The Client Disclosure Form listed their liquid net worth as approximately 20 percent higher than even the overstated Net Worth Exclusive listed in the new account form from about 15 months earlier.[270] JD and WD did not have any discussions about the risks and features of REITs mentioned in the Client Disclosure Form.[271] After they bought the REIT, WD called Patatian repeatedly for a copy of the application, but he never sent it to her.[272]

At the end of the first year after they bought the non-traded REIT, JD and WD called Patatian to withdraw their funds.[273] Patatian told them they would have to fill out a withdrawal form, which he promised to send them.[274] After repeated requests, Patatian finally sent JD and WD the form, but told them it was too late to process their withdrawal request for the year.[275]

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[261] Tr. 1343-44.

[262] Tr. 1348.

[263] Tr. 1352.

[264] Tr. 1352.

[265] Tr. 1353.

[266] Tr. 1353.

[267] CX-86.

[268] Tr. 1356, 1385.

[269] Tr. 1356, 1362-63.

[270] CX-86, at 1.

[271] Tr. 1358-62

[272] Tr. 1363.

[273] Tr. 1364.

[274] Tr. 1364.

[275] Tr. 1365.

So the next year, JD and WD called Patatian earlier and asked for the form, so that they could withdraw their investment.[276] JD and WD did not understand the form, so WD called the REIT issuer.[277] A representative of the REIT issuer told WD that she could not withdraw her money and that her money might be inaccessible for four years.[278] WD then tried to contact Patatian, but he did not return her calls.[279]

After the fourth year, WD called the REIT issuer again to sell her investment.[280] This time she was told she could only get her money back if she or her husband died.[281] She rejected offers from third parties to purchase their investment for half of their purchase price, and the issuer stopped paying dividends in 2020.[282] As of the hearing, their investment was still illiquid.[283]

5. JR

JR was a Patatian customer who passed away in October 2018.[284] Her son, DK, testified at the hearing. He is a field sergeant in the Los Angeles County Sheriff's Department.[285] He became involved in his mother's finances around 2008 or 2009.[286] His mother was a security officer who retired from DWP.[287]

Before her death in 2018, JR's health deteriorated over time, and she started to suffer from dementia in 2012.[288] So in 2012, DK assumed power of attorney for her.[289] JR's increasing mental instability required her to move into a retirement home in 2015 for less than a year, then for six months with DK and his wife, where JR received near-constant care.[290] When her condition deteriorated even further, JR moved into a facility that provided residential care for the

[276] Tr. 1365.

[277] Tr. 1365.

[278] Tr. 1365.

[279] Tr. 1366.

[280] Tr. 1366.

[281] Tr. 1366.

[282] Tr. 1367-68, 1371-72.

[283] Tr. 1368.

[284] Tr. 930.

[285] Tr. 928.

[286] Tr. 931.

[287] Tr. 929.

[288] Tr. 930.

[289] Tr. 936.

[290] Tr. 933-34.

elderly in May 2016.[291] To pay for the residence and her monthly costs, JR needed both her pension and between $2,500 and $3,000 a month from three variable annuities she had bought from Patatian while he was at CUSO.[292]

Patatian was aware of JR's poor health and need for income. In early 2015, as DK became more involved in his mother's finances, he reached out to Patatian often for disbursements from JR's annuities.[293] DK "vented a lot" to Patatian about the stresses caused by his mother's health and mental condition.[294] In particular, DK told Patatian about his mother's cognitive issues.[295] He also told Patatian in early 2016 that his mother was moving into an assisted living facility, and emphasized that he needed disbursements from her investments to pay for her care.[296]

JR opened an account with Western on April 19, 2016 – just 11 days before she moved into the assisted living facility.[297] In the new account form, JR's risk profile was listed as "moderate/aggressive," her investment time horizon as "Long (>10 Years)" and her liquidity needs as "medium."[298] Her knowledge of stocks, bonds, and mutual funds was "good," according to the new account form, and her knowledge of variable annuities was "extensive."[299] None of this was true,[300] nor was the financial information for JR listed in the form. Her annual income, assets, Net Worth Exclusive, and liquid assets were all substantially overstated.[301] In fact, the financial information for JR was blank when she signed the form.[302] JR signed the form without that financial information because she and her son trusted Patatian.[303]

According to DK, he and his mother were content to keep her three variable annuities.[304] But Patatian "pushed this REIT really, really hard," DK testified.[305] And, as DK put it, "it was a

[291] Tr. 934.

[292] Tr. 937, 939.

[293] Tr. 942-43.

[294] Tr. 943.

[295] Tr. 946.

[296] Tr. 947-48.

[297] Tr. 952.

[298] CX-138.

[299] CX-138.

[300] Tr. 953-57.

[301] Tr. 959-63.

[302] Tr. 963.

[303] Tr. 963.

[304] Tr. 964.

[305] Tr. 964.

very stressful time."[306] Patatian told DK and JR that a REIT investment would not lose money and would continue to provide monthly income.[307] Patatian never discussed with DK and JR the risks associated with investing in a REIT.[308] So on the same day that she opened an account at Western, JR bought a non-traded REIT.[309]

As with the new account form, JR signed the Client Disclosure Form even though her liquid net worth was left blank on the form because she and DK trusted Patatian to include that information later.[310] When filled in later, the Client Disclosure Form substantially overstated JR's net liquid worth.[311] JR and DK did not discuss with Patatian the features and risks listed in the Client Disclosure Form.[312] While JR initialed certain acknowledgements listed in the Client Disclosure Form, she and DK did not discuss them with Patatian.[313] So even though JR acknowledged with her initials that she received a prospectus, she had not received one when she initialed the form.[314] And she initialed an acknowledgment intended only for Alabama residents, even though she lived in California.[315]

The REIT bought by JR performed well, DK conceded at hearing, and JR could pay for her care at the assisted-living facility with monthly distributions.[316] When JR died in 2018, she still owned the REIT.[317] The REIT had to go through probate, which DK blamed on Patatian for not changing the beneficiary.[318] After he complained to Western, the firm paid a portion of the legal fees DK incurred related to the REIT going through probate.[319]

At the hearing, Patatian emphasized that JR's variable annuities were "fantastic" and had grown substantially since she bought them.[320] And he admitted that she had declined physically and mentally before he recommended that she sell her variable annuities.[321] Because of her

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[306] Tr. 964.

[307] Tr. 965.

[308] Tr. 971.

[309] CX-137.

[310] Tr. 974.

[311] CX-137; Tr. 974.

[312] Tr. 975-80.

[313] Tr. 983.

[314] CX-137, at 4; Tr. 976.

[315] CX-137, at 5; Tr. 984.

[316] Tr. 989-90, 1018, 1020.

[317] Tr. 991.

[318] Tr. 991.

[319] Tr. 996-97.

[320] Tr. 1797.

[321] Tr. 1799.

monthly withdrawals from the variable annuities, Patatian testified, "we were burning through an enormous amount of capital for her."[322] Because he was concerned about JR running out of money, Patatian testified, he recommended that she buy a non-traded REIT for "substantial monthly income."[323] As Patatian put it, "it really stabilized and anchored down her finances."[324] Again, however, Patatian did not explain why it was suitable for JR to invest in a non-traded REIT when the prospectus explicitly cautioned that "[p]ersons who require liquidity within several years from the date of their investment or seek a guaranteed stream of income should not invest in our common stock."[325]

J. Variable Annuity Surrenders and Exchanges

Enforcement also alleged that Patatian made several unsuitable recommendations to customers related to variable annuity surrenders and exchanges.

1. Tax Consequences of Variable Annuity Surrenders

Between 2013 and 2015, Patatian recommended that four customers, including a married couple, surrender their variable annuities to invest in non-traded REITs. When these customers surrendered their variable annuities, they incurred substantial, unplanned taxes on the investment gains. Patatian did not consider the tax consequences of his recommendations.

When confronted about the unexpected tax bills, Patatian tried to justify them as "1035 exchanges." This exchange refers to Section 1035 of the Internal Revenue Code, which generally allows an owner of an insurance product, such as a variable annuity, to exchange that product for a new insurance product without paying tax on the investment gains from the original contract.[326] Kelsey Goodman, a Certified Public Accountant and an Enforcement investigator, testified that he has reviewed thousands of exchange transactions over the course of at least 16 years studying variable annuities.[327] He has never seen or heard that using the surrender proceeds of a variable annuity to invest in a non-traded REIT qualifies as a 1035 exchange.[328] And Patatian admitted in his 2020 OTR that no insurance company or compliance officer told him that these qualify as 1035 exchanges.[329]

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[322] Tr. 1799.

[323] Tr. 1800.

[324] Tr. 1800.

[325] CX-48, at 3.

[326] Tr. 1638-39; FINRA Investor Alert, *Should You Exchange Your Variable Annuity?* (Mar. 2, 2006), https://www.finra.org/investors/alerts/should-you-exchange-your-variable-annuity-rot.

[327] Tr. 1640.

[328] Tr. 1640.

[329] CX-236, at 56-57.

AT was one of the four customers who surrendered a variable annuity to invest in a non-traded REIT. She surrendered her variable annuity in May 2014 and invested the proceeds – around $96,000 -- into a non-traded REIT recommended by Patatian.[330] She did not withhold federal income tax when she surrendered her variable annuity.[331] Because she surrendered her variable annuity, AT was assessed $19,005 in taxes on her gains, which included a $3,052 substantial tax understatement penalty.[332] She also incurred a surrender fee of around $2,100.[333] When AT received the tax bill, she asked Patatian to explain why she owed taxes.[334] In response, Patatian wrote that "[t]his transaction was a 1035 exchange."[335]

Similarly, the married couple, RS and BS, surrendered a variable annuity in January 2013 and used the proceeds, along with a partial withdrawal from another insurance policy, to buy a non-traded REIT.[336] Like AT, RS and BS did not withhold any taxes from the surrender proceeds.[337] And like AT, RS and BS incurred a tax penalty from their surrender, including a substantial tax understatement penalty. The total amount assessed by the IRS was over $20,000.[338] In response to a question about the taxes from the accountant for RS and BS, Patatian again characterized the transactions as a 1035 exchange.[339] This time, Patatian wrote that RS and BS invested the insurance proceeds into a "new contract/policy" with the REIT issuer.[340] As Patatian conceded at the hearing, however, the REIT investment was neither an insurance policy nor an insurance contract.[341]

Finally, JO, who testified at the hearing, incurred tax liabilities of around $34,000 when she surrendered her variable annuity to buy a non-traded REIT.[342] Prior to surrendering the variable annuity, JO testified, she did not have any discussions with Patatian about the tax consequences of her surrender.[343] At the hearing, Patatian claimed that he told JO that she would

[330] CX-160; CX-161.

[331] CX-160, at 8.

[332] CX-160, at 1.

[333] CX-160, at 4.

[334] Tr. 603.

[335] CX-160, at 4.

[336] CX-147; CX-148; CX-150.

[337] CX-148, at 5, 8.

[338] CX-150, at 2.

[339] CX-150, at 1.

[340] CX-150, at 6.

[341] Tr. 625.

[342] Tr. 1426.

[343] Tr. 1426-27.

incur taxes because of her surrender.[344] But at his 2020 OTR, Patatian admitted that he did not know whether JO would incur taxes as a result of her surrender.[345]

2. Surrender Fees and Penalties

Patatian also recommended in 2015 that a married couple, JE and ME, surrender their variable annuity to invest in a non-traded REIT.[346] Because JE and ME held their variable annuity at CUSO,[347] however, Patatian was not the agent of record for the variable annuity.[348] So when he recommended that JE and ME surrender their variable annuity, Patatian did not know if they would incur a surrender charge,[349] even though he acknowledged that was critical to disclose to a customer.[350] And because he "got impatient,"[351] he did not check to see if they would incur a surrender charge before recommending that JE and ME surrender their variable annuity.[352] In fact, JE and ME incurred a surrender charge of over $4,000.[353]

Patatian testified that he was "surprised"[354] and "uncomfortable"[355] when he learned of the amount of the surrender charge. "I felt it was too high a penalty for them to bear," he testified.[356] So he tried "everything [he] could to stop the transaction."[357] But he failed.[358] As he admitted at the hearing, he would not have recommended that JE and ME surrender their variable annuity had he known they would have incurred such a large surrender fee.[359]

After the surrender, Patatian impersonated JE in a telephone call with the insurance company that issued the variable annuity.[360] Patatian wanted to obtain the contract value and

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[344] Tr. 463.

[345] Tr. 463-64; CX-236, at 84-85.

[346] CX-95; CX-96; CX-97.

[347] Tr. 638-39; CX-96; Ans. ¶ 73.

[348] Tr. 629; Ans. ¶ 73.

[349] Tr. 641; Ans. ¶ 73.

[350] Tr. 628.

[351] Tr. 629.

[352] Tr. 641.

[353] CX-96.

[354] Tr. 653.

[355] Tr. 654.

[356] Tr. 1764.

[357] Tr. 1764.

[358] Tr. 653-54, 1764.

[359] Tr. 653.

[360] Ans. ¶ 75.

surrender charge of the variable annuity.[361] At the beginning of the call, Patatian claimed he was ME, who is a woman.[362] The insurance company representative asked Patatian to clarify his identity, so Patatian then claimed he was JE, ME's husband.[363] To authenticate his identity as JE, Patatian provided JE's date of birth and the last four digits of JE's social security number.[364]

At the hearing, Patatian claimed he had "written express authority" from JE and ME to obtain the contract value and surrender charge on their behalf.[365] "They had signed new account forms, they signed a broker-dealer change form, they had signed all kinds of agreements authorizing me," he testified.[366] But account forms and broker-dealer change forms did not authorize Patatian to impersonate JE in the call with the insurance company. And he pointed to no other documents or other evidence that would support his claim.

3. Erroneous Cost Differences for Exchanges

As Patatian conceded, when considering a variable annuity exchange, it is important to consider the difference in costs between two products.[367] But he failed to accurately calculate costs in two variable annuity exchanges that he recommended to a married couple, DG and AG.

DG and AG collectively owned two variable annuities that Patatian had sold to them at CUSO.[368] In November 2017, Patatian recommended that they exchange their two variable annuities for two new variable annuities, which carried new surrender periods.[369] In recommending the exchanges, Patatian disclosed to DG and AG the costs of the new variable annuities and compared them to the costs of their existing variable annuities.[370] According to Patatian's calculations, the new variable annuities would cost just five basis points more per year than the existing variable annuities.[371] The problem with Patatian's calculations, however, was that his cost comparison included fees that DG and AG were no longer paying for their existing variable annuities.[372]

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[361] Ans. ¶ 75.

[362] Ans. ¶ 76.

[363] Ans. ¶ 76.

[364] Ans. ¶ 76.

[365] Tr. 1763.

[366] Tr. 1762.

[367] Tr. 657-58.

[368] CX-102; CX-103.

[369] CX-114.

[370] CX-113, at 1; CX-114, at 1.

[371] CX-113, at 1; CX-114, at 1.

[372] CX-111.

In particular, Patatian included fees for a discontinued rider.[373] When confronted about his error at the hearing, Patatian claimed that the issuer had still been charging AG and DG for the rider, even after the issuer discontinued it in 2015.[374] This was untrue.[375] It also contradicted Patatian's 2020 OTR testimony, in which he admitted that he was unaware of whether the issuer continued to charge DG and AG for the defunct rider.[376]

The new variable annuities therefore cost DG and AG around $4,000 more per year than their exchanged annuities.[377] At the hearing, Patatian insisted that he still would have recommended the exchanges, because of an increased death benefit.[378] Again, though, during his 2020 OTR, Patatian admitted he would not have recommended the exchanges because of the "significant increase" in cost.[379]

4. Failure to Understand Features in Exchanges

For four recommended variable annuity exchanges in 2017 and 2018, Patatian did not understand that certain features were optional, rather than standard, and could only be purchased for additional cost.[380] Patatian recommended the exchanges to obtain a "step up" in death benefits, to the current market value of the existing variable annuities, which had appreciated over time.[381] On the form for one of the exchanges, for example, Patatian wrote that "the client is very concerned that we are in the 9th year of a bull market and we may see a decline in the market going forward."[382] Patatian recommended the exchange, he wrote, because the client "wants to lock in and protect the current Death Benefit" of his existing variable annuity.[383]

When he made the exchanges, however, Patatian failed to elect the optional "Protected Premium Death Benefit" rider for the new variable annuities.[384] This rider would have provided the stepped-up death benefit for his customers at more cost.[385] Patatian did not elect the Premium

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[373] CX-111.

[374] Tr. 672-73, 675.

[375] Tr. 1653-54; CX-17a.

[376] CX-237, at 50-51; Tr. 674.

[377] Tr. 1763-64.

[378] Tr. 684.

[379] CX-237, at 52-54; Tr. 686.

[380] The customers of these exchanges are JB, CM, RS, and a married couple, both with initials AT, who jointly owned their variable annuity.

[381] CX-64, at 3; CX-201, at 3; CX-157, at 3; CX-159, at 3.

[382] CX-157, at 3.

[383] CX-157, at 3.

[384] *See, e.g.*, CX-64, at 6.

[385] CX-64, at 6; Tr. 709.

Death Benefit rider for his customers because he thought it was a standard feature of the new contracts.[386] He did not know that the rider was optional and that the customer had to buy it.[387]

Patatian conceded at the hearing that he erred in failing to elect the rider for his customers.[388] Again, however, he characterized his failure as a "clerical mistake."[389] He testified that, after he learned in his 2020 OTR that the rider was optional, he contacted the issuer and corrected his mistake for his four customers.[390] But his mistake undermined his justification for the exchanges, as well as the cost comparison he used to recommend the exchanges.

III. Conclusions of Law

A. The Non-Traded REIT Suitability Violations (First Cause of Action)

Enforcement alleges that Patatian violated FINRA Rules 2111 and 2010 by making unsuitable REIT recommendations. FINRA Rule 2111 requires that an associated person "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 [] associated person to ascertain the customer's investment profile." There are two prongs of FINRA's suitability rule: a reasonable-basis suitability obligation and a customer-specific suitability obligation.

Some legal principles apply to both prongs of FINRA Rule 2111. Suitability is determined at the time of the recommendation, not with hindsight.[391] Patatian has pointed out that DK, JR's son, acknowledged that the REIT performed well for JR.[392] Enforcement's summary exhibit shows that some customers had unrealized gains from their illiquid REIT investments.[393] But it is not a defense to a suitability violation that the customer profited from the transaction.[394] Nor does disclosing a particular investment's risks to a customer satisfy a registered representative's suitability obligation.[395]

Further, Patatian pointed to evidence of potential supervisory lapses at Western throughout the hearing, which approved his transactions despite red flags and apparent

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[386] Tr. 709.

[387] Tr. 709.

[388] Tr. 712.

[389] Tr. 712.

[390] Tr. 1758-59.

[391] *Dep't of Enforcement v. Escarcega*, No. 2012034936005, 2017 FINRA Discip. LEXIS 32, at *53 (NAC July 20, 2017).

[392] Tr. 989-90.

[393] CX-2.

[394] *Escarcega,* 2017 FINRA Discip. LEXIS, at *58-59

[395] *Id.*

discrepancies in the transaction documents.[396] While Patatian raised substantial questions about the adequacy of Western's supervision, and whether more rigorous scrutiny of his REIT transactions may have prevented unsuitable REIT sales, an associated person cannot shift his suitability obligations to a firm or an issuer.[397] Simply because a registered representative's firm reviewed and approved the transactions does not absolve the representative from liability for making unsuitable recommendations.[398] Instead, a registered representative has an "independent obligation" to ensure that his recommendations are suitable.[399]

We find that Enforcement proved its first cause of action. Patatian violated FINRA Rules 2111 and 2010.

1. Reasonable-Basis Suitability Obligation

The reasonable-basis suitability obligation focuses on the broker's understanding of the recommendation.[400] A broker must "have a reasonable basis to believe, based on reasonable due diligence, that the recommendation is suitable for at least *some* investors."[401] Whether due diligence is reasonable depends on "the complexity of and risks associated with the security" and the "associated person's familiarity with the security[.]"[402] The due diligence must provide the broker "with an understanding of the potential risks and rewards associated with the recommended security[.]"[403] A broker who does not understand those potential risks and rewards violates the suitability rule.[404]

Patatian admitted that he had an obligation to understand a securities product before recommending it to customers.[405] Enforcement alleges that Patatian did not understand the potential risks of the non-traded REITs he recommended to any of his customers, and his lack of

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[396] *See, e.g.*, Tr. 575-81; CX-142b.

[397] *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *40 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

[398] *Escarcega*, 2017 FINRA Discip. LEXIS 32, at *62.

[399] *Cody*, 2011 SEC LEXIS 1862, at *26.

[400] *Dep't of Enforcement v. McGee*, No. 2012034389202, 2016 FINRA Discip. LEXIS 33, at *57 (NAC July 18, 2016), *aff'd*, Exchange Act Release No. 80314, 2017 SEC LEXIS 987 (Mar. 27, 2017), *petition for review denied*, 733 F. App'x 571 (2d Cir. 2018).

[401] Supplementary Material at FINRA Rule 2111.05(a).

[402] *Id.*

[403] *Id.*

[404] *Id.*; *see also Dep't of Enforcement v. Reyes*, No. 2016051493704, 2021 FINRA Discip. LEXIS 29, at *36 (NAC Oct. 7, 2021) ("We therefore look at the adequacy and reasonableness of the diligence and investigation that a broker undertakes prior to recommending a security to determine whether he possesses a reasonable basis to believe such recommendations are suitable for at least some customers").

[405] Tr. 188.

understanding "is a per se violation of the reasonable basis suitability obligations."[406] This allegation applies to each of the 81 non-traded REIT transactions that Patatian recommended to his 59 customers.

We find that Patatian did not understand the non-traded REITs he recommended to customers. In his 2020 OTR, Patatian admitted that he did not understand how REITs worked when he recommended them to his customers, comparing them to a "black box." Even at the hearing, Patatian did not understand that his customers invested in common stock, rather than directly in real estate. At the hearing, he also denied that the non-traded REITs carried liquidity risk, despite the multiple warnings in the prospectuses and Client Disclosure Forms. His misunderstanding was evident in his communications with customers, in which he described REITs as "low risk" and "very stable," and otherwise mischaracterized their liquidity. At the hearing, he defended his recommendation of a non-traded REIT to one customer because she needed guaranteed, stable income, despite the warnings in the prospectus that customers seeking guaranteed monthly income should invest elsewhere.

We therefore find that Patatian violated his reasonable-basis suitability obligations, and FINRA Rules 2111 and 2010, by making unsuitable recommendations to 59 customers for 81 non-traded REIT transactions.[407]

2. Customer-Specific Suitability

Enforcement alleges that Patatian also violated his customer-specific suitability obligation in recommendations for non-traded REITs to six customers – CN, JO, JD and WD, RC, and JR. This obligation requires an associated person to "have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile[.]"[408] A broker must also "assess whether a recommendation involving a security or securities is suitable for the specific customer to whom the recommendation is made."[409] To be suitable, a broker's recommendation must "be consistent with the customer's best interests and financial situation."[410] And a broker cannot make a suitable recommendation "without disclosing the risks of the security to the customer because the broker must be satisfied the customer is 'willing to take those risks.'"[411]

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[406] *Dep't of Enforcement v. Hicks*, No. 2017052867301, 2021 FINRA Discip. LEXIS 10, at *52 (OHO May 19, 2021) (citing *Cody*, 2011 SEC LEXIS 1862, at *31-34), *appeal docketed* (NAC July 7, 2021).

[407] These customers and their non-traded REIT purchases are attached to the Complaint as Exhibit A. Only the parties have received a copy of the Non-Party Reference Sheet that identifies the customers in Exhibit A.

[408] Supplementary Material at FINRA Rule 2111.05(b).

[409] *Reyes*, 2021 FINRA Discip. LEXIS 29, at *30 (citing *Newport Coast Sec. Inc.*, Exchange Act Release No. 88548, 2020 SEC LEXIS 917, at *18 (Apr. 3, 2020)).

[410] *Newport Coast Sec. Inc.*, 2020 SEC LEXIS 917, at *18.

[411] *Id.* (quoting *Patrick G. Keel*, Exchange Act Release No. 34-31716, 1993 SEC LEXIS 41 (Jan. 11, 1993)).

We find that Patatian violated his customer-specific suitability obligation to six customers. These six customers had certain common characteristics. Each had very little investing experience, limited to variable annuities recommended by Patatian and to selecting asset classes for their deferred pension plans. None had ever invested in a REIT, much less a non-traded REIT. None wanted an investment that was or could be illiquid. None wanted a risky investment. None understood the risks associated with investing in REITs. None demonstrated that they understood what they were investing in.

Each of the six customers had specific liquidity needs when they invested in a non-traded REIT. RC was in his 70s, had few liquid assets outside his non-traded REIT, and planned to retire. JD and WD were in their early 70s and late 60s, respectively, and wanted liquidity for their family-run business. CN was 76-years old and had complained before to Patatian that she wanted ready access to her money. JO was recently divorced, undergoing chemotherapy, and looking for a new place to live. JR was 73-years old, retired, suffering from dementia, paying significant medical expenses, and moved into a residential facility less than two weeks after she bought a non-traded REIT on Patatian's recommendation. Despite these specific liquidity needs, Patatian recommended that the customers invest a substantial percentage of their liquid net worth into a non-traded REIT. For these reasons, we find that Patatian also violated FINRA Rules 2111 and 2010 in the recommendations he made to these six customers.

B. Unsuitable Variable Annuity Surrenders (Second Cause of Action)

Enforcement alleges that Patatian made unsuitable recommendations to four customers that they surrender their variable annuities to purchase non-traded REITs, a violation of FINRA Rule 2111.[412] Rule 2111 explicitly states that a broker must consider a customer's tax status in making a recommendation.[413] And in recommending that a customer surrender a variable annuity, a broker must also consider whether the customer will incur a surrender fee and, if so, the amount of that fee.[414]

Patatian did not understand that the surrenders he recommended would cause four of his customers to incur significant tax liabilities. AT incurred a tax liability of slightly more than $19,000 from her surrender. RS and BS incurred more than $20,000 in taxes because of their surrender. JO was assessed around $24,000 in taxes from her surrender. Patatian incorrectly advised AT, RS, and BS that their surrenders qualified as tax-free 1035 exchanges. He told RS and BS's accountant that they invested the surrender proceeds into a "new contract/policy." But he admitted that the REIT investment was not an insurance policy, nor was it an insurance contract.[415] And while he claimed at the hearing that he warned JO that she would incur taxes

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[412] *See Dep't of Enforcement v. Orlando*, No. 2014043863001, 2020 FINRA Discip. LEXIS 26, at *39 (NAC Mar. 16, 2020).

[413] FINRA Rule 2111(a) ("A customer's investment profile includes, but is not limited to, . . . tax status . . .").

[414] *Orlando*, 2020 FINRA Discip. LEXIS 26, at *40; *see also Bernard G. McGee,* Exchange Act Release No. 80314, 2017 SEC LEXIS 987, at *40 (Mar. 27, 2017).

[415] Tr. 625.

from her surrender, JO credibly denied at the hearing that they discussed taxes before the surrender. JO's testimony was also corroborated by Patatian's 2020 OTR testimony that he did not know whether she would incur taxes before he recommended that she surrender her variable annuity.

Similarly, Patatian made an unsuitable recommendation to JE and ME to surrender their variable annuity. In following Patatian's recommendation, JE and ME incurred a surrender fee of more than $4,000. Patatian admitted that he thought the surrender fee was too high to justify his recommendation. He also admitted that he never would made his recommendation if he knew about the surrender fee. And he tried to reverse the surrender after it occurred, in part by impersonating JE in a phone call with the insurance company that issued the variable annuity.

We therefore find that Enforcement proved that Patatian violated FINRA Rules 2111 and 2010 in recommending unsuitable variable annuity surrenders to five customers, and thus the second cause of action.

C. Unsuitable Variable Annuity Exchanges (Third Cause of Action)

Enforcement alleges that Patatian made six unsuitable recommendations to customers that they exchange their variable annuities for new variable annuities. FINRA Rule 2330(b) imposes certain suitability requirements on brokers when they recommend exchanges of deferred variable annuities. FINRA Rule 2330(b) incorporates the suitability obligations of Rule 2111.

Along with the suitability requirements of FINRA Rules 2111, Rule 2330(b) requires a broker to consider factors specific to deferred variable annuity exchanges. Among those factors is whether the customer would incur a surrender charge, be subject to a new surrender period, lose existing benefits, or face increased fees or charges, such as charges for riders or product enhancements.[416] The rule also requires a broker to consider whether "the customer would benefit from product enhancements and improvements" in the exchange.[417] These considerations must be "documented and signed by the associated person recommending the transaction."[418] A broker who recommends a variable annuity exchange without considering these and other suitability factors violates FINRA Rule 2330(b).[419]

Patatian recommended that DG and AG exchange their variable annuities based on a faulty cost comparison. In his cost comparison, Patatian told DG and AG that their new variable annuities would cost just five basis points more per year than the existing variable annuities.[420] But he inflated the cost of their existing variable annuities by including rider fees that DG and

[416] FINRA Rule 2330(b)(1)(B)(i).

[417] FINRA Rule 2330(b)(1)(B)(ii).

[418] FINRA Rule 2330(b)(1).

[419] *Dep't of Enforcement v. Holloway*, No. 2016050025401, 2019 FINRA Discip. LEXIS 21, at *30-31 (OHO Apr. 11, 2019).

[420] CX-113, at 1; CX-114, at 1.

AG were no longer paying because the riders were discontinued.[421] Instead of a nominal increase, DG and AG were paying about $4,000 more per year for their new annuities. At the hearing, Patatian maintained that their exchanges were still suitable. But the increase in fees was significant, and Patatian admitted in his 2020 OTR that he would not have recommended the exchanges if he had calculated the costs correctly.

He made a similar error in four other exchange recommendations. He justified the exchanges by pointing to an increased death benefit in the new products. But he did not understand that the increased death benefit was available only via an optional rider, at more cost. As a result, he failed to secure the increased death benefit in the exchanges. While he dismissed his error as a "clerical mistake" that he says he fixed, his mistake undermined his justification for the exchanges, as well as the cost comparison he used to recommend the exchanges. And suitability is judged when a broker recommends transactions,[422] not years later when he tries to fix them. We therefore find that Patatian violated FINRA Rules 2330(b) and 2010.

D. Impersonating a Customer (Fourth Cause of Action)

Enforcement alleges that Patatian impersonated a customer on a phone call with an insurance company after he recommended that his customers JE and ME, a married couple, surrender a variable annuity to purchase a non-traded REIT. In his Answer, Patatian admitted that he impersonated his customer and violated FINRA Rule 2010.

He admitted, for example, that he impersonated JE to obtain the contract value and surrender charge of JE's variable annuity.[423] As part of his impersonation, he provided JE's date of birth and the last four digits of JE's social security number to the insurance company.[424] At the hearing, Patatian claimed that he had "signed documentation and express authority" from JE and ME to find out about the surrender charge and contract value from the insurance company.[425] But he provided no signed documentation or evidence of "express authority" that would have permitted him to impersonate JE on a phone call with the insurance company.

While he admits that he impersonated his customer, Patatian argues that we must still dismiss the fourth cause of action because Enforcement acted improperly. Enforcement obtained a recorded phone call between Patatian and the insurance company and then used that recording during Patatian's 2020 OTR. Because the recording lacked any notice that the call was recorded, Patatian argues, Enforcement's use of the recorded call violates California law.[426] And because

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[421] CX-111.

[422] *Escarcega*, 2017 FINRA Discip. LEXIS 32, at *53.

[423] Compl. ¶ 75; Ans. ¶ 75.

[424] Compl. ¶ 76; Ans. ¶ 76.

[425] Tr. 650.

[426] Respondent's Post-Hearing Brief ("Resp't Post-Hr'g Br.") 7-8 (citing Cal. Penal Code § 632).

Enforcement's use of the recorded call was illegal in California, Patatian reasons, his 2020 OTR testimony about the call is inadmissible as "fruit of the poisonous tree."[427]

We need not decide whether Enforcement's use of the recorded call violated California law. Nor do we need to resolve Patatian's "fruit of the poisonous tree" argument. Enforcement did not play the recorded phone call at the hearing or offer it for admission as evidence. We also did not consider Patatian's 2020 OTR testimony about the call in making our findings. We base our findings for the fourth cause of action solely on the Complaint and Answer. We therefore reject Patatian's argument that we should dismiss the fourth cause of action.

FINRA Rule 2010 provides that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." This is a "broad ethical rule that covers a wide range of conduct, even if that conduct is not connected with a securities transaction."[428] Impersonating a customer to obtain confidential customer information is "in complete disrespect of the duty to maintain the confidentiality of customer information."[429] As Patatian admitted in his Answer, we find that Patatian violated FINRA Rule 2010 when he impersonated JE on a telephone call with the insurance company.

E. Inaccurate Books and Records (Fifth Cause of Action)

Enforcement alleges that Patatian caused his firm to maintain inaccurate books and records in violation of FINRA Rules 4511 and 2010. Rule 4511 requires member firms to "make and preserve books and records as required under the FINRA Rules, the Exchange Act and the applicable Exchange Act rules." Rule 4511 thus incorporates Exchange Act Rule 17a-3(a)(6), which requires member firms to make and keep "a memorandum of each brokerage order, and any other instruction, given or received for the purchase or sale of a security . . ." Rule 4511 also incorporates Exchange Act Rule 17a-3(a)(17), which requires member firms to keep a customer "account record" that includes the customer's annual income, net worth, and investment objectives. The books-and-records rules "include[] the requirement that the records be accurate . . ."[430] While FINRA Rule 4511 imposes a requirement on member firms to maintain

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[427] Resp't Post-Hr'g Br. 8.

[428] *Dep't of Enforcement v. Lykos*, No. 2018059510201, 2021 FINRA Discip. LEXIS 33, at *21 (NAC Dec. 16, 2021), *appeal docketed*, No. 3-20703 (SEC Jan. 10, 2022); *see also Dep't of Enforcement v. Olson*, 2010023349601, 2014 FINRA Discip. LEXIS 7, at *6 (FINRA Bd. of Governors May 9, 2014), *aff'd*, Exchange Act Release No. 75838, 2015 SEC LEXIS 3629 (Sept. 3, 2015).

[429] *Dep't of Enforcement v. Golonka*, 2009017439601, 2013 FINRA Discip. LEXIS 5, at *24 (NAC Mar. 4, 2013).

[430] *Eric. J. Brown*, Exchange Act Release No. 66469, 2012 SEC LEXIS 636, at *26 (Feb. 27, 2012) (quoting *Merrill Lynch, Pierce, Fenner & Smith*, Exchange Act Release No. 33367, 1993 SEC LEXIS 3516, at *19-20 (Dec. 22, 1993), *aff'd sub nom*., *Collins v. SEC*, 736 F.3d 521 (D.C. Cir. 2013), *reh'g denied*, No. 12-1241, 2014 U.S. App. LEXIS 1223 (D.C. Cir. Jan. 22, 2014).

books and records, a registered representative can violate Rule 4511 by falsifying a firm's required books and records.[431]

Patatian created inaccurate records in two ways. First, he overstated his DWP customers' investment experience on Western's new account forms. As a general practice, he used their tenure at DWP as a proxy for their investment experience, even when they had no or scant experience investing in stocks, bonds, or mutual funds. Second, on the Client Disclosure Forms, Patatian inflated his customers' Net Worth Exclusive and liquid net worth, sometimes shortly after recording significantly lower amounts for those categories in the new account forms.

Patatian's explanation for the discrepancies – that he included his estimation of the present value of his customers' pensions – does not stand scrutiny. He admitted in his 2020 OTR that he was trying to "make the numbers fit into a puzzle" to circumvent investment limitations and obtain approval for the non-traded REIT purchases. And he did not include an estimate of the present value of his customers' pensions (or, for that matter, their Social Security payments) when he filled out the new account forms. Three of his customers and a deceased customer's son testified that they did not discuss their financial information with him when he completed the Client Disclosure Forms. They also testified that the investment experience in their new account forms was inaccurate, as was the Net Worth Exclusive and liquid net worth listed in the Client Disclosure Forms.

By overstating his customers' investment experience and other financial information, Patatian caused Western to make and preserve inaccurate books and records.[432] We therefore find that Patatian violated FINRA Rules 4511 and 2010.

F. Patatian's Defenses

While Patatian asserted many affirmative defenses in his Answer, he presented substantive evidence or argument on only two of them: laches and ratification. We reject both.

1. Laches

Patatian argues that we should dismiss the Complaint based on the doctrine of laches. This doctrine "bars, in equity, claims that are not timely pursued."[433] To succeed in his laches defense, Patatian must prove that Enforcement was not diligent and that Enforcement's lack of

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[431] *Escarcega*, 2017 FINRA Discip. LEXIS 32, at *63-64; *see also Mitchell T. Fillet*, Exchange Act Release No. 75054, 2015 SEC LEXIS 2142, at *38-39 (May 27, 2015) (finding registered representative liable for violation of FINRA's books-and-records rule), *remanded*, No. 2008011762801r, 2016 FINRA Discip. LEXIS 3 (NAC Mar. 7, 2016), *aff'd*, Exchange Act Release No. 79018, 2016 SEC LEXIS 3773 (Sept. 30, 2016).

[432] *See Escarcega*, 2017 FINRA Discip. LEXIS 32, at *4 (finding that overstating customers' net worth caused firm to make and preserve inaccurate books and records).

[433] *Talon Real Estate Holding Corp*., Exchange Act Release No. 87614, 2019 SEC LEXIS 4796, at *22 (Nov. 25, 2019).

diligence caused him harm.[434] Laches is "time plus prejudicial harm, and the harm is not merely that one loses what he otherwise would have kept, but that delay has subjected him to a disadvantage in asserting and establishing his claimed right or defense."[435] In determining whether Enforcement lacked diligence, we recognize that "[t]here is no fixed period of time that must elapse for a suit to be barred by the doctrine of laches."[436]

a. Patatian Did Not Prove That Enforcement Lacked Diligence

Patatian argues that Enforcement was not diligent in this matter. By November 2014, as Patatian asserts, Enforcement had obtained customer account forms and transaction documents for more than three-quarters of the REIT and variable-annuity transactions in the Complaint.[437] By January 2017, Enforcement had obtained all customer account documentation and commission information for Patatian on 80 of the 81 REIT transactions in the Complaint.[438] By February 1, 2017, Patatian asserts, Western had provided to Enforcement "all necessary documentation . . . supporting all five causes of action in the Complaint."[439] The Complaint stemmed from one "extended" investigation that started in 2013,[440] Respondent argues, and Enforcement told Patatian it had closed that investigation with the Closing Letter in February 2018.[441]

Patatian conflates laches with the fundamental fairness defense—a similar, but separate, defense he did not assert. Establishing a fundamental fairness defense requires a respondent to show that undue delay in filing a Complaint rendered the proceeding fundamentally unfair.[442] Patatian largely relies on fundamental fairness—not laches—cases to support his laches

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[434] *Dep't of Enforcement v. Tretiak*, No. C02990042, 2001 NASD Discip. LEXIS 1, at *50 (NAC Jan. 23, 2001), *aff'd*, Exchange Act Release No. 47534, 2003 SEC LEXIS 653 (Mar. 19, 2003). *See also Dep't of Enforcement v.Cantone Research, Inc.*, No. 2013035130101, 2019 FINRA Discip. LEXIS 5, at *102-03 (NAC Jan. 16, 2019) (respondent bears burden of proof for affirmative defense).

[435] *Leopard Marine & Trading, Ltd. v. Easy Street Ltd*., 896 F.3d 174, 195 (2d Cir. 2018).

[436] *Leopard Marine*, 896 F.3d at 194.

[437] Respondent's Pre-Hearing Brief ("Resp't Pre-Hr'g Br.") 4; Resp't Post-Hr'g Br. 9.

[438] Resp't Pre-Hr'g Br. 7; Resp't Post-Hr'g Br. 9.

[439] Resp't Pre-Hr'g Br. 8; Resp't Post-Hr'g Br. 9. This is incorrect. The third cause of action alleges that variable annuity exchanges that occurred after February 1, 2017 are unsuitable.

[440] Resp't Pre-Hr'g Br. 9.

[441] Resp't Pre-Hr'g Br. 9.

[442] *See Jeffrey Ainley Hayden*, Exchange Act Release No. 42772, 2000 SEC LEXIS 946, at *5-6 (May 11, 2000); *Dep't of Enforcement v. Morgan Stanley DW Inc*., No. CAF000045, 2002 NASD Discip. LEXIS 11, at *13–15 (NAC July 29, 2002) (citing *Hayden*). "In assessing the effect of a delay on the fairness of a disciplinary proceeding, there are 'not establish[ed] bright line rules about the impact of the length of a delay.'" Instead, "[t]he fairness of a proceeding is based on the 'entirety of the record,' and whether respondent has shown that his 'ability to mount an adequate defense was harmed by any delay in the filing of a complaint against him.'" *Dep't of Enforcement v. Mehringer*, No. 2014041868001, 2020 FINRA Discip. LEXIS 27, at *32 (NAC June 15, 2020) (quoting *Mark H. Love*, Exchange Act Release No. 49248, 2004 SEC LEXIS 318, at *16 (Feb. 13, 2004)).

argument. While those cases are not directly applicable, they set forth time periods that are relevant to Patatian's laches defense.

To be sure, some of the time periods that elapsed before Enforcement filed the Complaint are long:

- Almost eight years since Enforcement began to investigate Patatian in May 2013;[443]
- Nearly four years after Patatian's last allegedly unsuitable REIT sale (March 7, 2017);[444]
- More than four years after Enforcement had obtained documentation for 80 of the 81 REIT transactions at issue in the Complaint (January 2017);
- More than five years after it first took Patatian's investigative testimony (December 2015);[445] and
- Almost three years after Enforcement sent Patatian the Closing Letter.[446]

Enforcement does not dispute these time periods. We acknowledge Patatian's argument that investigating him for almost eight years – whether in one investigation or two related investigations – is excessive. Further, most of the REIT sales occurred in 2013, 2014, and 2015, yet Enforcement did not file the Complaint until 2021. Enforcement did not explain why the Complaint was filed so long after the REIT transactions, particularly given the number of customers who suffered injury and the negative news surrounding American Realty REITs in 2014 and 2015.

But these time periods alone, while long, do not demonstrate a lack of diligence by Enforcement. Aside from these time periods, Patatian adduced no evidence at the hearing that Enforcement lacked diligence in its investigation.

Other, shorter time periods also mitigate Patatian's arguments about Enforcement's lack of diligence. Enforcement filed the Complaint in February 2021, about three years after opening the 2018 investigation. None of the misconduct alleged in the Complaint occurred while Patatian was associated with CUSO. And the last alleged instance of misconduct – a variable annuity

[443] Resp't Post-Hr'g Br. 9.

[444] Exhibit A to Compl. (Customer 50); CX-2, at 8.

[445] CX-235.

[446] RX-540.

exchange[447] – occurred less than three years before the filing of the Complaint. Under the totality of the circumstances, we do not find that Enforcement engaged in unreasonable delay.

b. Patatian Failed to Show Prejudice Based on Undue Delay

Patatian failed to show that he suffered prejudice because of any alleged delay by Enforcement. Patatian needed to show that he could not "present a full and fair defense on the merits due to the loss of records, the death of a witness, or the unreliability of memories of long past events."[448] In proving this required element of the defense, "[c]onclusory statements that there are missing witnesses, that witnesses' memories have lessened, and that there is missing documentary evidence, are not sufficient."[449]

Patatian points to three ways in which Enforcement's alleged delay impaired his ability to defend himself. First, he argues that his defense was prejudiced because of "memories fading."[450] In particular, he asserts that each customer witness struggled to recall specific details about their REIT purchase.[451] This argument is unpersuasive. The recollections of the customer witnesses on important matters were not unduly diminished by time. Moreover, our findings are amply supported by documentary evidence, uncontested facts, and Patatian's own testimony. [452] Patatian has failed to show how any allegedly forgotten information was important to his defense.[453]

Next, Patatian argues that he had no "access to his notes, customer records or transaction documentation for years . . ."[454] He alleges that this lack of access inhibited his ability to "substantiate suitability, refresh memories and support affirmative defenses."[455] But Patatian identifies no documents that would have aided his defense. He was also provided with notes, customer records, and transaction documents under FINRA's discovery rules, including

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[447] CX-159.

[448] *Serdarevic v. Advanced Med. Optics, Inc.*, 532 F.3d 1352, 1360 (Fed. Cir. 2008); *see also Hearing Components, Inc. v. Shure Inc.*, 600 F.3d 1357, 1376 (Fed. Cir. 2010) ("[E]videntiary prejudice must consist of some separate disadvantage resulting from the delay, . . . that prevents a party from proving a separate claim or defense.").

[449] *Meyers v. Asics Corp.*, 974 F.2d 1304, 1308 (Fed. Cir. 1992); *accord Dana-Farber Cancer Inst., Inc. v. Ono Pharm. Co*., 379 F. Supp. 3d 53, 101 (D. Mass. 2019).

[450] Resp't Post-Hr'g Br. 9.

[451] Resp't Post-Hr'g Br. 9.

[452] *Dep't of Enforcement v. Rooney*, No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *93–95 (NAC July 23, 2015) (rejecting claim of evidentiary prejudice because "much of the findings" were supported by documentary evidence and uncontested facts); *cf. United States v. Weintraub*, 613 F.2d 612, 619 (6th Cir. 1979) (rejecting laches defense in case supported by evidence not "greatly affected by the lapse of time").

[453] *United States EEOC v. Lakemont Homes*, 718 F. Supp. 2d 1251, 1256 (D. Nev. 2010) ("Defendants do not provide, however, any argument or evidence elucidating in what respects the forgotten information referred to in the deposition is necessary or important to their defense.").

[454] Resp't Post-Hr'g Br. 9.

[455] Resp't Post-Hr'g Br. 9.

documents obtained by Enforcement after the Complaint was filed. And he worked at Western until April 2020. He presented no evidence that Western prevented him from seeing relevant notes, customer records, and transaction documentation while he worked there, or that they were otherwise inaccessible to him. Nor is there any evidence that he tried to obtain any information or documents from testifying customer witnesses until December 2021.[456]

Patatian also asserts that he was unable to locate "certain potential witnesses" due to the passage of time.[457] He identifies only one potential witness he was unable to locate, however, a former Western sales assistant. And he fails to show how her testimony would have helped his defense, or how its absence hampered that defense.[458] He suggests that she knew about his termination from Western.[459] But he does not explain how her testimony about his termination from Western would be relevant to any of Enforcement's charges, his defenses, or sanctions.

Finally, we are unconvinced by Patatian's argument that we should dismiss the Complaint because of the Closing Letter. The Closing Letter expressly advised Patatian that Enforcement's decision not to bring a disciplinary action was limited to his tenure at CUSO. Enforcement also told Patatian that he should not consider the Closing Letter an exoneration. Similarly, Enforcement reserved the right to use the information and documents it had obtained in the 2013 investigation in the 2018 investigation.

2. Ratification

Patatian argues that he did not violate FINRA's customer-specific suitability rules or books-and-records rule because his customers ratified their investments.[460] As Patatian points out, his customers signed new account forms and attested that their investment experience and financial information on those forms was accurate. In the Client Disclosure Forms, they acknowledged that they understood the risks of non-traded REITs, that they discussed the features of the REITs with Patatian, that they could afford the investment and meet the suitability standards of the issuer, and that the non-traded REIT met their financial goals. Patatian also notes that his customers received trade confirmations, prospectuses, and account statements for their REITs, and most did not complain for years after their purchase.

Patatian cites two cases in support of his ratification argument.[461] Both cases involved civil litigation between accountholders and their financial institutions about allegedly

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[456] *See* CX-122a; CX-142c.

[457] Resp't Post-Hr'g Br. 9.

[458] *Meyers*, 974 F.2d at 1308 (rejecting defendant's prejudice claim based on the alleged loss of key witnesses and documentary evidence that failed to state "exactly what particular prejudice it suffered from the absence of these witnesses or evidence").

[459] Resp't Post-Hr'g Br. 9.

[460] Resp't Post-Hr'g Br. 11-13.

[461] Resp't Post-Hr'g Br. 11 (citing *Pavlovich v. Nat'l City Bank*, 435 F.3d 560, 566 (6th Cir. 2006); *Richardson Greenshields, Sec., Inc. v. Lau*, 819 F. Supp. 1246, 1259 (S.D.N.Y. 1993)).

unauthorized trades. In both cases, the courts recognized that ratification can be a valid defense "when the customer acquiesces in the unauthorized trading."[462] And a customer acquiesces in unauthorized trading "if the customer knew the pertinent facts surrounding the transactions in question."[463]

As the SEC and NAC have repeatedly emphasized, however, we cannot ignore a respondent's suitability violation "merely because the customer acquiesces in the recommendation."[464] Instead, "[t]he test for whether [the broker]'s recommended investments were suitable is not whether [the customer] acquiesced in them, but whether [the broker]'s recommendations to [the customer] were consistent with her financial situation and needs."[465] As a result, the NAC has rejected the argument that adjudicators should excuse a broker's duty to make only suitable recommendations simply because the customer signed a form acknowledging the broker's strategy.[466] Similarly, the fact that a customer did not complain upon learning of the investments does not shield a broker from liability for violating FINRA Rules.[467] In any event, the testifying customers *did* complain about their investments once they understood what they had invested in. We therefore reject Patatian's ratification defense.

IV. Sanctions

A. The Sanction Guidelines

In considering the appropriate sanctions, we begin with FINRA's Sanction Guidelines ("Guidelines").[468] The Guidelines contain (1) General Principles Applicable to All Sanction Determinations ("General Principles") for adjudicators to consider in all cases; (2) Principal Considerations in Determining Sanctions ("Principal Considerations"), which consist of "generic factors for consideration in all cases"; and (3) principal considerations for specific violations ("Specific Considerations").[469]

The General Principles explain that "sanctions should be designed to protect the investing public by deterring misconduct and upholding high standards of business conduct." Adjudicators must "design sanctions that are meaningful and significant enough to prevent and discourage

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[462] Resp't Post-Hr'g Br. 11 (quoting *Richardson Greenshields, Sec., Inc. v. Lau*, 819 F. Supp. 1246, 1259 (S.D.N.Y. 1993)). *See also Pavlovich v. Nat'l City Bank*, 435 F.3d 560, 566 (6th Cir. 2006).

[463] Resp't Post-Hr'g Br. 11 (quoting *Richardson Greenshields*, 819 F.Supp. at 1259).

[464] *Dane S. Farber*, Exchange Act Release No. 49216, 2004 SEC LEXIS 277, at *24 (Feb. 10, 2004). The SEC has also rejected ratification as a defense to an unauthorized trading charge. *Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, *74 (Feb. 1, 2010).

[465] *Jack H. Stein*, Exchange Act Release No. 47335, 2003 SEC LEXIS 338, at *14 (Feb. 10, 2003).

[466] *Brian J. Kelly*, No. E9A2004048801, 2008 FINRA Discip. LEXIS 48, at *22-23 (NAC Dec. 16, 2008).

[467] *Dep't of Enforcement v. Wilson*, No. 2007009403801, 2011 FINRA Discip. LEXIS 67, at *27 n.18 (NAC Dec. 28, 2011).

[468] FINRA Sanction Guidelines (2021), https://www.finra.org/sanctionguidelines.

[469] Guidelines at 1 (Overview).

future misconduct by a respondent and deter others from engaging in similar misconduct." Sanctions should also "reflect the seriousness of the misconduct at issue"[470] and be "tailored to address the misconduct involved in each particular case."[471]

The sanctions we impose are appropriate and proportionally measured to address Patatian's misconduct. We designed the sanctions to protect and further the interests of the investing public, the industry, and the regulatory system.

B. Sanctions for the REIT-Related Causes of Action

Four of Enforcement's five causes of action stem from the same conduct by Patatian. Those four causes of action are: (1) the first cause of action, which alleges that Patatian made unsuitable REIT recommendations to customers; (2) the second cause of action, which alleges that Patatian made unsuitable recommendations to customers to surrender their variable annuities so that they could invest the proceeds in REITs; (3) the fourth cause of action, which alleges that Patatian impersonated a customer on a call with an insurance company to facilitate the surrender of a variable annuity to invest in a REIT; and (4) the fifth cause of action, which alleges that Patatian completed and submitted inaccurate new account forms and Client Disclosure Forms to facilitate his REIT recommendations. Each of these four causes of action relates directly to, and arises from, Patatian's strategy of recommending REIT purchases to his customers. We therefore impose a unitary sanction for these four causes of action.[472]

1. Bar

The first and second causes of action involve violations of FINRA's suitability rule, Rule 2111. The fifth cause of action involves violations of FINRA's recordkeeping rule, Rule 4511. The Guidelines for violations of both Rules recommend a bar for an individual respondent when aggravating factors predominate.[473] There are no specific Guidelines for impersonating a customer, but the most analogous violation is forgery.[474] The Guideline for forgery suggests a fine of $5,000 to $155,000 and a suspension between two months and two years, unless the respondent's forgery is "without authorization, in furtherance of another violation, resulting in

[470] *Id.* at 2 (General Principle No. 1).

[471] *Id.* at 3 (General Principle No. 3).

[472] *See Dep't of Enforcement v. Tucker*, No. 2009016764901, 2013 FINRA Discip. LEXIS 45, at *20 n.20 (NAC Dec. 31, 2013) (imposing unitary sanction for multiple causes of action, including conversion, because all violations related to conversion of funds), *petition for review dismissed*, Exchange Act Release No. 71972, 2014 SEC LEXIS 4626 (April 18, 2014). We impose a separate sanction for the third cause of action, which is not related to Patatian's REIT sales.

[473] Guidelines at 29, 96.

[474] *See Golonka*, 2013 FINRA Discip. LEXIS 5, at *27-28 (applying forgery Guidelines when respondent violated NASD Rule 2110 by impersonating customers in phone calls with insurance company).

customer harm or accompanied by significant aggravating factors[.]"[475] In that case, "a bar is standard."

Significant aggravating factors predominate here. A Principal Consideration is whether the respondent accepted responsibility for his misconduct before it was detected.[476] Patatian never accepted responsibility for his misconduct. Instead, he blamed others. He blamed his firm for putting pressure on him to sell REITs.[477] He blamed his fellow brokers for evading the firm's supervisory procedures and California's net-worth limitation.[478] He blamed his assistant for "clerical errors" when confronted with inaccurate customer information on Western's new account forms.

He even blamed and mocked his customers at the hearing. He called RC "a pain in the ass"[479] and invented a far-fetched scenario in which RC photocopied a blank form just so that he could use it years later to frame Patatian in this proceeding. He minimized JO's cancer diagnosis and treatment.[480] And he belittled the other DWP customers who followed his investment advice. "These people, like they tried to come up with creative ways to waste money," he testified.[481] "Like they have so much money coming in that they just want to spend it creatively, as wastefully as they can think of, pretty much."[482] Patatian's lack of candor and his refusal to acknowledge his misconduct at the hearing cast doubt on his willingness and ability to comply with the industry's regulatory requirements.[483]

There are other aggravating factors. Patatian's REIT suitability and books-and-records violations affected 59 customers and spanned almost five years.[484] His misconduct was reckless, in that he recommended non-traded REITs that he did not understand.[485] It resulted in injury to his customers and monetary gain for himself.[486] Many of his customers were over 65 years

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[475] Guidelines at 37.

[476] Guidelines at 7 (Principal Consideration No. 2).

[477] Tr. 163.

[478] Tr. 320.

[479] Tr. 1771.

[480] Tr. 1794.

[481] Tr. 349.

[482] Tr. 349.

[483] *See Fillet*, 2016 SEC LEXIS 3773, at *18 ("Fillet's refusal to acknowledge his misconduct and attempts to deflect blame increase the likelihood that he would engage in similar misconduct in the future.").

[484] Guidelines at 7 (Principal Considerations Nos. 8 and 9).

[485] Guidelines at 8 (Principal Consideration No. 13).

[486] Guidelines at 7-8 (Principal Considerations Nos. 11 and 16).

old,[487] and the customers who testified at the hearing were not financially sophisticated.[488] One of the customers, JR, had dementia when Patatian sold her an unsuitable REIT.[489] The inaccurate customer information recorded by Patatian was material to whether Western and the REIT issuer would allow the customers to purchase their REITs.[490] Patatian could complete his unsuitable REIT sales because he exaggerated his customers' investment experience and financial condition in Western's records.[491]

There are no significant mitigating factors. Patatian claimed at the hearing that he was expressly authorized by JE and ME to impersonate them in a phone call with the insurance company. Yet his claim was not supported by the documents he pointed to that allegedly gave him that authority. Patatian also points out that, before this proceeding, he had never been the subject of a disciplinary action by FINRA and is not a recidivist.[492] As the NAC has repeatedly held, however, "a lack of prior disciplinary history is not mitigating."[493] Finally, Patatian urges us not to impose a bar as a sanction because a bar "eviscerates" any order of restitution or disgorgement by making it unenforceable.[494] But this is not mitigating, nor does it relieve us of the obligation of determining a fitting, remedial sanction.

Considering the many aggravating factors, and the lack of mitigating circumstances, we conclude that the only appropriate sanction for the first, second, fourth, and fifth causes of action is a bar. A bar reflects the seriousness of Patatian's misconduct. A bar is also necessary to prevent and discourage similar misconduct by other registered representatives.

2. Restitution and Rescission

The Guidelines also instruct adjudicators to consider restitution where appropriate. As the Guidelines note, "[r]estitution is a traditional remedy used to restore the status quo ante where a victim otherwise would unjustly suffer loss."[495] As the SEC recently acknowledged,[496] restitution is appropriate "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct."[497] Restitution "is a particularly fitting

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[487] Guidelines at 8 (Principal Consideration No. 20).

[488] Guidelines at 8 (Principal Consideration No. 18).

[489] Guidelines at 8 (Principal Consideration No. 19).

[490] Guidelines at 29 ("Nature and materiality of inaccurate or missing information" are Principal Considerations for Rule 4511 violations).

[491] Guidelines at 29 ("Whether the violations allowed other misconduct to occur or to escape detection.").

[492] Resp't Post-Hr'g Br. 17-18.

[493] *Lykos*, 2021 FINRA Discip. LEXIS 33, at *26 n.18.

[494] Resp't Post-Hr'g Br. 18 (citing *Fiero v. Fin. Indus. Regulatory Auth., Inc.*, 660 F.3d 569, 574 (2d Cir. 2011)).

[495] Guidelines at 4.

[496] *J.W. Korth & Co., LP*, Exchange Act Release No. 94581, 2022 SEC LEXIS 852, at *39-40 (Apr. 1, 2022).

[497] Guidelines at 4.

sanction in cases of unsuitable recommendations."[498] Any order of restitution should be "based on the actual amount of the loss sustained by a person, . . . as demonstrated by the evidence."[499]

Some of Patatian's customers suffered a quantifiable loss caused by his unsuitable recommendations. Twenty customers who bought REITs in 22 separate transactions sold their REITs and realized losses of $262,958.73.[500] Attachment 1 to this decision identifies these customers and the amount of their realized losses.[501] We order Patatian to pay these customers restitution in the amount of their realized losses, plus interest,[502] from the date each customer sold the REIT until Patatian pays restitution. [503]

That leaves the REITs that Patatian's customers have not sold at a loss. Attachment 2 to this decision identifies these REIT transactions and customers.[504] Some of the customers, like JD and WD, still own REITs for which there has been no liquidity event.[505] Restitution for unrealized losses is appropriate when an injured customer holds a security that is worthless or practically worthless.[506] But that is not the case here; the illiquid REITs have some value, even if we cannot reliably determine it based on this record. For others, it is unclear whether they sold their REITs or still hold them. These customers suffered harm caused by Patatian's unsuitable recommendations. On this record, we cannot reasonably quantify the loss they suffered. But as

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[498] *David Joseph Dambro*, Exchange Act Release No. 32487, 1993 SEC LEXIS 1521, at *14 (June 18, 1993).

[499] Guidelines at 4.

[500] These 20 customers, the details of their REIT purchases and sales, and their realized losses are identified in CX-2. Another customer, JoRa, realized losses on two REIT purchases but settled his complaint with Western. CX-2; Tr. 1578-79. There was no evidence at the hearing regarding the terms of the settlement, so we cannot determine whether he suffered an identifiable loss and is entitled to restitution.

[501] Only the parties will receive a copy of Attachment 1.

[502] For the orders of restitution and disgorgement, interest is set at the rate established for the underpayment of income taxes in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2).

[503] If any of the customers identified on Attachment 1 cannot be located, unpaid amounts, plus accrued interest, should be paid to the appropriate escheat, unclaimed-property, or abandoned-property fund for the state of the customer's last known address. Satisfactory proof of payment, or of reasonable and documented efforts undertaken to make such payments, shall be provided to Enforcement no later than 90 days after the date when the decision becomes final.

[504] Only the parties will receive a copy of Attachment 2. Attachment 2 is based on CX-2, which identifies the customers and provides the details of their REIT purchases.

[505] The REITs sold by Patatian that did not undergo a liquidity event as of September 2021 are listed on CX-7.

[506] *See, e.g.*, *Dane S. Faber*, Exchange Act Release No. 49216, 2004 SEC LEXIS 277, at *13 (Feb. 10, 2004) (ordering restitution of unrealized losses in "nearly worthless stock"); *Dep't of Market Regulation v. Yankee Fin. Group, Inc.*, No. CMS030182, 2006 NASD Discip. LEXIS 21, at *87 (NAC Aug. 4, 2006) ("[b]ecause these securities were worthless, it was appropriate to order restitution of the customers' unrealized losses."), *aff'd in part, rev'd in part on other grounds sub nom., Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407 (June 29, 2007).

the person responsible for his customers' harm, Patatian bears the burden of returning his customers to the positions they occupied before his unsuitable recommendations.[507]

The Sanction Guidelines provide that "[a]djudicators may order that a respondent offer rescission to an injured party."[508] We therefore order Patatian to offer rescission to his customers. We order him to offer to purchase the REITs from the customers identified on Exhibit C at the original price he sold the REITs to them, less any cash distributions, plus interest running from the original purchase date, provided that the customers transfer ownership of their REITs to Patatian.[509] This returns the parties to the positions they held before the transaction and prevents any potential windfall to the customers.[510]

3. Disgorgement

When a respondent obtains a financial benefit from his misconduct, the Guidelines state, an adjudicator may order the respondent to disgorge those ill-gotten gains.[511] Relying on *Kokesh v. SEC*, [512] Patatian argues that FINRA cannot order disgorgement because it is an impermissibly punitive sanction. The SEC disagrees. The SEC has repeatedly held that an order of disgorgement in FINRA disciplinary proceedings is remedial so long as the disgorgement is limited to "a reasonable approximation of the violator's ill-gotten gains causally connected to the violations."[513] As the SEC recently put it, "[n]othing in *Kokesh*, which involved whether a civil action for disgorgement could be brought after a certain period of time, overturns these holdings that disgorgement may be imposed in a FINRA disciplinary action."[514]

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[507] *See Dambro*, 1993 SEC LEXIS 1521, at *14 ("As between Wiegman, who was placed in an unsuitable investment, and Dambro, who recommended it, equity requires Dambro, as the person responsible for the loss, to bear its burden and to return the customer to the position occupied prior to the improper recommendation.") (citing Restatement of Restitution § 1 comment a; § 151 comment f (1937)).

[508] Guidelines at 4-5.

[509] The SEC made a similar order of restitution in *Dambro*, 1993 SEC LEXIS 1521, at *15-16, when the record was silent as to whether the injured customer's estate still owned the stock that was the subject of an unsuitable recommendation, and whether that stock had any residual value. The SEC ordered that, if the customer's estate had not sold the stock and it still had some value, Dambro must either subtract that value from the amount of restitution or make full restitution provided that the customer's estate returned the stock to Dambro. *Cf. Dep't of Enforcement v. Kapara*, No. C10030110, 2005 NASD Discip. LEXIS 41, at *37 (NAC May 2, 2005) ("As a condition of restitution, the person entitled to restitution must return or offer to return that which he received as part of the transaction, or its value, unless such thing has, among other factors, been continuously worthless or consists of money that can be credited if restitution is granted.") (citing Restatement of Restitution ¶ 65 (1937)).

[510] *Kapara,* 2005 NASD Discip. LEXIS 41, at *37. (citing *Dambro*, 1993 SEC LEXIS 1521, at *15).

[511] Guidelines at 95.

[512] *Kokesh v. SEC,* 137 S. Ct. 1635 (2017).

[513] *Gopi Krishna Vungarala*, Exchange Act Release No. 90476, 2020 SEC LEXIS 4938, at *38 (Nov. 20, 2020) (quoting *Kimberly Springsteen-Abbott*, Exchange Act Release No. 88156, 2020 SEC LEXIS 2684, at *48-49 (Feb. 7, 2020)).

[514] *Springsteen-Abbott*, 2020 SEC LEXIS 2684, at *49.

We find that disgorgement is appropriate here. We therefore order Patatian to disgorge $458,418.07 in commissions he received from his unsuitable REIT recommendations, plus interest running from the dates he obtained the commissions until paid.[515] Patatian shall use this disgorgement amount to satisfy his obligation to make restitution to customers. Patatian shall pay any excess disgorgement amount to FINRA.

C. Sanctions for the Variable Annuity Exchange Suitability Violations

Although the third cause of action alleges violations of the suitability rules, it does not relate to Patatian's sale of non-traded REITs. Instead, the third cause of action alleges that Patatian recommended unsuitable variable annuity exchanges. Because these allegations do not stem from the same conduct as the REIT-related violations, we assess sanctions separately for the third cause of action.

There are no Sanction Guidelines specific to violations of FINRA Rule 2330 involving a registered representative's obligations in variable annuity exchanges. Adjudicators have looked to the Guidelines for unsuitable recommendations.[516] As noted above, the Guidelines provide that adjudicators should strongly consider a bar where aggravating factors predominate.[517] In non-egregious cases, the Guidelines suggest a fine of $2,500 to $116,000, and a suspension in any or all capacities for 10 business days to two years.[518]

As with the REIT-related violations, aggravating factors predominate here. Patatian made six unsuitable exchange recommendations.[519] Multiple customers were harmed.[520] Four were over 65 years old at the time of the exchanges.[521] Two of his customers, AG and DG, paid about $4,000 more in fees per year than Patatian told them they would pay because he included costs for a discontinued rider in his cost comparison. Four other exchanges led to customers losing a portion of their death benefits because Patatian failed to secure a death-benefit rider in their new contracts. He financially benefited from his unsuitable recommendations.[522] He also acted

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[515] CX-4; CX-5; Stip. ¶ 9; Tr. 1536-39. As the NAC has explained, "[b]y ordering prejudgment interest on a disgorgement amount, an adjudicator achieves the proper deterrence for the misconduct because disgorgement alone does not reflect the time value of ill-gotten gains and, in effect, provides the respondent with an interest-free loan until the disgorgement order is final." *Dep't of Enforcement v. Akindemowo*, No. 2011029619301, 2015 FINRA Discip. LEXIS 58, at *51 n.35 (NAC Dec. 29, 2015), *aff'd*, Exchange Act Release No. 79007, 2016 SEC LEXIS 3769 (Sept. 30, 2016).

[516] *See, e.g.*, *Holloway*, 2019 FINRA Discip. LEXIS 21, at *50 n.165.

[517] Guidelines at 96.

[518] Guidelines at 96.

[519] Guidelines at 8 (Principal Consideration No. 17).

[520] Guidelines at 7 (Principal Consideration No. 11).

[521] Guidelines at 8 (Principal Consideration No. 20).

[522] Guidelines at 8 (Principal Consideration No. 16).

recklessly by ignoring basic information in the prospectuses and annuity applications about the variable annuities he recommended.[523]

We identified no mitigating factors. At the hearing, Patatian acknowledged that he had made a mistake. He said that he corrected his error for four of his customers by purchasing a death-benefit rider on their behalf. But he also minimized his failure as a "clerical mistake," and his corrective measures occurred only after Enforcement told him about his error in his 2020 OTR.[524]

Patatian failed to meaningfully analyze or assess these exchanges despite the risk that they might not benefit his clients. His overriding concern was to generate a sales commission. His misconduct was egregious. Patatian was repeatedly evasive during the hearing, causing us grave concern about his potential to engage in future misconduct. For Patatian's violations of FINRA Rule 2330, and to protect the investing public and discourage misconduct by other brokers, we impose a separate bar for the third cause of action.

V. Order

We find that Patatian recommended and sold non-traded REITs to 59 customers without a reasonable basis to believe that the investments were suitable for any investor, violating FINRA Rules 2111 and 2010. We also find that Patatian recommended and sold non-traded REITs to six specific customers without a reasonable basis to believe that the investments were suitable for those customers given their investment profiles, violating FINRA Rules 2111 and 2010. We also find that Patatian made five unsuitable recommendations to customers to surrender their variable annuities so that they could invest in non-traded REITs, violating FINRA Rules 2111 and 2010. We also find that Patatian made six unsuitable recommendations to customers to exchange their variable annuities, violating FINRA Rules 2330(b) and 2010. We find that Patatian impersonated a customer in a telephone call with an insurance company, violating FINRA Rule 2010. Finally, we find that Patatian created inaccurate documents to facilitate his sale of non-traded REITs, causing his firm to create and maintain inaccurate books and records, in violation of FINRA Rules 4511 and 2010.

For the first, second, fourth, and fifth causes of action, we bar Patatian from associating with any member firm. We impose a separate bar of Patatian from associating with any member firm for the third cause of action.

For the first cause of action, we also order Patatian to pay restitution, rescission, and disgorgement. We order him to pay restitution to the customers identified in Attachment 1 to this decision in the sum of $262,958.73, plus interest running from the date each customer sold the REIT until Patatian pays restitution. Restitution is due in full, and satisfactory proof of payment of restitution shall be provided to Enforcement staff involved in this case, 60 days

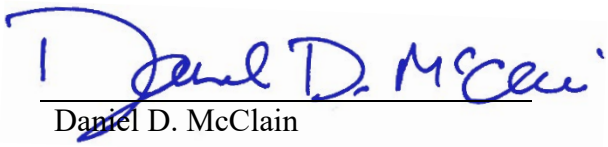
[523] Guidelines at 8 (Principal Consideration No. 13).

[524] Guidelines at 7 (Principal Consideration Nos. 2-3).

after the date when this decision becomes final. Patatian is required to provide to Enforcement proof of payment for each REIT transaction identified in Attachment 1; if Patatian cannot locate a customer, he must provide proof that he made a bona fide attempt to locate the customer. We order Patatian to offer rescission for the transactions identified in Attachment 2 to this decision. Patatian must complete the rescission within 60 days of the effective date of this decision. If Patatian cannot locate a customer identified in Attachment 2, he must provide proof that he made a bona find attempt to locate the customer. Finally, we order Patatian to pay disgorgement in the amount of $458,418.07, plus interest running from the dates he obtained the commissions until paid, with an offset for any amounts paid to satisfy his restitution obligation. He must pay any leftover disgorgement funds to FINRA.

If this decision becomes FINRA's final disciplinary action, the bar will take effect immediately.

Patatian is ordered to pay costs in the amount of $19,083.33, which includes a $750 administrative fee and $18,333.33 for the cost of the transcript.[525] The costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final action.



Daniel D. McClain
Hearing Officer
For the Extended Hearing Panel

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[525] The Hearing Panel has considered and rejects without discussion all other arguments of the parties.