

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2007008935002**

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

RE: Cory Schmelzer, Respondent
CRD No. 2822157

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, I submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against me alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

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

BACKGROUND

Schmelzer has been in the securities industry since 1996. He joined SunAmerica Securities, Inc. (which became part of AIG Financial Advisors, Inc./Sagepoint Financial, Inc. in 2005) in January 2004. He is registered as a Series 3, 7, 24, 53, 63, and 65, and works in San Diego, California. During the time period relevant to this matter (June 2007 to December 2007), Schmelzer was a financial advisor and supervisor. He supervised only one registered representative during this time period, and spent most of his time on his activities as a registered representative.

OVERVIEW

During 2007, a registered representative under Schmelzer's supervision recommended that his insurance business customers participate in a so-called "Stock to Cash" program, offered by a third-party entity under which customers would pledge stock to obtain loans to purchase other products. Fifteen of the representative's customers (three of whom were clients of the firm) participated in

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that program at his recommendation, obtaining forty-two loans of more than \$4.2 million in the aggregate.

Schmelzer failed to fulfill his supervisory responsibilities over the activities of this registered representative because he did not (i) ensure that the representative promptly disclosed his participation in this activity to their employing member firm after learning that the representative had ignored his prior instruction to make such disclosure, and (ii) he did not supervise the representative's performance of his suitability and due diligence obligations in connection with recommending the Stock to Cash program to customers. Schmelzer thereby violated NASD Conduct Rules 3010 and 2110.

FACTS AND VIOLATIVE CONDUCT

The "Stock to Cash" Program

The Stock to Cash program was marketed as a way for customers to obtain funds to purchase financial products, such as insurance or fixed or equity indexed annuities. Under the terms of the program, customers obtained non-recourse loans from a non-broker-dealer company and "pledged" stock to that entity as collateral for the loans. The "pledged" stock would be transferred to the loaning entity's securities account, which was maintained at a clearing firm. The loans were in amounts up to 90% of the value of the "pledged" stock and were typically for a short period of time, usually three years. No payments were required during the term of the loan; instead, customers were required to pay the full principal and interest due at the end of the loan term.

At that time, customers supposedly had four options: (1) the customer could renew the loan for an additional time period; (2) the customer could pay the total amount due on the loan and reclaim the stock that had been pledged; (3) if the value of the pledged stock had increased above the total amount due on the loan, the customer could elect to receive a cash payment equal to this profit (i.e., the current value of the stock, minus the total amount due on the loan); or (4) if the total amount due on the loan exceeded the value of the pledged stock, the customer could "walk away" from the transaction, keeping the money that had been loaned and forfeiting his or her interest in the pledged stock.

The promoters of the Stock to Cash program represented that customers would continue to have an ownership interest in the pledged securities and that the shares, if transferred, would be held by investment grade institutions. Certain documentation used by the loaning entity made it appear that the entity was retaining the securities pledged by customers and might use those securities to

enter into hedging transactions.¹ The loaning entity also credited dividends paid on the pledged securities against a customer's loan balance.

Despite this, however, when customers "pledged" stock as a part of the Stock to Cash program, they actually conveyed full ownership of their stock to the entity conducting the program. That entity routinely sold the securities upon receipt and often moved the money into its own bank account. Moreover, although the entity's ability to perform its contractual obligations under the Stock to Cash program was largely dependent on the success of supposed hedging strategies, it was not always performing such activities.²

By the spring of 2008, the entity running the program became unable to make complete payments to customers with profitable portfolios. It instead used the proceeds from the sale of securities pledged by new customers to pay off its obligations to existing customers. In addition, money was diverted from the entity to pay for expenses not related to its operation. The entity stopped making all payments to customers in early 2009, and stopped making loans in the spring of 2009.

Schmelzer's Supervisory Failures

In approximately May or June 2007, a registered representative under Schmelzer's supervision began marketing the Stock to Cash program to customers. He did not disclose his participation in Stock to Cash to Schmelzer or the firm, but Schmelzer became aware of it through his review of the representative's emails during June 2007. Schmelzer directed the representative to disclose the activity to the firm. The representative did not comply. Schmelzer did not conduct adequate follow-up to determine whether the representative had in fact done so.

In late October 2007, Schmelzer learned that the representative had not followed his instruction to disclose the activity to the firm, and he again directed the representative to do so. However, Schmelzer did not determine whether the representative followed his directions for three more weeks, until the day the firm's annual audit of the representative's branch was to begin. At that point, the representative disclosed the activity to the firm. Once the firm was notified about

¹ The loaning entity claimed it was entering into "hedging" transactions using the customers' pledged stock as collateral. This would supposedly generate cash and, through the use of options strategies, allow the entity to return the stock, or sell it and pay the profits, to the customers at the end of the loan terms.

² Because the customers received 90% of the value of their stock at the time the loan was initiated, and did not have to pay any interest unless they sought to recover stock they had pledged, the potential out-of-pocket loss in any case was limited to 10% of the value of the pledged stock.

the representative's participation in the Stock to Cash program, the firm directed the representative to cease utilizing it. The representative's recommendations resulted in forty-two loans to fifteen of his customers, in the amount of more than \$4.2 million.

The representative failed to understand and to conduct adequate due diligence into the program and thus did not have a reasonable basis for his recommendations that his customers participate in the program. The activity violated Conduct Rule 2310. Schmelzer did not provide meaningful supervision or oversight of the representative's activities in connection with the Stock to Cash program between June and December 2007.

Schmelzer also failed to take reasonable steps to ensure that the representative disclosed his recommendations that his customers utilize the Stock to Cash program to the firm, as required by Conduct Rule 3040. Although Schmelzer initially directed the representative to disclose the activity, he did not undertake adequate follow-up to ensure that the disclosure was made in a timely fashion.

As a result of Schmelzer's supervisory deficiencies, the representative engaged in conduct which the firm deemed inappropriate and which potentially put the firm's clients' assets at risk between June and December 2007.

* * *

By failing to reasonably supervise the registered representative's participation in, and disclosure of, the Stock to Cash program, Schmelzer violated NASD Conduct Rules 3010 and 2110 (now FINRA Rule 2010).

B. I also consent to the imposition of the following sanctions:

1. a suspension from association with any FINRA member in a principal capacity for a period of fifteen business days; and
2. a fine in the amount of \$7,500.

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

II.

WAIVER OF PROCEDURAL RIGHTS

I specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

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

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

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

III.

OTHER MATTERS

I understand that:

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

any of the allegations against me; and

C. If accepted:

1. this AWC will become part of my permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;
2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about my disciplinary record;
3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
4. I may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. I may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects my right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

D. I may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. I understand that I may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

E. I agree to pay the monetary sanction(s) upon notice that this AWC has been accepted and that such payment(s) are due and payable. I have submitted an Election of Payment form showing the method by which I propose to pay the fine imposed.

I specifically and voluntarily waive any right to claim that I am unable to pay, now or at any time hereafter, the monetary sanction(s) imposed in this matter.

F. I understand that if I am suspended from associating with any FINRA member in a supervisory capacity, I become subject to a statutory disqualification as that term is defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended. Accordingly, I may not be associated with any FINRA member in a supervisory capacity during the period of the suspension (see FINRA Rules 8310 and 8311).

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

10/18/2010
Date

[Signature]
Respondent

Reviewed by:

[Signature]
Thomas M. Campbell
Smith Campbell, LLP
110 Wall Street
New York, NY 10005
(212) 344-1500
Counsel for Respondent

Accepted by FINRA:

10/28/10
Date

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

[Signature]
Thomas B. Lawson
Vice President and Chief Counsel
FINRA Department of Enforcement
1801 K Street, N.W.
Washington, DC 20006