

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2006005546004**

RECEIVED
2008 JUL 24 A 6:
REGISTRATION & DISCLOSURE

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

RE: Cindy Schwartz, Respondent
CRD No. 4649760

Pursuant to NASD Rule 9216 of FINRA's Code of Procedure, Respondent 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 Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent 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

Respondent Cindy Schwartz (CRD No. 4649760) ("Schwartz") first became registered with FINRA (f/k/a National Association of Securities Dealers, Inc. or NASD) as a General Securities Representative in 2005. From July 29, 2005 through August 11, 2006, Schwartz was registered as a Government Securities Limited Representative (Series 72) of SAMCO Financial Services, Inc. ("SAMCO"). Schwartz has not been registered with any member firm since her registration with SAMCO was on August 11, 2006. FINRA retains jurisdiction over Schwartz pursuant to Article V, § 4(a) of the By-Laws since the conduct which serves as the basis for this action commenced prior to her termination of registration from a member firm and this AWC is filed within two years after the effective date of her termination of registration from a member firm.

000082207 2008

OVERVIEW

During the relevant period of July 29, 2004, through August 11, 2006, Respondent Schwartz made recommendations to 2 customers to open accounts with SAMCO for purposes of buying and selling Collateralized Mortgage Obligation ("CMO") securities. Each of these customers opened accounts, invested in CMOs, and incurred substantial losses. Based upon the financial situations and needs of her customers, Schwartz did not have reasonable grounds to believe that her recommendations to these customers to invest in CMOs were suitable. As a result, Schwartz's recommendations violated NASD Conduct Rules 2310 and 2110. Further, in recommending that customers invest in CMOs, Schwartz made misstatements of material fact and omitted material facts in connection with the CMO investments, in violation of NASD Conduct Rules 2120 and 2110, and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

Schwartz knew at the time that she opened accounts for her customers that another registered representative would be exercising discretion over the accounts. Yet at no time did Schwartz obtain written authorization signed by any of her clients and a firm principal, in order to authorize Schwartz or anyone at the firm to exercise discretion in any of her customer accounts. Schwartz was aware that all of her clients had non-discretionary accounts and that she needed to get authorization from her clients before each and every trade. Schwartz, nonetheless, delegated the authority to this other individual to (a) select particular CMO investments for her customers; (b) decide how much of the security her customers would buy and when; and (c) decide how much margin borrowing would be utilized to purchase CMOs. By allowing this other representative to exercise discretionary authority in 7 of her customers' accounts in this manner, Schwartz violated NASD Conduct Rules 2510(b) and 2110.

FACTS AND VIOLATIVE CONDUCT

Inverse Floating Rate CMOs

A CMO is a security that pools together mortgages and issues shares, called tranches, with various characteristics and risks. The underlying mortgages serve as the collateral for the CMO and provide principal and interest payments, which are directed to the various tranches and paid to shareholders.

One of the most volatile and risky CMO tranches is the inverse floater CMO ("inverse floater"). An inverse floater is a type of tranche that pays an adjustable rate of interest that moves in the opposite direction from movements of an interest rate index, such as the London Interbank Offered Rate ("LIBOR"). Inverse floaters are thinly traded securities which trade in the over-the-counter market. FINRA informed members as

early as 1993 that inverse floaters "are only suitable for sophisticated investors with a high-risk profile."¹

Inverse floaters typically are highly leveraged and vulnerable to a high degree of price volatility as interest rates move. An increase in the interest rate index decreases the interest rate of an inverse floater and subsequently, the interest earned by the CMO holder. Rising interest rates also generally reduce the prepayment speeds of inverse floaters because home owners are less likely to refinance their mortgages. Although most mortgages include at least a partial repayment of principal with each payment, refinancing results in large principal payments before the expiration of the loan. A slow down in home refinancing may result in a decrease in principal payments to the CMO owner. The smaller repayment of principal extends the maturity date and keeps the owner's investment tied up in the CMO, potentially for as much as 30 years. In addition, an increase in the index reflects an increase in prevailing interest rates, which further decreases the value of the inverse floater. Should the CMO owner need to sell the security on the open market, the trading price could be significantly lower than the original purchase price. Furthermore, inverse floaters generally are traded for institutional clients. Therefore, trades of smaller denominations can be difficult to execute without being subjected to lower than market pricing.

Due to the fact that each inverse floater tranche is uniquely structured and thinly traded, prices used for valuation purposes are determined using theoretical pricing models. These prices are strictly best estimates of value and can vary substantially from prices obtained through actual bidding or market offerings. Consequently, the risk of inverse floaters can be exacerbated by the use of margin borrowing given that the value of the underlying asset is difficult to ascertain until it is actually offered for sale on the market.

SAMCO's Boca Raton Branch Office

During the relevant period of July 29, 2005, through August 11, 2006, Schwartz was one of eight registered persons working in SAMCO's Boca Raton, Florida branch office. During this period, the business conducted in the Boca Raton branch office consisted almost entirely of investing in inverse floaters.

The head of that branch office, JLS, was a self-proclaimed expert in highly complex mortgage backed securities and its derivative CMOs. JLS's business focused almost exclusively on purchasing large par amounts of inverse floaters and allocating the shares among the branch's retail customer accounts, utilizing margin borrowing to finance the customers' investments, in some cases borrowing twice or three times as much as the equity the customer initially deposited. Within the branch office, Schwartz and seven other registered representatives were responsible for soliciting potential retail customers to invest in JLS's CMO program. Schwartz prospected for potential retail

¹ NASD Notice to Members 93-73, Members' Obligations to Customers When Selling Collateralized Mortgage Obligations (CMOs), at 3.

CMO investors by speaking with friends and Certified Public Accountants about potential investors.

After Schwartz and the other representatives opened the customers' accounts, JLS employed a trading strategy of buying and selling the same inverse floater for large numbers, or even all, of the branch office's retail customers. JLS determined which inverse floaters to purchase and how shares were to be allocated to individual customers' accounts. In addition, JLS decided how to utilize margin borrowing to fund additional CMO purchases for customers. None of the branch office's customers provided the firm with written authorization for the firm or any of its representatives to exercise discretionary authority over their accounts.

Schwartz's Recommendations to Customers

At the time that Schwartz recommended that a customer open an account for the purpose of investing in JLS's CMO program, she was responsible for ensuring that such an investment was suitable for the customer. As part of this obligation, Schwartz had an independent duty to investigate the inverse floater product as well as JLS's investment strategy. Yet, Schwartz did no independent due diligence on the investment or JLS's investment strategy. Instead, Schwartz relied exclusively on representations made by JLS about the investment risks and trading strategy. She also did not have a basic understanding of investing in CMOs and knew nothing about the trading strategy that would be employed on her customers' behalf.

Schwartz was also required under NASD Conduct Rule 2310 to have reasonable grounds for believing her recommendations were suitable for her particular customers based upon the facts disclosed by those customers as to their financial situations and needs. Schwartz, however, failed to ask about her customers' risk tolerances and failed to conduct *any* suitability analysis. As a result, she made unsuitable recommendations to customers who were unsophisticated investors with low risk profiles. These recommendations violated NASD Conduct Rules 2310 and 2110.

In connection with making these unsuitable recommendations to customers, Schwartz also recklessly made material misrepresentations and/or omitted material information as detailed below in violation of NASD Conduct Rules 2120 and 2110, and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

1. Customers AB and HB

In September 2005, Schwartz met with customers AB and HB and recommended that they open an account at SAMCO for purposes of investing in CMOs. AB and HB were 76 years old and 58 years old, respectively, and retired when their account was opened. According to the new account form, their annual household income was between \$40,000 and \$64,999 and their net worth and liquid net worth exceeded \$1 million. AB and HB listed 15 years of investment experience with stocks. Their new account form listed their investment objectives as "Income" and "Growth and Income."

Their conservative investment objectives made inverse floaters an unsuitable investment for them. However, Schwartz recommended that AB and HB open an account at SAMCO to invest in inverse floaters.

AB and HB opened their account at SAMCO in September 2005 with an initial deposit of \$40,000. On September 27, 2005, an inverse floater was purchased for AB and HB's account using their initial investment and borrowing \$60,535.39 on margin. This CMO was subsequently sold in April 2006 and generated a realized loss of \$4,867.71.

The proceeds from the sale of the first inverse floater were used to purchase two additional CMOs in April 2006. The costs of the two CMOs were \$92,438.15 and \$4,007.43. By May 31, 2006, the value of the two CMOs decreased and AB and HB were issued a margin call for \$20,121.92. SAMCO allowed AB and HB to deposit an additional \$7,000 in July 2006 in order to avoid having their holdings sold off to meet their margin obligations. Although their deposit did not meet the entire margin call and their account equity was still less than 4%, SAMCO kept the account open. From the additional cash deposit in July 2006 through November 2006, there were no additional CMO transactions but AB and HB paid an additional interest of \$2,326.39 on the margin borrowings.

Between September 2005 and the margin notice in June 2006, the value of AB and HB's original \$40,000 investment dropped to \$2,105.10. On December 11, 2006, AB and HB closed their account at SAMCO. At that time, the value of their total investment of \$47,000 had dropped to \$6,593.29.

2. Customers BP and CP

In September 2005, customers BP and CP opened a joint account with Schwartz for the purpose of investing in inverse floaters. BP was 49 years old and employed as a sales representative at the time of the account opening. CP was a 54 year old attorney. Their new account form listed household income between \$125,000 and \$249,999, and net worth and liquid net worth of over \$1 million. They had no previous investment experience. In addition, BP and CP had a low risk tolerance and were concerned about volatile investment returns. Despite BP and CP being non-sophisticated investors with a conservative risk tolerance, Schwartz recommended they open an account at SAMCO for purposes of investing in CMOs.

During her discussion with BP and CP, Schwartz generally described the features of CMOs. In connection with recommending the CMO program to BP and CP, Schwartz represented that (1) BP and CP could not lose their investment unless they redeemed funds before the CMO's maturity; and (2) the inverse floater would mature within six months to one year. Each of Schwartz's statements was material and false. Investors *can* lose their principal investment in inverse floaters, and be asked to deposit additional

funds when margin is utilized in their account when interest rates rise. In addition, numerous market events such as rising interest rates will impact the ultimate maturity of a CMO. Schwartz also omitted to state material information in connection with recommending the CMO program to BP and CP. Specifically, she failed to discuss with them the risks associated with utilizing margin to fund the purchase of inverse floaters.

In September 2005, BP and CP opened a joint account with a \$25,000 initial deposit based upon Schwartz's recommendation. Using the initial deposit, along with \$37,630.11 of margin borrowing, was used to fund the purchase of an inverse floater. This inverse floater was sold in April 2006 and incurred a realized loss of \$3,035.37.

The proceeds from the sale of the inverse floater were used to purchase two additional CMOs at costs of \$57,585.93 and \$2,497.94, respectively. These securities were still in BP and CP's account on May 31, 2006, and due to a decrease in value, BP and CP were issued a margin call for \$12,448.95. Between the account opening in September 2005 and June 2006, the account earned \$1,081.98 in interest but paid \$2,316.40 for the funds borrowed on margin. As of June 30, 2006, the account originally opened with \$25,000, was valued at \$1,398.71. BP and CP later deposited an additional \$30,000 at the request of Schwartz to meet their margin obligations because their CMO holdings could not be sold. BP and CP did not recover either their initial deposit of \$25,000 or the \$30,000 subsequent contribution to meet the margin call, resulting in a total loss of \$55,000.

Schwartz Improperly Exercised Discretionary Authority in Customer Accounts

Schwartz knew at the time that she opened accounts for her customers that JLS would be exercising discretion over the accounts. At no time did Schwartz obtain written authorization signed by any of her clients and a firm principal, in order to authorize Schwartz, JLS or the firm to exercise discretion in any of her customer accounts. Schwartz was aware that all of her clients had non-discretionary accounts and that she needed to get authorization from her clients before each and every trade. Schwartz, nonetheless, delegated the authority to JLS to (a) select particular CMO investments for her customers; (b) decide how much of the security her customers would buy and when; and (c) decide how much margin borrowing would be utilized to purchase CMOs. Due to Schwartz allowing JLS to control all of the trading in her customers' accounts in this manner, Schwartz's customers were not always contacted by Schwartz or anyone else at SAMCO for trade authorization prior to trades being executed in their accounts. As a result, Schwartz improperly exercised discretionary authority in 7 customer accounts in violation of NASD Conduct Rules 2510(b) and 2110.

B. Respondent also consents to the imposition of the following sanctions:

A bar from associating with any member firm in any and all capacities.

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

Respondent understands that if she is barred from associating with any FINRA member, she becomes subject to a statutory disqualification as that term is defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended. Accordingly, Respondent may not be associated with any FINRA member in any capacity, including clerical or ministerial functions, during the period of the bar or suspension. (See NASD Rule 8310 and IM-8310-1.)

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent 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 her;
- 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, Respondent 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.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of NASD Rule 9143 or the separation of functions prohibitions of NASD 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

Respondent 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 NASD Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against her; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against her;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-3; and
 - 4. Respondent 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. Respondent 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 Respondent's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that she 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.

Respondent certifies that she has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that she 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 him to submit it.

7-16-08

Date

Cindy M. Schwartz
Respondent Cindy Schwartz

Reviewed by:

Carl F. Schoeppl

Carl Schoeppl
Schoeppl & Burke, P.A.
4651 N. Federal Highway
Boca Raton, FL 33431-5133
Counsel for Respondent

Accepted by FINRA:

July 23, 2008
Date

Signed on behalf of the
Director of ODA, by delegated
authority

Samuel L. Israel

Samuel L. Israel
Associate Vice President And Chief
Counsel
FINRA Department of Enforcement
1801 K Street, N.W., Suite 800
Washington, D.C. 20006-1334
(t) 202-974-2868