SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 70046 / July 26, 2013

Admin. Proc. File No. 3-15080

In the Matter of the Application of

ACAP FINANCIAL, INC. and GARY HUME
c/o Anthony W. Djinis
Pickard and Djinis LLP
1990 M Street, NW, Suite 660
Washington, DC 20036

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDING

Unregistered Sale of Securities

Conduct Inconsistent with Just and Equitable Principles of Trade

Failure to Establish Written Supervisory Procedures

Failure to Supervise

Member firm of registered securities association engaged in unregistered sale of securities in violation of Securities Act and association's rules. Member firm and its compliance officer failed to reasonably supervise firm's registered representative engaging in unregistered sale of securities. Member firm and compliance officer also failed to maintain adequate written supervisory procedures. *Held*, association's findings of violation and sanctions imposed *sustained*.

APPEARANCES:

Anthony W. Djinis and *Paul J. Bazil*, of Pickard and Djinis LLP, for *ACAP Financial, Inc.* and *Gary Hume*.

Alan Lawhead, *Carla Carloni*, and *Jennifer Brooks*, for *Financial Industry Regulatory Authority, Inc.*

Appeal filed: October 25, 2012
Last brief received: March 5, 2013

I.

ACAP Financial, Inc., a FINRA[1] member firm, and Gary Hume, currently and during the relevant period, its compliance officer and head trader,[2] seek review of a FINRA disciplinary action.[3] FINRA found that ACAP violated Section 5 of the Securities Act of 1933 and NASD Conduct Rule 2110[4] through sales of Greyfield Capital securities on an unregistered basis without an applicable exemption from registration.[5] FINRA also found that ACAP and Hume violated NASD Conduct Rules 3010[6] and 2110 by failing to take steps to ensure that the registered representative who made the Greyfield trades at issue ascertained the information necessary to determine whether the Greyfield securities could be sold in compliance with the Securities Act and also by failing to establish and maintain written procedures regarding transactions in restricted securities or the receipt of stock certificates.[7]

FINRA fined ACAP $50,000 for its unregistered sales of securities in violation of the Securities Act.[8] For its supervisory violations, FINRA fined ACAP an additional $50,000 and required it to revise its procedures and retain an independent consultant to review and approve them.[9] FINRA further suspended ACAP from receiving and liquidating penny stocks for which no registration statement is in effect until it implemented appropriate procedures approved by the

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1 We apply the conduct rules of NASD, FINRA's predecessor, that were in place at the time of the misconduct.

2 Hume has been associated with ACAP since 1991.

3 *Dep't of Enf. v. ACAP Fin., Inc.*, Complaint No. 2007008239001, 2012 FINRA Discip. LEXIS 55 (NAC Sept. 26, 2012).

4 NASD Conduct Rule 2110, now FINRA Rule 2010, requires members to "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business.

5 *ACAP Fin.,* 2012 FINRA Discip. LEXIS 55, at *11.

6 Among other things, NASD Conduct Rule 3010 requires members to "establish and maintain a system to supervise the activities of" registered representatives and other associated persons "that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules" and to "establish, maintain, and enforce written procedures to supervise the types of business in which it engages" and the activities of registered representatives and other associated persons "that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD." *See* NASD Conduct Rule 3010(a) & (b)(1). Because Hume had responsibility for creating and maintaining ACAP's supervisory and compliance procedures, Rule 3010 applies to him. *See* NASD Rule 0115(a) ("Persons associated with a member shall have the same duties and obligations as a member under these Rules.").

7 *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *12-13.

8 *Id.* at *21.

9 *Id.* at *25.

consultant.[10] For his supervisory violations, FINRA fined Hume $25,000, suspended him for six months in all capacities, and required him to requalify before acting in any capacity requiring qualification.[11] ACAP and Hume now challenge those sanctions but not FINRA's underlying findings of misconduct, to which they stipulated. We base our findings on an independent review of the record.

II.

A. Background

ACAP Financial, Inc. is a FINRA member firm based in Salt Lake City, Utah and has been a member of FINRA and its predecessor, NASD, since 1978. Gary Hume has been in the securities industry since 1988 and has been employed by ACAP since 1991. At the time of the events at issue, Hume held Series 7, 24, and 63 licenses. In 2005, Hume was ACAP's compliance officer and head trader and maintained supervisory responsibilities over all but one of the registered representatives in ACAP's home office.[12]

Since at least 1990,[13] the majority of ACAP's business has been in lower-priced Bulletin Board and Pink Sheet securities.[14] Most of ACAP's business is liquidating stock. Such transactions in lower-priced securities present a risk of abuse because, among other things, information about issuers of such securities "can be extremely difficult to find, making them more vulnerable to investment fraud schemes."[15]

In light of these considerations, we have cautioned broker-dealers to be alert to the possibility of an illegal, unregistered distribution of lower-priced stock,[16] and attentive to the possibility that customers or related persons might attempt to mislead them regarding the legality

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[10] *Id.*

[11] *Id.* at *26.

[12] The single representative whom Hume did not supervise primarily worked with ACAP's owner on private placements and was supervised by ACAP's owner.

[13] ACAP Br. at 2.

[14] In 2005, "[t]he 'Pink Sheets' [wa]s a quotation service for over-the-counter securities operated by Pink Sheets LLC." *Gateway Int'l Holdings, Inc.*, Exchange Act Release No. 53907, 2006 SEC LEXIS 1288, at *4 n.5 (May 31, 2006). OTC Markets Group Inc. is the successor to Pink Sheets LLC and now operates the OTCPink marketplace on the OTC Link electronic quotation system. *See OTC Link LLC*, http://www.sec.gov/answers/pink.htm (last visited July 2, 2013); *OTC Markets Overview*, http://www.otcmarkets.com/about/overview (last visited July 2, 2013).

[15] *Microcap Stock: A Guide for Investors*, http://www.sec.gov/investor/pubs/microcapstock.htm (last visited July 2, 2013); *see also id.* (stating that "[w]hile all investments involve risk, microcap stocks are among the most risky"); *OTC Link LLC* (explaining that the fact that many OTC Link quoted issuers "do not file periodic reports or audited financial statements with the SEC" makes it "very difficult for investors to find current, reliable information about those companies" and observing that they can be "among the most risky investments").

[16] *Distribution by Broker-Dealers of Unregistered Securities*, Securities Act Release No. 4445, 27 Fed. Reg. 1251, 1251 (Feb. 2, 1962) ("*1962 Securities Act Release*") ("[A] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter.").

of a sale.[17] For this reason, it is essential for broker-dealers and their associated persons, in determining whether a sale of securities is exempt from registration under the Securities Act, to make "routine inquiries" of customers,[18] as well as conduct independent inquiries as a matter of course regarding the securities that those customers seek to sell,[19] to detect any warning signs indicating the possibility of an unlawful distribution. While the amount of inquiry necessarily varies with the circumstances of a particular case, the need for vigilance is "particularly acute" where "substantial amounts of a previously little-known security appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act of 1933."[20] Other "red flags" may include customers liquidating stock shortly after deposit,[21] the stock being thinly traded,[22] or the issuer being newly formed or recently experiencing a change in control.[23]

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[17] *Sales of Unregistered Securities by Broker-Dealers*, Securities Act Release No. 5168, 1971 SEC LEXIS 19, at *7 (July 7, 1971) ("*1971 Securities Act Release*") ("[I]nformation received from little-known companies or their officials, transfer agent or counsel must be treated with great caution as these are the very parties that may be seeking to deceive the firm."), quoted in *Midas Sec., LLC*, Exchange Act Release No. 66200, 2012 SEC LEXIS 199, at *41 n.56 (Jan. 20, 2012); *see also Benjamin Werner*, Exchange Act Release No. 8579, 44 SEC 886, 1972 SEC LEXIS 743, at *4 n.4 (Apr. 24, 1972) (citing *1971 Securities Act Release* with approval).

[18] These inquiries include (1) if a customer has direct or indirect connections with any publicly owned company or the issuer, (2) if the customer's financial condition is consistent with the value of the securities to be sold, (3) if the customer acquired the securities on the open market, (4) if the customer is the true beneficial owner of the securities, (5) if the customer has non-public information about the issuer, and (6) if the customer is currently selling or attempting to sell the same securities through other brokerage houses. *1971 Securities Act Release,* 1971 SEC LEXIS 19, at *5-6.

[19] This basic information should include, at a minimum, the issuer's "address, business activities, principals, products, assets, financial condition and number of shares of stock outstanding." *Id.* at *6.

[20] *1962 Securities Act Release*, 27 Fed. Reg. at 1251; *see also James L. Owsley*, Exchange Act Release No. 32491, 51 SEC 524, 1993 SEC LEXIS 1525, at *13 (June 18, 1993) ("[T]he enormous volume of trades emanating from a few accounts should have alerted Nelson to the likelihood that unlawful distributions were taking place."); *Gilbert F. Tuffli, Jr.*, Exchange Act Release No. 12534, 46 SEC 401, 1976 SEC LEXIS 1467, at *18 (June 10, 1976) ("[I]nquiry is essential whenever a salesman is presented with a large block of an obscure stock.").

[21] *Jacob Wonsover*, Exchange Act Release No. 41123, 54 SEC 1, 1999 SEC LEXIS 430, at *25 n.25 (Mar. 1, 1999) ("A distribution within a relatively short period after acquisition is evidence of an original intent to distribute."), *petition denied*, 205 F.3d 408 (D.C. Cir. 2000); *see also Robert G. Leigh*, Exchange Act Release No. 27667, 50 SEC 189, 1990 SEC LEXIS 153, at *9 (Feb. 1, 1990) (finding that because customer "immediately sold" shares following deposit, customer was "deemed to have acquired them with a view to distribution").

[22] *Charles F. Kirby*, Exchange Act Release No. 47149, 56 SEC 44, 2003 WL 71681, at *5 (Jan. 9, 2003) (finding that trader failed to make appropriate inquiry into "stock's true status" when, among other things, company traded "only sporadically"), *petition denied sub nom.*, *Geiger v. SEC*, 363 F.3d 481 (D.C. Cir. 2004); *Butcher & Singer Inc.*, Exchange Act Release No. 23990, 48 SEC 640, 1987 SEC LEXIS 2813, at *3, *7 (Jan. 13, 1987) (reciting that stock was an "obscure penny stock for which prices had not been quoted in the pink sheets for about two months" and finding that trader failed to make required inquiry under the circumstances), *aff'd*, 833 F.2d 303 (3d Cir. 1987) (table).

[23] *Midas Sec.*, 2012 SEC LEXIS 199, at *34 (finding the fact that issuer was a "newly formed company that had been trading for less than two weeks" constituted a red flag); *Kirby*, 2003 WL 71681, at *5 (noting fact that "there was little or no information available regarding the Company's business since [its] change in control" as support for finding that trader failed to make necessary inquiry).

B. ACAP's procedures regarding transactions in restricted securities and the receipt of stock certificates without restrictive legends were minimal.

Notwithstanding the extent of its penny stock business, ACAP did not have any written procedures regarding transactions in restricted securities[24] or the receipt of stock certificates without restrictive legends,[25] and there was nothing in ACAP's written procedures manual regarding the determination of whether stock could legally be traded.[26] When presented with a stock certificate without a restrictive legend, ACAP and Hume would make no effort to determine whether a Securities Act registration statement was in effect as to the offer and sale of the stock or an exemption from registration applied. No one at ACAP would undertake any effort to determine how the customer obtained the stock, how long the customer had held it, what the customer paid for the stock, or whether the customer was an officer, director, control person, or otherwise an affiliate of the issuer.[27] Nor would Hume undertake any other due diligence to obtain information about the issuer or its securities. In his investigative testimony, Hume could not recall ever raising a question as to whether stock could be sold in compliance with the registration requirements of the Securities Act. Indeed, Hume admitted that, under ACAP's procedures, he had no way of knowing whether shares deposited by a customer and represented by stock certificates that did not bear restrictive legends could legally be sold.

ACAP relied on Jim Walker, an employee of ACAP's clearing firm, Alpine Securities, to make such a determination. Although an employee of Alpine, Walker maintained offices on site at ACAP in 2005. Hume testified that he would check with Walker "to make sure it was OK" to sell securities the first time ACAP would sell a particular stock and that, depending on the volume of stock certificates received, Hume might talk with Walker multiple times a day or as

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[24] Rule 144(a)(3) of the Securities Act defines the term "restricted securities" to include "[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering." 17 C.F.R. § 230.144(a)(3); *see also* FINRA Regulatory Notice 09-05 (citing Rule 144(a)(3) definition of restricted securities).

[25] A restrictive legend is "a statement placed on restricted stock notifying the holder that the stock may not be resold without registration." *Kirby*, 2003 WL 71681, at *2.

[26] Instead, ACAP's written procedures generally provided that Hume, as the firm's compliance officer, would review and approve penny stock transactions, investigating and documenting all "suspicious activity." These procedures did not provide specific guidance. Hume conceded that he conducted any penny stock review of other traders' transactions only after those trades were executed and that he never disapproved a trade. Because most of ACAP's business was liquidating stock, Hume did not consider sales to be suspicious activity. Rather, Hume looked for large numbers of purchases in a particular security, as well as sales followed by purchases, under circumstances in which he could not discern a reason for the trades.

[27] ACAP and Hume assert that "whenever a customer placed a sell order, Hume would review customer new account forms to see whether the customer disclosed that he (or she) was an officer, director, greater than 10% shareholder or otherwise [a] control [person] of a public company . . . ." ACAP Br. at 3. But the record does not support this assertion. Hume testified that when he reviewed a new account application, he reviewed the answer to the control person question in the application. Although he testified that he had reviewed new account forms in connection with some trades in the past, Hume could not specify how often that had occurred or whether he had ever done so without prompting from ACAP's clearing firm. In any event, these forms were updated only if clients moved or notified the broker of changes to their information. Hume also testified that at times he had asked brokers whether there was a relationship between clients. There is no testimony that it was ACAP's and Hume's regular practice to do this before trades.

seldom as once a week. Hume's general understanding was that, after Walker had received stock certificates from ACAP or its customer, he would send them to the Depository Trust Company ("DTC")[28] to determine if they could be offered and sold consistent with the registration requirements of the Securities Act. Hume did not know if DTC did any research into the history of the ownership of the stock. Rather, Hume believed that DTC's "main goal" was to have the stock placed in the name of its nominee, Cede & Co.[29] As Hume explained, ACAP's view was that the only limitation on the ability to sell stock represented by a certificate without a restrictive legend was to wait until Alpine sent it to DTC. Other than as discussed above, the record contains no evidence that Walker or anyone else at Alpine conducted any type of inquiry to determine whether shares represented by stock certificates lacking restrictive legends could legally be offered and sold absent registration or that ACAP provided Alpine with the type of information necessary to make this determination.

C. ACAP executed unregistered sales of Greyfield securities.

On May 3, 2005, a certificate for 25 million shares of Greyfield Capital was deposited into an account that Gold Technologies, LLC, a Texas entity owned by Mervin George Fiessel, maintained at ACAP. On the same day, an ACAP account maintained by a business associate of Fiessel received 20 million shares of Greyfield stock. Both accounts had been opened in 2003 by Vincent Michael McGuire, a registered representative at ACAP supervised by Hume.[30]

On July 6, 2005, Gold Technologies deposited 10 million additional shares. All 55 million deposited shares had been issued on April 28, 2005, i.e., less than a week before the initial deposits, and together they made up approximately 11% of the total issued and outstanding shares of Greyfield. No Securities Act registration statement was in effect for the offer and sale of any Greyfield securities, and none of these stock certificates carried a restrictive legend.

At the time of the deposits and ACAP's subsequent sales, Greyfield was a little-known development-stage company that was quoted in the Pink Sheets. Greyfield had begun trading in the over-the-counter market on May 24, 2002, at an initial price of $1.40 per share. In the nearly three years before May 6, 2005, Greyfield stock had traded only four times with a total volume of 1,530 shares.[31] Other than the initial trade, each trade was at $.01 per share. Just prior to ACAP's customers' Greyfield trades, the market for Greyfield securities suddenly became active.

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[28] DTC "was created by the securities industry to improve efficiencies and reduce risk in the clearance and settlement of securities transactions" and is the largest securities depository in the world. *Investor Bulletin: DTC Chills and Freezes*, SEC Office of Investor Education and Advocacy (May 2012), http://www.sec.gov/investor/alerts/dtcfreezes.pdf (last visited July 2, 2013).

[29] FINRA 000291 (Investigative Test. of Gary Hume ("Hume Test.") at 45:19-23).

[30] The record does not contain evidence of improper activity linked to the accounts before the events underlying this proceeding.

[31] While the parties stipulated that 1,330 shares were traded, historical trading data from Google Finance reflects that 1,530 Greyfield shares traded prior to May 6, 2005. *See* http://www.google.com/finance/historical?cid=825226&startdate=Jan+1%2C+2002&enddate=May+6%2C+2005&num=30&ei=tcQwUcCXDYyy0AG_eQ (listing of GRYF trades between January 1, 2002 and May 6, 2005) (last visited July 2, 2013). This 200 share discrepancy is

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On May 6, 2005, Greyfield issued a press release touting its business prospects.[32] According to the press release, Greyfield had acquired Autorama, which it described as a "highly profitable, fast growing premium automobile dealership" with "explosive growth" that was "quickly becoming the largest automobile dealership in western Canada" although it had only a single location.[33] The press release's focus on Autorama's activities was consistent with the fact that Greyfield itself had no business operations as of April 2005. From May through July 2005, Greyfield released a number of additional press releases touting its business prospects.

On May 9, 2005, Gold Technologies sold 423,684 of the Greyfield shares in its ACAP account. Thereafter, between June 17 and June 30, 2005, Fiessel's associate sold 20 million shares of Greyfield from his ACAP account. Between July 8 and July 26, 2005, Gold Technologies sold an additional 7.3 million shares of Greyfield. McGuire acted as the registered representative for each of these sales. The average daily trading volume in Greyfield shares from May 6 through July 26, 2005 was approximately 1,580,000 shares, i.e., over 1,000 times the entire volume of Greyfield shares that had been publicly traded over its nearly three-year trading history before May 6, 2005.

This pattern of trading raised substantial red flags. Nonetheless, ACAP and Hume failed to take adequate steps to ensure that McGuire ascertained (1) whether the offer and sale of the Greyfield securities were the subject of a Securities Act registration statement, (2) how and from whom ACAP's customers obtained their shares, (3) whether and when those shares were paid for, and (4) whether the sales of the Greyfield shares were exempt from registration under the Securities Act. Moreover, supervisory personnel at ACAP undertook no efforts to determine whether the Greyfield shares were eligible for sale without registration, other than relying on the fact that the stock certificates did not bear a restrictive legend and whatever efforts ACAP's clearing firm made to determine whether the shares could be traded consistent with the registration requirements of the Securities Act.

On July 27, 2005, we suspended trading of Greyfield securities for ten days, finding that there were questions regarding Greyfield's corporate domicile, the identity of its officers and directors, whether its shares were validly issued, and the accuracy of information in its press releases.[34] In all, prior to the suspension and under Hume's watch, ACAP had sold more than

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immaterial and our findings herein are not affected by it. *Cf.* Rule of Practice 323, 17 C.F.R. § 201.323 (authorizing Commission to take official notice of certain "material fact[s]").

[32] The parties stipulated to the May 6, 2005 press release date. Business Wire appears to have distributed the press release on the following business day, May 9, 2005. *See Greyfield Completes Reverse Merger With Autorama: Acquires 100% Ownership of Highly Profitable, Fast Growing, Premium Automobile Dealership in Canada*, Westlaw 5/9/05 Bus. Wire 11:30:00. This minor difference is immaterial to our analysis.

[33] FINRA 000066 (Stipulations of Facts and Violations ("Stipulations") ¶ 18). When Greyfield subsequently announced the opening of a second dealership, it claimed to be "aggressively expanding its network of dealerships throughout Canada." *Id.*

[34] *See* http://www.sec.gov/litigation/suspensions/34-52127.pdf (press release announcing action); http://www.sec.gov/litigation/suspensions/34-52127-o.pdf (order halting trading).

27 million shares of Greyfield stock from its customers' accounts into the public markets for proceeds of approximately $46,000 without registration or an applicable exemption.

D. ACAP's sales of Greyfield securities were part of a broader illegal distribution.

The sales of Greyfield shares that ACAP's customers made from their ACAP accounts were part of a broader unregistered distribution of hundreds of millions of Greyfield shares that began in late April 2005. That month or earlier, Fiessel and two colleagues took control of Greyfield by providing false documents to its transfer agent. Using a signature stamp he had obtained from a former president of Greyfield, Fiessel generated letters appointing two of his colleagues as its controlling officers and directors. Also in April 2005, Greyfield authorized the issuance of 600 million new shares. Although 466 million of these shares were issued to Gold Technologies, Fiessel caused the transfer agent to break the shares up into groups and to send them to various entities and individuals, including his business associate. Neither Fiessel nor Gold Technologies ever paid for the Greyfield shares, despite Gold Technologies's entering into an April 20, 2005 agreement with Greyfield that stated that $120,000 was being paid with the execution of the agreement.

In the first two weeks of trading, the Greyfield stock price rose from $.04 per share to $0.05 per share but subsequently fell substantially. By the first week of June 2005, Greyfield traded at less than $0.01 per share, i.e., a greater than 80% decline from its peak price, and subsequently never rose above $0.01.

In November 2006, the SEC and the British Columbia Securities Commission announced settlements with Fiessel and one of his colleagues for market manipulation and the violation of Section 5 of the Securities Act in connection with sales of Greyfield securities.[35] The defendants agreed to injunctions, officer-and-director bars, penny stock bars, and financial sanctions of more than $180,000 in the Commission's case and additional sanctions in the BCSC action.

E. FINRA initiated proceedings against McGuire, ACAP, and Hume.

On June 7, 2010, FINRA's Department of Enforcement filed a two-count Complaint against McGuire,[36] ACAP, and Hume. On October 27, 2010, ACAP and Hume entered into Stipulations of Facts and Violations with FINRA. ACAP and Hume admitted that ACAP had made unregistered sales of Greyfield securities in violation of Section 5 of the Securities Act and that this conduct violated NASD Conduct Rule 2110. They also admitted that they each had violated NASD Conduct Rules 3010 and 2110 "[b]y failing reasonably to supervise McGuire in

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[35] *SEC v. Mervin George Fiessel and Robert Michael Doherty, Civil Action No. 1:06-CV-1260 (E.D. Va., Nov. 8, 2006)*, Lit. Release No. 19902, 2006 SEC LEXIS 2570, at *2 (Nov. 8, 2006); *Cross-border stock scheme ends with two B.C. men ordered out of capital market*, British Columbia Securities Commission, http://www.bcsc.bc.ca/release.aspx?id=4724 (Nov. 8, 2006) (last visited July 2, 2013).

[36] On November 24, 2010, FINRA accepted an offer of settlement by McGuire in which he admitted making unregistered sales of Greyfield securities in violation of the Securities Act and NASD Conduct Rule 2110. McGuire was suspended from association with any FINRA member firm in any capacity for forty-five calendar days and fined $15,000. The findings contained in the order of settlement were not binding on ACAP or Hume and we do not rely on them.

connection with the [unregistered] sale of [Greyfield] securities, and by failing to establish, maintain and enforce written procedures reasonably designed to achieve compliance with applicable securities laws and regulations."[37] The parties also agreed to limit the proceeding before the FINRA Hearing Panel to a determination, based on a paper record, of appropriate sanctions in light of the stipulated facts and violations.

The Hearing Panel issued a decision on May 3, 2011 in which it found that the record supported the stipulated misconduct and ordered a combination of monetary and other sanctions.[38] The Hearing Panel fined ACAP $25,000 for its unregistered sales of securities and, with respect to its supervisory failures, fined ACAP an additional $50,000, required it to revise its written procedures to ensure that they were reasonably designed to comply with the requirements of Securities Act Section 5, and required it to retain an independent consultant to review and approve the firm's revised procedures. The Hearing Panel also "suspended [ACAP] from the activity of receiving [] penny stocks" for which no Securities Act registration statement was in effect as to the offer and sale of the stock "including those [stocks] represented by unlegended stock certificates, and liquidating those positions, until it has implemented its revised procedures after approval by the independent consultant."[39] The Hearing Panel fined Hume $10,000, suspended him from associating with any FINRA member firm in all principal capacities for one year, and required him to re-qualify by examination as a principal before re-entering the securities industry in any principal capacity.

The review subcommittee of FINRA's National Adjudicatory Council (the "NAC") subsequently called the case for review solely as to the sanctions issued. On September 26, 2012, the NAC affirmed the Hearing Panel's findings of misconduct but modified the sanctions.[40] The NAC fined ACAP $50,000 for the Section 5 and Rule 2110 violations, thereby increasing the $25,000 fine previously ordered by the Hearing Panel.[41] Consistent with the Hearing Panel's prior determination, the NAC also fined ACAP an additional $50,000 for its supervisory failures, required it to revise its relevant procedures and retain an independent consultant to review and approve them, and suspended ACAP from receiving and liquidating penny stocks for which no registration statement is in effect until it implemented the approved procedures.[42] The NAC also fined Hume $25,000 for his supervisory failings, thereby increasing the $10,000 fine previously ordered by the Hearing Panel, and suspended him in all capacities for six months, in contrast to the Hearing Panel's decision to suspend him for one year in all principal capacities.[43] The NAC also required Hume to requalify before acting in any capacity requiring qualification.[44] On

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[37] FINRA 000069 (Stipulations ¶ 32).

[38] *Dep't of Enf. v. ACAP Fin. Inc.*, Complaint No. 2007008239001, 2011 FINRA Discip. LEXIS 32, at *4 (OHO May 3, 2011).

[39] *Id.* at *28.

[40] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *11, *13, *19, *23.

[41] *Id.* at *13, *21.

[42] *Id.* at *25, *29.

[43] *Id.* at *26-27, *29.

[44] *Id.*

October 25, 2012, ACAP and Hume timely filed an application for review of the NAC's decision, in which they challenged these sanctions and the NAC's determination that their misconduct was egregious.

III.

A. ACAP violated NASD Rule 2110 through the unregistered sale of Greyfield securities in contravention of Securities Act Section 5.

In the FINRA proceeding, ACAP conceded that it engaged in unregistered sales of Greyfield securities in violation of Securities Act Section 5 and, in so doing, violated NASD Conduct Rule 2110.[45] We find that the record amply supports ACAP's concessions and accordingly affirm FINRA's finding of violation.

Securities Act Sections 5(a) and (c) prohibit any person from offering or selling securities in interstate commerce unless a registration statement is filed or in effect with the Commission or an exemption from registration is available.[46] The Securities Act was designed "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions."[47] "The registration requirements are the heart of" the Securities Act.[48]

A *prima facie* case for a violation of Section 5 requires a showing that "(1) the defendant directly or indirectly sold or offered to sell securities; (2) through the use of interstate transportation or communication and the mails; (3) when no registration statement was in effect."[49] There is no requirement to show scienter,[50] i.e., an "intent to deceive, manipulate, or defraud."[51] Once a prima facie case is established, the burden shifts to the person seeking an exemption from registration to establish the availability of the exemption.[52]

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[45] *See Midas Sec.*, 2012 SEC LEXIS 199, at *46 n.63 ("A violation of Securities Act Section 5 also violates NASD Rule 2110." (citing *Sorrell v. SEC*, 679 F.2d 1323, 1326 (9th Cir. 1982))); *Kunz v. SEC*, 64 F. App'x 659, 663-64, 668 (10th Cir. 2003) (noting SEC conclusion that respondent violated Conduct Rule 2110 by failing to comply with Securities Act registration requirements and affirming that determination).

[46] 15 U.S.C. § 77e(a) & (c); *see also Wonsover*, 1999 SEC LEXIS 430, at *15.

[47] *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953).

[48] *Pinter v. Dahl*, 486 U.S. 622, 638 (1988); *Kirby*, 2003 WL 71681, at *11; *see also Leigh*, 1990 SEC LEXIS 153, at *16 ("The registration provisions are a keystone of securities regulation and set forth basic requirements for the protection of public investors.").

[49] *SEC v. Calvo*, 378 F.3d 1211, 1214 (11th Cir. 2004); *accord Lively v. Hirshfeld*, 440 F.2d 631, 631 (10th Cir. 1971).

[50] *Calvo*, 378 F.3d at 1215 (collecting authority).

[51] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976). Scienter can also be shown through recklessness. *David Disner*, Exchange Act Release No. 38234, 52 SEC 1217, 1997 SEC LEXIS 258, at *15 (Feb. 4, 1997) (internal citation omitted); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (noting that "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly").

[52] *SEC v. Cavanagh*, 445 F.3d 105, 111 n.13 (2d Cir. 2006) (citing *SEC v. Ralston Purina.*, 346 U.S. at 126); *Andrews v. Blue*, 489 F.2d 367, 374 (10th Cir. 1973); *see also Apex Fin. Corp.*, Exchange Act Release No. 16749,

(continued...)

ACAP stipulated to facts establishing the existence of each of the elements required to make out a prima facie case of a Section 5 violation with respect to the Greyfield transactions at issue. First, ACAP and Hume conceded that between May 9 and July 26, 2005, ACAP sold more than 27 million shares of Greyfield stock into the public markets from its customers' accounts. Second, Greyfield stock traded in the over-the-counter market and was quoted on the Pink Sheets. ACAP obtained market maker quotes for each of its customers' sales of Greyfield stock. Third, no Securities Act registration statement was in effect with respect to the offer and sale of the Greyfield stock at the time of the sales. In addition, ACAP conceded that no exemption from registration was available, and the record also fully supports this concession.[53] Accordingly, we affirm FINRA's findings that ACAP violated Securities Act Section 5 and NASD Conduct Rule 2110.

B. ACAP and Hume violated NASD Conduct Rule 3010(a) by failing to reasonably supervise McGuire in connection with the unregistered sale of Greyfield securities and by failing to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with Securities Act Section 5.

ACAP and Hume also stipulated that they violated NASD Conduct Rules 3010 and 2110 by failing to (1) reasonably supervise McGuire in connection with the unregistered sale of the Greyfield securities without an applicable exemption and (2) establish, maintain, and enforce written procedures reasonably designed to achieve compliance with Securities Act Section 5. We find the record fully supports ACAP and Hume's concessions and affirm FINRA's findings that they violated NASD Conduct Rules 3010 and 2110.[54]

First, NASD Conduct Rule 3010(a) requires members to "establish and maintain" a system of supervision that is "reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules."[55] In addition to an adequate

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(... continued)
47 SEC 265, 1980 SEC LEXIS 1663, at *2 (Apr. 16, 1980) ("It is well settled that the burden of establishing the availability of an exemption from registration rests upon those who claim it.") (collecting cases).

[53] ACAP did not argue that the "broker's exemption" under Securities Act Section 4(a)(4), formerly Section 4(4), exempted its sales of Greyfield securities. *See* 15 U.S.C. § 77d(a)(4). As we explained in *Midas Securities*, the broker's exemption "is designed to exempt ordinary brokerage transactions and is not available if the broker knows or has reasonable grounds to believe that the selling customer's part of the transaction is not exempt from Section 5 of the Securities Act." *Midas Sec.,* 2012 SEC LEXIS 199, at *30 (internal citation omitted). Brokers thus have a "duty of inquiry" regarding facts surrounding a proposed sale. *Id.* (internal citation omitted). "A broker cannot rely on the Section 4[(a)](4) exemption when his customer is an 'underwriter,' defined as 'any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security . . . .'" *Id.* at *35 (citing 15 U.S.C. § 77b(a)(11)). For these purposes, "an 'issuer' includes 'any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.'" *Id.* Had ACAP and Hume conducted a reasonable inquiry discharging their duty, they would have perceived the high likelihood that their customers were underwriters and the proposed sales were part of an illegal distribution.

[54] A violation of NASD Conduct Rule 3010 also violates NASD Conduct Rule 2110. *John B. Busacca, III*, Exchange Act Release No. 63312, 2010 SEC LEXIS 3787, at *48 & n.56 (Nov. 12, 2010), *petition denied*, 449 F. App'x 886 (11th Cir. 2011).

[55] NASD Conduct Rule 3010(a).

supervisory system, "[t]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation."[56] "[R]ed flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review."[57]

ACAP and Hume fell far short of this standard. Appellants conceded before FINRA that neither Hume, who was ACAP's compliance officer and supervised McGuire, nor ACAP itself took adequate measures to ensure that McGuire did not engage in the unregistered sale of securities in violation of Securities Act Section 5. Specifically, Hume and ACAP failed to take adequate steps to ensure that the registered representative ascertained whether the offer and sale of the shares were registered under the Securities Act, how and from whom the customers obtained their shares, whether and when the shares were paid for, and whether the transactions were exempt from registration. Supervisory personnel at ACAP undertook no efforts to determine whether the Greyfield shares were eligible for sale without registration, either when the stock was deposited or sold, other than relying on the absence of a restrictive legend on the stock certificates deposited at ACAP and the efforts of its clearing firm.

Second, under NASD Conduct Rule 3010(b), a member must "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities" of associated persons.[58] These procedures must be "reasonably designed to achieve compliance with applicable securities laws and regulations" and applicable NASD rules.[59] We have emphasized that "all registered broker-dealers should establish minimum standard procedures to prevent and detect violations of the federal securities laws and to ensure that the firm meets its continuing responsibility to know both its customers and the securities being sold."[60] Hume and ACAP conceded that ACAP had no written or formal procedures regarding transactions in restricted securities or the receipt of unlegended stock certificates. There was nothing in the firm's written procedures manual regarding the determination of whether stock could be sold consistent with the registration requirements of the Securities Act. Accordingly, we also affirm FINRA's findings that ACAP and Hume violated NASD Rules of Conduct 3010(b) and 2110 by failing to establish, maintain, and enforce appropriate written procedures.

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[56] *Michael T. Studer*, Exchange Act Release No. 50543A, 57 SEC 1011, 2004 WL 2735433, at *6 (Nov. 30, 2004), *petition denied*, 260 F. App'x 342 (2d Cir. 2008).

[57] *Busacca*, 2010 SEC LEXIS 3787, at *35 (citation omitted); *see also George J. Kolar*, Exchange Act Release No. 46127, 55 SEC 1009, 2002 WL 1393652, at *4 (June 26, 2002) ("Decisive action is necessary whenever supervisors are made aware of suspicious circumstances, particularly those that have an obvious potential for violations.").

[58] NASD Conduct Rule 3010(b).

[59] *Id.*

[60] *Midas Sec.*, 2012 SEC LEXIS 199, at *48 (*quoting 1971 Securities Act Release*, 1971 SEC LEXIS 19, at *4).

IV.

Under Exchange Act Section 19(e)(2), we sustain FINRA sanctions unless we find that, giving due regard to the public interest and the protection of investors, the sanctions are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition.[61] ACAP and Hume request that we find the sanctions imposed by FINRA excessive and reduce them. Alternatively, they ask us to vacate the sanctions and remand this case to the NAC for further consideration of the evidentiary record.[62]

In assessing the appropriate sanctions to impose on ACAP and Hume, FINRA looked to its Sanction Guidelines. FINRA promulgated the Guidelines to achieve greater consistency, uniformity, and fairness in its sanctions.[63] Although the Guidelines do not bind us, they serve as a benchmark for our review under Exchange Act Section 19(e)(2).[64] We analyze the sanctions ordered for each of the two violations separately below.

A. The sanctions imposed for ACAP's unregistered sale of securities are not excessive or oppressive based on the record and FINRA's Sanction Guidelines.

For ACAP's unregistered sales of Greyfield stock without an applicable exemption, FINRA fined ACAP $50,000,[65] increasing the $25,000 fine issued by the Hearing Panel.[66] FINRA determined that four guideline-specific considerations were relevant to ACAP's misconduct and that each weighed in favor of an increased fine.[67] Applying these considerations, the NAC found significant that, in the face of multiple red flags,[68] ACAP made no attempt to determine if a registration statement was in effect for the offer and sale of the Greyfield securities or an exemption from registration applied, but rather "exclusively relied upon the lack of a restrictive legend and clearance of the stock by the clearing firm."[69] The NAC also cited as significant "the severe danger to investors" from the 27 million shares of Greyfield stock that

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[61] 15 U.S.C. § 78s(e)(2). Exchange Act Section 19(e)(2) permits us to cancel, reduce, or remit a FINRA sanction but does not authorize us to increase the sanction. *Id.*; *see also Gregory W. Gray*, Exchange Act Release No. 60361, 2009 SEC LEXIS 2554, at *39 n.41 (July 22, 2009) (noting that the Exchange Act does not authorize us to increase SRO disciplinary sanction). Neither ACAP nor Hume claims, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

[62] ACAP Br. at 26.

[63] *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 SEC LEXIS 3719, at *39 n. 38 (Oct. 20, 2011).

[64] *Jason A. Craig*, Exchange Act Release No. 59137, 2008 SEC LEXIS 2844, at *18 n.27 (Dec. 22, 2008).

[65] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *2. Because ACAP was the lone non-settling respondent with respect to the first count, the NAC imposed sanctions solely on ACAP under this count.

[66] The NAC was authorized to increase the sanctions that the Hearing Panel imposed. *Harry Friedman*, Exchange Act Release No. 64486, 2011 SEC LEXIS 1699, at *25 (May 13, 2011) ("We have repeatedly held that the NAC reviews the Hearing Panel's decision *de novo* and has broad discretion to modify the Hearing Panel's decisions and sanctions.").

[67] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *13-14.

[68] *Id.* at *19-20.

[69] *Id.* at *14-15.

ACAP sold into the public marketplace without registration or an applicable exemption.[70] The NAC found that ACAP "intentionally ignored the legality of the Greyfield trades," which supported treating ACAP's misconduct as egregious,[71] and concluded that ACAP's actions evinced a "deliberate disregard of its gate-keeping responsibilities pursuant to Securities Act Section 5," which merited the increased fine.[72]

For unregistered sales of securities without an applicable exemption, FINRA's Sanction Guidelines recommend a fine of $2,500 to $50,000.[73] In egregious cases, the Guidelines call for consideration of a higher fine and suspension of the firm with respect to any or all activities or functions for up to 30 business days or until procedural deficiencies are remedied.[74] In addition, FINRA has identified the following considerations as relevant to the determination of sanctions for an unregistered sale of securities where no exemption was available: (1) whether the respondent attempted to comply with an exemption from registration; (2) whether the respondent had implemented reasonable procedures to ensure that it did not participate in an unregistered distribution; (3) whether the respondent disregarded "red flags" suggesting the presence of an unregistered distribution; and (4) the share volume and dollar amount of transactions involved.[75] We review these factors below.[76]

First, the record contains no evidence, and ACAP does not assert, that it ever attempted to determine if a registration statement was in effect for the offer and sale of the Greyfield shares or if an exemption from registration was available. Instead, ACAP points to record evidence that shows that its practice was to execute stock sales if a certificate did not contain a restrictive legend and ACAP's clearing firm determined that the shares "could be sold into the market."[77] Consistent with its admission that it "failed to determine . . . whether there was an applicable exemption to registration in the circumstances present here,"[78] ACAP could not reasonably follow such a practice and maintain that it attempted to comply with the conditions of the Section 4(a)(4) exemption from registration. Over fifty years ago, we explained that, while the standard of diligence for a broker is flexible, it requires "searching inquiry" when "a dealer is offered a substantial block of a little-known security" under circumstances that suggest that an illegal

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[70] *Id.* at *18.

[71] *Id.* at *19.

[72] *Id.* at *21.

[73] FINRA Sanction Guidelines (2011) at 24, http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf (last visited July 2, 2013).

[74] *Id.* The Guidelines also set out other considerations applicable to the determination of appropriate sanctions for individuals in egregious cases of unregistered sales of securities, which are inapplicable here.

[75] *Id.*

[76] The Guidelines also call for consideration of "whether the respondent sold securities before the effective date of the registration statement for the shares at issue." FINRA Sanction Guidelines at 24. We agree with the NAC that this factor did not apply to ACAP's sales of Greyfield stock because no registration statement was ever in effect for the offer and sale of its securities. *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *14 n.12.

[77] ACAP Br. at 8-9.

[78] FINRA 000068 (Stipulations ¶ 25).

distribution might be underway.[79] And we have repeatedly explained that where, as here, there are indicia of an illegal distribution, a broker cannot claim that its sales of a security were exempt from registration simply because the stock certificates lack a restrictive legend[80] or a clearing firm or transfer agent raises no objections to the sales.[81] Because ACAP exclusively relied on precisely these half measures, it failed to take any reasonable steps to comply with an applicable exemption from registration.[82] As the NAC aptly observed,[83] ACAP's practices were particularly egregious given that the majority of its business involved the liquidation of lower priced securities in the over-the-counter markets.[84]

Second, ACAP failed to implement reasonable procedures to ensure that it did not participate in an unlawful securities distribution. We long ago identified the pressing need for broker-dealers to establish appropriate minimum standard procedures[85] and specified non-

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[79] *1962 Securities Act Release*, 27 Fed. Reg. at 1251 (explaining that duty is triggered when persons offering the little-known stock in question "appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters"); *id.* (noting that "it must be assumed that these securities emanate from the issuer or from persons controlling the issuer" unless some other source is known).

[80] *See, e.g.*, *John A. Carley*, Exchange Act Release No. 57246, 2008 SEC LEXIS 222, at *48 n.55 (Jan. 31, 2008) (The absence of a restrictive legend on stock certificates does not "warrant the conclusion" that stock may be traded consistent with the registration requirements of the Securities Act. (citing *Gilbert F. Tuffli, Jr.*, Exchange Act Release No. 12534, 46 SEC 401, 1976 SEC LEXIS 1467, at *19 (June 10, 1976))), *petition denied in relevant part sub nom.*, *Zacharias v. SEC*, 569 F.3d 458 (D.C. Cir. 2009); *Transactions in the Securities of Laser Arms Corp. by Certain Broker-Dealers*, Exchange Act Release No. 28878, 50 SEC 489, 1991 SEC LEXIS 257, at *39 (Feb. 14, 1991) (Exchange Act 21(a) report) ("[A] broker-dealer may not rely upon the absence of restrictive legends on the stock certificates when the circumstances surrounding the transaction indicate the need for a thorough investigation." (citing *Quinn & Co. v. SEC*, 452 F.2d 943, 947 (10th Cir. 1971))); *Stone Summers & Co.*, Exchange Act Release No. 9839, 45 SEC 105, 1972 SEC LEXIS 835, at *11-12 (Nov. 3, 1972) (The absence of a restrictive legend does not "relieve a broker-dealer from his duty as a professional in the securities business to make reasonable inquiry to assure himself that he is not participating in an illegal sale of unregistered securities.").

[81] *Midas Sec.*, 2012 SEC LEXIS 199, at *41 ("[I]t is well established that the clearance of sales by a transfer agent and clearing firm does not relieve a broker of its obligation to investigate."); *Kirby*, 2003 WL 71681, at *5 n.34 ("[W]e have held that a securities professional cannot rely on the determination of a transfer agent that stock is free trading.") (internal citations omitted); *see also Wonsover v. SEC*, 205 F.3d 408, 415 (D.C. Cir. 2000) ("Precedent will not suffer [broker's] argument that he justifiably relied on the clearance of sales by [his firm's restrictive stock department], the transfer agent and counsel." (*citing*, *e.g.*, *Stead v. SEC*, 444 F.2d 713, 716 (10th Cir. 1971) ("[C]alling the transfer agent is obviously not a sufficient inquiry."))).

[82] *See A.G. Becker Paribas*, Exchange Act Release No. 2139, 48 SEC 118, 1985 SEC LEXIS 2139, at *8 (Feb. 19, 1985) ("If a broker relies on others to make the inquiry called for in any particular circumstances, it does so at its peril.") (settled proceeding cited in *Wonsover*, 20 F.3d at 415-16 and *Midas Sec.*, 2012 SEC LEXIS 199, at *41 n.56).

[83] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *23.

[84] *See 1971 Securities Act Release*, 1971 SEC LEXIS 19, at *1 ("The potential harm to the public [from an unlawful distribution] is particularly acute when securities of a little-known issuer . . . are sold to the public on the over-the-counter market."); *see also Laser Arms Corp.*, 1991 SEC LEXIS 257, at *42 ("[B]rokers and dealers often are pivotal to the success of fraudulent and manipulative schemes involving penny stocks.").

[85] *See supra* note 60 and associated text; *see also Midas Sec.*, 2012 SEC LEXIS 199, at *50-51 (discussing need to provide meaningful guidance in written supervisory procedures to detect and avoid illegal distributions).

exclusive lists of routine inquiries regarding customers and issuers that firms should make.[86] These inquiries were not required under ACAP's procedures, and ACAP failed to conduct the requisite inquiry with respect to the sales of Greyfield shares.

Third, the NAC found that, in executing the Greyfield trades, ACAP "ignored several red flags" suggesting those sales were part of an unregistered distribution.[87] The NAC properly identified the following red flags: (1) Greyfield was an unknown, development-stage company that had recently undergone a change in control;[88] (2) more than 10% of the outstanding Greyfield stock was deposited into ACAP accounts beginning less than a week after those shares were issued;[89] and (3) ACAP's customers began liquidating their shares soon after depositing them,[90] and at the same time that Greyfield was issuing press releases promoting its business prospects.[91] It was also a red flag that the 45 million shares initially deposited in ACAP's customers' accounts represented nearly 30,000 times the total volume of Greyfield stock that traded over the approximately three previous years. Moreover, it was a matter of public record that no Securities Act registration statement was in effect for the offer and sale of Greyfield's securities.[92] ACAP should have discovered or taken note of these facts and expeditiously conducted an investigation to determine whether the sales of Greyfield shares were part of an illegal distribution. But due to its lack of inquiry, ACAP failed to discover that Fiessel's company, Gold Technologies, had obtained its shares directly from Greyfield for no consideration and that, soon thereafter, Gold Technologies had transferred a portion of those shares to Fiessel's business associate. The record, including Hume's on-the-record testimony,[93] supports the NAC's conclusion that ACAP "turned a blind eye and conducted no inquiry into the

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[86] *See supra* notes 18 & 19 and associated text.

[87] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *19.

[88] *See Kirby*, 2003 WL 71681, at *5 (finding that respondent failed to make appropriate investigation of "little-known company with limited assets" that had traded only sporadically and experienced a change of control).

[89] *See Laser Arms Corp.*, 1991 SEC LEXIS 257, at *43 (emphasizing that "a broker-dealer that is asked to sell a large block of a relatively unknown stock must conduct an appropriate inquiry regarding the need for registration and must be alert to any unusual circumstances that may exist or which may come to light").

[90] *See Midas Sec.*, 2012 SEC LEXIS 199, at *33 (finding that broker "was required to conduct a searching inquiry to assure itself that . . . proposed sales were exempt from the registration requirements and not part of an unlawful distribution" when client "deposited a large block of recently issued shares of a little-known stock into his account and directed [broker] to sell the shares shortly thereafter without a registration statement in effect").

[91] *Cf. Id.*, 2012 SEC LEXIS 199, at *15, *35 (finding that client's "known stock promotion activities should have raised additional concerns that his sales were part of an unlawful distribution" and noting that "spam campaign coincided with several upbeat press releases").

[92] Issuers must file Securities Act registration statements on the Commission's publicly accessible EDGAR system, which is searchable over the Internet. *See* http://www.sec.gov/edgar/searchedgar/companysearch.html.

[93] As the NAC accurately observed, "Hume testified in a 2008 on-the-record interview with [FINRA] Enforcement that ACAP took no action to investigate whether a stock [could legally be] trad[ed] when a customer deposited a stock certificate that bore no restrictive legend." *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *20.

circumstances surrounding the Greyfield activity."[94] ACAP's inaction in the face of obvious red flags underscores the egregiousness of its violation.

Finally, the NAC appropriately found that the 27 million Greyfield shares ACAP sold into the public marketplace without registration or an available exemption posed a "severe danger" to investors and that these sales were an aggravating factor in the determination of sanctions.[95] The NAC found that the proceeds from the sale of these shares were "not insignificant" and that the dollar amount of the sales and commissions that ACAP earned in no way mitigated the severity of its misconduct.[96] We agree and also reject ACAP's argument that the relevant monetary sanction should be determined as a function of the amount of the commissions it received from the illegal sales of securities.[97] Such an approach would unduly limit incentives to comply with the Securities Act's registration requirements, where, as here, tens of millions of shares of penny stocks were sold to the public without registration or an applicable exemption and would place excessive reliance on a single factor in the determination of sanctions.

In sum, all four relevant considerations identified by FINRA's Sanction Guidelines weigh in favor of finding that ACAP's unregistered sales of Greyfield securities in violation of the Securities Act were egregious. While the Guidelines authorize a fine of up to $50,000 for unregistered sales of securities where no exemption is available, they recommend consideration of higher fines, where, as here, the violation was egregious. Because we agree with the NAC that ACAP's conduct was egregious, we find that the $50,000 fine was neither excessive nor oppressive.[98]

B. The sanctions imposed for ACAP's and Hume's failures to supervise are not excessive or oppressive based on the record and FINRA's Sanction Guidelines.

For ACAP's supervisory failings, FINRA imposed an additional $50,000 fine, required the firm to revise its procedures and retain an independent consultant acceptable to FINRA to review and approve the procedures, and suspended ACAP from receiving and liquidating penny stocks for which no Securities Act registration statement is in effect until the revised procedures

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[94] *Id.* We address in detail in Section IV.C.1. below ACAP's contention that the NAC erred by making this determination.

[95] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *18.

[96] *Id.* at *18 n.14.

[97] *See* ACAP Br. at 17-18 (arguing that the fines imposed by the Hearing Panel are "disproportionate to the size of the underlying transaction and are excessive" because FINRA purportedly "typically assesses fines proportionate to . . . the commission received by the sales agent"). Although the Sanction Guidelines provide that a fine may be increased by the amount of the personal benefit to the violator, they do not mandate that the base amount of the fine be determined based on that benefit. *See* FINRA Sanction Guidelines at 24 n.1 ("Adjudicators may increase the recommended fine amount by *adding* the amount of a respondent's financial benefit.") (emphasis added); *id.* at 103 n.2 (same).

[98] In finding that the sanctions were not excessive or oppressive, we have considered ACAP's contrary arguments. We separately address those arguments in Section IV.C. below but rely on that analysis here.

are approved by the consultant and implemented.[99] FINRA also fined Hume $25,000, suspended him in all capacities for six months, and required him to requalify before acting in any capacity requiring qualification.[100] FINRA explained that ACAP's and Hume's supervisory violations were egregious in that they ignored red flags, conducted no inquiry, and abdicated their gate-keeping role to ACAP's clearing firm, thereby permitting the illegal sales of Greyfield shares to occur through their misconduct.[101] FINRA also found that the firm's failure to employ any supervisory procedures was particularly egregious given that ACAP's business principally involved brokering transactions in lower-priced Bulletin Board and Pink Sheets securities, and it considered the large volume of Greyfield shares sold to the public to be aggravating.[102]

FINRA's Sanction Guidelines set out sanctions recommendations for both failure to supervise and failure to maintain adequate written supervisory procedures. The Guidelines recommend a fine of $5,000 to $50,000 for a failure to supervise and call for consideration of independent, rather than joint-and-several monetary sanctions for the firm and individual.[103] In egregious cases, the Guidelines call for consideration of the following additional sanctions: (1) suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual; (2) limiting activities of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days; and (3) where there were systemic supervision failures, suspending the firm with respect to any or all activities or functions for up to two years or expelling the firm.[104]

The Guidelines recognize the following principal considerations in determining sanctions for a failure to supervise: (1) whether the respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny and whether individuals responsible for underlying misconduct attempted to conceal misconduct from respondent; (2) the nature, extent, size, and character of the underlying misconduct; and (3) the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls.[105]

Each of those considerations supports FINRA's egregiousness finding. First, as explained above, ACAP and Hume ignored multiple red flags that should have caused additional

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[99] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *25. ACAP does not challenge the non-monetary sanctions for its supervisory failings.

[100] *Id.* at *26.

[101] *Id.* at *23.

[102] *Id.* at *23-24.

[103] FINRA Sanction Guidelines at 103. The Guidelines also call on the adjudicator to consider suspending the responsible individual in all supervisory capacities for up to 30 business days, and to consider limiting activities of an appropriate branch office or department for up to 30 business days. *Id.*

[104] *Id.*

[105] *Id.*

supervisory scrutiny.[106] The NAC properly treated this as an aggravating factor supporting its finding of egregious conduct.[107]

Second, the nature, extent, size, and character of the underlying misconduct, i.e., the illegal sales of securities in violation of Securities Act Section 5, also support treating ACAP and Hume's supervisory violations as egregious. The NAC properly treated the millions of shares of Greyfield stock sold without registration or an available exemption as an aggravating factor because these sales of a little-known penny stock were precisely the sort of transactions for which particular attention is required.[108] ACAP and Hume's assertions that ACAP made only limited profit, and that they were not involved in or knowledgeable regarding the underlying fraudulent scheme, do not mitigate the seriousness of their misconduct and evidence a troubling indifference to the danger it posed to investors.

Third, the quality and degree of Hume's implementation of the firm's supervisory procedures and controls were poor. The NAC accurately observed that ACAP and Hume "fail[ed] to employ any supervisory procedures" and "engaged in no due diligence and abdicated all responsib[ility] to [ACAP's] clearing firm," all of which it properly found to be aggravating.[109] Although ACAP and Hume go to great lengths to explain their practices when receiving securities that bore no restrictive legend,[110] the evidence they highlight merely confirms that they habitually relied on the lack of a restrictive legend on stock certificates and their clearing firm to determine whether a stock could be sold on an unregistered basis. Indeed, when asked directly to identify the efforts ACAP would take to determine if securities that bore no restrictive legend could legally be sold without registration, Hume admitted that there were "[n]one really" and explained that Applicants instead relied on their clearing firm.[111] There was thus no system in place to prevent illegal distributions of the sort effected by Fiessel.

FINRA's Sanction Guidelines also recommend a fine of $1,000 to $25,000 for failure to maintain adequate written supervisory procedures.[112] In egregious cases, the Guidelines call for consideration of suspending the responsible individual in any or all capacities for up to one year and of suspending the firm with respect to any or all relevant activities or functions for up to 30 business days and thereafter until the supervisory procedures are amended to conform to rule requirements.[113]

The Guidelines identify the following principal considerations as applicable to determining the appropriate sanctions for deficient written supervisory procedures: (1) whether

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[106] *See* discussion of third factor in Section IV.A. above.

[107] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *23.

[108] *See supra* note 84 and associated text.

[109] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *23.

[110] *See, e.g.*, ACAP Br. at 2-3, 8-9.

[111] FINRA 000290 (Hume Test. at 44:15-24).

[112] FINRA Sanction Guidelines at 104.

[113] *Id.*

deficiencies allowed violative conduct to occur or to escape detection and (2) whether the deficiencies made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance.[114]

These considerations also support treating ACAP and Hume's supervisory failings as egregious. First, the failure to maintain written procedures allowed violative conduct to occur in the form of unregistered sales of tens of millions of Greyfield shares without an available exemption. Second, because there were no written procedures, the deficiencies in the written supervisory procedures made it difficult to determine the individual or individuals responsible for specific areas of supervision or compliance. No one at ACAP conducted the necessary inquiry; ACAP relied solely on its clearing firm.

Each of the applicable considerations identified by FINRA's Sanction Guidelines thus weighs in favor of FINRA's finding that ACAP's and Hume's supervisory failures were egregious. The fines FINRA imposed on ACAP and Hume are within the range recommended by the Guidelines for even non-egregious failures to supervise. ACAP does not challenge the requirement that it revise its procedures with the approval of an independent consultant or its suspension from certain trading until revised procedures have been implemented, and we find that these measures are also consistent with the Guidelines.[115] We therefore determine that these sanctions were neither excessive nor oppressive and sustain them.[116]

C. ACAP and Hume's arguments that the sanctions are excessive lack merit.

ACAP and Hume present three principal arguments in support of their assertion that the sanctions imposed by FINRA were excessive: (1) that the NAC ignored critical evidence because it was not contained in the parties' stipulations; (2) that a number of alleged mitigating factors required lesser sanctions,[117] and (3) that Hume's six-month all-capacities suspension was excessive. We reject each of these arguments for the reasons explained below.

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[114] *Id.*

[115] *See* FINRA Sanction Guidelines at 3 (authorizing adjudicators to craft appropriate sanctions, including those that "require a respondent firm to retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements" or "suspend or bar a respondent firm from engaging in a particular line of business"); *see also id.* at 103 (authorizing "suspension of the firm with respect to any or all activities or functions (of up to two years) or expulsion of the firm" in "a case against a member firm involving systemic supervision failures").

[116] We separately address Hume's challenge to his all-capacities suspension in Section IV.C.3. below. In determining that the other sanctions issued for supervisory misconduct were not excessive or oppressive, we have considered ACAP and Hume's other arguments discussed in Section IV.C. below.

[117] In making the first two arguments, ACAP and Hume generally do not distinguish between arguments applicable to ACAP, Hume, or each of them, or differentiate between the two separate violations for which FINRA ordered sanctions. Where appropriate, we make such distinctions in our analysis below.

1. The NAC's decision is consistent with the entirety of the record.

ACAP and Hume argue that the NAC ignored undisputed evidence contradicting[118] the NAC's determinations that ACAP "intentionally ignored the legality" of the sales of Greyfield shares at issue, acted in "deliberate disregard of its gate-keeping responsibilities pursuant to Securities Act Section 5," and "turned a blind eye" to the legality of the sales.[119] ACAP and Hume contend that these findings "give the false and misleading impression that ACAP entered into a deliberate, thoughtful/planned course of action to ensure that [Greyfield] securities" were sold to the public without registration or an available exemption and that other NAC statements "give the false and misleading impression that ACAP and Hume were complicit with the [Greyfield] fraud scheme conspirators."[120] ACAP and Hume also assert that the NAC "completely ignored" evidence showing that it engaged in efforts to determine whether shares could legally be sold prior to sale[121] and imply that they permitted the sales of Greyfield shares to go forward only because they were deceived by Fiessel, the Greyfield scheme's "mastermind."[122] Finally, ACAP and Hume assert that the NAC's identification of red flags relied on factual errors and therefore that its findings that they engaged in egregious conduct are incorrect.[123]

Contrary to ACAP and Hume's contentions, the NAC did not determine that they were complicit in Fiessel's underlying scheme to seize control of Greyfield and distribute newly issued shares of the company without registration or exemption. Instead, the NAC based its sanctions on ACAP and Hume's inaction in the face of obvious red flags and their lack of any reasonable system to ensure the sales ACAP executed complied with Securities Act Section 5.[124] When charged with a duty of inquiry, a broker may not defend his conduct by pleading ignorance of facts he may have discovered if he had made required inquiries.[125] ACAP's relationship with its customers uniquely positioned it "to ask relevant questions, acquire material information, or disclose [its] findings" regarding the existence of an illegal distribution.[126] Although the facts in their possession or readily available to them triggered a duty of inquiry, ACAP and Hume chose

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118 ACAP Br. at 1; *see also id.* at 7-8.

119 *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *19, *21, *20.

120 ACAP Br. at 8, 11-12.

121 *Id.* at 7.

122 *Id.* at 11.

123 *Id.* at 11-12.

124 *See generally ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *13-27.

125 *See Owsley*, 1993 SEC LEXIS 1525, at *12-13 (rejecting representative's claim that he "did not know [the illegal distribution] was occurring" because the circumstances presented "the classic pattern of an unlawful distribution" and sustaining NASD findings of Securities Act Section 5 violations); *see also SEC v. Mono-Kearsarge Consolidated Mining Co.*, 167 F. Supp. 248, 259 (D. Utah 1958) ("[A dealer] cannot close his eyes to obvious signals which if reasonably heeded would convince him of, or lead him to, the facts and thereafter succeed on the claim that no express notice of those facts was served upon him."), cited in *1971 Securities Act Release*, 1971 SEC LEXIS 19, at *3 n.2; *cf. Hanly v. SEC*, 415 F.2d 589, 596 (2d Cir. 1969) (holding that salesman "cannot deliberately ignore that which he has a duty to know").

126 *Kane v. SEC*, 842 F.2d 194, 198 (8th Cir. 1988).

instead to rely on the absence of a restrictive legend on stock certificates and ACAP's clearing firm to determine whether the Greyfield stock could legally be sold without registration. Because we long ago rejected that practice,[127] ACAP and Hume's detailed explanation in their briefs of exactly how they relied on these measures, based on evidence they contend the NAC ignored, is irrelevant; this evidence does not establish that ACAP and Hume conducted any inquiry into the Greyfield transactions.[128] The entirety of Hume's investigative testimony and the parties' stipulations clearly demonstrated that ACAP and Hume failed to maintain and apply appropriate practices. On this record, the NAC's finding that ACAP "intentionally ignored the legality" of the sales of Greyfield shares merely reflects that applicants intentionally abdicated their duty to ascertain the legality of the sales prior to permitting ACAP to execute them.

We also reject ACAP and Hume's suggestion that their actions were not egregious because Fiessel concealed his scheme from them. ACAP and Hume assert that the NAC erred by finding that Fiessel "and his associates deposited more than 10 percent of the outstanding Greyfield stock into ACAP accounts within weeks of the Greyfield shares being issued"[129] because ACAP's customers purportedly never held 10% or more of Greyfield's outstanding stock in their ACAP accounts at any one time. Based on this contention, ACAP and Hume imply that they did not discover the illegal distribution of Greyfield shares because their customers "staggered" their deposits of Greyfield shares and the sales of these shares to avoid detection.[130]

ACAP and Hume incorrectly suggest that the NAC's findings relied on a determination that ACAP's customers held more than 10% of Greyfield's issued and outstanding shares in their accounts at any one moment in time. ACAP's customers deposited approximately 11% of Greyfield's total issued and outstanding stock over slightly more than two months, over 80% of which was deposited on a single day less than a week after the shares were issued. That the initial deposits made up approximately 9%, rather than more than 10% of all issued and outstanding Greyfield stock is of no moment;[131] those deposits still presented "the classic warning signs of an obscure issuer, a thinly traded security, and the deposit of stock certificates in a large volume of shares" that demanded that ACAP and Hume conduct a searching inquiry.[132] Days after the initial deposit, Gold Technologies then began to sell its Greyfield shares, as Hume generally expected ACAP's customers to do. ACAP and Hume were not relieved of their duty of inquiry simply because ACAP's customers did not sell all of their Greyfield stock at one time.

ACAP and Hume also argue that the NAC erred by referring to Fiessel in its recitation of red flags because Fiessel was not the account holder on either of the customer accounts. There was no error. Broker-dealers must be on the alert to deposits that might have been made on

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127 *See supra* notes 80 & 81.

128 *See, e.g., supra* notes 26 & 27; *see also generally* Section II.B.

129 *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *19.

130 ACAP Br. at 12.

131 ACAP and Hume stipulated that the 55 million total Greyfield shares their customers deposited between May 3 and July 6, 2005 constituted approximately 11% of Greyfield's float. The 45 million shares deposited on May 3, 2005 thus constituted approximately 9% of Greyfield's stock.

132 *Midas Sec.*, 2012 SEC LEXIS 199, at *51.

behalf of an issuer or its control persons.[133] Thus, the fact that the Greyfield securities were deposited into the accounts of Fiessel's company[134] and business associate, rather than his own personal account, does not excuse ACAP and Hume's failure to conduct any inquiry consistent with their obligations.[135]

ACAP and Hume also assert that there is "no evidence in the record that ACAP or Hume knew that [ACAP's customers'] accounts were related in any way."[136] Tellingly, neither ACAP nor Hume asserts that they attempted to determine whether there was a connection between the two accounts. They should have. On the same day, ACAP's customers both deposited tens of millions of Greyfield shares that had been issued only six days earlier. It was thus obvious that at least the possibility of a connection between Gold Technologies's and Fiessel's business associate's accounts needed to be investigated. Any suggestion that ACAP and Hume were deceived by Feissel or his associate is disproven by the fact that they failed to obtain any information from their customers through which they could have been misled.[137]

2. FINRA properly considered and rejected ACAP and Hume's arguments regarding alleged mitigating factors.

ACAP and Hume also erroneously assert that the sanctions are excessive because FINRA failed to accord weight to certain alleged mitigating factors. First, ACAP and Hume contend that FINRA should have considered their stipulations to be a mitigating factor meriting a reduction in the sanctions against them.[138] FINRA's Sanction Guidelines call for consideration of whether a respondent "accepted responsibility for and acknowledged the misconduct" at issue "prior to detection and intervention."[139] Because ACAP and Hume did not stipulate to their misconduct until after FINRA had instituted a disciplinary proceeding against them, their stipulations came too late to warrant consideration under the Guidelines.

Nonetheless, ACAP and Hume cite three FINRA decisions for the proposition that FINRA has considered an admission of misconduct to be a mitigating factor even when it

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[133] *Id.* at *31-32 (explaining that "ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters" (quoting *1962 Securities Act Release*, 27 Fed. Reg. at 1251)).

[134] Fiessel was the owner of Gold Technologies.

[135] We reject ACAP's suggestion that its conduct is mitigated because it purportedly could not have discovered Fiessel's wrongdoing before the Commission did so. *See Apex Fin.*, 1980 SEC LEXIS 1663, at *5 ("We have repeatedly held that a broker-dealer cannot shift its responsibility for compliance with applicable requirements to regulatory authorities.").

[136] ACAP Br. at 4, 12.

[137] We also cannot accept ACAP and Hume's argument that their conduct was not egregious because each of the red flags present in *Department of Enforcement v. Patrick F. Harte, Jr.*, Proceeding No. 2006003672401, 2009 FINRA Discip. LEXIS 32 (OHO Aug. 31, 2009) was not present here. ACAP Br. at 9-11. The relevant question is whether a respondent ignored red flags, not whether the red flags at issue are identical to those in a prior case.

[138] ACAP Br. at 15.

[139] FINRA Sanction Guidelines at 6. Although the Guidelines contemplate that an individual might acknowledge responsibility to an employer before the firm's detection of misconduct, there is no evidence in the record that Hume acknowledged the misconduct to his employer or that ACAP independently discovered it.

occurred after an investigation was initiated.[140] These decisions provide no support for a reduction in sanctions. Each decision determined that the respondent demonstrated a genuine showing of remorse and, in any event, imposed significant sanctions.[141] In contrast, ACAP and Hume, while admitting their misconduct, have attempted to minimize its significance. For example, ACAP and Hume argued below (but not before us) that their failure to conduct any due inquiry with respect to the sale of the Greyfield shares did not merit significant sanctions because it purportedly was consistent with standard industry practice[142] and also argued that FINRA's action was based on only recently asserted obligations.[143] Before us, ACAP and Hume unconvincingly cast themselves as victims of the underlying fraud, rather than acknowledge the gravity of their misconduct. Under these circumstances, we do not find that ACAP and Hume's acknowledgement of their violations before FINRA—over five years after their misconduct—should mitigate their sanctions.[144]

Second, ACAP and Hume also assert that FINRA should have attached mitigative weight to the fact that ACAP revised its procedures in 2008 by instituting the use of a "large block" questionnaire created by ACAP's clearing firm to obtain relevant information from customers.[145] FINRA's Sanction Guidelines call for consideration of whether a respondent "voluntarily employed subsequent corrective measures, *prior to detection or intervention* . . . to revise general

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[140] ACAP Br. at 15.

[141] *See Dep't of Enf. v. Kelly*, Complaint No. E9A2004048801, 2008 FINRA Discip. LEXIS 48, at *32, *33 n.34, *34 (NAC Dec. 16, 2008) (finding respondent "consistently expressed remorse" and according "some mitigative value in Kelly's frank admission to the Hearing Panel" but determining that "sanctions at the highest end of the recommended ranges" were "necessary and proportional" and imposing a two-year suspension and greater than $100,000 fine); *Dep't of Enf. v. Leopold*, Complaint No. 2007011489301, 2012 FINRA Discip. LEXIS 2, at *21, *23-24 (NAC Feb. 24, 2012) (recognizing that respondent was "genuinely remorseful" but fining him $25,000 and suspending him for one year); *Dep't of Market Reg. v. Drake*, Proceeding No. 20060053785-02, 2012 FINRA Discip. LEXIS 48, at *4, *23-24 (OHO May 3, 2012) (finding that, although Drake was "sincerely remorseful," this did not "demonstrate that he would be able to fulfill a supervisory role effectively in the future" and barring him from association with any FINRA member firm in a supervisory capacity).

[142] Our long-standing, unambiguous precedent precludes that argument. *Midas Sec.*, 2012 SEC LEXIS 199, at *45 (rejecting argument that industry standard authorized reliance on transfer agent because "applicable standard of care was clear"); *see also Monetta Fin. Servs., Inc. v. SEC*, 390 F.3d 952, 956 (7th Cir. 2004) (finding that "the mere presence of an industry practice is insufficient to overcome the conclusion" that investment advisor violated statutory duties); *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 274 (3d Cir. 1998) (noting that "[e]ven a universal industry practice may still be fraudulent"). The NAC also properly rejected ACAP and Hume's argument because they presented no evidence of an industry practice. *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *15-16; *see also Midas Sec.*, 2012 SEC LEXIS 199, at *44-45 (rejecting factual assertion that reliance on transfer agent was "widely, if not universally, the practice in the brokerage industry").

[143] ACAP and Hume also have abandoned this argument before us. In any event, it has no merit. *See Midas Sec.*, 2012 SEC LEXIS 199, at *45 n.62 (rejecting argument that brokers "lacked sufficient notice of their requirements under the Securities Act" to conduct a reasonable inquiry to prevent unregistered distributions of securities without an available exemption based on prior Commission and NASD guidance).

[144] *See Mark F. Mizenko*, Exchange Act Release No. 52600, 58 SEC 846, 2005 SEC LEXIS 2655, at *17 (Oct. 13, 2005) (according "little weight" to broker's admission of misconduct "because it came only after he was confronted by his employer with his wrongdoing").

[145] ACAP Br. at 15.

and/or specific procedures to avoid recurrence of misconduct."[146] ACAP and Hume do not dispute the NAC's finding that "ACAP took no remedial measures before Enforcement commenced its investigation of the Firm,"[147] nor can they. Hume testified that ACAP had begun using a questionnaire in connection with the deposit of large blocks of stock to determine if the stock was eligible for resale without registration only "in the last week or two" prior to his investigative testimony and that ACAP had not put in place a requirement dictating when the questionnaire was to be used. Accordingly, FINRA's Sanction Guidelines afford no mitigative weight to ACAP's remedial measures.[148]

Nonetheless, ACAP and Hume argue that these belated measures should be granted mitigative weight because they implemented them before FINRA filed its complaint. ACAP and Hume rely on a FINRA hearing panel decision, *Department of Enforcement v. Ranni*.[149] In that case, the supervisory failure predated the respondent's tenure by years and was discovered after the respondent had been on the job for a matter of months, at which time he began to take action.[150] The hearing panel found that the fact that Ranni made "some revisions to the [written supervisory procedures] when he recognized problems" after the commencement of an investigation, along with other factors, supported treating his failure to supervise as serious but not egregious.[151] In contrast, when the misconduct cited here occurred in 2005, Hume had worked at ACAP since 1991 and served as compliance officer since 2002. ACAP and Hume first began to create necessary procedures in 2008, over three years after the unregistered sale of Greyfield securities in violation of the Securities Act.[152] We find that any modicum of mitigative weight that we might reasonably afford to this "trace evidence" of remedial measures,[153] and ACAP and Hume's stipulations of violations, is outweighed by the egregiousness of their misconduct and other factors discussed herein.

Third, ACAP argues that the NAC should have reduced the sanctions against the firm due to ACAP's alleged inability to pay the monetary sanctions.[154] Under the Guidelines, "[a]djudicators are required to consider a respondent's bona fide inability to pay when imposing a

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146 FINRA Sanction Guidelines at 6 (emphasis added).

147 *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *24-25.

148 FINRA Sanction Guidelines at 6; *see also Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *68 (Apr. 11, 2008) ("Remedial action taken after the initiation of an examination has little mitigative value.").

149 Proceeding No. 20080117243, 2012 FINRA Discip. LEXIS 6 (OHO Mar. 9, 2012).

150 *Id.* at *44.

151 *Id.* at *44-45.

152 Also in contrast to *Ranni*, there is no evidence that ACAP and Hume changed their *written* supervisory procedures in 2008. Instead, Hume testified that ACAP began to use a large block questionnaire but had not put in place a requirement for when the questionnaire was to be used.

153 *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *24.

154 Before the NAC, Hume argued that the sanctions against him should be reduced based on his financial circumstances. The NAC rejected Hume's argument because Hume failed to raise it before the Hearing Panel and there was no evidence in the record that he could not pay the sanction assessed. *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *28 n.26. We agree with the NAC that Hume's (now abandoned) argument lacks merit.

fine or ordering restitution."[155] "The burden is on the respondent to raise the issue of inability to pay and to provide evidence thereof."[156] The Guidelines also provide that "[a]djudicators should require respondents who raise the issue of inability to pay to document their financial status through the use of standard documents that FINRA staff can provide[]."[157] Further, under the Guidelines, "[a]lthough Adjudicators must consider a respondent's bona fide inability to pay when the issue is raised by a respondent, monetary sanctions imposed on member firms need not be related to or limited by the firm's required minimum net capital."[158]

We agree with the NAC that ACAP failed to establish an inability to pay the monetary sanctions.[159] ACAP argues that because, at year end 2009, its net loss was $143,133 and its excess net capital was approximately $90,000, the $100,000 total fines would have the "practical effect of shuttering" ACAP and thus are "improper and excessive."[160] But there is no evidence before us of ACAP's current financial circumstances. Because ACAP did not seek to supplement the record,[161] it has not met its burden to show that it currently cannot pay the monetary sanction. Moreover, even if ACAP had submitted current information regarding its finances in the form that it previously submitted below, that would not be sufficient to establish the firm cannot pay the sanctions.[162] ACAP has not demonstrated that it could not obtain financing, employ other sources of funds to discharge the monetary liability, or agree to an appropriate installment payment plan or other alternate payment option with FINRA.[163]

Citing several FINRA and NASD decisions, ACAP and Hume also argue that the sanctions were excessive because they were not commensurate with the sales commissions

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155 FINRA Sanction Guidelines at 5.

156 *Id.*; *see also* Order Denying Mot. for Recon., *Joseph J. Vastano, Jr.*, Exchange Act Release No. 50691, 2004 SEC LEXIS 2775, at *3 (Nov. 18, 2004) ("[A] respondent carries the burden of demonstrating an inability to pay."); *Robert Tretiak*, Exchange Act Release No. 47534, 56 SEC 209, 2003 WL 1339182, at *5 (Mar. 19, 2003) (noting that NASD was "entitled to make a searching inquiry" into allegations of inability to pay).

157 FINRA Sanction Guidelines at 5.

158 *Id.*

159 *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *27-28.

160 ACAP Br. at 16-17.

161 *See* Rule of Practice 452, 17 C.F.R. § 201.452.

162 Contrary to ACAP's suggestion, *Department of Enforcement v. Berry-Shino Securities*, Proceeding No. C3A030001, 2003 NASD Discip. LEXIS 61 (Hearing Panel Dec. 10, 2003), does not establish that a fine is *per se* excessive if it exceeds a firm's available net capital. In that case, the Hearing Panel declined to grant a disgorgement remedy where the "extraordinary circumstances" at issue involved the firm's "good faith involvement in collecting commissions that, although allowable under European laws, were unfair and excessive under NASD rules." *Id.* at *39. Based on these "unique" facts not present here, the hearing panel also found that the $250,000 disgorgement sought would be punitive given the firm's less than $100,000 net capital. *Id.* at *39-40.

163 *See ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *28 n.28 (citing FINRA Sanction Guidelines at 11 regarding alternative payment plans); *Robert L. Den Herder*, Exchange Act Release No. 39297, 53 SEC 329, 1997 SEC LEXIS 2293, at *10 n.11 (Nov. 5, 1997) (noting that, although respondent had failed to establish his inability to pay, "NASD makes available an installment plan which would permit [him] to pay over time").

ACAP received.[164] We are satisfied that FINRA appropriately analyzed and applied the Guidelines to the facts to reach a reasoned basis for the sanctions imposed.[165] The egregiousness of the supervisory failures, the large volume of shares illegally sold, and the other factors discussed herein, as well as the need for general and specific deterrence, provide ample support for the monetary sanction. Moreover, ACAP and Hume fail to cite recent cases in which we sustained FINRA fines for unregistered sales of securities and associated supervisory failures that exceeded the commissions earned from those sales.[166] In any event, we have consistently held that "the appropriateness of the sanctions imposed depends on the facts and circumstances of the particular case and cannot be determined precisely by comparison with action taken in other cases."[167]

3. FINRA's six-month all-capacities suspension of Hume protects investors from future harm.

Finally, Hume argues that his six-month all-capacities suspension with a requalification requirement[168] is excessive because his misconduct occurred solely in a supervisory capacity. According to Hume's argument, FINRA "has recognized that when the misconduct at issue is a failure to supervise, barring or suspending a registered representative in all capacities has limited remedial value" and thus limiting Hume's suspension to a supervisory capacity would be more appropriately tailored to his misconduct.[169]

Hume's argument does not recognize that FINRA's Sanction Guidelines applicable to supervisory failures expressly authorize an all-capacities suspension or bar for egregious conduct[170] and that FINRA has ordered sanctions consistent with this guidance in the past.[171]

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164 ACAP Br. at 17-18 (citing FINRA Sanction Guidelines, Principal Consideration No. 18 (providing for consideration of "the number, size and character of the transactions at issue")). In their briefing, ACAP and Hume concentrate on the size of their commissions and ignore the large number of shares sold in unregistered transactions and the egregious character of those sales.

165 *See supra* note 97 & associated text.

166 *See Midas Sec.*, 2012 SEC LEXIS 199, at *1, *4, *17 (sustaining fines of $80,000 to firm and $50,000 to its president where sales generated approximately $2,200 in commissions); *see also World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *1, *4, *15 (Jan. 6, 2012) (sustaining fines that exceeded commissions), *appeal docketed*, 12-70681 (9th Cir. Mar. 2, 2012).

167 *Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *74 (Jan. 30, 2009), *petition denied*, 416 F. App'x 142 (3d Cir. 2010); *cf. Butz v. Glover Livestock Commission Co.*, 411 U.S. 182, 187 (1973) ("The employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases.").

168 FINRA's Sanction Guidelines provide that a requalification requirement may be imposed where, as here, "a respondent's actions have demonstrated a lack of knowledge or familiarity with the rules and laws governing the securities industry." FINRA Sanction Guidelines at 5. Hume does not challenge the requalification requirement and we believe it is fitting under the circumstances.

169 ACAP Br. at 18-19.

170 FINRA Sanction Guidelines at 103, 104.

171 *See, e.g.*, *Dennis S. Kaminski*, Exchange Act Release 65347, 2011 SEC LEXIS 3225, at *45 (Sept. 16, 2011) (sustaining FINRA's imposition of an 18-month all-capacities suspension and requalification requirement); *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *112 & n.155 (July 2, 2013) (sustaining

(continued...)

FINRA accurately found that Hume was "centrally responsible for the rule violations at issue here" and that he abdicated his responsibility to others and displayed a disturbing lack of understanding and ignorance of FINRA rules.[172] Indeed, Hume's supervisory misconduct goes to the heart of the obligations of a securities professional.[173] Although Hume was charged with establishing written procedures for ensuring the legality of the sales of securities and ensuring that registered representatives adhered to them, proper procedure would require representatives to make many of the same inquiries that Hume chose not to require or make when stock certificates did not bear restrictive legends.[174] Moreover, given the nature of ACAP's business model, which relies heavily on the liquidation of penny stocks, the associated risk is all the more concerning given Hume's continued employment with ACAP.[175] Accordingly, we sustain the all-capacities suspension.[176]

(... continued)
all-capacities bar imposed for egregious conduct and noting that "[b]ecause proper supervision serves such an important role in protecting investors, egregious violations of supervisory rules often warrant the most severe sanctions"); *cf. Dep't of Enf. v. Pellegrino*, No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *70 n.57 (NAC Jan. 4, 2008) (explaining that FINRA's "imposition of a principal bar in this proceeding does not mean . . . that broader sanctions, such as a bar or suspension in all capacities, would not be warranted in other cases involving supervisory failures" and noting that "[t]he appropriate sanctions depend on the facts and circumstances of each case").

[172] *ACAP Fin.*, 2012 FINRA Discip. LEXIS 55, at *27.

[173] *See supra* note 48 and associated text; *cf. Carley*, 2008 SEC LEXIS 222, at *93 (imposing bar on association with broker or dealers where individuals' "failure to conduct a searching inquiry into the origin" of OTC Bulletin Board stock at issue "despite numerous indications that it was part of an unregistered distribution, evince[d] a disregard for regulatory requirements that call[ed] into serious question their ability to function as securities professionals").

[174] *See World Trade Fin.*, 2012 SEC LEXIS 56, at *28, *42 (noting that "duty of inquiry extends to both the broker and the registered representative executing the transactions" and sustaining FINRA finding that registered representative violated Securities Act Section 5 through unregistered sales of thinly traded penny stock (citing *Leigh*, 1990 SEC LEXIS 153, at *11)).

[175] For this reason, the present case is distinguishable from the hearing panel decision in *Stonegate*, cited by ACAP and Hume, in which there was "no indication" that the respondent posed any threat in a non-supervisory capacity. *Stonegate*, 2008 FINRA Discip. LEXIS 26, at *37. Similarly, in *Drake*, the sanction focused on preventing harm to the public from poor supervision. *Drake*, 2012 FINRA Discip. LEXIS 48, at *24. Here, the risk is not limited to Hume's supervisory capacity. *General Securities Corp. v. SEC*, 583 F.2d 1108 (9th Cir. 1978), is also unhelpful to Hume. There, the Ninth Circuit noted our conclusion that the sanction imposed on the individual petitioner "was appropriately tailored to fit his failings as a manager and supervisor" where "[h]is ability to continue as a salesman in the securities field was not impaired." 583 F.2d at 1110. That decision also rejected the petitioners' challenge to sanctions based on the fact that they were purportedly out of line with those imposed in other cases, i.e., the essence of ACAP and Hume's argument here. *Id.*

[176] Our decision in *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843 (Dec. 19, 2008), does not aid Hume's cause. In *Pellegrino*, we sustained NASD's imposition of a supervisory bar to remedy Pellegrino's supervisory misconduct, finding that NASD "appropriately tailored" the bar to remedy and deter his misconduct when it determined not to bar him in all capacities. *Id.* at *71. In taking that action, NASD relied in part on a finding that Pellegrino's "early and prompt firing" of certain representatives to address serious concerns was mitigating. 2008 FINRA Discip. LEXIS 10, at *79; *see also* 2008 SEC LEXIS 2843, at *70 n.71 (same). A different calculus applies here where Hume was suspended for six months, rather than barred, and where the underlying facts and circumstances differ as well.

Finally, we cannot say that the six-month suspension is unduly long. For egregious supervisory violations, the Guidelines recommend consideration of a suspension of up to two years or a bar in appropriate circumstances.[177] A six-month suspension, while not insignificant, falls on the lower end of this spectrum.

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Based on the foregoing, we find that the sanctions FINRA imposed on ACAP and Hume were neither excessive nor oppressive. Because "violations of the antifraud and other provisions of the securities laws frequently depend for their consummation on the activities of broker-dealers who fail to make diligent inquiry," it is essential that broker-dealers and their associated persons discharge their duties.[178] ACAP and Hume's failure to discharge their duties as securities professionals caused 27 million shares of an unknown stock to be sold to investors without registration under the Securities Act when no exemption from registration was available, depriving investors of the protections afforded by the registration and disclosure requirements of the Securities Act. Their failure to adopt or implement any reasonable protections was shocking and demonstrated a lack of knowledge of their responsibilities and the laws and regulations governing the securities profession, particularly in light of the fact that the majority of ACAP's business is the liquidation of low-priced stock. Under these circumstances, we conclude that FINRA's sanctions are justified under its Sanction Guidelines, result from a thoughtful weighing of the relevant facts, and are appropriately remedial because they will serve as a reminder that ACAP and Hume must comply with fundamental regulatory requirements and deter others from engaging in similar misconduct.[179]

Accordingly, we sustain these sanctions.

An appropriate order will issue.[180]

By the Commission (Chair WHITE and Commissioners WALTER, AGUILAR, and GALLAGHER); Commissioner PAREDES not participating.

Elizabeth M. Murphy
Secretary

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[177] FINRA Sanction Guidelines at 103.

[178] *Laser Arms Corp.*, 1991 SEC LEXIS 257, at *42 n.35 (internal citation and ellipsis omitted), quoted in *Midas Sec.*, 2012 SEC LEXIS 199, at *72-73; *accord Apex Fin.*, 1980 SEC LEXIS 1663, at *9-10 ("We have stressed the responsibility of broker-dealers to prevent their firms from being used as conduits for illegal distributions, such use having frequently been a major factor in the success of such unlawful activity.").

[179] *See McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005) ("[G]eneral deterrence is not, by itself, sufficient justification for expulsion or suspension . . . [but] may be considered as part of the overall remedial inquiry.").

[180] We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70046 / July 26, 2013

Admin. Proc. File No. 3-15080

In the Matter of the Application of

ACAP FINANCIAL, INC. and GARY HUME
c/o Anthony W. Djinis
Pickard and Djinis LLP
1990 M Street, NW, Suite 660
Washington, DC 20036

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action, and the sanctions imposed, by FINRA on ACAP Financial, Inc. and Gary Hume be, and they hereby are, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary