

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2005002244701**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: McDonald Investments (n/k/a KeyBanc Capital Markets Inc.)
CRD # 566

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, McDonald Investments (n/k/a KeyBanc Capital Markets, Inc.) ("McDonald" or "the firm") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against the firm alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. McDonald hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

KeyBanc Capital Markets Inc. (formerly McDonald Investments) is a broker-dealer based in Cleveland, OH, and has been a member of FINRA (formerly known as NASD or the National Association of Securities Dealers) since 1944. The Firm has 14 active branches and 456 registered personnel. In February 2007, UBS purchased the McDonald Investments retail brokerage network from KeyCorp, KeyBanc Capital Markets Inc.'s parent company. As a result of the UBS transaction, KeyBanc Capital Markets Inc. no longer engages in retail brokerage, and its securities business is limited to providing corporate and investment banking and capital markets services for institutional customers.

RELEVANT DISCIPLINARY HISTORY

McDonald has the following prior relevant disciplinary history:

In October 2003, McDonald was fined \$25,000 by the State of Idaho Securities Commission in which McDonald consented to findings that it failed to have a reasonable basis to believe that its recommendations were suitable; to provide adequate supervisory review; to appropriately assign a registered supervisory representative; to adequately review transactions in customer accounts; and to enforce written supervisory procedures. As part of the settlement, McDonald was required to review and revise its supervision policies.

OVERVIEW

McDonald, through one of its registered representatives, CB, recommended 32 unsuitable variable annuity (VA) transactions to 25 elderly customers between June 2004 and January 2006 (the "relevant period"), thus violating NASD Rules 2310 and 2110.¹ The firm failed to supervise CB by not responding adequately to red flags that CB was engaging in unsuitable transactions, and the firm had inadequate systems and procedures to supervise its VA business, thus violating NASD Rules 3010 and 2110.

CB operated out of a branch of Key Bank, an affiliate of McDonald. Most of CB's customers were elderly bank customers who had been referred to her by Bank employees. The vast majority of her business was generated by sales of VAs to her customers, and she was one of the top sellers of VAs at McDonald.

She consistently engaged in a pattern of VA sales by recommending that many other customers purchase the same VA with the same riders. Between January 2000 and November 2003, CB was the subject of nine customer complaints about her annuity sales, with seven complaining about her VA sales practices.

As a result of these complaints, the firm placed CB under heightened supervision, where she remained for three years until leaving the firm. While under heightened supervision, CB recommended 32 VA purchases to 25 customers that were unsuitable because the VAs (which were identical) included an enhanced death benefit, the value of which did not outweigh the cost. The rider bases the value of the death benefit on the greatest contract value on any contract anniversary prior to the owner's 81st birthday reduced by any withdrawals. Customers 80 years old or older were ineligible to purchase the rider according to the terms of the VA contract. Six of the 25 customers to whom CB recommended the VAs with the enhanced death benefit rider were at least 80 years old – too old to be eligible to purchase the rider. The rest of the customers were between 77 and 80 years old, and they paid substantial fees for the entire time they owned the VA while only having, at most, four years to enjoy any enhancement of their death benefit.

The firm's failure to prevent CB's unsuitable sales demonstrated the deficiencies in its supervision of her. The terms of her heightened supervision failed to address the compliance issues that gave rise to the complaints against her and the firm did not comply with its own procedures in placing her under heightened supervision. While she was on heightened

¹ Unless otherwise noted, all activities referred to in this AWC took place during the relevant period.

supervision, the firm failed to respond adequately to indications that she was engaging in unsuitable transactions.

FACTS AND VIOLATIVE CONDUCT

The Firm, Through CB, Recommended Unsuitable VA Transactions

CB was a registered representative with the firm from May 1999 through December 2005. CB was the only registered representative in a bank branch in East Aurora, NY, and was supervised by a registered principal located in Buffalo, NY, approximately 30 minutes away.

CB principally obtained customers through referrals by Key Bank employees. Many of CB's customers were over 65 years old, retired, and on a fixed income with limited liquidity. Over 87% of her revenue during the relevant period was derived from sales of variable and fixed annuities. CB was one of the top 15 sellers of VAs at McDonald.

A VA is an insurance contract that offers investment features similar in many respects to mutual funds. A customer's premium payments to purchase a VA are allocated to underlying investment portfolios, known as subaccounts, or to a guaranteed fixed interest subaccount that is part of the general account of the insurer. The subaccount value will fluctuate in response to market changes and other factors, and the investor assumes these investment risks.

VA customers are assessed various fees that generally make the investment more costly than an investment in a mutual fund. These include fees related to insurance features, such as the death benefit, the amount of money beneficiaries receive upon the customer's death; fees for withdrawing assets during the surrender period, often a seven-year period after purchase; and fees related to the optional features, known as riders. An investor may select a rider to guarantee a certain percentage of income every year or other withdrawal options, or to offer a potential increase in the value of the death benefit, but riders often have restrictions, including waiting periods, and charge annual fees for the life of the contract whether the benefit is used or not.

Between February 2000 and November 2003, CB was the subject of nine customer complaints. Seven of the nine customers complained about her VA sales. Every complaint relating to her VA sales alleged that CB failed to disclose material information about the VA, including the nature of the product (some customers thought they were buying a fixed annuity or Certificate of Deposit) and surrender charges. The firm settled all but two of the complaints, and paid a total of over \$26,000 to customers as part of the settlements.

In November 2003, the firm placed CB under heightened supervision as a result of the customer complaints. She remained under heightened supervision until she left the firm in December 2005. During the entire time that she was under heightened supervision, however, her business practices remained unchanged, and she continued to derive the majority of her business from sales of VAs to her elderly client base. While she was on heightened supervision, as before, CB sold many of her clients the same VA with an enhanced death benefit rider. A standard death benefit is generally the greater of 1) the value the contract on the date the beneficiary redeems it after the customer's death or 2) the value of all premiums. The enhanced

death benefit rider in the VAs sold by CB, known as the "Highest Anniversary Value" benefit, allowed customers to take advantage of any increase in value of the overall contract by basing the death benefit on the greatest contract value on any contract anniversary prior to the customer's 81st birthday less any withdrawals. The customer paid 25 basis points every year for the rider, and, under the terms of the contract, the rider was unavailable for purchase by customers age 80 or older.

During an 18-month time period between 2004 and 2005 while she was under heightened supervision, CB engaged in unsuitable VA transactions by selling 25 customers the same VA with enhanced death benefit feature in 32 transactions, thereby violating NASD Rules 2310 and 2110. The firm, through CB's supervisor, reviewed and approved each of the transactions.

Of the 32 transactions, six were executed for customers age 80 or older, too old to be eligible for the enhanced death benefit. CB's recommendation that they purchase the VA with the enhanced death benefit was therefore unsuitable since it demonstrated she did not understand the terms of the VA (including the rider) and did not have a reasonable basis for recommending it. Of the remaining 26 transactions, seven transactions were executed where the customer was 79 years old, nine were executed where the customer was 78 years old, and 10 were executed where the customer was 77 years old. These customers paid an additional 25 basis points for the life of the contract for a rider that provided little or no benefit to them. Those customers had, at most, four possible opportunities to lock in gains to the value of the death benefit while paying substantial fees over the life of the VA for this minimal benefit.

McDonald Failed to Supervise CB by Failing to Respond Adequately to Repeated Red Flags Indicating Her VA Sales Were Unsuitable

McDonald had numerous red flags indicating that CB was engaging in unsuitable recommendations and failed to respond to them adequately, thereby violating NASD Rules 3010(a) and 2110.

The mere fact that CB was the subject of seven customer complaints all concerning VA sales was an obvious red flag, and the firm's follow up was inadequate. Under the terms of her heightened supervision, the firm was required to review and "pre-approve" all VA transactions and "verbally verify" VA sales to customers who were 65 years or older. The firm also was supposed to help CB diversify her homogenous VA book of business into other products, such as mutual funds. Despite the firm's preapproval of each of CB's transactions, the firm allowed her to effect 32 unsuitable transactions. Moreover, its follow up with CB's elderly customers, including those who were 65 years or older, who purchased VAs was ineffective. CB also continued to concentrate her business on VA sales.

While CB was on heightened supervision, McDonald's Compliance Department raised concerns about CB's VA transactions on a number of occasions, to no avail. For instance, in June 2004, a senior member of the Compliance Department recommended that CB no longer be allowed to offer VAs to her customers as a result of her seven VA-related customer complaints, but this recommendation was not accepted. In July 2004, the same senior Compliance Department member recommended that CB be moved from her bank branch satellite office to the

Buffalo OSJ for closer supervision but Sales Management decided instead to leave her in her branch, where her supervisor failed to oversee CB adequately while she was under heightened supervision.

The firm also provided an exception report that captured all types of transactions involving customers age 65 or older and instructed the reviewer to provide heightened scrutiny to those transactions to ensure they were suitable. CB's transactions appeared on that report 63 times in 2004, and 25 times between January 1, 2005 and June 30, 2005, but the firm did not follow up adequately on those trades.

McDonald's Systems and Procedures Were Inadequate to Supervise VA Sales Because They Failed to Identify Certain Red Flags in VA Transactions

Broker-dealers are required to have systems and procedures in place that are appropriately tailored to their business and adequate to provide them reasonable assurance that they are complying with applicable securities laws and FINRA rules.

The firm's systems and procedures did not provide adequate guidance to principals approving VA transactions and the firm failed to have systems in place adequate to identify potentially unsuitable VA sales. McDonald's procedures were therefore neither robust nor appropriately tailored to the firm's VA business, thereby violating NASD Rules 3010(b) and 2110.

Approximately 10 percent of the firm's revenue came from sales of variable and fixed annuities. Despite the importance of VA sales to McDonald, the firm's Written Supervisory Procedures relating to VA sales and supervision were inadequate. They provided inadequate instruction on how to assess the suitability of VA transactions in general. The only reference to VAs in the firm's WSPs related to exchanges and that procedure merely identified the forms required to complete the sale without giving any guidance on how to use the information on the forms to determine the suitability of an exchange.

McDonald also failed to have any system to adequately detect patterns of potentially unsuitable sales of VAs, such as the sale of the same VA with the same rider – a pattern that provided some indication that a registered representative may not be tailoring recommendations to each customer's situation. The firm was therefore unable to identify or investigate these patterns to determine whether the transactions were in fact unsuitable.

McDonald Failed to Retain Required Books and Records

McDonald failed to retain records of rejected VA sales transactions in violation of Conduct Rule 3110 and SEC Rule 17a -4.

B. The firm consents to the imposition of the following sanctions:

1. Censure.

2. A fine of \$425,000.

3. In addition, McDonald shall comply with the following undertakings within the time periods specified (unless otherwise extended by FINRA staff):

- a. McDonald further shall undertake to allow each of the customers identified in Attachment A to rescind the purchase of each of the VAs identified in Attachment A and to rebate to each of the affected customers the purchase price of his or her original investment, interest from the date of purchase until the effective date of this AWC, and any applicable surrender charges charged to the customer (except to the extent such surrender charges already have been paid by McDonald), less the amount of any income received on or withdrawals from the VAs. In order to effectuate this undertaking, McDonald shall:
 - i. Within 90 days of the acceptance of the AWC, provide written notice, in plain English, to each customer of the VAs identified in Attachment A of this AWC, explaining his or her right to rescind his or her VA purchase pursuant to this AWC and how to exercise that right. The written notice must make clear that the right to rescind is offered pursuant to a settlement with FINRA and as a term of this AWC. The written notice shall not be unacceptable to FINRA staff;
 - ii. Provide the customers with a toll-free number to call in order to receive assistance with the surrender process. McDonald shall ensure that calls to the toll-free number will be answered by appropriately licensed customer service personnel trained to assist the customers identified in Attachment A with the process of rescinding their VA purchases. McDonald shall monitor the process to ensure that the applicable customers are permitted to surrender their VAs at no charge;
 - iii. At the same time it sends the customer the letter described in Section B(3)(b)(i) above, provide a surrender form to the customers with instructions for completing it and a cover letter explaining that no surrender charges will be charged to the customer on the contract. Both the surrender form and the cover letter must be not unacceptable to FINRA staff. Customers shall have 60 days from the receipt of the letters (mailing date plus three business days) to accept the offer and advise McDonald of their decision to accept;
 - iv. Notify the carrier of the customer's intent to surrender the product, once the customer has elected such an option in order to allow the carrier to notify McDonald as soon as the

surrender has been effected. McDonald will reimburse the customer promptly, but in no case more than 45 days after it received notification that the surrender has been effected, for the cost of any surrender charge imposed by the issuer; and

- v. McDonald will offer each customer identified on Attachment A the ability to rescind his or her relevant VA purchase. Should a customer elect to rescind, McDonald will repurchase his or her VA for cash equal to the consideration paid, interest from the date of purchase until the date this AWC is accepted by FINRA, and any surrender charges imposed by the carrier (except to the extent such surrender charges already have been paid by McDonald), less the amount of any income received on or withdrawals from the VA. Interest shall be paid at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from the date of the purchase of the subject VAs to the date McDonald rescinds the VA purchase.
 - vi. If any customer identified on Attachment A elects not to rescind, then McDonald shall have no further obligation to compensate that customer pursuant to this AWC.
- d. McDonald further consents, agrees and undertakes to cooperate fully with FINRA in any and all investigations, litigation or other proceedings that concern, relate or arise from the matters described in this AWC. In connection with such cooperation, McDonald agrees:
- i. to produce promptly any and all documents and other non-privileged information requested by FINRA's staff in McDonald's possession, custody or control;
 - ii. to use its best efforts to ensure that its officers, managers, principals, employees, representatives, and associated persons also cooperate fully with FINRA, including by (i) being interviewed by FINRA staff at such times as FINRA staff reasonably may request; and (ii) appearing and testifying truthfully and completely in such investigations or hearings as FINRA staff may reasonably request. McDonald agrees that in connection with any request pursuant to this paragraph that notice may be served by regular mail on its attorneys, as follows: Dean M. Jeske, Foley & Lardner LLP, 321 N. Clark St., Suite 2800, Chicago, IL 60654-5313.
- e. Upon written request showing good cause, FINRA staff may extend any of the procedural dates set forth above.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

McDonald specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against McDonald;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, McDonald specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

McDonald further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

McDonald understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against McDonald; and
- C. If accepted:
1. this AWC will become part of McDonald's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the firm;
 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about McDonald's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 4. McDonald may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. McDonald may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects the firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. The firm may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

McDonald certifies that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that McDonald has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce McDonald to submit it.

Date

4/13/09

Respondent

~~Key Banc Capital Markets~~
KeyBanc Capital Markets Inc.

3y: Douglas W. Preiser
Douglas Preiser
Chief Executive Officer, KBCM

Reviewed by:

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Accepted by FINRA:

7/23/09
Date

Signed on behalf of the
Director of ODA by delegated authority

James E. Day
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