Quarterly Disciplinary Review

October 2014

FINRA publishes this quarterly review to provide firms with a sampling of recent disciplinary actions involving misconduct by registered representatives. The sample includes settled matters and decisions in litigated cases (National Adjudicatory Council (NAC) decisions and SEC decisions in FINRA cases). These summaries call attention to, and remind registered representatives and member firms of, specific conduct that violates FINRA rules and may result in disciplinary action. FINRA also provides detailed disciplinary information and decisions and a summary of monthly disciplinary actions on its website.

Disseminating Materially Misleading Securities-Related Communications and Failing to Establish, Maintain and Enforce an Adequate Supervision System

- FINRA settled a matter involving a registered representative who disseminated materially misleading securities-related communications to the public, and failed to establish, maintain and enforce an adequate supervision system. From September 2010 through February 2012, the representative served as his firm's CEO and managing principal. During that same period, the representative operated two non-firm websites that offered a subscription-based "stock analyzer" that used mathematical algorithms to identify stocks with the "strongest performance." Many of the communications contained on the websites failed to provide a sound basis for potential investors to evaluate the stock analyzer, and failed to present a balanced statement of the analyzer's benefits and risks.

  The representative's statements on the websites exaggerated the stock analyzer's benefits. For example, the representative implied that investors who purchased the stock analyzer would have access to non-public information. The websites also contained many communications that falsely implied that investors who did not purchase the stock analyzer were taken advantage of by professional investors, and that investors who purchased the analyzer would have the same access to the securities market as professional investors.

  The representative similarly failed to define terminology about the stock analyzer, failed to provide an explanation of risks associated with purchasing and using the analyzer or the portfolios contained within it, and failed to disclose his association with a FINRA firm and the FINRA firm's connection, if any, with the websites. The representative's materially misleading communications to promote the sale of the stock analyzer violated NASD Rule 2210* (communications with the public) and FINRA Rule 2010 (ethical standards).

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Finally, the representative failed to reasonably supervise the firm's activities while serving as the firm's CEO and managing principal. Despite knowing that a member of the firm's staff had forged a significant, but unknown, number of Deposit Securities Request forms and caused numerous unregistered low-priced stocks to be deposited into customer accounts without supervisory review, the representative failed to conduct any investigation to determine the scope of the forgeries and unsupervised low-price stock trading. The representative's failure to reasonably supervise his firm's activities violated NASD Rule 3010 (supervision) and FINRA Rule 2010 (ethical standards).

For disseminating materially misleading securities-related communications to the public, and failing to establish, maintain and enforce an adequate supervision system, FINRA suspended the representative in all principal capacities for three months, imposed a concurrent, 10-business-day suspension in all capacities, and fined him $15,000.

Marking the Close of the Market

- Marking the close is the prohibited practice of buying a security at the very end of the trading day at a significantly higher price than the current price of the security. The purpose is to raise the closing price of the security, making the security's value appear to be higher than it actually is. FINRA settled a matter involving a registered representative who marked the close in the minutes leading up to the close of trading one day in June 2009.

  Prior to the conduct at issue, the representative had discussions with his firm's senior management about the firm's possible participation in a shelf offering of a Minnesota-based oil and gas company. On the specified trading day, the representative transmitted buy orders of the oil and gas company's shares to his firm's trading desk on behalf of five customers, instructing the trading desk to execute the transactions in the last 10 minutes of the trading day.

  The representative's five buy orders totaled 37,000 shares and represented 58 percent of the oil and gas company's total trading volume during the last 10 minutes of trading. Indeed, the national best bid and offer moved from $5.98 – $6.00, approximately eight minutes prior to the close, to $6.09 – $6.10 at the close.

  The representative's marking the close of the market constitutes a willful violation of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) (regulation of the use of manipulative and deceptive devices), Exchange Act Rule 10b-5 (employment of manipulative and deceptive devices), and FINRA Rules 2020 (use of manipulative, deceptive, or other fraudulent devices) and 2010 (ethical standards). FINRA suspended the representative in all capacities for 40 days and fined him $25,000.

Failing to Reasonably Supervise, Causing the Creation and Maintenance of Inaccurate Books and Records, and Failing to Timely Amend a Form U4

- FINRA settled a matter involving a registered representative who failed to reasonably discharge his supervisory responsibilities in connection with an offering of securities, caused his FINRA firm to create and maintain inaccurate books and records, and failed to timely amend his Form U4 to disclose unsatisfied federal and state tax liens.

  Between December 2009 and February 2011, associated persons of the representative's FINRA firm sold $3 million of a mining company's notes to 59 customers. In offering and selling the notes, several of the associated persons misrepresented and omitted material facts to investors, including how proceeds from the offering were to be used, the true ownership structure of the mining company, and the fact that there was no collateral for the notes. When these sales occurred, the representative was an owner of the firm's parent company, a senior officer of the firm, and a member of its Investment Committee. As a member of the Investment Committee, the representative was responsible for reviewing and approving all investment banking transactions, ensuring that the firm conducted reasonable due diligence on the securities offerings, and confirming that the offerings promoted and sold through the firm were in compliance with the federal and state securities laws and FINRA rules. The representative failed to conduct reasonable due diligence of the mining company's shares and permitted the firm's associated persons to participate in a fraudulent offering of securities. The representative's conduct violated NASD Rule 3010 (supervision) and FINRA Rule 2010 (ethical standards).

  In addition, from at least January 2012 to July 2013, after becoming the firm's president and a co-owner of its parent company, the representative caused the firm to pay more than $193,000 of his personal expenses and the personal expenses of another employee of the firm. Instead of recording the payments as personal expenses, however, the representative caused the firm to categorize the payments as business expenses, which in turn, caused the firm to create and maintain inaccurate general ledgers, income statements, annual audit reports and FOCUS Reports. The firm also lacked an adequate system for supervisory review and approval of expenses, and the representative, as the firm's CEO, failed to establish and maintain a supervisory system, including written supervisory policies and procedures, that were reasonably designed to achieve compliance with applicable federal securities laws and FINRA's recordkeeping rules. The representative's conduct caused the firm to violate Section 17(a) of the Exchange Act (accounts and records, examinations of exchanges, members, and others), Exchange Act Rules 17a-3 (records to be made by certain exchange members, brokers, and dealers) and 17a-5 (reports to be made by certain brokers and dealers), NASD Rule 3010 (supervision), and FINRA Rules 4511 (books and records) and 2010 (ethical standards).

Finally, the representative failed to timely amend his Uniform Application for Securities Industry Registration or Transfer, or Form U4, to disclose unsatisfied federal and state tax liens totaling $1.875 million. As a result, the representative violated Article V, Section 2 of FINRA's By-Laws (application for registration), and FINRA Rules 1122 (filing of misleading information as to membership or registration) and 2010 (ethical standards).

For this misconduct, FINRA suspended the representative in all capacities for two years, fined him $25,000 and ordered him to pay disgorgement of $25,000, an amount that the representative had received in connection with the firm's sales of the mining company's notes.

Soliciting Sales of Securities Without FINRA Registration

- FINRA settled a matter involving an associated person who solicited sales of securities without being registered with FINRA. From May 2012 through December 2012, the associated person solicited sales of certain debentures by communicating with prospective customers. The associated person discussed the details of the debentures as an investment, recommended the purchase of the debentures and assisted seven customers with completing the documents necessary to purchase the debentures.

  After soliciting the sales, the associated person mailed the sales documents, which did not identify the associated person's role in the sales, to a registered representative with whom the associated person was formerly affiliated through their then-current firm. The registered representative submitted the sales documentation for the debentures to the firm as the broker of record. When the associated person engaged in all of these sales activities, he was scheduled to take two FINRA licensing examinations, but he was not registered with any FINRA firm in any capacity. The associated person's sales of the debentures, without being registered with FINRA, violated NASD Rule 1031 (registration requirements) and FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the associated person in all capacities for 30 business days and fined him $5,000.

Converting Firm Funds and Causing the Firm to Maintain Inaccurate Books and Records

- FINRA settled a matter involving a registered representative who submitted false expense reports to his firm, consequently, causing it to maintain inaccurate books and records. The representative had a firm-issued corporate card that was for use with business travel and other business-related expenses. During this same period, his firm's written travel, expense and corporate credit card policies required that corporate cardholders use their corporate credit cards exclusively for business purposes. The firm's policies expressly stated that the firm would not reimburse personal charges made on the corporate credit card.

Despite these warnings, between February 2010 and June 2011, the representative prepared and submitted false expense reports to his FINRA firm on a monthly basis. Specifically, the representative charged personal expenses to his corporate card each month. After incurring the charges, the representative falsely identified many of the personal purchases as business expenses in expense reports and caused the firm to reimburse him for those purchases. During the relevant period, the firm identified 132 personal purchases totaling approximately $10,200 for which the representative submitted business expense reports.

FINRA found that the representative converted his firm's funds when he obtained payment for personal expenses by falsely claiming that those purchases were business expenses. As such, the representative acted inconsistent with high standards of commercial honor and just and equitable principles of trade, and violated FINRA Rule 2010 (ethical standards). FINRA similarly found that the representative's preparation of false expense reports constituted falsification of records, that the representative's submission of false expense reports caused his firm to maintain inaccurate books and records, and that the representative violated NASD Rule 3110** (books and records) and FINRA Rule 2010 (ethical standards). FINRA barred the representative in all capacities for the misconduct.

Forging Customer Signatures

- FINRA settled a matter involving a registered representative who improperly signed firm forms on behalf of at least six customers, five of which were signed without the customers' knowledge, authorization or consent. Between April 2012 and September 2012, the representative's firm instituted a "Books and Records Suitability Update." As part of the update, the firm's registered representatives were required to obtain updated suitability information on behalf of all of their customers.

Each customer was required to sign a form that verified the customers' personal information, their financial holdings, their investment objectives and horizon, and other information pertinent to making a suitability determination. Registered representatives of the firm were provided a 14-month deadline to obtain the updated information. If any registered representative failed to timely obtain the updated information, the representative's customer account would be transferred to a new registered representative.

At various times between April 2012 and August 2012, the representative improperly signed the signatures of at least six customers on suitability update forms and submitted them to his firm. With respect to five of these customers, the representative signed the customers' signatures on the documents without their knowledge, authorization or consent. The firm's written supervisory procedures also specifically prohibited registered representatives from signing a customer's name, even if the customer requested that they do so.

The representative's misconduct—forging customers' signatures on the firm's forms—violated FINRA Rule 2010 (ethical standards). For this misconduct, FINRA suspended the representative in all capacities for six-months and fined him $5,000.

Forging Customer Signatures and Impersonating Customers

- FINRA settled a matter involving a registered representative who forged customer signatures on forms and impersonated customers to obtain their confidential information. In December 2012 the representative forged a customer's signature and initials on certain forms to assist the customer with transferring investments and disbursing the investments' proceeds.

  In January 2013, the representative also submitted a forged Transfer on Death (TOD) registration form to a real estate company on behalf of two customers, a couple who had both passed away in late 2012 without any children or beneficiaries. Shortly before submitting the TOD registration form, the representative contacted the real estate company to obtain the form. After receiving the form from the real estate company, the representative forged the couple's signatures on it, backdated it to July 2010 and then submitted the form to the real estate company. The couple had accounts with the real estate company totaling $210,000, and if the real estate company had accepted the TOD registration form, the representative would have been able to receive the funds in the couple's account. The real estate company, however, noted concerns with the form, froze the couple's account and contacted the representative's firm to initiate an investigation.

  The representative contacted the same real estate company on another occasion in January 2013, this time impersonating another elderly customer. In this instance, the representative contacted the real estate company in an attempt to obtain confidential information concerning the customer's withdrawal of a required minimum distribution from an investment. When the call to the real estate company proved unsuccessful, the representative contacted a life insurance company the following day, again impersonating the elderly customer, in an attempt to obtain the customer's confidential information to withdraw the required minimum distribution.

  By forging customer signatures and impersonating customers in an attempt to obtain confidential account information, the representative violated FINRA Rule 2010 (ethical standards). FINRA barred the representative in all capacities for the misconduct.

Check Kiting

- FINRA settled a matter involving an associated person who engaged in a check-kiting scheme. Check kiting involves the practice of writing checks against a bank account, knowing the check amount exceeds the funds available, then depositing it into another account knowing it will eventually be dishonored, and then making use of the funds before the check is dishonored by writing checks or withdrawing funds from the second account.

On 20 dates between March 2012 and January 2013, the associated person wrote a check drawing on an account that exceeded the balance in that account. The associated person then deposited the check at an ATM machine, and she immediately withdrew funds from the account into which the deposit was made, relying, in whole or in part, on the account's temporarily inflated balance from the deposit of the worthless check. Each deposit represented an overdraft of the account from which the check was written, and the associated person was charged an overdraft fee in most instances. The associated person obtained a total of $3,380 in withdrawals based on the 20 illegitimate deposits.

Although the associated person's check kiting did not involve securities or customers of a FINRA firm, the conduct nevertheless violated FINRA Rule 2010 (ethical standards) because the funds that the associated person accessed did not rightfully belong to her. For this misconduct, FINRA suspended the associated person in all capacities for three months and imposed a deferred fine of $5,000.

* NASD Rule 2210 has been superseded by FINRA Rule 2210, effective July 11, 2014.

** NASD Rule 3110 has been superseded by the FINRA Rule 4510 series, effective December 5, 2011.