BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Brookstone Securities, Inc. Lakeland, FL, Antony Lee Turbeville Lakeland, FL, Christopher Dean Kline Baraboo, WI, and David William Locy Overland Park, KS, Respondents.	DECISION Complaint No. 2007011413501 Dated: April 16, 2015

Firm and registered representatives made unsuitable recommendations and committed fraud; firm and a registered representative violated the content standards applicable to member communications with the public; firm and registered representative failed to review customer discretionary accounts; and firm and registered representatives failed to supervise reasonably the firm's activities. Held, findings and sanctions affirmed.

Appearances

For the Complainant: Karen Whitaker, Esq., Adam B. Walker, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Alan M. Wolper, Esq., Nathan W. Lamb, Esq., Ulmer & Berne, LLP; James D. Sallah, Esq., Joshua A. Katz, Esq., Sallah & Cox, LLC

TABLE OF CONTENTS

Pages

I. Background 2

II. Procedural History 3

III. Facts 5

A. CMO Risks 5

B. Brookstone's CMO Program 7

C. The Highlighted Accounts of Brookstone Customers 8

1. Turbeville's Customers 9

a. The MRs 9

b. BC 12

c. BB 14

2. Kline's Customers 15

a. CP 15

b. JG 15

c. HP 16

d. SB 17

IV. Discussion 18

A. Brookstone, Turbeville, and Kline Recommended Unsuitable Investments 18

B. Brookstone, Turbeville, and Kline Engaged in Fraud 26

C. Brookstone and Turbeville Violated the Content Standards That Apply to All FINRA Member Communications with the Public 32

D. Brookstone and Locy Failed to Review Customer Discretionary Accounts 35

E. Brookstone, Turbeville, and Locy Failed to Supervise 35

1. Brookstone and Locy Failed to Supervise Reasonably CMO Trading 36

2. Brookstone, Locy, and Turbeville Failed to Enforce Procedures to Safeguard Customer Information.....38

F. The Respondents' Evidentiary Objections.....40

V. Sanctions.....43

A. The Respondents' Relevant Disciplinary Histories.....43

B. Suitability Violations.....46

C. Fraud.....49

D. Violations of NASD Rule 2210 Content Standards.....51

E. Supervision Violations.....52

F. Restitution.....54

VI. Conclusion.....56

Decision

Brookstone Securities, Inc. ("Brookstone"), Antony Lee Turbeville ("Turbeville"), Christopher Dean Kline ("Kline"), and David William Locy ("Locy"), appeal a May 31, 2012 Extended Hearing Panel ("Hearing Panel") decision. The Hearing Panel found that Brookstone, Turbeville, and Kline recommended collateralized mortgage obligations ("CMOs") to unsophisticated customers with a low tolerance for risk for whom the securities were unsuitable and engaged in fraud. The Hearing Panel further found Brookstone and Turbeville issued letters to customers that violated the content standards applicable to all FINRA member communications with the public. The Hearing Panel also found that Brookstone and Locy failed to review customer discretionary accounts. Finally, the Hearing Panel found that Brookstone, Locy, and Turbeville failed, on several levels, to enforce and maintain the firm's written supervisory procedures and supervise reasonably the activities of the firm's registered representatives.

For this misconduct, the Hearing Panel imposed serious, definitive sanctions. In brief, the Hearing Panel censured Brookstone and fined the firm $1,000,000; barred Turbeville and Kline from associating with any FINRA member in any capacity; and barred Locy from acting in any supervisory or principal capacity, suspended him in all capacities for a period of two years, and fined him $25,000. In addition, the Hearing Panel ordered that Brookstone, Turbeville, and Kline pay to their respective customers, jointly and severally, restitution totaling $1,620,100.

After careful consideration of the substantial record in this matter, we affirm the Hearing Panel's findings that Brookstone, Turbeville, Kline, and Locy violated the federal securities laws and FINRA rules as alleged in the complaint. Although we modify, in part, the sanctions the Hearing Panel imposed, we affirm them in their effect.

I. Background

Brookstone purchased FINRA member RISE, Inc., in April 2005. Brookstone employed 157 registered persons and operated 44 branch offices when this proceeding began. FINRA expelled the firm from membership in October 2012 for its failure to pay fines imposed in two separate FINRA disciplinary matters.

Turbeville entered the securities industry in July 1987. He indirectly owned and controlled Brookstone as the sole shareholder of its parent company, Brookstone Capital Management, LLC. Turbeville served as Brookstone's chairman and chief executive officer, and he registered through the firm as a general securities representative, general securities principal, and investment company products and variable contracts limited representative from April 2005 to June 2012.[1] He is not associated currently with a FINRA member.

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[1] From November 2006 to June 2012, Turbeville also registered as an investment adviser representative of Brookstone Investment Advisory Services, an investment adviser firm that is no longer in business.

Kline began in the securities industry in February 1985. From April 2005 to June 2012, Kline registered through Brookstone as a general securities representative. Kline is not associated currently with a FINRA member.[2]

Locy entered the securities industry in 2003 and served at all times relevant to this matter as Brookstone's chief compliance officer. He registered through the firm as a general securities representative, general securities principal, financial and operations principal, municipal securities principal, and options principal from June 2005 to July 2012. FINRA revoked Locy's registrations on October 9, 2012, for his failure to pay a fine imposed on him, jointly and severally with Brookstone, in a disciplinary matter.

II. Procedural History

This matter stems from an investigation that followed FINRA's first routine sales practice examination of Brookstone in 2007. Staff's examination uncovered a CMO trading strategy that appeared directed at senior, retired investors whose accounts were invested heavily, on a discretionary basis, in high-risk inverse-floating-rate securities, sometimes with the use of margin. These customers, who had a significant portion of their assets invested in CMOs, experienced significant losses during the exam's review period. A referral to FINRA's Department of Enforcement ("Enforcement") followed.

On December 30, 2009, Enforcement commenced a disciplinary proceeding when it filed a six-cause complaint that alleged the respondents engaged in misconduct during the period July 2005 through July 2007.[3] The first cause of action alleged that Brookstone, acting through Turbeville and Kline, fraudulently made material misrepresentations of fact and omitted material facts that misled eight senior and retired customers concerning the risks associated with CMOs, in willful violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110.[4] The third cause of action alleged that Brookstone, again acting through Turbeville and Kline, recommended that the same eight customers purchase high-risk CMOs without reasonably believing that the securities, including those purchased on margin, were suitable for these customers based on their disclosed age, investment objectives, financial background, and risk tolerance, in violation of NASD Rules 2310(a) and 2110. The fourth cause of action alleged that Brookstone and Turbeville made

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[2] From January 2007 to June 2012, Kline was also registered as an investment adviser representative of Brookstone Investment Advisory Services. He is currently registered as an investment adviser representative in the State of Wisconsin with investment adviser firm Capstone Wealth Management Corp.

[3] The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

[4] The second cause of action, as an alternative to the first, alleged that these misrepresentations and omissions were negligent, in violation of NASD Rule 2110.

misrepresentations, omitted material facts, and utilized misleading statements in letters sent to some customers, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110. The fifth cause of action alleged that Brookstone, acting through Locy, failed to review customer discretionary accounts at frequent intervals, in violation of NASD Rules 2510(c) and 2110. Finally, the sixth cause of action alleged that Brookstone, acting through Locy, failed to supervise reasonably the firm's activities, and that the firm, acting through both Turbeville and Locy, failed also to enforce Brookstone's procedures for safeguarding customer information, both in willful violation of NASD Rules 3010(b) and 2110.

On February 22, 2010, the respondents filed an answer in which they denied the allegations of wrongdoing set forth in Enforcement's complaint. The Hearing Panel conducted a hearing over 16 hearing days during an eight-month period that began on June 13, 2011, and ended on February 17, 2012. During the hearing, Enforcement presented the testimony of 10 witnesses, including eight customers or their relations, an expert, and a FINRA examiner, and the respondents presented the testimony of six witnesses, including two experts and the three individual respondents. The Hearing Panel also admitted into evidence 324 exhibits submitted by Enforcement and 185 exhibits submitted by the respondents.

The Hearing Panel issued its decision on May 31, 2012. The Hearing Panel found that Brookstone, Turbeville, Kline, and Locy violated the federal securities laws and FINRA rules as alleged in the complaint.[5] The Hearing Panel censured Brookstone, fined the firm $500,000, and barred Turbeville and Kline for their fraud. For making unsuitable recommendations, the Hearing Panel fined Brookstone an additional $300,000, and it imposed additional bars on Turbeville and Kline. For sending misleading letters to customers in violation of the content standards that apply to FINRA member communications with the public, the Hearing Panel fined Brookstone a further $50,000, but it declined to impose additional sanctions on Turbeville in light of the bars imposed for his other misconduct. The Hearing Panel also fined Brookstone $50,000 for the firm's failure to review discretionary accounts, and it barred Locy from acting in any supervisory or principal capacity with any FINRA member for this misconduct. For their supervisory failures, the Hearing Panel fined Brookstone $100,000, it again barred Locy from acting in any supervisory or principal capacity, suspended him in all capacities for a period of two years, and fined him $25,000, but it declined to impose any additional sanctions on Turbeville in light of the bars it imposed also on him. Finally, the Hearing Panel ordered that Brookstone pay $1,620,100 in restitution to customers, with $440,600 of that amount imposed jointly and severally on Turbeville and $1,179,500 imposed jointly and severally on Kline.

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[5] The Hearing Panel declined, due to a lack of evidence, to make findings concerning allegations surrounding one of the eight customers—LD—whose accounts were highlighted in the complaint. Because it found that Brookstone, Turbeville, and Kline committed fraud, the Hearing Panel also made no findings that these respondents made negligent misrepresentations and omissions of material fact as alleged in the complaint's second cause of action. We do not revisit these decisions in this appeal.

On June 12, 2012, Brookstone, Turbeville, Kline, and Locy appealed the Hearing Panel's decision to the National Adjudicatory Council ("NAC") under FINRA Rule 9311.

III. Facts

A. CMO Risks

A CMO is a complex mortgage-backed security.[6] Smart Bond Investing—Types of Bonds, *available at* http://www.finra.org/Investors/InvestmentChoices/Bonds/SmartBond Investing/typesofbonds/P133243. Unlike a "pass-through" mortgage bond, which pays to an investor his pro rata share of the principal and interest derived from generally like-featured loans, a CMO comprises multiple pools of mortgage securities or loans and is structured with different bond classes or "tranches" that each operates under its own set of rules for distributing the cash flows from the underlying mortgages. *Id.* These tranches are thus each designed to have their own unique risk characteristics and maturity dates.[7] Smart Bond Investing—Types of Bonds.

This matter concerns primarily two CMO tranche types—inverse floating-rate and interest-only CMOs.[8] Inverse floating-rate CMOs or "inverse floaters" are securities that are structured to offset floating-rate tranches.[9] *Id.* at *8. They are designed to pay interest and

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[6] A mortgage-backed security is a bond secured by home and other real estate loans. *See* Smart Bond Investing—Glossary, *available at* http://www. finra.org/Investors/ InvestmentChoices/Bonds/SmartBondInvesting/glossary/index.htm.

[7] The risks associated with CMOs include interest rate risk, as well as prepayment or extension risk. *Id.*; *see generally* Frank J. Fabozzi, *The Handbook of Fixed Income Securities*, 502-508 (8th ed. 2012) (discussing the component risks of mortgage-backed securities). Interest rate risk is the risk that changes in market interest rates will cause fluctuations in the market value of an investment. Fabozzi, *supra*, at 502. Prepayment risk arises when, as interest rates fall, homeowners and others refinance their mortgages or prepay the principal on their loans, increasing the chance that the security to which the loan is tied will pay interest and principal ahead of schedule. *Id.* at 502-503. Finally, extension risk, which is the opposite of prepayment risk, is the risk that, as interest rates rise, an investor may be forced to hold their security longer than anticipated, thus creating additional exposure to risk during the security's life. *Id.* at 24.

[8] A third CMO type, tiered-indexed bonds or "TIBs," were also sold to Brookstone's customers. Because their numbers were small, and they are subject to risks similar to those associated with inverse floaters, we conclude that further discussion of these securities is not necessary for purposes of this decision.

[9] An inverse floater is ordinarily created by dividing a fixed-rate CMO tranche into both a floating-rate component and the inverse floater. Fabozzi, *supra*, at 553. Floating-rate securities, or "floaters," carry interest rates tied to a variable interest rate index such as LIBOR. *NASD Notice to Members 93-73*, 1993 NASD LEXIS 175, at *7-8 (Oct. 1993).

principal periodically from underlying mortgage pool payments.[10] Interest payments on inverse floaters, however, reset periodically and vary inversely with the chosen index. *Id.* As interest rates drop, the interest rate on the inverse floater rises at an accelerated pace.[11] *Id.* Rising rates, conversely, cause interest payments for inverse floaters to drop, and they can extend the return of principal beyond the anticipated average life of the loans underlying the security. *Id.* Because they are more leveraged than other CMO tranches, inverse floaters are subject to high price volatility as interest rates change.[12] *NASD Notice to Members 93-73*, 1993 NASD LEXIS 175, at *8. In the event an investor wishes to sell an inverse floater in an environment of high or rising interest rates, the value of the security could be significantly lower than its original purchase price.

In contrast, interest-only tranches are formed by separating the interest payments from the principal payments that are due from the mortgage loans that are used to form principal-only tranches.[13] *Id.* at *7. They are often used to hedge portfolios against interest-rate risk. *Id.* Unlike principal-only securities, interest-only securities increase in value when interest rates rise and prepayments slow. *Id.* When interest rates decline, however, prepayments of principal on the underlying loans tend to accelerate, which results in less interest received as the outstanding loan principal declines.[14] *Id.* In these conditions, an investor may receive less cash back than initially invested. *Id.*

In addition to interest rate risks and the risks associated with changes in principal prepayment rates, some CMOs are subject to credit risk, which is the risk that an issuer will default on its obligations. Fabozzi, *supra*, at 25. Most mortgage-backed securities, however, including CMOs, are issued either by an agency of the U.S. government and supported by Ginnie Mae, or by government-sponsored enterprises, such as Fannie Mae or Freddie Mac, and they carry the guarantee of the issuing organization to timely pay interest and principal. Smart Bond

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[10] Unlike many fixed-income securities that pay interest at intervals but only return principal at the final maturity or call date, a mortgage-backed security or CMO generally returns principal in increments over the life of the security.

[11] Faster prepayments of principal, however, may diminish the value of any increased interest to the security's holder. Fabozzi, *supra*, at 554.

[12] Inverse floaters are often structured with a leverage factor or multiplier in their coupon formulas. Fabozzi, *supra*, at 553.

[13] Principal-only tranches are structured so that investors receive only principal payments generated by the underlying collateral. *NASD Notice to Members 93-73*, 1993 NASD LEXIS 175, at *6.

[14] An interest-only security sells at a discount to its notional principal amount. The security has no face or par value and, as the notional principal amortizes or is prepaid, the security's cash flows decline. *Id.*

Investing—Types of Bonds. Although the guarantee associated with Ginnie Mae securities is backed by the full faith and credit of the U.S. government, the guarantee associated with securities issued by government-sponsored enterprises is not, and these securities trade with some, albeit limited, credit risk. Fabozzi, *supra*, at 207, 223, 514. Moreover, any guarantees associated with these securities apply only to the interest and principal payments due from the underlying loans and not to the market value of the security.[15] *Id.*; *NASD Notice to Members 93-18*, 1993 NASD LEXIS 93, at *9-10 (Mar. 1993).

If an investor sells a CMO prior to receiving the final principal payment due from the security, the CMO may be worth more or less than what the investor initially paid for it, resulting in a gain or loss from the sale of the security to the investor. *NASD Notice to Members 93-73*, 1993 NASD LEXIS 175, at *6; *NASD Notice to Members 93-18*, 1993 NASD LEXIS 93, at *9-10. In cases of volatile interest rates, investors who own CMOs should be prepared for the risk of illiquidity and radical changes in pricing as a result of illiquidity. Fabozzi, *supra*, at 566; *see also Kenneth R. Ward*, 56 S.E.C. 236, 241 (2003) ("While there is a sizable secondary market for CMOs generally, there is less of a market for the more risky and complex tranches. . . . It is also harder to obtain current pricing.").

B. Brookstone's CMO Program

From July 2005 through July 2007, Brookstone retained Doug Green ("Green"), then a registered representative with Crocker Securities ("Crocker"), as a consultant. Under the terms of their written agreement, which Turbeville executed for Brookstone, Green agreed to "review portfolios of . . . CMOs . . . for balance, for cohesiveness with interpreted market conditions, to discuss with appropriate officers . . . and representatives of [Brookstone] strategy regarding CMO portfolios, to locate sellers and buyers of CMOs willing to sell or buy at fair prices given market conditions at the time of purchase or sale, and to act as an expert in the area of CMOs on behalf of [Brookstone]."

To facilitate their arrangement, Brookstone provided Green and his unregistered assistant, Robert Utne ("Utne"), access to the account information of Brookstone customers. Green identified and recommended specific CMOs to Turbeville and Locy for purchase by Brookstone. Turbeville and Locy, in turn, advised Brookstone's registered representatives about the CMOs available for their customers' accounts. Turbeville and Kline relied heavily on Green's guidance to manage the portfolios of CMOs that they purchased for their customers.

Each month from July 2005 through July 2007, Green purchased through Crocker large blocks of CMOs—primarily inverse floaters and some interest-only securities—that he then sold, after charging mark-ups, to Brookstone. In turn, Brookstone sold the CMOs it purchased from Green to Brookstone's customers, after charging customers additional mark-ups. In total, from July 2005 through July 2007, Brookstone purchased $63,547,632 in CMOs that it then sold to its customers, earning the firm mark-ups totaling $1,906,322.

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[15] If an investor pays a premium to purchase a CMO, the premium is thus not guaranteed. *NASD Notice to Members 93-73*, 1993 NASD LEXIS 175, at *6.

Brookstone allocated CMOs to the accounts of its customers based on their relative "buying power," i.e., the available cash or margin that they had to purchase the bonds. These CMOs, however, were not held in customer accounts for long. To create buying power, Brookstone each month also sold large blocks of CMOs from customer accounts.[16] In total, from July 2005 to July 2007, Brookstone sold $62,348,009 in CMOs from customer accounts, earning the firm additional mark-downs totaling $266,252.

Brookstone's monthly CMO purchases and sales did not reduce the risk or increase the yield of its customers' portfolios. From July 2005 to July 2006, short-term interest rates increased, and they remained at relatively high levels until September 2007. At the same time, long-term interest rates, such as 30-year mortgage rates, increased and then fluctuated. These changes had a dramatic negative effect on the value of the CMOs held within Brookstone's customer accounts, which were composed predominantly of highly-leveraged inverse floaters. Indeed, because Brookstone regularly bought CMOs for its customers at a premium, held them for a short period, and then sold them at a discount, customers realized significant losses during the relevant period. Purchasing CMOs on margin exacerbated the losses suffered by some of these customers.

C. The Highlighted Accounts of Brookstone Customers

The complaint alleged that eight Brookstone customers were harmed by unsuitable CMO trading and fraud. This appeal concerns primarily CMO trading undertaken for seven of those customers, including three customers whose accounts were traded by Turbeville—Mr. and Mrs. MR, BC, and BB—and four customers whose accounts were traded by Kline—CP, JG, HP, and SB. Each of the seven customers granted Turbeville or Kline written discretionary authority over their Brookstone accounts. Thus, other than when customers requested that their accounts be liquidated, Turbeville and Kline made all decisions concerning the customers' CMO trading and the composition of their CMO portfolios.

Turbeville and Kline first recommended and purchased CMOs for each of the highlighted customers while they were associated with firms other than Brookstone, including Kovack Securities, Inc. ("Kovack"), GunnAllen Financial, Inc. ("GunnAllen"), and Archer Alexander Securities Corp. ("Archer Alexander"). Each time Turbeville and Kline moved to a new firm, they sent the customers partially-completed new account applications to facilitate the transfer of the customers' accounts to their new firms. They ordinarily requested that the customers simply initial and sign the documents where the forms were tagged and highlighted for them to do so.

When Turbeville and Kline joined Brookstone in 2005, they employed a similar practice. Turbeville and Kline sent the seven customers new Brookstone account applications that contained pre-populated information concerning, among other things, the customer's investment

[16] Some transactions resulted in cross trades between customer accounts, where customer accounts with available buying power purchased the CMOs sold by other customers. Other CMOs were sold back to Green through Crocker, which sold the bonds back to the market.

experience, financial information, "investment style," and "investment objectives." The account applications for each of these customers almost uniformly identified the customer's investment style as "moderate" or "aggressive," and they ranked their investment objectives, from highest to lowest priority, as "aggressive income," "income," "growth," "preservation of capital," and "speculation." Turbeville and Kline represented to the customers that the new Brookstone account applications had been completed using the information the customers had provided to their previous firms. In several instances, however, the customer's investment objectives were changed, without explanation, to emphasize "aggressive" investment objectives over growth or preservation of capital.

The account forms provided to the Brookstone customers included a "CMO Disclosure Form" and, for margin customers, margin disclosure forms. Among other disclosures, each client acknowledged, with their initials, that the primary types of securities in their accounts would be inverse floaters and interest-only securities; that the time to maturity could vary as the timing of principal payments changed; that selling the CMOs prior to receipt of the final principal payment could result in a loss; that rising interest rates could lower interest payments and extend the return of principal on inverse floaters; and that, for CMOs purchased at a premium, any guarantees as to principal only applied to the par value of the security and not to any premium paid. The customers involved in this matter nevertheless testified that they either did not read these disclosures closely, because they had come to trust Turbeville and Kline, or they did not understand them.

1. Turbeville's Customers

a. The MRs

Mr. and Mrs. MR met Turbeville in 2000 or 2001, when they attended a seminar that Turbeville hosted titled "Senior Citizens Maximum Income and Asset Protection Seminar." At that time, Mr. MR, a high school graduate, had been retired for several years after a career that included owning and operating a mobile home park, mobile home sales, and working in phosphate mines.[17] Mrs. MR worked as a nursing administrator.[18]

Shortly after attending his seminar, the MRs met Turbeville at his office. They informed Turbeville that they did not want any investments with high risk and, because they were both at, or near, retirement age, they could not afford to lose any of their money. At the time, the MRs had approximately $1.5 million in cash and investments, with nearly all of that money, the entirety of their retirement savings, invested in money market funds, mutual funds, and

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[17] Prior to his retirement, Mr. MR also owned two self-service car washes and two convenience stores.

[18] Mrs. MR retired in 2010.

municipal bonds.[19] Their annual income was approximately $173,000, which included her salary as a nursing administrator, interest and dividends, his Social Security, and income from rental properties. The MRs had limited knowledge about investing and securities, and they relied upon others to direct the trading in their investment accounts. They had never invested in CMOs before meeting Turbeville, and they did not understand the risks of trading on margin.

After their meeting, Turbeville prepared a "Financial Profile" and specific investment recommendations for the MRs. The Financial Profile reflected that the couple had expressed to Turbeville that their greatest financial concerns were maintaining liquidity for unexpected expenses, preserving investment capital for Mrs. MR, and having guaranteed savings. Receiving maximum current income was ranked as the least of the six financial concerns discussed in the Financial Profile, because Mr. MR did not feel that he needed to draw income from his investment accounts.

The Financial Profile identified several investment "goals," including "[p]reservation of principal," "[a]bove average return," and "[s]ome liquidity." Based on these goals, Turbeville recommended, "[f]or those assets that you wish to maintain principal with a high degree of predictability and wish to obtain above average returns, the Government Agency Bond strategy discussed in our previous meeting." It was in Turbeville's opinion "the single best option available for [the couple's] situation," and would provide the MRs "AAA or Implied AAA rated Government Agency Bonds," "[a] hedged portfolio which will provide stability of principal," "[a] return of 10% with a high degree of predictability (although not guaranteed)," "[n]o commissions to you," and "[l]iquidity." Turbeville also stated, "if you allow the use of margin, you can reasonably expect a 15% annual return (although not guaranteed) with all of the previously mentioned benefits."

The Financial Profile that Turbeville prepared for the MRs recommended that they invest "$300,000 in Money Market Funds in the Government Agency Bond Strategy" and "[u]tilize [m]argin in the Bond account to enhance returns." Turbeville concluded the Financial Profile with the statement that, "[b]y following the above recommendations, you will put safety values in place to help preserve the income producing power of the principal invested in equities, protect the principal of equity investments in the event of death, . . . obtain returns substantially above average in a stable Government Agency Bond Strategy, maintain liquidity, avoid commissions, and help to provide for [Mrs. MR's] independence."

Based on Turbeville's representations, Mr. and Mrs. MR agreed to transfer the bulk of their savings, approximately $1.4 million, to accounts through which Turbeville would invest in CMOs, investments that he led them to believe were safe and backed by the federal government. Turbeville informed them that he would structure a portfolio of CMOs that would make money in any economic environment. Turbeville never discussed with the MRs the risks associated

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[19] The majority of their net worth was accumulated through the sale of Mr. MR's businesses.

with CMOs. Because Turbeville stated that they could expect to make more money if they allowed him to purchase CMOs on margin, Mr. and Mrs. MR allowed him to do so.

Each time Turbeville changed firms, Mr. and Mrs. MR moved their accounts to his new firm. Turbeville continued trading their accounts utilizing the same CMO strategy that he had been pursuing at the previous firm. Mr. and Mrs. MR, however, remained conservative and risk averse in their investment outlook, and they wanted to preserve their assets so that they would have enough money to see them through retirement.

In 2005, when Turbeville moved to Brookstone, Mr. and Mrs. MR opened three discretionary accounts with the firm to allow Turbeville to continue trading CMOs on their behalf. At the time, Mr. and Mrs. MR were 70 and 59, respectively. As of June 30, 2005, their accounts included CMOs with a total market value of $2,303,000, and Mr. and Mrs. MR continued to allow Turbeville to trade using margin.

After their accounts were transferred to Brookstone, Mr. MR would regularly review the couple's account statements to determine how well their CMO investments were performing. Mr. MR found the account statements complex and difficult to understand, but as interest rates increased beginning in 2005, he noticed that the total value of the couple's investments would fluctuate wildly from month to month. When MR called Turbeville to discuss the account statements, Turbeville informed MR that the CMOs were not being priced properly or that the statements did not account for the full value of their CMO portfolio. Turbeville stated that although interest rates were rising, Mr. and Mrs. MR shouldn't worry about their accounts.

Turbeville regularly wrote to Mr. and Mrs. MR concerning their CMO portfolio. For example, in a letter dated December 7, 2005, Turbeville informed the couple that "the rising interest rate market has been difficult for the CMO portfolios." Turbeville explained that "over the past two years we have worked diligently to shorten the average life of the portfolios." "By doing so," he stated, "we have minimized the amount of time for the bonds to return principal." Turbeville attached to these letters a spreadsheet that showed Mr. and Mrs. MR's accounts valued "at par." "In other words," he explained, "what the account will be worth when all of the principal has paid back." "We hope this helps you feel some comfort," he concluded.

Similarly, in a letter dated April 5, 2006, Turbeville stated that he had "worked diligently to shorten the life of [Mr. and Mrs. MR's] portfolio," and that he was, "for the most part, in a buy and hold pattern." He stated that "by holding the bonds to maturity you will receive the principal value (face value) back, plus any interest due." "While some principal has been depleted over the last two years, principal value will remain (look at each bond on your statement as 100 instead of its current value)." Turbeville again included with his letter spreadsheets that showed the value of the MRs' CMOs "at par."

Finally, one month later, on May 4, 2006, Turbeville wrote to the MRs to advise them that a "substantial sell off" in the bond market had occurred. "What this means to you is [a] fairly dramatic downward movement of your statement values." Emphasizing again that Mr. and Mrs. MR focus not on the market value of their CMO portfolio, but rather "par value," Turbeville included updated spreadsheets that showed the value of Mr. and Mrs. MR's CMOs at par.

From July 1, 2005 to July 31, 2007, the portfolio of CMOs in Mr. and Mrs. MR's accounts consisted almost exclusively of inverse floaters. During this period, Mr. and Mrs. MR's accounts lost $414,800, and Turbeville earned total commissions of $133,000.[20] Their losses were exacerbated by Turbeville's use of margin to trade CMOs in their accounts. Turbeville bought on average CMOs worth $208,500 each month for their accounts, and he maintained an average monthly margin balance of $784,000 during the review period.

b. BC

BC's brother referred her to Turbeville in late 2003. She was employed at the time by Publix Super Markets in a clerical capacity, and she knew little about investing. Her annual income was approximately $25,000. During a meeting at Turbeville's office, BC informed Turbeville that she had a retirement account, worth approximately $44,000, at Wachovia that she wanted to transfer because her broker, who made the trading decisions on her behalf, had been losing her money.[21] BC also informed Turbeville that she had a 401(k) account that she intended to transfer once she retired. BC made clear to Turbeville that these funds would be, with her Social Security income, the primary source of her retirement income and that she could not afford to lose any money. Her investment goals were to generate income and grow her investments to help offset against inflation.

Turbeville told BC that he could meet her investment objectives. He recommended that she invest the proceeds from her Wachovia account in growth investments. He further recommended that she invest the money from her 401(k) account in CMOs. Turbeville explained that CMOs were mortgage investment bonds which would be guaranteed to return their principal. He stated that, when interest rates rose, her interest income would be lower, but when interest rates dropped, she could make more money. Although he could not provide any guarantees, he told her he was confident that her investments could earn 10%, with the potential for returns between 15 and 20%. Turbeville did not discuss with BC any of the risks with investing in CMOs.

As a result of Turbeville's representations, BC agreed to invest with him. She transferred her Wachovia account to his firm in November 2003. The funds from this account were invested in stocks. In July 2004, after BC retired from Publix Super Markets, she also transferred her 401(k) account to Turbeville's firm, and he reinvested the funds, approximately $237,000, in CMOs.

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[20] Brookstone paid Turbeville and Kline commissions equal to approximately 90 percent of the mark-ups and mark-downs earned from their CMO trading for customers.

[21] BC's Wachovia account was originally funded with stock given to her through her employment at Publix Super Markets.

In late 2004 and early 2005, BC noticed that the value of her CMO portfolio was steadily declining.[22] She called Turbeville, and he informed her that there was no way she could lose money as long as she was patient and gave the bonds time to mature.

In February 2006, Turbeville sent BC new account documents to sign in connection with the transfer of her account to Brookstone. A customer risk assessment form had already been checked with a "moderate" risk tolerance, but BC scratched out moderate and checked the box for "stable/income." On a form concerning financial information, BC found that her income and investment experience were overstated, and she changed that information as well. She also changed her investment style from "moderate" to "conservative." Although the pre-populated form listed her investment objectives, in order of importance, as growth, speculation, aggressive income, income, and preservation of capital, she changed them to income, preservation of capital, growth, aggressive income, and speculation. After making these changes, she returned the revised forms to Turbeville unsigned.

Like Mr. and Mrs. MR, Turbeville sent BC a letter dated April 5, 2006, that stated that he had "worked diligently to shorten the life of [her] portfolio," and that he was, "for the most part, in a buy and hold pattern." Turbeville repeated that, "[w]hat this means to you, is that the face amount of the bonds will be paid back to you as the underlying mortgages are paid off. Therefore, even though the account value may decline, the maturity value will remain." He again reiterated that "by holding the bonds to maturity you will receive the principal value (face value) back, plus any interest due," and "[w]hile some principal has been depleted over the last two years, principal value will remain (look at each bond on your statement as 100 instead of its current value)."

In May 2006, BC met Turbeville at his office to review and sign the new account documents. During her review, she noticed that her primary investment objective had been marked as "aggressive income." When BC asked Turbeville what this meant, he stated that it didn't mean "high risk" and that she should not be concerned. BC didn't understand the documents she reviewed, but she signed them at Turbeville's request.

On May 4, 2006, Turbeville also wrote to BC to advise her that a "substantial sell off" in the bond market had occurred. "What this means to you is [a] fairly dramatic downward movement of your statement values." Turbeville advised BC that "now is not the time to panic." "We are not selling bonds below par value ($100) unless we can buy another bond similarly far below par value that offer a better yield to life." "What this means to you," he explained, "is that holding the bonds to life will result in a return of the principal value plus interest due along the way." "The average life of the bonds in your portfolio is 3-5 years." As he had done with Mr. and Mrs. MR, Turbeville included spreadsheets that showed the value of BC's CMOs "at par."

When BC received these spreadsheets, she noticed that Turbeville had been buying for her account CMOs with stated maturities beyond the year 2030. She became concerned because

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[22] Due to insufficient retirement funds, BC returned to the work force from 2005 to 2010 as a teaching assistant earning approximately $18,000 a year.

she did not understand how these bonds worked, and she did not want to risk the potential for additional losses on these bonds for several more years. In August 2007, she informed Turbeville she wanted to close her account. It took several months to do so, and her account suffered additional losses during this time.

As of June 30, 2005, BC was 61 years old and the CMOs within her Brookstone account had a total market value of $220,070. From July 2005 through July 2007, the account, which Turbeville had invested largely in inverse floaters with some interest-only securities, lost $22,100. During the same period, Turbeville purchased on average $20,500 in new CMOs each month for the account, and he earned commissions totaling $15,400.

c. BB

BB retired in 1988 after a long career as a registered nurse. Prior to her husband's death in 1982, BB relied upon him to make their investment decisions. After her husband died, and with limited knowledge about investing, BB relied upon a broker to assist her with making investment decisions.

BB met Turbeville when she attended two or three lunch seminars that he held for senior citizens in the late 1990s. After attending Turbeville's seminars, BB agreed to meet with him to discuss her investments. At the time, BB's income consisted of $1,200 in Social Security each month and required minimum withdrawals from an IRA account. Her total liquid net worth was approximately $140,000. Her investments consisted primarily of mutual funds and blue-chip stocks held in her IRA account and a trust account held at Merrill Lynch.

BB told Turbeville that her investment objectives were to generate income for her required minimum IRA distribution and to achieve some growth. She told Turbeville that, due to her age and financial situation, her risk tolerance was very low and that she did not want to invest in aggressive investments or risk losing her retirement savings.

Based on Turbeville's recommendations, BB agreed in 2002 to transfer her Merrill Lynch accounts to Turbeville's firm. Her IRA and approximately $15,000 were invested in variable annuities, and an additional $50,000 was invested in CMOs.

As of June 30, 2005, after her accounts had been transferred to Brookstone, BB had CMO investments with a total market value of $42,098. She was 82 years old at the time. During the summer of 2007, after reviewing her monthly account statements, BB realized that the CMOs in her account had fallen in value by several thousand dollars in one month. She became very concerned and decided to transfer her account to another firm.

In total, from July 2005 through July 2007, BB's CMO portfolio, consisting of a mixture of inverse floaters, TIBs, and a small number of interest-only securities, lost $3,700. During that period, Turbeville earned $2,000 in commissions on monthly average CMO purchases of $2,800.

2. Kline's Customers

a. CP

CP and her husband, MP, who died in 2002, were both retired when they met Kline in 2001. CP worked as a home economics teacher for 27 years before her retirement. She had no understanding of investments and relied on her husband, a former small business owner and mechanic, to make their financial decisions before he died. Prior to investing with Kline, their investments consisted of stocks in accounts at Merrill Lynch. They were unhappy, however, with their Merrill Lynch accounts because they had experienced losses and margin had been utilized for trading against their wishes.

CP and her husband opened two accounts with Kline in 2002—a trust account in each of their names. At the time, the couple lived off her retirement income and the investment income on the proceeds from the sale of his business. Their net worth (excluding their primary residence) was approximately $2.8 million, and they had approximately $80,000 in annual income. Their investment objectives were to generate income for living expenses while also growing their capital.

After MP's death, CP relied on Kline to make the investment decisions for her accounts. Kline sent CP materials that explained that the objective behind investing in CMOs was to achieve a combination of income and capital gains that exceeded what was available from traditional fixed income securities. These materials further explained that her CMO portfolio would be structured to benefit from both rising and falling interest rates, and it would employ hedging strategies to protect against changes in interest and principal prepayment rates.

In early 2007, as CP's physical and cognitive health began to decline, her son, RP became concerned about the excessive use of margin to trade CMOs in her accounts. Kline responded that margin had been used to "diversify" CP's accounts by buying CMOs. He told RP not to worry, that his mother's accounts were doing "fine," and that the CMOs that were purchased for his mother's accounts were "guaranteed to pay off at par ($100) if held to full maturity." Kline also stated that he had been actively managing CP's portfolio to reduce the need for margin, increase "face values," increase interest earned on the bonds, and decrease durations.

As of June 30, 2005, after CP, then 78, transferred her accounts to Brookstone, they had CMOs with a total market value of $2,265,314, including primarily inverse floaters with a small number of interest-only securities. From July 2005 through July 2007, her account lost $551,800. During that same period, Kline earned commissions totaling $167,400 and purchased on average for CP's accounts CMOs worth $209,700 monthly. He also maintained an average margin balance during the period of $1,282,700. In 2007, after CP's accountant advised RP that his mother's accounts had suffered significant losses, they were transferred to another firm.

b. JG

JG and her husband, AG, who died in February 2005 at age 80, were referred to Kline by an insurance agent. At the time, AG had been retired for approximately 18 years, after a career

running his family's dry-dock business. JG retired from her work as a real estate agent in 2004 to care for her husband after he had a stroke. Both JG and AG were college graduates. They knew little about investing and finance, however, and relied on financial professionals to assist them with their investing.

The couple invested their entire retirement savings, approximately $500,000, with Kline in 2002. They were then receiving a small amount of Social Security and pension income, but relied primarily on the income generated by their retirement accounts to cover their living expenses. They also owned a home and invested the proceeds from its sale in 2004, approximately $400,000, with Kline. When they invested with Kline, JG and her husband informed him that, because of their age, they were looking for a safe source of income without subjecting their principal to any losses. Kline recommended that JG and AG invest using margin. Because they had never traded using margin before, JG and AG asked Kline to explain the risks of using margin to trade their accounts. Kline informed them that using margin was the safest way to achieve their investment goals.

Prior to his death, AG handled their investments and had the most contact with their brokers. After investing with Kline, they noticed that the balances reflected in their account statements were falling. When they called Kline to ask him about these statements, he would always tell the couple their investments were doing fine. Because they did not understand their investments, and they found the account statements difficult to read, they trusted Kline's representations. JG did not recall reviewing any account forms or disclosures that she was asked to sign.

As of June 30, 2005, JG, then age 75 and a widow, had three Brookstone accounts with CMOs that had a total market value of $1,688,438. These CMOs were invested principally in inverse floaters, with some TIBs and interest-only securities. At the time, she had an annual income of between $50,000 and $100,000. From July 2005 through July 2007 her accounts lost $342,100. During that period, Kline made monthly average CMO purchases for her accounts of $125,600, earning $97,600 in commissions, while maintaining an average margin balance in the accounts of $509,000.

After AG passed away, JG's son, an equities trader for institutional clients, became more involved in JG's finances. He testified that he could not understand the CMO investments in his mother's accounts and began asking questions about their falling values in 2007. By mid-2007, he decided that, if he could not understand Kline's trading strategies, his mother certainly would not. He advised her therefore to close her accounts. Because the CMOs in her accounts were generally illiquid, and a quick sale of the bonds would result in additional losses, it took several months to liquidate the positions in her accounts.

c. <u>HP</u>

The United States Navy drafted HP at age 18, and he never graduated from high school. Prior to his retirement in 1992, he owned and operated a business making corrugated sheet metal. He was 85 years old when he died in February 2011.

HP possessed limited investment experience and knowledge. In the late 1990s, he opened an IRA account and two trust accounts with a broker-dealer. The accounts, worth around $3 million, represented the vast majority of his retirement savings, and they were invested in blue chip stocks that were recommended by his broker.

HP became dissatisfied with the handling of his accounts after they began to lose money, losses that were exacerbated by the use of margin. In 2002, HP transferred his accounts to Kline's firm so that he could trade them. He met Kline at his office, where Kline wrote on a blackboard the rates of return he could enjoy investing with him.

Because of his age, HP told Kline that he did not want to risk his money and was not interested in any aggressive investments. His investment objective instead was to earn a steady stream of interest income to fund his retirement.

Kline recommended that HP invest in CMOs to obtain his investment objectives. Kline, however, did not discuss with him any risks associated with CMOs or the possibility that HP could lose money. HP did not know what CMOs were or understand how they functioned as an investment.

When he transferred his accounts to Kline's firm in 2002, they were worth greater than $2 million. HP's income was approximately $34,000 per year, and it included income from Social Security, rental properties, and a small military pension. Soon after the accounts were transferred, the stocks in the accounts were sold and the existing margin balance was paid off. The remaining funds were invested in CMOs.

After he transferred his accounts to Kline, Kline convinced HP to allow him to use margin to trade the account. In 2006, HP began to notice that his accounts were losing money, despite assurances from Kline that his accounts were performing well. After experiencing substantial losses, HP moved his accounts away from Brookstone and Kline.

As of June 30, 2005, when HP was 79, his CMO investments in three Brookstone accounts had a total market value of $2,066,306, and they were composed primarily of inverse floaters. From July 2005 through July 2007 his accounts lost a total of $258,800. During that period, Kline purchased, on average, CMOs for HP's accounts worth $105,000 each month. The average margin balance for the account was $561,400, and Kline earned $61,400 in total commissions.

d. SB

An insurance agent referred SB, a retired school teacher with limited investment knowledge, to Kline in 2002. SB had accounts at the time with Raymond James and Smith Barney that were worth approximately $165,000 and $150,000, respectively, and they were invested in money market funds and mutual funds. SB also had approximately $900,000 invested in annuities and $150,000 in real estate. He relied on the advice of others to help him with his investing. He and his wife received monthly income of $2,000 per month from his teaching pension, $1,560 from Social Security, and $1,000 from annuities.

SB told Kline he wanted his investments to be safe and secure. He wanted conservative investments that would generate income with limited risk. After meeting with Kline several times, including at SB's house, SB agreed to transfer his Raymond James accounts to Kline to invest in CMOs. Kline told SB that CMOs were guaranteed by the government, were safe, could make money if interest rates went up or down, and were paying high interest rates between 10 and 15%. "A customized portfolio designed to balance income as well as capital gains can be constructed to maximize both return and safety," Kline said in one letter during this period. The primary features of CMOs, he said, were a "AAA rating, high level of monthly income, growth/capital gains, and asset protection." Additional information provided with this letter stated that the benefits of CMOs included "above average monthly income, ability to hedge the portfolios against interest rate swings, high credit ratings-primarily AAA, security of bonds backed by government agencies, and medium term limitations." CMOs may be suitable, Kline emphasized, for "retired persons seeking additional income and safety and equity oriented investors seeking an alternative to the stock market."

Based on Kline's representations, and his failure to mention any risks, SB believed CMOs would be safe and profitable investments. SB's Smith Barney accounts were later transferred to Kline, the securities therein liquidated, and the proceeds invested in CMOs.

At some point, SB noticed his CMO investments were beginning to lose money. He called Kline to ask about his accounts, and Kline always said everything was fine and that SB had nothing to worry about. SB later noticed that his accounts were being traded on margin. SB told Kline that he had heard trading on margin was speculative and risky, and that he did not want or need such risks. Kline subsequently ceased trading on margin.

In 2006, SB's accountant informed him that his CMOs lost $50,000 in 2005. SB again called Kline, who told him not to worry, that his accounts were doing fine, and if he waited long enough, the accounts would rebound. In April 2007, SB decided to transfer his accounts back to Raymond James.

As of June 30, 2005, SB, who was then 92, had two Brookstone accounts with CMO investments that had a total market value of $226,812 and consisted largely of inverse floaters and TIBs, with a small percentage of interest-only securities. From July 2005 through July 2007, SB's CMO portfolio lost $26,800, with Kline buying on average $21,500 in CMOs each month for the accounts. During this same period, Kline earned total commissions from SB's account of $15,700.

IV. Discussion

A. Brookstone, Turbeville, and Kline Recommended Unsuitable Investments

We address first the allegations set forth in the third cause of Enforcement's complaint. The Hearing Panel found that that Brookstone, acting through Turbeville and Kline, failed to possess a reasonable basis for believing that the CMOs recommended and purchased for accounts of seven highlighted customers were suitable for them based on their financial profiles and investment objectives, in violation of NASD Rules 2310 and 2110. We affirm the Hearing Panel's findings.

NASD Rule 2310 provides, "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."[23] NASD Rule 2310(a). The rule "requires a broker to make a customer-specific determination of suitability and to tailor his recommendations to the customer's financial profile and investment objectives."[24] *F.J. Kaufman & Co.*, 50 S.E.C. at 168. "A broker's recommendations must be consistent with his customer's best interests, and he or she must abstain from making recommendations that are inconsistent with the customer's financial situation." *Dane S. Faber*, 57 S.E.C. 297, 310 (2004) (citations omitted).

In 1993, FINRA provided specific guidance to its members and their associated persons concerning the complexity of CMOs and their substantial risks, and it highlighted the obligations of members and their associated persons to their customers. *NASD Notice to Members 93-73*, 1993 NASD LEXIS 175, at *4. FINRA made clear that "members must be conversant in all characteristics of CMOs to assess adequately the suitability of CMOs for their customers." *Id.* at *1. In this respect, FINRA clearly advised members that "certain tranches may be structured in such a way that, depending on interest rates and prepayments, investors are at substantial risk and may lose all or a significant portion of their principal." *Id.* at *4. FINRA thus cautioned generally that CMOs may not be suitable for individual, retail customers, and it warned unambiguously that certain high-risk CMO tranches, such as inverse floaters and interest-only securities, "are only suitable for sophisticated investors with a high-risk profile." *Id.* at *7-8.

As the Hearing Panel found, and we also conclude, the evidence in this case readily establishes that Turbeville and Kline recommended and sold complex, high-risk CMO tranches to seven customers that were not suited for such investments. Each of these customers had a similar financial profile and needs. They ranged in age, at the time their accounts were transferred to Brookstone, from 59 to 92, and all were in or near retirement. The customers generally possessed little or limited investment experience and knowledge. To the extent they had invested previously, their investments were ordinarily in stocks, mutual funds, annuities, or

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[23] NASD Rule 0115 imposes upon persons associated with a member the same duties and obligations imposed on members under FINRA's rules.

[24] NASD Rule 2310 also requires a broker to possess an "'adequate and reasonable basis' for any recommendation he makes." *See F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989) (quoting *Hanly v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969)). This test, which is commonly referred to as the "reasonable basis" test, relates to a particular recommendation, rather than to a particular customer, and requires that a broker have a reasonable basis to believe his recommendation could be suitable for at least some customers by his understanding the potential risks and rewards inherent in that recommendation. *Id.* In this case, Enforcement did not allege, and the Hearing Panel did not find, that the respondents violated NASD Rule 2310 by failing to possess a reasonable basis that their recommendations concerning CMOs were suitable for at least some customers.

municipal bonds that were directed by financial professionals. When each of the customers first invested with Turbeville or Kline, their stated investment objectives, although often couched in different terms, focused on their expectation for conservative and safe investments for all, or a substantial portion, of their retirement savings. They sought stability, income, and principal protection or growth to help them cover their expenses and see them through retirement. In this respect, the seven customers were uniform in their desire and need to avoid aggressive investments or investments that bore a significant risk of loss. Simply put, the customers were not sophisticated customers and did not seek high-risk investments.

By all accounts ignoring the broad financial objectives and profiles of their senior and retired customers, Turbeville and Kline recommended CMOs and constructed CMO portfolios for the customers that consisted almost exclusively of CMOs that were heavily, if not entirely at times, concentrated in inverse floater tranches.[25] Their recommendations were unsuitable for several reasons.

First, Turbeville's and Kline's CMO recommendations were inconsistent with their customers' conservative investment objectives and financial needs. *See, e.g.*, *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *37 (May 27, 2011) ("Cody recommended that Mr. Bates make substantial investments in these bonds, which were rated speculative and highly speculative, even though he knew that Mr. Bates was retired, needed to preserve principal, requested low-risk investments, and needed immediate income for monthly withdrawals to cover living expenses."), *aff'd*, 693 F.3d 251 (1st Cir. 2012); *Faber*, 57 S.E.C. at 311 (finding an investor's inexperience, modest income and net worth, retirement needs, and inability to withstand loss "demanded an investment strategy that limited risk"); *Larry Ira Klein*, 52 S.E.C. 1030, 1037 (1996) (finding that the degree of risk associated with the debt securities broker recommended made them inappropriate for retired customers whose overriding need was for safety to principal). The prices for, and values of, highly-interest-rate-sensitive, leveraged inverse floaters can be extremely volatile. *See Fundamental Portfolio Advisors, Inc.*, 56 S.E.C. 651, 662 (2003) ("Inverse floater prices can be highly volatile . . . ."), *aff'd*, 167 F. App'x 836 (2d Cir. 2006); *see also John M. Repine*, Exchange Act Release No. 54937, 2006 SEC LEXIS 2916, at *7 n.3 (Dec. 14, 2006) ("Inverse floaters . . . are among the most thinly traded and volatile types of CMOs."). Inverse floaters are exposed to various and substantial risks—interest rate risk, extension risk, and liquidity risk—that are detrimental to their value as interest rates increase. *Repine*, 2006 SEC LEXIS 2916, at *7 n.3; *see also SEC v. Betta*, Case No. 09-80803-Civ-MARRA/JOHNSON, 2011 U.S. Dist. LEXIS 108429, at *8 (S.D. Fla. Feb. 16, 2006) ("Inverse floaters expose investors to concentrated interest rate risk, which can quickly lead to devastating market losses when interest rates rise."). "Although inverse floaters are guaranteed as to principal, they can have very lengthy maturities and, because of this extension risk, were unsuitable for these customers." *See Ward*, 56 S.E.C. at 263; *see also FINRA Regulatory Notice 07-43*, 2007 FINRA LEXIS 42, at *5 (Sept. 2007) ("[I]nvestors whose investment time horizons

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[25] Because Turbeville and Kline were granted and exercised discretion over the seven customers' accounts, they implicitly recommended the transactions in the accounts, thereby triggering application of the suitability rule. *See Paul C. Kettler*, 51 S.E.C. 30, 32 n.11 (1992) (stating that transactions a broker effects for a discretionary account are recommended).

afford less time or opportunity to recover investment losses may be disproportionately affected by market fluctuations."). In short, Turbeville's and Kline's customers sought, or should have been recommended, low-risk, stable investments; they instead received, as a direct result of Turbeville's and Kline's unsuitable recommendations, investments marked with unpredictable cash flows, substantial risks of loss, and a high degree of uncertainty over time. *See Luis Miguel Cespedes*, Exchange Act Release No. 59404, 2009 SEC LEXIS 368, at *23 (Feb. 13, 2009) ("We have previously held that risky investments are unsuitable recommendations for investors with relatively modest wealth and limited investment experience.").

Second, the risks associated with inverse floaters meant that Turbeville's and Kline's decision to concentrate a large portion of the customers' assets in these securities created the risk of a significant, negative change in portfolio value in response to even moderate changes in interest rates. *See Fundamental Portfolio Advisors*, 56 S.E.C. at 662. Inverse floaters are "very risky but not in a uniform way, which makes them exceptionally difficult to value and manage." *Betta*, 2011 U.S. Dist. LEXIS 108429, at *9. The high concentration of inverse floaters, without enough other types of CMOs, such as interest-only securities, to effectively hedge and offset these risks, made the customers' CMO portfolios particularly risky and exposed customers to significant losses.[26] Turbeville's and Kline's decision to concentrate their customers' CMO portfolios in one or a limited number of risky securities or types of securities was thus not suitable for the customers.[27] *See Faber*, 57 S.E.C. at 311 ("We have repeatedly found that high concentration of investments in one or a limited number of speculative securities is not suitable for investors seeking limited risk."); *James B. Chase*, 56 S.E.C. 149, 156 (2003)

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[26] Inverse floaters accounted for at least 77 percent of the total market value of CMOs in each customer's accounts during the review period. At times during that period, the percentage of inverse floaters in certain customer accounts was as high as 100 percent.

[27] The interest rate sensitivity for CMOs is measured in terms of "duration," which is a generic term that describes the responsiveness of a bond's price to a change in interest rates and is denominated in years. *Piper Capital Mgmt., Inc.*, 56 S.E.C. 1033, 1040 (2003); *see also* Fabozzi, *supra*, at 137-49 (discussing generally duration and its use to estimate price changes). For example, in the event of a one percent increase in interest rates, a security with a duration of 15 would be expected to decline in value immediately by 15 percent. *Piper Capital Mgmt.*, 56 S.E.C. at 1040. A high duration indicates that a security has high price sensitivity when interest rates change. *Id.* The duration of an entire portfolio is the weighted average duration of its individual securities. *Id.*

Enforcement's expert, H. Gifford Fong ("Fong"), calculated the duration of the seven highlighted customers' CMO portfolios at regular intervals during the period July 2005 through July 2007. His calculations showed that the durations for all seven customer portfolios during this period were significantly higher than that of a comparative index, the Barclays Capital US MBS Index. His findings thus showed that the customers' portfolios exhibited high interest rate sensitivity that exemplified the excessive risk to which customers were exposed. For example, as of July 31, 2006, midway through the review period, all seven of the customers' portfolios had durations of 19.73 or higher, when the duration of the comparative index was 4.34.

("[C]oncentration of the entire amount in one speculative security created substantial risk . . . ."); *Stephen Thorlief Rangen*, 52 S.E.C. 1304, 1308 (1997) ("[B]y concentrating so much of their equity in particular securities, Rangen increased the risk of loss for these individuals beyond what is consistent with the objective of safe, non-speculating investing.").

Finally, further leverage, in addition to the leverage inherent in the inverse floater CMOs purchased for customer portfolios, was created by Turbeville's and Kline's use of margin to purchase additional CMOs in four customer accounts.[28] Margin accounts result in margin interest charges on the amounts borrowed that add to the amount a security must appreciate to show a profit. *Chase*, 56 S.E.C. at 157. Margined accounts are also at risk to lose more than the amount the customer invested if the securities purchased on margin depreciate significantly. *Id.*; *see also Cespedes*, 2009 SEC LEXIS 368, at *26 ("Trading on margin also increases the risk of loss to a customer."). Turbeville's and Kline's use of margin in this case compounded the unsuitability of the already risky CMO transactions undertaken on a discretionary basis for the four customers' accounts and exacerbated the customers' losses. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *46 (July 12, 2013) ("Murphy's extensive trading on margin in Lowry's account . . . made his risky options trading even riskier and, therefore, even less suitable for Lowry."); *Cespedes*, 2009 SEC LEXIS 368, at *27 ("[W]e find that Cespedes's recommendations that these customers invest with significant concentrations in the technology sector, often using margin to purchase the securities in the accounts, were unsuitable . . . ."); *Chase*, 56 S.E.C. at 161 ("Chase violated [NASD Rules 2310 and 2110] by recommending that Horvath open a margin account to make purchases of FHC stock, when virtually all of Horvath's assets were already invested in FHC.").

During this proceeding, Turbeville and Kline have made a number of arguments to justify the suitability of their recommendations. Like the Hearing Panel, we have considered each of these arguments, and we reject them all.

First, Turbeville and Kline testified that CMOs were suitable for their customers because the customers were looking for greater interest income as an alternative to investments that were then offering low interest rates or the volatility of the stock market. In this respect, Turbeville and Kline asserted the clients were willing to take on additional investment risk, as indicated by their Brookstone account forms, which almost uniformly listed their primary investment objectives as "aggressive income." Even if we were to assume that the customers' account forms accurately reflected their investment objectives, which we do not, a recommendation is not rendered suitable because the customer acquiesces in the recommendation. *Faber*, 57 S.E.C. at 310-11. "[A] customer's investment objectives constitute only one factor for a broker to consider when determining the suitability of an investment recommendation."[29] *Chase*, 56

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[28] Fong's measurement of duration did not take into consideration the effects of leverage from using margin. If the use of margin was included, the durations would have been even higher.

[29] One of the respondents' experts, Robert M. MacLaverty ("MacLaverty"), opined that the CMOs recommended in this case were suitable for customers based almost exclusively on his

[Footnote continued on next page]

S.E.C. at 160. If Turbeville and Kline understood that their customers were interested in pursuing higher returns through riskier investments, these facts did not justify recommendations that were clearly inconsistent with the customers' other investment objectives. *See Cody*, 2011 SEC LEXIS 1862, at *39; *see also Klein*, 52 S.E.C. at 1037 ("We would not be surprised if these relatively unsophisticated investors . . . had expressed interest in earning a higher yield. In any event, each of them had additional investment objectives."); *Charles W. Eye*, 50 S.E.C. 655, 659 (1991) ("[R]egardless whether Ramini appeared willing, or even eager, to pursue 'growth' as Eye understood it, it was Eye's duty to advise her against that pursuit to the extent it was incompatible with her acknowledged needs."). "If the only approach capable of producing the desired income levels involved significant risk, [Turbeville and Kline] should have advised against it." *See Eye*, 50 S.E.C. at 659. As FINRA has cautioned, "[f]or many investors who are at or nearing retirement, there can be a temptation to reach for yield to maximize retirement income without the appreciation of the concomitant risk." *FINRA Regulatory Notice 07-43*, 2007 FINRA LEXIS 42, at *6-7. FINRA members and their associated persons thus "are required to . . . recommend only those products that are suitable in light of the customer's financial goals and needs." *Id.* at *7.

Second, Turbeville and Kline contend that their customers understood and accepted the risks involved in their CMO trading. As evidence, they pointed to various disclosures that they claim they made to their customers, including written disclosures made in Brookstone's account forms concerning the risks associated with CMOs, including inverse floaters.[30] A registered representative, however, does not satisfy his obligations under NASD Rule 2310 simply by disclosing the risks of an investment that he has recommended to his customer. *Jack H. Stein,* 56 S.E.C. 108, 113 (Feb. 10, 2003). "Although it is important for a broker to educate clients about the risks associated with a particular recommendation, the suitability rule requires more from a broker than mere risk disclosure." *Dep't of Enforcement v. Chase*, Complaint No. C8A990081, 2001 NASD Discip. LEXIS 30, at *17 (NASD NAC Aug. 15, 2001), *aff'd*, 56 S.E.C. 149 (2003). Indeed, as the Commission has stated, before a registered representative recommends a risky or speculative investment, he must be satisfied that the investment is appropriate for his customer and "satisfied that the customer fully understands the risks involved and is not only able but willing to take those risks." *Patrick G. Keel*, 51 S.E.C. 282, 284 (1993) (internal quotation omitted). Turbeville and Kline had an obligation to assess suitability for each of their customers

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[cont'd]

consideration of the "aggressive income" investment objectives marked on customer account forms. It is for this reason, and the fact that he considered the accounts of only two of the seven highlighted customers in forming his opinions, that we, like the Hearing Panel, give limited weight to his testimony.

[30] The Hearing Panel found neither Turbeville nor Kline credible and did not believe their claims that they fully explained their trading to their customers so that the customers involved understood the risks involved in trading CMOs or the risks of trading on margin. Absent substantial evidence to the contrary, the Hearing Panel's credibility determinations are entitled to our deference. *See Daniel D. Manoff*, 55 S.E.C. 1155, 1162 (2002).

that was wholly independent of the customer's understanding of the transactions or desire to proceed with them.

Third, Turbeville and Kline suggest that they should not be held responsible for what they contend was an unpredictable and unprecedented interest rate environment during the review period. In this respect, they argue that prior to 2005 the CMOs they recommended to the seven customers performed relatively well. "This reasoning betrays a troubling misunderstanding of the duty of a securities professional to make customers aware of the potential downside of an investment even if a decline in an investment's value is outside the salesperson's experience." *Ward*, 56 S.E.C. at 264. "The prior favorable performance of inverse floaters in no way lessened the associated risks." *Id.* "It was those risks . . . that [Turbeville and Kline were] obligated to consider in determining suitability and that precluded the sale of such securities here to customers with clearly stated conservative investment objectives." *See id.* at *50.

Fourth, the respondents argue that the customers' CMO portfolios would have recovered when interest rates dropped after 2007. They speculate that, if the seven customers had continued to hold their inverse floaters to the present, they would have experienced significant gains. This argument misses the mark too. A key element of suitability is matching the recommended purchases with the customer's risk tolerance. The seven highlighted customers, however, were not willing to see large declines in the values of their holdings. "Suitability is determined at the time the recommendation is made; unsuitable recommendations do not become suitable if they later result in a profit." *Cody*, 2011 SEC LEXIS 1862, at *37. The ultimate success or failure of Turbeville's and Kline's CMO recommendations is irrelevant to the issue of suitability. *See Laurie Jones Canady*, 54 S.E.C. 65, 81 (1999); *see also Klein*, 52 S.E.C. at 1038 n.29 ("We also reject Klein's contention that Towster would have made a profit had she not sold her shares in the high-yield bond fund against his recommendation.").

Fifth, Turbeville and Kline assert that they actively managed their customers' accounts in an effort to minimize risk and improve the performance of their customers' CMO portfolios as interest rates increased. Nevertheless, Turbeville's and Kline's recommendations did not become suitable simply because they monitored the investments carefully. *See Cody*, 2011 SEC LEXIS 1862, at *37. Their regular sales of CMOs purchased for their customers' accounts and purchases of replacement CMOs that possessed similar risk characteristics did not in this case do anything to reduce the risks associated with the customers' CMO portfolios or improve yields to customers.[31] Turbeville's and Kline's active trading served only to cause customers to realize the losses stemming from the decline in their portfolio values, while Turbeville and Kline

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[31] Enforcement's expert, Fong, calculated that Turbeville's and Kline's active trading in fact increased the duration of the seven customers' CMO portfolios during the review period, with the respondents regularly replacing CMOs sold from the customers' accounts with like CMOs that had longer durations. Indeed, Fong testified that, as time went on, the riskiness of the customers' portfolios increased until they were exposed to a degree of risk that would only be appropriate for sophisticated institutional customers interested in speculation.

enjoyed the benefits of the substantial commissions they earned from their frequent trading. Under these circumstances, we cannot condone their actions as satisfying their obligations under FINRA's suitability rule. *Cf. F.J. Kaufman & Co.*, 50 S.E.C. at 170 ("[T]his type of switching was unsuitable because the benefits of multiple trading was 'illusory' and because such switching actually 'decreased the customer's chances for profit' as a result of the broker's commissions on each purchase and sale." (quoting *Thomas Arthur Stewart*, 20 S.E.C. 196, 202 (1945))).

Finally, the respondents contest the Hearing Panel's determinations that the customers credibly testified about their lack of financial sophistication and low tolerance for risk.[32] As noted above, absent substantial evidence to the contrary, the Hearing Panel's credibility determinations are entitled to our deference. *See Manoff*, 55 S.E.C. at 1162. We conclude that the respondents have failed to show substantial evidence that would support disturbing the Hearing Panel's credibility determinations.[33] Although the customers who testified sometimes could not, because of their advanced ages, recall certain details of their dealings with Turbeville and Kline, or may have been mistaken with respect to certain details, this is not grounds to overturn the panel's credibility findings. *See Anthony Tricarico*, 51 S.E.C. 457, 461 (1993) ("Neither these alleged inconsistencies . . . , nor Shaikh's inability to recollect certain details of his conversations with Tricarico causes us to reject the credibility determination of the NYSE Hearing Panel."); *see also Dep't of Market Regulation v. Field*, Complaint No. CMS040202, 2008 FINRA Discip. LEXIS 63, at *36 (FINRA NAC Sept. 23, 2008) ("The Hearing Panel properly noted that although some of the elderly customers may have been mistaken with respect to each and every detail, the customers' testimony was candid, supported in certain instances by

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[32] Turbeville and Kline point to the relative wealth of some of their customers as evidence that their recommendations in this case were suitable. While some customers may have accumulated comfortable retirement savings, this did not make CMO investments suitable for them. *See William C. Piontek*, 57 S.E.C. 79, 94 (2003); *see also Arthur Joseph Lewis*, 50 S.E.C. 747, 749 (1991) ("The fact that a customer . . . may be wealthy does not provide a basis for recommending risky investments."). Nor do we find the general business experience of some of the customers evidence of the levels of investor sophistication necessary to understand Turbeville's and Kline's CMO trading or to make an independent evaluation of the CMO securities as issue here. *See Steven D. Goodman*, 54 S.E.C. 1203, 1210 (2001) ("Goodman's customers can hardly be characterized as sophisticated."); *Al Rizek*, 54 S.E.C. 261 (1999) ("Although Rizek's customers may have been successful businessmen . . . they were totally lacking in the degree of investor education necessary to understand Rizek's strategy . . . .").

[33] Just prior to the hearing in this matter, Turbeville provided to the MRs an affidavit that he prepared in an effort to certain settle claims that they may have asserted against him. Although the MRs signed the affidavit, which in some respects undermined an earlier declaration that they provided to Enforcement in this case, they testified that they did not want to sign the affidavit and felt pressured by Turbeville to do so. We find that the existence of this affidavit is insufficient to undermine the credibility determinations made by the Hearing Panel as to the MRs.

written notes, and consistent."). The testimony and other evidence presented by the customers, who did not know one another, concerning Turbeville's and Kline's handling of their accounts was similar and consistent on several important points and supports the Hearing Panel's determination to credit their version of events. *See Canady*, 54 S.E.C. at 79; *see also Alvin W. Gebhart, Jr.*, 58 S.E.C. 1133, 1146 n. 18 (2006) ("[W]here, as here, there are similarities among the investors' testimony regarding the salespersons' behavior, the reliability of that testimony is strengthened."), *aff'd in part*, 255 F. App'x 254 (9th Cir. 2007).

In sum, we conclude that Turbeville and Kline recommended unsuitable CMO transactions to the seven highlighted customers. We also hold Brookstone accountable for this misconduct. *See Dep't of Mkt. Regulation v. Yankee Fin. Grp., Inc.*, Complaint No. CMS030182, 2006 NASD Discip. LEXIS 21, at *68 (NASD NAC Aug. 4, 2006) (citing *SIG Specialists, Inc.*, 58 S.E.C. 519, 537 (2005)), *rev'd in part sub nom.*, *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407 (June 29, 2007). In reaching this conclusion, we note that Turbeville, Brookstone's founder and chief executive officer, played a pivotal role in Brookstone's CMO program. *See Prime Investors, Inc.*, 53 S.E.C. 1, 11 (1997) ("We . . . reject Prime's claim that it had no involvement with the investment program. This assertion is belied by the record, which establishes Prime's central role (through its offices and personnel) in promoting the program."). He hired Green to identify and recommend specific CMOs for purchase by Brookstone and, with Locy, Brookstone's chief compliance officer, reviewed Green's recommendations and advised the firm's registered representatives about the CMOs available for their customers' accounts. We therefore affirm the Hearing Panel's findings that Brookstone, Turbeville, and Kline violated NASD Rules 2310 and 2110.[34]

B. Brookstone, Turbeville, and Kline Engaged in Fraud

The Hearing Panel found that Brookstone, acting through Turbeville and Kline, fraudulently misrepresented and failed to disclose material facts to the seven highlighted customers, in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110. We affirm the Hearing Panel's findings.[35]

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[34] It is well established that a violation of the federal securities laws or FINRA rules is conduct that is inconsistent with just and equitable principles of trade, and is therefore a violation of NASD Rule 2110. *Frank Thomas Devine*, 55 S.E.C. 1180, 1192 n.30 (2002).

[35] The Hearing Panel found, and Enforcement contends, that Turbeville and Kline, among other things, intentionally or recklessly induced the seven customers' initial CMO investments with false representations that their investments were a safe way, through government-backed bonds, to obtain a high rate of return on their retirement savings. Our review of the record, however, indicates that Turbeville and Kline apparently made such misrepresentations to customers while they were associated with firms other than Brookstone. Because the complaint filed in this matter specifically alleged that Brookstone, Turbeville, and Kline engaged in fraud during the period of July 2005 through July 2007 only, we limit our findings to any misrepresentations or omissions of material facts made with scienter during that period.

Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rule 2120 prohibit fraudulent and deceptive acts and practices in connection with the purchase or sale of securities.[36] To establish a violation of these provisions for purposes of the allegations made in this case, Enforcement must show that the respondents made material misrepresentations of fact, or omitted material facts for which they had a duty to disclose, in connection with the purchase or sale of a security, and that they did so with scienter.[37] *See Faber*, 57 S.E.C. at 305-06 (citing *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996)).

We conclude that Enforcement proved the elements of fraud by a preponderance of the evidence. "Federal law requires persons to tell the truth about material facts once they commence speaking . . . ." *Ackerman v. Schwartz*, 947 F.2d 841, 846 (7th Cir. 1991). Exchange Act Rule 10b-5 further "imposes a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading." *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 504 (9th Cir. 1992). "That duty is a general one, and arises whenever a disclosed statement would be 'misleading' in the absence of the 'disclos[ure] of [additional] material facts' needed to make it *not* misleading." *SEC v. Fehn*, 97 F.3d 1276, 1290 n.12 (9th Cir. 1996) (quoting *Hanon*, 976 F.2d at 504). The duty to not omit material facts, however, is unambiguous where a securities professional holds a position of trust and confidence with, or is a fiduciary to, their customer. *See Chiarella v. United States*, 445 U.S. 222, 230 (1980) (holding that liability for failing to disclose material information is "premised upon a duty to disclose arising from a relationship of trust or confidence between parties to a transaction"); *see also SEC v. Zandford*, 535 U.S. 813, 823 (2002) ("[A]ny distinction between omissions and misrepresentations is illusory in the context of a broker who has a fiduciary duty to her clients.").

Turbeville and Kline held positions of trust and confidence by virtue of the discretionary authority granted to them by the seven customers. *See Dep't of Enforcement v. Dratel Group, Inc.*, Complaint No. 2008012925001, 2014 FINRA Discip. LEXIS 6, at *60 (FINRA NAC May

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[36] Exchange Act Section 10(b) makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5, among other things, makes it unlawful, in connection with the purchase or sale of a security, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). NASD Rule 2120 (now FINRA Rule 2020) is FINRA's antifraud rule, and it prohibits members and their associated persons from effecting any transaction in, or inducing the purchase or sale of, a security "by means of any manipulative, deceptive or other fraudulent device or contrivance."

[37] Exchange Act Rule 10b-5 also requires proof that the respondents, in connection with their fraud, used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. The respondents do not dispute that this requirement is satisfied in this case.

2, 2014) (citations omitted), *appeal docketed*, SEC Admin. Proceeding No. 3-15869 (May 12, 2014); *see also United States v. Wolfson*, 642 F.3d 293, 295 (2d Cir. 2011) ("[T]he presence of a discretionary account automatically implies a general fiduciary duty between a broker and a customer . . . ."). As a result of their positions, and given the implicit recommendations they made to buy and sell CMO securities during the period of July 2005 through July 2007, Turbeville and Kline possessed a duty to discuss and disclose fully all material facts to, and not mislead, their customers concerning the trading activity in which they engaged in the customers' accounts.[38] *See Michael Batterman*, 57 S.E.C. 1031, 1043 (2004) (finding respondent owed "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading his customers" (internal quotations omitted)), *aff'd*, 121 F. App'x 410 (2d Cir. 2005); *see also De Kwiatkowski v. Bear, Stearns & Co.*, 306 F.3d 1293, 1302 (2d Cir. 2002) (holding that a registered representative owes a duty to his customers to disclose material information fully and completely when recommending a transaction). Turbeville and Kline nevertheless failed to abide by this duty.

First, it is clear that Turbeville and Kline misled several of the seven customers concerning the performance of their CMO portfolios. Despite knowing full well that the value of the customers' portfolios had declined substantially, Turbeville and Klein repeatedly informed customers "not to worry" and assured them that their accounts were doing "fine." These promises were undoubtedly false and materially so. *See Canady*, 54 S.E.C. at 79 ("Canady . . . failed to alert them to losses in their accounts and falsely assured them that their accounts were doing 'fine.'").

Second, the preponderance of the evidence establishes that Turbeville and Kline failed to disclose adequately to the seven highlighted customers that the CMOs, specifically the inverse floaters, purchased and sold on their behalf are complex securities with high risks that are only suitable for sophisticated customers. These risks include the interest rate risk, prepayment or extension risks, and liquidity risk associated with inverse floaters, and the changes in cash flows, as well as the volatility in pricing and substantial risk of loss, that can result from small changes in interest rates. The decision of Turbeville and Kline to recommend that the seven customers purchase and sell inverse floaters, without disclosing fully and highlighting these risks, was materially misleading when considered in the context of the total mix of information made available to them. *See SEC v. Brookstreet Sec. Group*, Case No. SACV 09-1431 DOC (ANx), Order Granting Summary Judgment, at 10-11 (C.D. Cal. June 29, 2012) (concluding that a "reasonable investor . . . would have found it important that [inverse floaters] are highly complex, exceptionally risky securities"), *aff'd*, 584 F. App'x 689 (9th Cir. 2014); *Ward*, 56 S.E.C. at 259 ("Ward deceived his customers by recommending inverse floaters without also disclosing the associated risks."); *see also Lormand v. U.S. Unwired, Inc.*, 565 F.3d 228, 248

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[38] Information is material if there is a substantial likelihood it would be important to a reasonable investor in making an investment decision. *Basic v. Levinson*, 485 U.S. 224, 235 n.13 (1988). The key question in this regard is whether the "disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 231-32 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

(5th Cir. 2009) ("The omission of a known risk, its probability of materialization, and its anticipated magnitude, are usually material to any disclosure discussing the prospective result from a future course of action."); *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953 (E.D. Mich. 1978) (holding that a broker handling a discretionary account must, among other things, "explain forthrightly the practical impact and potential risks of the course of dealing in which the broker is engaged"). Their omissions left customers with the false impression that the CMOs purchased for their accounts were safe, low-risk investments. *Cf. Philip L. Spartis*, Exchange Act Release No. 64489, 2011 SEC LEXIS 1693, at *36 (May 13, 2011) ("Given the one-sided disclosure that was made to each customer concerning the customer's earning potential, [a] reasonable investor would want to know of any risks or potential harms associated with his or her investment." (Internal quotation omitted)).

Third, Turbeville and Kline also failed to disclose material information to the seven customers concerning their decisions to concentrate the customers' accounts almost exclusively in inverse floating rate securities. *See Henry James Faragelli*, 52 S.E.C. 1132, 1135-36 (1996) ("It is undisputed that Faragelli . . . failed to disclose . . . the level of EECO concentration . . . ."). Under these circumstances, Turbeville and Kline had a duty, which they breached, to disclose the fact of this concentration and its market implications should interest rates rise, including the possibility that customer portfolios could become illiquid or subject to distressed pricing and valuations in the event of high interest rates. *See id.* at 1136.

Finally, Turbeville and Kline omitted to disclose material facts concerning the use of margin to purchase CMOs for the accounts of the MRs, CP, JG, and HP. "Trading on margin also increases the risk of loss to a customer." *See Cespedes*, 2009 SEC LEXIS 368, at *26. Turbeville and Kline failed to explain the substantial risks of margin trading and did not explain that, in addition to paying interest on the margin debt they used to fund the customers' CMO portfolios, cash infusions or the sales of securities at a loss might be necessary in the event of an adverse interest rate environment. *See Justine Susan Fischer*, 53 S.E.C. 734, 740 (1998) (finding that the respondent omitted to disclose material facts to customers about her strategy to trade mortgage backed securities on margin); *cf. Spartis*, 2011 SEC LEXIS 1693, at *31 ("We are further troubled by the omission of information . . . regarding the potential adverse consequences of financing these transactions on margin.").

We also find that the evidence supports the conclusion that Turbeville and Kline acted with scienter when they misrepresented or failed to disclose the foregoing facts. Scienter is a necessary element to establish fraud under the federal securities laws and FINRA rules. *See SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1364 (9th Cir. 1993); *see also Gebhart*, 58 S.E.C. at 1168 ("Violations of these provisions may be established by showing that persons acting with scienter misrepresented or omitted material facts . . . ."). Scienter is proven by direct or circumstantial evidence. *Gebhart v. SEC*, 595 F.3d 1034, 1041 (9th Cir. 2010). It is "a mental state embracing intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976), and is established by either intentional or reckless conduct. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (1997). Reckless conduct includes "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or so obvious that the actor

must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted).

In the case of material omissions, "scienter is satisfied where, as here, the [respondents] had actual knowledge of the material information." *Fenstermacher v. Phila. Nat'l Bank*, 493 F.2d 333, 340 (3d Cir. 1974). Both Turbeville and Kline testified at length concerning their understanding of CMOs and, specifically, of their knowledge about the risks associated with inverse floater tranches, including the extent to which small changes in interest rates can affect dramatically the cash flows associated with these securities, the significant losses that can occur in a high interest rate environment, and how the use of margin could increase the risk of loss. The failure of Turbeville and Kline to disclose these risks to their customers, and to do so in obvious disregard for the customers' full investment objectives and concerns, constituted, at a minimum, reckless conduct. *See Kehr v. Smith Barney, Harris Upham & Co.*, 736 F.2d 1283, 1286 (9th Cir. 1984) ("[T]he jury had sufficient facts from which to conclude that Smith Barney's failure to apprise Kehr of the risky nature of her transactions consisted 'reckless' conduct."); *see also VandeGiessen v. First of Mich. Corp.*, Case No. K86-276A CA, 1989 U.S. Dist. LEXIS 16231, at *5 (W.D. Mich. Jan. 19, 1989) ("[A] jury could reasonably conclude that a failure to apprise [customers with limited financial knowledge] of the allegedly risky nature of the transaction constituted reckless conduct."). We also find it troubling, and evidence of scienter, that Turbeville and Kline continued to regularly sell purchased CMOs from their customers' accounts, resulting in actual customer losses, while generating commissions that served to further their own self-interests. *See Ward*, 56 S.E.C. at 259-60 ("The record also establishes that Ward acted with scienter in that, although he was aware of the associated risks and of his customers' lack of sophistication, he failed to make the appropriate disclosures but instead chose to exploit their limited understanding for his own gain."); *cf. Warwick Capital Mgmt., Inc.*, Investment Advisers Act Release No. 2694, 2008 SEC LEXIS 96, at *29 (Jan. 16, 2008) ("His self-interest in providing inaccurate information about Warwick is apparent."). Lastly, the failure of Turbeville and Kline to disclose and discuss the risks associated with inverse floaters following the issuance of NASD Notice to Members 93-73 is evidence of scienter. *See Ward*, 56 S.E.C. at 260 ("Ward's failure to discuss the risks associated with these securities following the issuance of the NASD Notice . . . is further evidence of scienter.").

Before the NAC, the respondents' singular argument against our finding fraud is that a broker's misrepresentations or omissions are rendered immaterial when written risk disclosures are made available to customers. We, however, find this argument unpersuasive. As a general matter, both the Commission and we have concluded that a broker's written disclosures do not work to insulate him from disciplinary claims for fraud. *See Klein*, 52 S.E.C. at 1036 ("Klein's delivery of a prospectus to Towster does not excuse his failure to inform her fully of the risks of the investment package he proposed."); *see also Field*, 2008 FINRA Discip. LEXIS 63, at *36 ("[E]ven assuming . . . that he had sent official statements to each customer prior to the customer's purchase, this does not excuse his fraudulent misrepresentations."). Moreover, we conclude that the context in which Brookstone disclosed in writing the risks of Turbeville's and Kline's CMO trading program in this case—where such disclosures were made to unsophisticated, discretionary-account customers, several years after Turbeville and Kline initially induced the customers to invest in CMOs as safe investments, and against the backdrop of statements that customers need not worry about their accounts—does not render the misrepresentations and omissions we have found to exist here an insufficient basis upon which to

find fraud. *See SEC v. Morgan Keegan & Co.*, Inc., 678 F.3d 1233, 1250 (11th Cir. 2012) ("The way information is disclosed can be as important as its content."); *see also SEC v. Merchant Capital, LLC*, 484 F.3d 747, 767 (11th Cir. 2007) ("The bespeaks caution doctrine is ultimately simply 'shorthand for the well-established principle that a statement or omission must be considered in context . . . .'").

The cases cited by the respondents in support of their argument—*Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, *Brown v. E.F. Hutton Group, Inc.*, and *In re Westscap Enters.*—are each inapposite to the issues presented here. These cases concern generally the issue of whether plaintiffs in private litigation may justifiably rely on a defendant's material misstatements or omissions of fact for purposes of claims under federal or state law. *See Banca Cremi*, 132 F.3d 1017, 1027-28 (4th Cir. 1997); *Brown*, 991 F.2d 1020, 1032 (2d Cir. 1993); *In re Westcap Enters.*, 230 F.3d 717, 726 (5th Cir. 2000). The reasonableness of an investor's reliance is not an element of a FINRA enforcement action for fraud.[39] *See Dep't of Enforcement v. Kaweske*, Complaint No. C07040042, 2007 NASD Discip. LEXIS 5, at *22 n.16 (NASD NAC Feb. 12, 2007); *cf. SEC v. Hasho*, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992) ("As long as the information withheld or the misstatements made are material, positive proof of reliance is not necessary to establish violations of the anti-fraud provisions.").

In sum, we affirm the Hearing Panel's findings that Turbeville and Kline committed fraud. Based on Turbeville's and Kline's misconduct, Brookstone is also liable. *See SEC v. Sells*, No. C 11-4941 CW, 2012 U.S. Dist. LEXIS 112450, at *24 (N.D. Cal. Aug. 10, 2012) (concluding, for purposes of a Commission civil enforcement action for fraud, that an officer's "knowledge may be imputed to [his firm] by application of the doctrine of respondeat superior under which wrongful acts of an employee undertaken within the scope of employment can be imputed to the employer"); *see also Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *59 (Dec. 10, 2009) (affirming FINRA disciplinary action against member firm for the manipulation of a security sold to public investors by the firm's co-chief executive and head trader); *Kirk A. Knapp*, 50 S.E.C. 858, 860 n.7 (1992) (noting that NASD properly attributed scienter of firm's owner to firm and thereby found primary antifraud violation by firm based on owner's conduct). We therefore affirm the Hearing Panel's findings that Brookstone, Turbeville, and Kline violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110.[40]

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[39] Indeed, in cases such as this one, "involving primarily a failure to disclose, positive proof of reliance" would also not be a prerequisite to recovery by a private litigant. *See Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972). "All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." *Id.* at 153-54.

[40] We also find that the actions of Brookstone, Turbeville, and Kline were willful, as alleged in the complaint. The term "willful" means in this context intentionally committing the act which constitutes the violation. *Mathis v. SEC*, 671 F.3d 210, 216-18 (2d Cir. 2012). There is no requirement that the actor be aware that he or she is violating a particular rule or regulation. *Id.*; *see also Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (holding that the term

[Footnote continued on next page]

C. Brookstone and Turbeville Violated the Content Standards That Apply to All FINRA Member Communications with the Public

Enforcement alleged, and the Hearing Panel found, that Brookstone and Turbeville violated the content standards that apply to all FINRA member communications with the public when Turbeville sent to his customers two pieces of correspondence, dated April 5, 2006, and May 4, 2006, in an apparent attempt to quell their concerns about the values of their CMO portfolios. The Hearing Panel thus found Brookstone and Turbeville violated NASD Rules 2210 and 2110. We affirm these findings.

The April 5, 2006 letter stated "[m]any of you have expressed concerns regarding your account balances." Turbeville assured customers that "[o]ver the past two years we have worked diligently to shorten the life of your portfolio." He continued that, "since this process has been completed, we are now, for the most part, in a buy and hold pattern. What this means to you, is that the face amount of the bonds will be paid back to you as the underlying mortgages are paid off." Turbeville stated that he "[understood] concerns about portfolio values" and "the negative emotions that can occur when statement value goes down." But he urged customers to remember that "[y]our account continues to produce income while it matures back to par." "[B]y holding the bonds to maturity," Turbeville emphasized, "you will receive the principal value (face value) back, plus any interest due." "We are on the back end of the interest rate cycle" and "at some point, interest rates should again begin to fall." "And keep in mind," he concluded, "you own primarily Gov't agency backed bonds which carry an implied AAA rating."

One month later, on May 4, 2006, Turbeville again wrote to his customers stating that a "dramatic sell off" had occurred in the bond market. "What this means to you," he stated, "is [a] fairly dramatic downward movement of your statement values." "However, I encourage you to keep our previous notification in mind." He stated that "we are not selling bonds below par value ($100) unless we can buy another bond similarly below par value that offers a better yield. What this means to you is that holding the bonds to life will result in a return of principal value plus interest due along the way." He added, "[t]he average life of the bonds in your portfolio is 3-5 years."

Attached to the April 5, 2006, and May 5, 2006 letters were statements which purported to show the "value at par" of the customer's portfolio of CMOs. These statements included a description of the bonds held in the customer's accounts, the number of shares of each bond the customer currently held, the "current price" and "current factor," bond type, and "value at par."

[cont'd]

"willful" means that the person with the duty knows what he is doing, but does not require that one know that he is breaking the law). Pursuant to Sections 3(a)(39) and 15(b)(4)(D) of the Exchange Act, broker-dealers and individuals are subject to disqualification from the securities industry for willful violations of the federal securities laws or MSRB rules. 15 U.S.C. § 78c(a)(39), 15 U.S.C. § 78o(b)(4)(D).

NASD Rule 2210 generally governs FINRA member communications with the public and includes content standards that apply to all member communications, including correspondence.[41] *See* NASD Rule 2210(d)(1). These content standards require, among other things, that FINRA members base their public communications on principles of fair dealing and good faith, ensure that their communications are fair and balanced, provide within their communications a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service discussed, and to disclose any material fact if the omission of that fact, in light of the material presented, would cause the communications to be misleading. *See* NASD Rule 2210(d)(1)(A). They further prohibit a member firm from making "any false, exaggerated, or unwarranted or misleading statement or claim in any communication," and proscribe the publication, circulation, or distribution of any communication the firm "knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading." *See* NASD Rule 2210(d)(1)(B). We conclude that Turbeville's communications violated these content standards.

As an initial matter, we find that the "value at par" statements omitted material information that caused the statements to be misleading, including: information concerning the meaning of the terms "current price," "current factor," and "value at par"; evidence concerning how the values for the data presented under these terms were calculated and when; the source or sources of the information presented; clear disclosure that the par values cited were not market values; and references to a source or means for calculating the current market value of the CMOs listed. We thus affirm the Hearing Panel's findings that Turbeville's communication violated NASD Rule 2210(d)(1)(A) standards. *See Dep't of Enforcement v. Beloyan*, Complaint No. 2005001988201, 2011 FINRA Discip. LEXIS 44, at *21-22 (FINRA NAC Dec. 20, 2011) (finding that emails did not provide a sound basis for evaluating an investment where they did not provide any support or explanation for the investment, omitted negative facts, and made no risk disclosures).

We also affirm the Hearing Panel's findings that Turbeville's communications violated the standards within NASD Rule 2210(d)(1)(B). First, Turbeville's statements that he was in a "buy and hold pattern" and that the customers' CMOs would necessarily return interest, as well as principal at "face" or "par" value, were false or misleading as presented. Turbeville failed to disclose that he was regularly selling bonds from customer accounts (to purchase additional CMOs) at a time when interest rates were rising or remained high, thus causing customers, who held primarily inverse floaters, to suffer losses of their principal. Moreover, by suggesting that customers overlook the current market value of their CMO portfolios, in favor of par or face value, Turbeville misled customers about the substantial decline in the portfolios' values and implied that the customers' investments were safe when, in fact, they continued to be subject to significant risks and volatility. *See Shlomo A. Sela*, Exchange Act Release No. 33789, 1994 SEC LEXIS 863, at *3 (Mar. 21, 1994) (finding respondent made false or materially misleading statements, and omitted material facts, when he, among other things, stated to customers that their accounts were making money, when they were not, that his investment strategy did not

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[41] Under NASD Rule 2210, the phrase "communications with the public" is defined to include "correspondence," which is itself defined in the rule. NASD Rule 2210(a)(3).

involve great risk, when it did, and that monthly account statements were not accurate, when they indeed were). The exposure to these risks, including interest rate risk and prepayment and extension risks, and their effects on the cash flows expected from the inverse floaters in the customers' portfolios, was reflected in the current market value of the bonds, not their par values. If a customer was forced to sell their bonds prior to maturity, the price that they could obtain for their inverse floaters, assuming a liquid market, would be the current market value (less mark-downs and transaction costs). Even in the unlikely event that Turbeville's retired and elderly customers were to hold their inverse floater bonds to maturity, the maturity date would necessarily be uncertain due to changes in principal repayment rates, and customers could not be assured of receiving interest payments or the amounts thereof as a result of fluctuations in interest rates.

Second, Turbeville's statement that he was buying bonds at a "discount" in order to improve "yield" was also misleading. *See Fischer*, 53 S.E.C. at 740 (finding that the respondent made material misstatements of or omitted to disclose material facts about her strategy to purchase CMOs). Turbeville omitted to disclose that customers would enjoy the spread between the discounted purchase price and the bond's par value only if they held the CMOs in question to maturity. *Id.* If interest rates increased, the market value of the portfolios' inverse floaters, even if purchased at a discount, would continue to fall, in which case customers could face additional losses. *Id.*

Third, Turbeville's claims that he had worked to shorten the life of customer portfolios were materially misleading when considered in their context. At the time Turbeville made these statements, the customers' CMO portfolios consisted largely of inverse floater bonds with stated maturities of greater than 20 years. Although Turbeville regularly sold CMOs from customers portfolios, he generally replaced those CMOs with others that possessed similar maturities and coupon levels. A fall in interest rates could accelerate the rate at which principal was repaid on these bonds, thus perhaps accelerating their anticipated maturities, but any attempt to predict future changes in interest rates would necessarily be speculative. *See NASD Notice to Member 93-18*, 1993 NASD LEXIS 93, at *10 ("It should disclose that the yield and average life will fluctuate depending on the actual prepayment experience and changes in current interest rates."). When he later stated that portfolios consisted of CMOs with an average life of three to five years, Turbeville falsely implied that the price volatility of these bonds was low and similar to that of relatively less-risky securities, such as a short or intermediate-term bond fund. *See Fundamental Portfolio Advisors*, 56 S.E.C. at 673 (finding it materially misleading that a fund's marketing material compared the duration of the fund's portfolio, which consisted largely of inverse floaters, to short term government funds); *see also NASD Notice to Members 93-18*, 1993 NASD LEXIS 93, at *10 ("A communication would be misleading if it indicated that the anticipated yield and average life of a CMO were assured."). As Enforcement's expert concluded, however, Turbeville's customers' portfolios, both before and after what the respondents described as the active management of the accounts, were marked with durations that belied any suggestions that they were neither risky nor subject to high price volatility when compared to other investments.

Finally, Turbeville's references to government agency backing of the CMOs that comprised customer portfolios were incomplete. Although a government agency issue could be characterized as "government agency backed," Turbeville should have clearly stated that the government agency backing applies only to the face value of the CMO, and not to any premium

paid, to avoid misleading his customers. *See NASD Notice to Members 93-18*, 1993 NASD LEXIS 93, at *9.

In sum, we find that Turbeville sent letters to his CMO customers that omitted material facts, made misrepresentations, and used misleading statements that violated the content standards that apply to all FINRA member communications with the public, and we hold Brookstone accountable for this misconduct. *See SIG Specialists*, 58 S.E.C. at 537; *see also Dep't of Enforcement v. CapWest Sec., Inc.*, Complaint No. 2007010158001, 2013 FINRA Discip. LEXIS 4, at *30 (FINRA NAC Feb. 25, 2013) (holding member firm liable for violating NASD Rule 2210 content standards based on the communications of its registered representatives), *aff'd*, Exchange Act Release No. 71340, 2014 SEC LEXIS 205 (Jan. 17, 2014). Accordingly, we affirm the Hearing Panel's findings that Brookstone and Turbeville violated NASD Rules 2210(d)(1)(A) and 2210(d)(1)(B) and NASD Rule 2110.

D. Brookstone and Locy Failed to Review Customer Discretionary Accounts

The Hearing Panel found that Brookstone, acting through Locy, failed to review all discretionary customer accounts at frequent intervals, in violation of NASD Rules 2510(c) and 2110. We affirm these findings.

NASD Rule 2510(c) states that a "member or the person duly designated by the member shall approve promptly in writing *each* discretionary order entered and shall review *all* discretionary accounts at frequent intervals in order to detect and prevent transactions which are excessive in size or frequency in view of the financial resources and character of the account." (emphasis added). In his testimony, however, Locy plainly admitted that, although he was responsible for conducting the reviews required by NASD Rule 2510(c) for the firm accounts that traded in CMOs, all of which were discretionary, he did not review each discretionary order, and he also did not review at frequent intervals all of the accounts. He instead conducted a random review of specific discretionary customer transactions, and on a monthly basis he reviewed a random sampling of customer accounts, some of which, depending on the sample selected, might also have been discretionary accounts.

Based on this evidence, we affirm the Hearing Panel's findings that Locy violated NASD Rules 2510(c) and 2110 and that Brookstone is responsible for these violations. *See SIG Specialists*, 58 S.E.C. at 537.

E. Brookstone, Turbeville, and Locy Failed to Supervise

The Hearing Panel found that Brookstone, acting through Locy, failed to supervise reasonably customer CMO accounts and transactions, in violation of NASD Rules 3010(b) and 2110. The Hearing Panel also found that Brookstone, acting through Turbeville and Locy, failed

to follow and enforce the firm's written supervisory procedures for safeguarding customer information, also in violation of NASD Rules 3010(b) and 2110.[42] We affirm these findings.

1. Brookstone and Locy Failed to Supervise Reasonably CMO Trading

"Assuring proper supervision is a critical component of broker-dealer operations." *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007) (citing *Rita H. Malm*, 52 S.E.C. 64, 68 n.13 (1994)). NASD Rule 3010(b) requires members to establish, maintain, and enforce written procedures to supervise the businesses in which they engage, as well as the activities of registered representatives, registered principals, and other associated persons, that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable FINRA rules. NASD Rule 3010(b)(1). "The standard of 'reasonable' supervision is determined based on the particular circumstances of each case." *John A. Chepak*, 54 S.E.C. 502, 513 n.27 (2000). In addition to requiring an adequate supervisory system and procedures, "[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." *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004).

Locy was Brookstone's designated supervisor responsible for reviewing all CMO transactions during the relevant period. Brookstone's written supervisory procedures also required Locy to monitor and review all of the firm's securities related activities and records. Among other necessities, the firm's procedures required that Locy review daily all new account forms, all incoming and outgoing correspondence, and all trades conducted the prior day with regard to their suitability for particular investors, including for the excessive concentration of customer assets in a particular investment. The firm's written supervisory procedures also required that Locy strictly and continuously monitor the firm's discretionary accounts. In this respect, Locy was required to approve and accept all accounts for which trades would be executed on a discretionary basis, to approve all discretionary trades prior to entry, and to generally conduct a detailed review of all discretionary accounts with a view towards uncovering unsuitable recommendations, excessive trading, and undue concentrations in a single security. As to the firm's procedures for margin accounts, they required Locy to conduct a rigorous scrutiny and regular review and oversee all margin activities of the firm. Finally, Brookstone's written supervisory procedures required that Locy take all appropriate steps to ensure that the firm's associated persons understood and informed their customers of the risks associated with transactions involving bonds, perform a customer-specific suitability analysis for specific bond

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[42] On appeal, Locy argues that we must dismiss any claims concerning his alleged supervisory failures if we find that Brookstone, Turbeville, and Kline did not, as alleged in the complaint, violate the federal securities laws or FINRA rules. This argument is moot. As discussed above, we find that the record amply supports the Hearing Panel's findings that Brookstone, Turbeville, and Kline violated the federal securities laws and FINRA rules. Moreover, "[a] determination that a respondent has violated [FINRA's] supervisory rule is not dependent on a finding of a violation by those subject to the respondent's supervision." *Robert J. Prager*, 58 S.E.C. 634, 662 (2005).

transactions, and ensure that customers received a balance disclosure of the risks, costs, and rewards associated with those bond transactions.

Locy nevertheless did not exercise reasonable supervision consistent with his responsibilities. Although Locy reviewed and approved all new accounts, he did not review and approve all CMO transactions, which were conducted on a discretionary basis, and he did not conduct any analysis that these transactions were suitable for the customers to whom they were recommended. As noted above, Locy did not review and approve each discretionary order prior to entry, and he disclaimed any responsibility for determining whether any specific CMO transaction was suitable for a particular customer. He instead left that determination to Turbeville and Kline. To the extent that Locy performed any review of the CMO transactions at issue in this case, he concedes that it was, at best, "limited" and "random," encompassed only a small subset of the customers whose accounts traded in CMOs, and occurred mostly after the fact.

Locy claimed that he reviewed all new accounts and new account documentation to determine that the accounts were suitable generally for trading in CMOs, but he could not recall a single instance where he determined that a CMO strategy was unsuitable for a particular customer. In this respect, Locy relied primarily on the investment objectives disclosed in the customers' new account forms, although he acknowledged that Brookstone, not the customer, often provided the information on those forms and customers were regularly asked to sign the forms with pre-populated answers. He never spoke directly with any of the customers whose accounts are at issue in this case, nor did he seek to test the information provided in the account documentation, relying instead on Turbeville's and Kline's representations as to the customers' investment objectives. As his testimony made clear, he largely concluded that CMOs were suitable for any investor that wanted an above average rate of return and whose new account forms indicated that that the customers had either a "moderate" to "aggressive" risk tolerance or investment objective.[43]

As we concluded in the prior section, Locy did not review discretionary customer accounts at frequent intervals. Rather, he conducted a random review of all customer accounts on a monthly basis, some of which, depending on his sampling, might also have been discretionary accounts. Locy also could not recall conducting any formalized review of the firm's margined accounts, and he assumed instead that his monthly, random review of all firm accounts would likely have included a random sampling of some of the firm's accounts that also traded on margin. Finally, there is no evidence that Locy conducted any review of customer CMO portfolios for undue concentrations of securities, either on a transactional level or generally.

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[43] He was also persuaded that CMOs were suitable for customers because Turbeville and Kline had engaged in CMO trading on a discretionary basis while the customers' accounts were held at other firms, and the accounts performed relatively well before they were transferred to Brookstone.

Based on the foregoing, we agree with the Hearing Panel's assessment of the evidence and its conclusion that Locy exhibited a lax approach to supervision. This resulted in his intentional inattention to or reckless disregard of numerous, troubling red flags. These included: the number of senior, retired customers whose accounts were invested in complex, risky CMOs; the extent to which the new account forms for these accounts nearly uniformly indicated, despite the age and limited resources of the customers, that the customers possessed aggressive investment objectives; the significant losses for these accounts as interest rates rose; the extent to which CMO trades were executed solely in accounts for which Turbeville and Kline exercised discretionary authority; the manner in which Turbeville and Kline enhanced the leverage inherent in their customers' accounts by concentrating investments in inverse floaters; and, for some customers, the degree to which Turbeville and Kline compounded this leverage by using margin to support their trading.

The evidence establishes that Locy failed to effectively and reasonably enforce and implement the firm's supervisory procedures. *See Robert E. Strong*, Exchange Act Release No. 57426, 2008 SEC LEXIS 467, at *29 (Mar. 4, 2008) ("[T]he evidence establishes that Strong's unreasonable inaction effectively nullified the supervisory system related to the Firm's compliance with Rule 2711."). The results were devastating for the seven highlighted customers. *See Dep't of Enforcement v. Pellegrino*, Complaint No. C3B050012, 2008 FINRA Discip. LEXIS 10, at *71 (FINRA NAC Jan. 4, 2008) ("While [respondent] implemented a variety of supervisory actions, those actions, whether viewed individually or collectively, failed to directly address the problems that were causing voluminous amounts of unsuitable recommendations and misleading sales presentations."), *aff'd*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843 (2008).

Final responsibility for proper supervision of a member's business rests with the member. *See* NASD Rule 3010(b); *see also CapWest Sec., Inc.*, 2013 FINRA Discip. LEXIS 4, at *28. Consequently, we affirm the Hearing Panel's findings that both Brookstone and Locy violated NASD Rules 3010(b) and 2110.

2. Brookstone, Locy, and Turbeville Failed to Enforce Procedures to Safeguard Customer Information

Brookstone's written supervisory procedures further charged Locy with the responsibility of ensuring that the firm and its associated persons followed the firm's procedures for safeguarding the security of customer information.[44] The firm's procedures were designed to "[e]nsure the security and confidentiality of customer information," "[p]rotect against any anticipated threats or hazards to the security or integrity of such information," and "[p]rotect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer." Among other things, Brookstone's security standards required

[44] Rule 30(a) of Regulation S-P requires every broker-dealer registered with the Commission to adopt written policies and procedures that address administrative, technical, and physical safeguards for the protection of customer records and information. 17 C.F.R. § 248.30.

access controls on customer information systems, encryption of electronic customer information, and measures to protect against destruction, loss, or damage of customer information.

As noted above, Brookstone and Turbeville entered into a consulting agreement with Green, a registered representative of another firm, Crocker Securities, to advise Brookstone and its registered representatives as an expert on CMOs. To facilitate that agreement, Brookstone regularly provided Green and his unregistered assistant, Utne, with access to the account information of Brookstone's customers. Among other information sent, Brookstone routinely sent confidential account information concerning Brookstone's customers to Green and Utne at their internet-based Hotmail and AOL email accounts.[45] This information included non-public personal information and personally identifiable financial information, such as lists of customer names with account numbers, as well as account balance information, including information concerning customer cash and margin balances, and information concerning their securities investments. *See* 17 C.F.R. § 248.3(t)-(u) (defining the terms "nonpublic personal information" and "personally identifiable financial information").

Turbeville and Kline failed to enforce the firm's procedures for the safeguarding of customer information. Although the firm's procedures required that it exercise appropriate due diligence in selecting service providers, inquire as to the security policies of those providers, and require service providers to implement measures designed to meet the objectives of Brookstone's information security policies, the written consulting agreement between Brookstone and Green, which Turbeville signed, did not require Green to implement any measures to meet the objectives of Brookstone's security protocols. Moreover, Turbeville and Locy knew, or must have known, based both on the emails they received personally and the nature of the firm's consulting relationship with Green, that he and his unregistered assistant used their personal, internet-based email accounts to send and receive information concerning Brookstone's customers. Turbeville and Kline nonetheless failed to take any discernable measures to ensure that the information shared with Green and Utne could not be and was not compromised. Finally, Brookstone did not provide the firm's customers with the opportunity to opt out of any information-sharing of nonpublic personal information between the firm and Green, as required by both the firm's written supervisory procedures and Regulation S-P. *See* 17 C.F.R. § 248.10 (establishing limits on a broker-dealer's disclosure of nonpublic personal information to nonaffiliated third parties).

We thus also affirm the Hearing Panel's findings that Turbeville and Locy violated NASD Rules 3010(b) and 2110 by failing to enforce the firm's procedures for safeguarding

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[45] Brookstone's procedures specifically advised its employees of the prohibition of disclosing client information over the telephone, or in response to an email, unless they clearly identified the person to whom they were communicating as either the client, a fiduciary representative of the client, or a party in need of the information to complete a transaction for the client, for example, "a clearing firm or other appropriate third party."

customer information. We also hold Brookstone liable for these violations.[46] *See CapWest Sec.*, 2013 FINRA Discip. LEXIS 4, at *28.

F. The Respondents' Evidentiary Objections

The respondents' appeal is premised largely on several claims that the Hearing Officer and Hearing Panel committed procedural error when they ruled on the propriety or admissibility of certain evidence. We have considered each of these claims, and we reject them all.

First, the respondents argue that the Hearing Officer unfairly restricted their ability to discover and present evidence concerning the prior investment experience of the customers whose accounts were highlighted in this case. Specifically, they find error in the Hearing Officer's decision to deny a February 28, 2011 pre-hearing motion, made under FINRA Rule 9252, seeking an order to compel FINRA Rule 8210 requests "to the ten largest FINRA clearing firms seeking documents for brokerage accounts related to any of the identified clients," including "all new account documents for [the eight customers identified in the complaint], and all monthly account statements from January 1, 2001 to [February 28, 2011]."[47] The respondents contend that such documents, to the extent they existed, would be relevant to their defense because the customers' investment experiences at other broker-dealers would shed light on the suitability of the recommendations that are at the center of this case.

FINRA Rule 9263(a) establishes the criteria for receiving and excluding evidence, and it provides that the Hearing Officer "shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial." The Hearing Officer is granted broad discretion to accept or reject evidence under this rule. *Dep't of Enforcement v. Strong*, Complaint No. E8A2003091501, 2008 FINRA Discip. LEXIS 19, at *17-18 (FINRA NAC Aug. 13, 2008). "Because this discretion is broad, the party arguing abuse of discretion assumes a heavy burden that can be overcome only upon showing that the Hearing Officer's reasons to admit or exclude the evidence were 'so insubstantial as to render . . . [the admission or

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[46] Pursuant to Sections 3(a)(39) and 15(b)(4)(E) of the Exchange Act, broker-dealers and individuals are subject to disqualification from the securities industry for, among other things, willful failures to reasonably supervise, with a view to preventing violations of the Exchange Act and Exchange Act rules, another person who commits such violations, if such person is subject to his supervision. 15 U.S.C. § 78c(a)(39), 15 U.S.C. § 78o(b)(4)(E). We find that the supervisory failures of Brookstone and Locy were willful, as alleged in the complaint, and that they are therefore subject to statutory disqualification as a result of the fraud that occurred here in violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5(b). Because no federal securities laws were violated as a result of Turbeville's supervisory violation, we decline to address whether his supervisory violations were also willful.

[47] The Hearing Officer also denied an April 25, 2011 "omnibus" motion in which the respondents renewed their request for an order to compel production of the documents sought in the February 28, 2011 motion.

exclusion] an abuse of discretion." *Id.* (citing *Omnipoint Corp. v. FCC*, 213 F.3d 720, 723 (D.C. Cir. 2000)).

We find no abuse of discretion in the Hearing Officer's decision to deny the respondents' motion. FINRA Rule 9252 provides, among other things, that a request that FINRA compel the production of documents shall be granted only upon a showing that "the information sought is relevant, material, and non-cumulative." FINRA Rule 9252(b). The Hearing Officer correctly concluded that the information sought by the respondents was irrelevant and immaterial to this proceeding.[48] Where, as here, excessive trading is not alleged and control of a customer's account is not an issue, "information about a customer's trading activity at other broker-dealers (before, during, or after the trading at issue) is irrelevant" to claims concerning the suitability of recommended transactions. *See Dep't of Enforcement v. Medeck*, Complaint No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *53-54 (FINRA NAC July 30, 2009); *see also Dist. Bus. Conduct Comm. v. Vaughan*, Complaint No. C07960105, 1998 NASD Discip. LEXIS 47, at *13 (NASD NAC Oct. 22, 1998) ("A customer's prior transactions . . . are not relevant in a suitability determination . . . ."). "What matters is the suitability of the trade(s) at issue." *Medeck*, 2009 FINRA Discip. LEXIS 7, at *54.

Second, the respondents assert that the Hearing Officer erred in denying their request to call a third expert witness, Dennis Pape ("Pape"), at the hearing.[49] The respondents' pre-hearing motion for leave to call Pape as an expert stated that he would testify regarding "general compliance issues, client risk disclosures, customs and practices related to the supervision of retail client accounts, the legal standards associated with the violations of federal securities laws asserted in the complaint and . . . apply this knowledge and experience to a review of the customer accounts referenced in the complaint."

We find no error in the Hearing officer's decision to deny the respondents' request to call Pape as an expert. FINRA Hearing Panels and the NAC act as expert bodies whose "business judgment" may be brought to bear in reaching decisions in the disciplinary process. *See Meyer*

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[48] In addition, the Hearing Officer found that the respondents' motion was overly broad and sought cumulative evidence, noting that the respondents already had within their possession information concerning the highlighted customers' accounts at other firms. Indeed, our de novo review of the extensive record found that account documents and account statements evidencing trading undertaken on the behalf of several of the customers, at firms other than Brookstone, were admitted as evidence during the hearing.

[49] Notwithstanding the respondents' request for leave to present Pape's testimony, the Hearing Officer permitted two other witnesses to testify as experts in the respondents' defense. As noted above, one of those experts, MacClaverty, testified before the Hearing Panel about his opinions concerning the suitability of the CMO transactions at issue in this case. The other, Faten Sabry, addressed generally the disclosures concerning CMOs that Turbeville and Kline provided to customers, but did not analyze the trading in Brookstone's customers' accounts and did not give any opinions on suitability.

Blinder, 50 S.E.C. 1215, 1222 n.32 (1992). Therefore, "the Hearing Officer's discretion to accept or reject expert testimony is particularly broad." *Dep't of Enforcement v. Fiero*, Complaint No. CAF980002, 2002 NASD Discip. LEXIS 16, at *89 (NASD NAC Oct. 28, 2002). We agree with the Hearing Officer's conclusion that Pape's proffered testimony was not necessary to the Hearing Panel's understanding of the evidence and issues at the center of this case. *See Cody*, 2011 SEC LEXIS 1862, at *71 ("[W]e find that Cody has not substantiated a need for expert testimony."); *see also Dep't of Enforcement v. Padilla*, Complaint No. 2006005786501, 2012 FINRA Discip. LEXIS 46, at *23 n.27 (FINRA NAC Aug. 1, 2012) ("[E]ven if the motion had been submitted, the respondents had not shown that expert testimony was necessary, particularly because the law is clear as to a broker's obligations when selling unregistered securities.").

Lastly, the respondents argue that the Hearing Panel erred by admitting hearsay evidence into the record by receiving the declarations of customers BB and HP, permitting the sons of two customers, JG and CP, to testify, and accepting the videotaped testimony of SB. We find no error in the Hearing Panel's admission of this evidence.

As an initial matter, "it is well-established that hearsay evidence is admissible in administrative proceedings and can provide the basis for findings of violation, regardless of whether the declarants testify." *Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *46-47 (Jan. 30, 2009). In determining whether to rely upon hearsay evidence, it is necessary to evaluate its probative value, reliability, and fairness of use. *Charles D. Tom*, 50 S.E.C. 1142, 1145 (1992). Factors to consider in this respect include, among other things, the type of hearsay at issue, whether the evidence is signed or sworn, whether the evidence is contradicted by direct testimony, and whether the evidence is corroborated. *Id.*

Consideration of these factors supports the conclusion that each of the foregoing pieces of evidence was probative, reliable, and fairly used in this case. The declarations of BB and HP were sworn under penalty of perjury and addressed directly the customers' dealings with Turbeville or Kline.[50] They were relevant and material, and the Hearing Panel properly admitted them. *See, e.g.*, *Wanda P. Sears*, Exchange Act Release No. 58075, 2008 SEC LEXIS 1521, at *10 n.16 (July 1, 2008); *Michael A. Rooms*, 58 S.E.C. 220, 223 n.8 (2005) ("We agree with the NASD that the declarations are reliable and probative."), *aff'd*, 444 F.3d 1208 (10th Cir. 2006).

We also find no error in the Hearing Panel's decision to allow the sons of JG and CP to testify in their stead. JG and CP were unwilling or unable to testify because of their advanced ages and physical and cognitive frailties. A third party nevertheless may be allowed to testify concerning an unavailable witness if the testimony is probative to the issues of the case and reliable. *See, e.g.*, *Edgar B. Alacan*, 57 S.E.C. 715, 729 (2004) ("We reject Alacan's argument

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[50] BB appeared at the hearing but was unable to give substantive testimony due to her advanced age and infirmities. HP died prior to the hearing. Their declarations, however, were prepared several years prior to the hearing and at a time when each witness was still competent to testify.

that it was improper to admit the testimony of [two witnesses] regarding Alacan's handling of their relatives' accounts."). CP's son testified that he too had an account with Kline that traded CMOs, he knew well CP's investment knowledge and experience, was present when CP established her account with Kline, and discussed his interactions with Kline concerning Kline's handling of CP's account. JG's son testified as to her limited investment experience and investment objectives, his personal efforts to understand and reconstruct the trading Kline conducted on his mother's behalf, and his dealings with Kline after JG decided to close her accounts. The testimony given by the sons of JG and CP was relevant and material and properly admitted as probative and reliable. *See id.* at 730 ("We consider the evidence probative because it relates directly to whether the customers authorized the trading at issue and, more generally, the nature of the customers' relationships with Alacan and the circumstances surrounding [his] handling of their accounts.").

We conclude too that the Hearing Panel properly accepted the videotaped testimony of SB, who was also unable to testify at the hearing due to his advanced age. SB testified under oath and was cross-examined by counsel for the respondents. He testified concerning his initial meetings with Kline, his discussions with Kline concerning the use of margin in his accounts, the process by which his account was moved to Brookstone, and his interactions with Kline concerning the performance of his Brookstone account. Although the respondents object that SB was not competent to testify because of his inability to remember certain events and conversations, his testimony was appropriately considered by the Hearing Panel.[51] *Cf. Field*, 2008 FINRA Discip. LEXIS 63, at *23 ("The Hearing Panel properly noted that although some of the elderly customers may have been mistaken with respect to each and every detail, the customers' testimony was candid, supported in certain circumstances by written notes, and consistent.").

V. Sanctions

A. The Respondents' Relevant Disciplinary Histories

The Sanction Guidelines ("Guidelines") instruct us to "always consider a respondent's disciplinary history in determining sanctions."[52] Therefore, before we assess sanctions for the

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[51] While the respondents, on one hand, argue that SB was not competent to testify, they also assert, on the other, that they should have been permitted to cross examine SB at greater length during his videotaped testimony. We find no evidence that the respondents were prejudiced in any manner in not being able to conduct a longer cross examination of SB given his advanced age and limited recall at the time.

[52] *See FINRA Sanction Guidelines* 2 (General Principles Applicable to All Sanction Determinations, No. 2), 6 (Principal Considerations in Determining Sanctions, No. 1) (2013), http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf [hereinafter *Guidelines*].

specific violations of the federal securities laws and FINRA rules for which the respondents are liable, we begin with a review of the respondents' relevant disciplinary histories.

On April 30, 2010, Brookstone settled FINRA disciplinary charges when it signed a Letter of Acceptance, Waiver, and Consent ("AWC"). FINRA censured the firm and fined it $17,500 for violating Exchange Act Rules 17a-3(a), 17a-3(a)(18), 17a-4, and 17a-4(b)(1), Article V, Section 2 of the FINRA By-Laws, and NASD Rules 6230, 3070, 3110(d), 3010(a)(7), and 2110. Brookstone consented to findings that it failed to ensure that all of its registered personnel participated in the firm's annual compliance meeting; failed to timely update a registered representative's Form U4 to disclose required information, failed to timely disclose customer complaints, failed to report quarterly statistical and summary information regarding customer complaints, failed to create and maintain records of customer complaints, failed to report transactions to TRACE, and failed to evidence the creation and maintenance of order tickets in certain corporate bond sales transactions.

Brookstone and Locy also agreed to settle FINRA disciplinary charges when they executed an AWC on May 23, 2011. In this matter, Brookstone and Locy consented to findings that they failed to reasonably supervise the firm's activities, in violation of NASD Rules 3010 and 2110, and FINRA Rule 2010. Brookstone and Locy were fined, jointly and severally, $25,000 for this misconduct.[53] Specifically, the AWC stated that Brookstone, acting through Locy, had no written supervisory procedures addressing due diligence requirements for third-party private placements. Moreover, the firm and Locy failed to conduct an adequate due diligence of a third-party private placement offering before Locy approved the offering. Among other things, Locy's due diligence did not include any investigation into the offering, and instead, despite knowing very little about the offering and having limited information at his disposal, he relied on the opinions of the firm representatives that formed the offering and their claims that they had conducted adequate due diligence.

On August 8, 2011, FINRA issued an AWC in which Brookstone agreed to a censure and a $15,000 fine for violating Article V, Sections 2 and 3 of the FINRA By-Laws, NASD Rule 3070 and IM-1000-1, and FINRA Rules 1122 and 2010.[54] The firm consented to findings that it failed to update or timely amend Forms U4 and U5 with required information and provided inadequate information in connection with filings made pursuant to NASD Rule 3070.

On September 27, 2011, Brookstone, Turbeville, and Locy agreed to an order accepting an offer of settlement in an additional disciplinary matter. Under the terms of the settlement, Brookstone was censured and fined $200,000, and Turbeville and Locy each were suspended for three months from acting in any principal capacity and fined $10,000. The settlement was based on findings that the firm violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, NASD

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[53] As is noted above, FINRA summarily expelled Brookstone from membership on October 9, 2012, for failing to pay this fine. FINRA also summarily revoked Locy's registrations on October 9, 2012, for his failure also to pay this fine.

[54] FINRA expelled Brookstone on October 17, 2012, for its failure to pay this fine as well.

Rules 3010(a) and (b), 2510, 2310, 2120, and 2110, and FINRA Rules 2020 and 2010. Specifically, Brookstone, acting through its registered representatives, made misrepresentations and omissions of material fact in connection with unsecured bridge notes and warrants, provided unwarranted price predictions to customers regarding the future price of common stock for which warrants would be exchangeable, failed to disclose any risks associated with the investments to customers, including that customers could lose all of their money, guaranteed to customers they would receive back their principal investments plus returns, made unsuitable investment recommendations given the financial circumstances and condition of the customers, and exercised discretion in customer accounts without prior written authorization or acceptance of the accounts as discretionary by the firm. Additionally, Brookstone, acting through Turbeville and Locy, failed to reasonably supervise a registered representative, failed to follow up on red flags that should have alerted them to the need to investigate the firm's sales practices, and failed to establish, maintain and enforce supervisory procedures reasonably designed to achieve compliance with the federal securities laws and FINRA rules. Among other things, Turbeville, as the firm's chief executive officer, was found to have been aware of the lack of supervisory controls to prevent and detect unsuitable recommendations resulting from excessive trading, excessive use of margin, and the over concentration of accounts, knew that the firm's account application process was flawed so that the reviewing principal was unable to obtain an accurate picture of the financial status and investment objectives of its customers, and failed to act. Locy, then the firm's president, also was aware of a representative's frequent appearance on an active trading report, and was responsible for addressing exceptions on the report, but took no steps to contact the registered representative's customers or place the representative on heightened supervision. Instead, Locy initialed the report and noted that the exceptions had been cleared.

Kline settled a FINRA disciplinary action on June 18, 2012. As a result of the settlement, Kline was suspended in all capacities for nine months, fined $10,000, and ordered to pay $67,523.67 in disgorgement. Kline consented to findings that he violated NASD Rules 3040 and 2010 by participating in variable insurance policy transactions away from his firm after introducing customers to a third party for the purpose of making tax-advantaged investments, attending and participating in meetings regarding tax planning, facilitating paperwork for the investments, and receiving compensation from the transactions without notifying Brookstone of his role in the transactions or the selling compensation he was due to receive from them.

Finally, on July 23, 2012, Locy settled a FINRA disciplinary matter, agreeing to pay a $5,000 fine and serve a three-month suspension in any principal capacity. The settlement was based on findings that Locy, as Brookstone's president, violated NASD Rules 3010(a) and 2110, and FINRA Rule 2010, by failing to conduct, or taking steps to ensure others within the firm conducted, reasonable due diligence regarding two oil and gas private placement offerings. Specifically, Locy failed to review the due diligence package provided by the issuer, any marketing materials, and third-party due diligence reports available to him.

The sanctions previously imposed on Brookstone, Turbeville, Kline, and Locy in the foregoing disciplinary matters serve, in part, to frame our assessment of sanctions for their misconduct in this matter. As the Guidelines state, in order to deter and prevent future

misconduct, sanctions imposed in the disciplinary process should be more severe for recidivists.[55] The respondents' relevant disciplinary histories include past misconduct similar to that at issue here and evidence a disregard for fundamental regulatory requirements, the need for investor protection, and the importance of commercial integrity.[56] Having considered the foregoing matters in our assessment of sanctions, we judge them further evidence that each of the respondents poses a risk to the investing public and severe and stringent sanctions are in order to confront those risks. *See John Joseph Plunkett*, Exchange Act Release No 69766, 2013 SEC LEXIS 1699, at *48 (June 14, 2013) ("FINRA properly considered these matters in assessing sanctions because they evidence a disregard for regulatory requirements and are further evidence that he poses a risk to the investing public absent a bar."); *Joseph Ricupero*, Exchange Act Release No. 62891, 2010 SEC LEXIS 2988, at *24 (Sept. 10, 2010) (considering respondent's disciplinary history and finding that it was further evidence that he poses a risk to the investing public should he re-enter the securities industry), *aff'd*, 436 F. App'x 31 (2d Cir. 2011).

B. Suitability Violations

The Hearing Panel fined Brookstone $300,000, and barred Turbeville and Kline from associating with any FINRA member in any capacity, for violating NASD Rules 2310(a) and 2110. We concur in the Hearing Panel's assessment of sanctions for the suitability violations that occurred here.

The Guidelines for making unsuitable recommendations recommend a fine of $2,500 to $75,000.[57] They further recommend a suspension in any or all capacities for a period of 10 business days to a year for an individual respondent or, in egregious cases, a longer suspension of up to two years or a bar.[58] In assessing sanctions for suitability violations, we also consider the "Principal Considerations in Determining Sanctions" that apply to all violations of FINRA rules.[59]

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[55] *See Guidelines*, at 2 (General Principles Applicable to All Sanction Determinations, No. 2.

[56] *See id.*

[57] *Guidelines*, at 94 (Suitability-Unsuitable Recommendations). The Guidelines recommend also increasing the recommended fine amount by adding the amount of the respondent's financial benefit or requiring the respondent to offer rescission to the injured customers. *Id.* at 94 n.2.

[58] *Id.* at 94. For a violation involving a member firm, the Guidelines also recommend suspending the firm with respect to any or all activities or functions for up to two years. *Id.* Because FINRA previously expelled Brookstone from membership, we need not consider the appropriateness of suspending some or all of the firm's activities for their suitability violations in this case. *See CapWest Sec.*, 2013 FINRA Discip. LEXIS 4, at *30 n.24.

[59] *Guidelines*, at 94.

We agree with the Hearing Panel that the suitability violations that occurred here were egregious. Turbeville and Kline breached an important duty that is fundamental to the relationship between registered representatives and their customers when they recommended CMOs for the accounts of the seven highlighted customers. *See Stephen W. Wilson*, Complaint No. 2007009403801, 2011 FINRA Discip. LEXIS 67, at *47 (FINRA NAC Dec. 8, 2011) ("Wilson's unsuitable recommendations were in serious breach of his duty to his customers."); *see also Klein*, 52 S.E.C. at 1036-37 ("The NASD's suitability rule . . . is based upon the 'fundamental responsibility for fair dealing' that is implicit in the relationship between a registered representative and his customers." (quoting *John M. Reynolds*, 50 S.E.C. 805, 809 n.13 (1991))). They each engaged in an obvious course of conduct that was without any apparent concern for their customers' understanding of the risks involved with their recommendations or willingness to accept those risks. *See Wilson*, 2011 FINRA Discip. LEXIS *47; *cf. Keel*, 51 S.E.C. at 284 (finding that a registered representative must be "satisfied that the customer fully understands the risks involved and is not only able but willing to take those risks" when recommending an investment).

We consider it highly aggravating that Turbeville and Kline, without any meaningful supervision or oversight by Brookstone and Locy, engaged in a clear and systematic pattern of misconduct, and abused the trust and confidence placed in them by their customers, by recommending large numbers of unsuitable transactions over an extended period of time.[60] *See Dep't of Enforcement v. Dunbar*, Complaint No. C07050050, 2008 FINRA Discip. LEXIS 18, at *38 (FINRA NAC May 20, 2008) ("Dunbar engaged in his unsuitably risky course of trading for more than 13 months."); *see also Dep't of Enforcement v. Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *94 (FINRA NAC Dec. 20, 2007) ("Given that Epstein made unsuitable recommendations to at least 12 customers over a period of several months, we find that Epstein systematically failed to uphold high standards of commercial honor."), *aff'd*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3rd Cir. 201). The seven customers whose accounts are at issue in this case were elderly and retired, lacked financial sophistication, and relied on Turbeville and Kline for their investment advice.[61] *See Cody*, 2011 SEC LEXIS 1862, at *80 ("The Customers entrusted Cody with considerable discretion over their retirement savings and, based on Cody's assurances, believed that he was acting in their interest."); *Dep't of Enforcement v. Kelly*, Complaint No. E9A2004048801, 2008 FINRA Discip. LEXIS 48, at *31 (FINRA NAC Dec. 16, 2008) ("GM was not a sophisticated investor, and because of his limited investment experience, he relied heavily on Kelly."); *Epstein*, 2007 FINRA Discip. LEXIS 18, at *94 ("Epstein's misconduct involved injury to numerous retired, elderly, and unsophisticated customers . . . ."); *see also Klein*, 52 S.E.C. at 1040 ("Klein knew that his customers were not experienced or sophisticated investors and that they could not afford to gamble with their limited savings."). After gaining their trust, Turbeville and Kline routinely purchased complex, risky CMOs for the customers' accounts, exposed them to substantial risks of loss at a time when they could least afford it, and

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60 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, Nos. 5, 8, 9).

61 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 19).

often replaced purchased CMOs with others of similar complexity and risk, in which case they subjected customers to actual losses of principal while garnering for themselves healthy commissions.[62]

In this respect, we find that Turbeville's and Kline's "trading over a course of years was not just risky, but extremely so." *See Dep't of Enforcement v. Murphy*, Complaint No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *113 (FINRA NAC Oct. 20, 2011), *aff'd*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933 (July 12, 2013). Because Turbeville and Kline compounded the risks of their trading by concentrating the customers' accounts in inverse floaters and, for some customers, by using margin to support greater levels of trading, we conclude that they exhibited an intentional or reckless disregard of their suitability obligations.[63] *See Murphy*, 2011 FINRA Discip. LEXIS 42, at *113 ("The record demonstrates that Murphy acted with intent."); *see also Dunbar*, 2008 FINRA Discip. LEXIS 18, at *38 ("Dunbar's suitability violations were reckless at best, and intentional at worst."); *Dep't of Enforcement v. Siegel*, Complaint No. C05020055, 2007 NASD Discip. LEXIS 20, at *48-49 (NASD NAC May 11, 2007) ("Siegel's recommendations of World ET securities involved an extreme departure from the standards of ordinary care, especially considering the trust that Siegel knew his customers placed in him."), *aff'd*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008), *aff'd in part*, 592 F.3d 147 (D.C. Cir. 2010). Finally, we find it extremely troubling that Turbeville and Kline have not during this proceeding accepted any responsibility for their misconduct, arguing instead that they simply recommended to their customers the risky investments that the customers desired and that the customers were at fault for not staying the course until interest rates dropped at some point in the future.[64] *See Wilson*, 2011 FINRA Discip. LEXIS 67, at *49 ("Wilson's own misunderstanding of his unequivocal suitability obligations warrants significant sanctions."); *Epstein*, 2007 FINRA Discip. LEXIS 18, at *98-99 ("Epstein's failure to accept responsibility for his own actions and his continued blame of others for the circumstances that have occurred are aggravating factors that we have considered in reaching our conclusion that a bar is an appropriate sanction in this case."); *see also Dunbar*, 2008 FINRA Discip. LEXIS 18, at *40 ("While Dunbar clearly regrets how events unfolded . . . he continues to dispute that his conduct violated the suitability rule.").

In light of our duty to protect the investing public and ensure the integrity of the market, we find we must act decisively in this case, as we have done in similar cases, where the evidence proves that the respondents were indifferent to their duties to ensure that they recommend suitable transactions to their customers. *See Epstein*, 2007 FINRA Discip. LEXIS 18, at *100-01 ("Epstein's demonstrated insouciance and indifference towards his responsibilities under NASD rules poses a serious risk to the investing public."). Because the securities industry "'presents a great many opportunities for abuse and overreaching, and depends heavily on the integrity of its

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62 *Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 11, 17, 18).

63 *Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 13).

64 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 2).

participants,'" we conclude that barring Turbeville and Kline is necessary to prevent them from inflicting the same harm upon customers that they inflicted upon their customers in this case. *See id.* (quoting *Bernard D. Gorniak*, 52 S.E.C. 371, 373 (1995)); *see also Gerald J. Kesner*, Complaint No. 2005001729501, 2010 FINRA Discip. LEXIS 2, at *52 (FINRA NAC Feb. 26, 2010) ("To ensure that Kesner causes no similar harm to the investing public in the future . . . we bar Kesner from associating with any member firm in any capacity."). A bar will also serve to deter others from engaging in similar misconduct. *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005) ("Although general deterrence is not, by itself, sufficient justification for expulsion or suspension, we recognize that it may be considered as part of the overall remedial inquiry.").

Accordingly, and consistent with the Hearing Panel's assessment of sanctions, we bar Turbeville and Kline from acting in any capacity with any FINRA member and fine Brookstone $300,000 for their suitability-related violations.[65]

C. Fraud

The Hearing Panel censured and fined Brookstone $500,000, and barred Turbeville and Kline from associating with any FINRA member in any capacity, for committing fraud in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110. We affirm these sanctions.

The Guidelines for intentional or reckless misrepresentations or material omissions of fact recommend a fine of $10,000 to $100,000, suspending an individual in any or all capacities for a period of 10 days to two years, and suspending the firm with respect to any or all activities or functions for a period of 10 business days to two years.[66] In egregious cases, the Guidelines recommend barring an individual and expelling the firm.[67]

We have no doubt, based on the record before us, that Turbeville's and Kline's material misrepresentations and omissions were egregious. Their misrepresentations and failures to disclose material risks associated with the CMOs they recommended and purchased for their customers' portfolios deprived the customers of the opportunity to make informed decisions and to assess whether the trading undertaken in the accounts served their best interests. *See Field*, 2008 FINRA Discip. LEXIS 63, at *41 ("Field's violations were egregious. Field knowingly and intentionally provided his customers with false information while recommending the bonds

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65 The recommended ranges in the Guidelines are not absolute and we may, for instance in an egregious case, impose a sanction above or otherwise outside of a recommended range. *Guidelines*, at 3 (Technical Matters No. 3). Given the extent and egregious nature of the violations at issue here, and conscious of the firm's prior disciplinary history, we conclude that a $300,000 fine serves as an appropriately remedial sanction against Brookstone in this case.

66 *Guidelines*, at 88 (Misrepresentations or Material Omissions of Material Fact).

67 *Id.*

and abrogated his duty to provide full disclosure to his customers."); *Dep't of Enforcement v. Frankfort*, Complaint No. C02040032, 2007 NASD Discip. LEXIS 16, at *41 (NASD NAC May 24, 2007) ("Frankfort totally disregarded his duty of fair dealing to his customers, including his obligation to disclose negative information about a recommended investment."). Turbeville and Kline instead exploited their positions of trust and confidence to serve their own interests. *See Dratel*, 2014 FINRA Discip. LEXIS 6, at *112 & n.74 ("We find it further aggravating that Dratel disregarded his fiduciary obligations."); *Keel*, 51 S.E.C. at 287 ("Keel has exhibited a disturbing lack of understanding about a registered representative's fiduciary duty to his clients and about the risks involved in options trading.").

As with our assessment of sanctions for their suitability violations, we also consider the Principal Considerations in Determining Sanctions that apply to all violations of FINRA rules in our assessment of the sanctions to impose for Turbeville's and Kline's fraud.[68] In this respect, Turbeville's and Kline's misconduct is marked by a number of factors, discussed in greater length in the previous section, that serve to aggravate their misconduct for the purpose of assessing sanctions. These aggravating factors include: the pattern of misconduct in which Turbeville and Kline engaged and the extended period of time over which it occurred; the breadth and character of their misconduct; the vulnerability of their unsophisticated customers; the real and potential injuries to the customers that resulted from their misconduct; their obvious monetary gain; and their persistent refusal to accept responsibility for their actions.

"The risk posed to the investing public by associated persons who engage in fraud is profound and obvious." *Alvin W. Gebhart*, Exchange Act Release No. 58951, 2008 SEC LEXIS 3142, at *46 (Nov. 14, 2008), *aff'd*, 595 F.3d 1034 (9th Cir. 2010). We conclude that the failure of Turbeville and Kline to abide in this case by their duty to refrain from misrepresenting material facts, and to disclose all material facts related to their investment recommendations, warrants the severest of sanctions. *See Marshall E. Melton*, 56 S.E.C. 695, 713 (2003) ("[C]onduct that violates the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions . . . ."). Under these circumstances, we agree with the Hearing Panel that Turbeville and Kline pose too great a risk to the investing public to be permitted to remain in the securities industry. *See Gebhart*, 2008 SEC LEXIS 3142, at *46; *see also Keel*, 51 S.E.C. at 287 ("For the protection of investors, Keel must be excluded from the securities business."); *Field*, 2008 FINRA Discip. LEXIS 63, at *44 ("Under the circumstances, and in light of the numerous aggravating factors associated with Field's egregious misconduct, we find that barring Field in all capacities is the only effective remedial sanction.").

Accordingly, we impose additional bars on Turbeville and Kline that will prevent them from associating with any FINRA member in any capacity. We also censure and fine Brookstone $500,000 for its role in their fraud.[69]

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68 *Guidelines*, at 88.

69 *See infra* n.65.

D. Violations of NASD Rule 2210 Content Standards

The Hearing Panel fined Brookstone $50,000 for the public communications that Turbeville used in this case, in violation of NASD Rules 2210(d)(1)(A) and 2210(d)(1)(B) and NASD Rule 2110.[70] We affirm this sanction.

The Guidelines for inadvertent misleading communications with the public, and communications that otherwise violate the content standards of NASD Rule 2210, recommend imposing a fine of $1,000 to $20,000, suspending the firm in any or all activities or functions for up to six months, or in egregious cases up to one year, and suspending the responsible individual in any or all capacities for up to 60 days.[71] In cases involving intentional or reckless conduct, the Guidelines recommend a fine of $10,000 to $100,000 and suspending the firm and responsible person for up to two years.[72] Where numerous acts of intentional or reckless misconduct occur over an extended period of time, the Guidelines recommended suspending the firm and responsible individual for up to two years or expelling the firm and barring the responsible individual.[73] A principal consideration in this context is whether the violative communications were circulated widely.[74]

We conclude that Turbeville's misconduct and his use of misleading public communications was in this case widespread and, at a minimum, reckless. *See Dep't of Enforcement v. Jordan*, Complaint No. 2005001919501, 2009 FINRA Discip. LEXIS 15, at *46 (FINRA NAC Aug. 21, 2009) ("Jordan's omission of her conflicts of interest and her financial interest could only have been made with reckless indifference to her duty to disclose."). Turbeville sent letters to his CMO customers in an effort to quell their concerns about the performance of their accounts and, presumably, to dissuade customers from moving their accounts or filing complaints. Turbeville misled his customers about the substantial decline in the value of their CMO portfolios and implied, falsely, that the customers' investments were safe by downplaying the risks involved with their portfolios and suggesting wrongly that their portfolios would quickly and steadily return principal and interest despite the obvious interest rate and other risks associated with the CMOs purchased for their accounts.

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[70] The Hearing Panel found, in light of Turbeville's intentional misconduct in violation of NASD Rule 2210 content standards, that a significant fine against Turbeville was in order. In light of the bars imposed for Turbeville's other misconduct, however, it concluded that a fine would not serve a remedial purpose in this case, and it declined to impose one. We see no error in this decision.

[71] *Guidelines*, at 79-80 (Communications With the Public—Late Filing; Failing to File; Failing to Comply With Rule Standards or Use of Misleading Communications).

[72] *Id.* at 80.

[73] *Id.*

[74] *Id.* at 79.

Turbeville violated important safeguards for the protection of public investors. *See Robert L. Wallace*, 53 S.E.C. 989, 996 (1998). We conclude that the sanction imposed by the Hearing Panel, which is within the range of recommended sanctions in the Guidelines, strikes an appropriately remedial purpose for Brookstone's role in this misconduct. In light of the foregoing, we fine Brookstone $50,000 for violating NASD Rules 2210(d)(1)(A) and 2210(d)(1)(B) and NASD Rule 2110.

E. Supervision Violations

Applying the Guidelines for a failure to supervise, the Hearing Panel fined Brookstone $50,000 and barred Locy from acting in any supervisory or principal capacity for any FINRA member for violating NASD Rules 2510(c) and 2110 by failing to review discretionary accounts. Applying the same Guidelines, the Hearing Panel further fined Brookstone $100,000, barred Locy from acting in any supervisory or principal capacity and suspended him for a period of two years in all capacities, and fined him $25,000 for failing to supervise the firm's activities and enforce the firm's procedures for the safeguarding of customer information, in violation of FINRA Rules 3010(b) and 2110. We modify these sanctions, in part, by imposing unitary sanctions for all supervision-related violations.[75]

For a failure to supervise, the Guidelines recommend a fine of $5,000 to $50,000 and a suspension of the responsible individual for up to 30 business days.[76] In egregious cases, the Guidelines recommend "suspending the responsible individual in any or all capacities for up to two years or barring the responsible individual."[77] Finally, in determining the proper remedial sanctions, the Guidelines for a failure to supervise recommend that adjudicators consider three principal considerations: 1) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny; 2) the nature, extent, and character of the underlying misconduct; and 3) the quality and degree of the implementation of the firm's supervisory procedures and controls.[78]

We conclude that the supervisory failures that occurred in this case were egregious. The quality and level of Locy's implementation of Brookstone's supervisory controls was fundamentally flawed. He plainly marginalized numerous duties imposed on him by the firm's

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[75] The Hearing Panel's decision stated that the panel would have also suspended and fined Turbeville for his role on the firm's failure to enforce Brookstone's procedures regarding the safeguarding of customer information. In light of the bars imposed for his other misconduct, however, the Hearing Panel determined that additional sanctions for Turbeville's violations of NASD Rule 3010(b) and 2110 would serve no remedial purpose. We find no error in this conclusion.

[76] *Guidelines*, at 103 (Supervision—Failure to Supervise).

[77] *Id.*

[78] *Id.*

written procedures and ignored potent red flags. Where he should have been a line of defense against Turbeville's and Kline's egregious misconduct, he intentionally abdicated or recklessly disregarded his tasks to supervise them, including their discretionary trading of CMOs for numerous low-risk, unsophisticated senior and retired customers and the use of margin to leverage the accounts of some of these customers. His lax supervision resulted in Turbeville and Kline repeatedly making unsuitable recommendations and, through their misrepresentations and omissions, misleading customers as to the risks involved with their CMO trading over an extended period of time. His supervisory lapses resulted in real and substantial harm to the customers, and allowed Turbeville, Kline, and the firm to enrich themselves at the expense of their customers.

"Proper supervision is the touchstone to ensuring that broker-dealer operations comply with the securities laws and [FINRA] rules." *Dennis S. Kaminski*, Exchange Act Release No. 65347, 2011 SEC LEXIS 3225, at *35 (Sept. 16, 2011) (citing *Rita H. Malm*, 52 S.E.C. 64, 68 (1994)). Although Locy's abandonment of his supervisory responsibilities led to a clear breakdown in Brookstone's compliance systems and culture, he accepts no responsibility for this result. His "refusal to recognize his misconduct 'reveal[s] a fundamental misunderstanding of his supervisory duties'" and is an aggravating factor that supports the definitive sanctions we impose. *See Pellegrino*, 2008 SEC LEXIS 2843, at *66 (quoting *Stephen J. Horning*, Exchange Act Release No. 56886, 2007 SEC LEXIS 2796, at *45 (Dec. 3, 2007)).

Consequently, we agree with the Hearing Panel that barring Locy from serving in a principal or supervisory capacity is necessary to protect investors and remedy his misconduct. *See id.* at 66 ("The principal bar will protect investors from dealing with securities professionals who are not adequately supervised." (Internal quotation omitted)); *see also Dep't of Enforcement v. Lane*, Complaint No. 20070082049, 2013 FINRA Discip. LEXIS 34, at *95 (FINRA NAC Dec. 26, 2013) ("[W]e find that Jeffrey Lane's supervisory failures were egregious and that he poses a risk to investors were he to act as a principal or supervisor again."), *aff'd*, Exchange Act Release No . 74269, 2015 SEC LEXIS 558 (Feb. 13, 2015). We further conclude that suspending him for a period of two years in all capacities and imposing a $25,000 fine will impress on him and others the necessity of following the federal securities laws and FINRA rules. *See Kaminski*, 2011 SEC LEXIS 3225, at *43 ("[A] suspension . . . in all capacities will have the remedial effect of protecting the investing public from harm . . . ."). Finally, we fine Brookstone $150,000.[79]

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[79] In cases involving egregious misconduct, the Guidelines for a failure to supervise further recommend that FINRA adjudicators consider limiting or suspending the firm with respect to any or all activities or functions for up to two years or an expulsion of the firm. *Guidelines*, at 103. Because Brookstone was expelled from FINRA membership, we conclude that these elements of the Guidelines for supervisory violations are inapplicable here. *See CapWest Sec.*, 2013 FINRA Discip, LEXIS 4, at *30 n.24.

F. Restitution

The Guidelines instruct us to order restitution where it is appropriate to remediate misconduct and is necessary to restore the status quo ante for victims who would otherwise unjustly suffer loss.[80] The Hearing Panel ordered Brookstone, Turbeville, and Kline to make full restitution to the seven highlighted customers for the losses they suffered during the period of July 2005 through July 2007. We affirm the Hearing Panel's decision to order restitution to these customers.

We may order restitution "when an identifiable person . . . has suffered a quantifiable loss proximately caused by a respondent's misconduct."[81] Proximate causation generally refers to "'[a] cause that directly produces an event and without which the event would not have occurred.'" *United States v. Paroline*, 672 F. Supp. 2d 781, 791 (E.D. Tex. 2009) (quoting *Black's Law Dictionary* 234 (8th ed. 2004)0. Neither the Commission nor the courts, however, have adopted a single, definitive expression of what constitutes "proximate causation." *See United States v. Monzel*, 746 F. Supp. 2d 76, 85 (D.D.C. Oct. 22, 2010) ("[T]here is no single approach to proximate causation in either the federal or state courts . . . ."); *see also Michael Frederick Siegel*, Exchange Act Release No. 62324, 2010 SEC LEXIS 2015, at *3 (June 18, 2010) (setting aside order of restitution in a NASD disciplinary proceeding but declining to articulate the causation standard required under the Guidelines). Some courts focus upon the "foreseeability" of the harm caused by a wrongdoer's actions, while other courts focus upon whether the harm caused is a "temporal" consequence of the misconduct. *See generally Monzel*, 746 F. Supp. 2d at 85 (citing Restatement (Third) of Torts §29 cmts. (2010)). More recently, courts have incorporated a "substantial factor" test, which asks whether a wrongdoer's conduct was a substantial factor in producing a victim's harm, or a "materialization of the risk" approach, where a harm suffered was the product of the zone of risks that made the actor's conduct unlawful. *See id.* at 85-86; *see also Nuveen Mun. High Income Opportunity Fund v. City of Alameda*, 730 F.3d 1111, 1120 (9th Cir. 2013) ("These principles of loss causation are well established . . . .").

We need not, for purposes of ordering restitution in this case, pick one of the foregoing notions of proximate causation to the exclusion of all others. We conclude that, using any one of the tests articulated above, the losses suffered by the seven highlighted customers were the foreseeable, direct, and proximate result of the responsible respondents' misconduct. The customers' losses arose out of and were substantially the result of the decision of Brookstone, Turbeville, and Kline to recommend highly-risky CMOs to customers for whom those investments were clearly and unmistakably unsuitable, and they no doubt fall within the scope of the considerable risks associated with those investments and which the respondents withheld from the customers in the course of making their recommendations. *See David Joseph Dambro*, 51 S.E.C. 513, 518-19 (1993) ("As between Wiegman, who was placed in an unsuitable investment and Dambro, who recommended it, equity requires Dambro, as the person

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80 *Guidelines*, at 4 (General Principles Applicable to All Sanction Determinations, No. 5).

81 *Guidelines*, at 4.

responsible for the loss, to bear its burden and to return the customers to the position occupied prior to improper recommendation."); *see also Yankee Fin. Grp., Inc.*, 2006 NASD Discip. LEXIS 21, at *85 (noting that FINRA has ordered respondents to pay restitution in cases involving fraudulent solicitations and unsuitable recommendations (collecting cases)).

The preponderance of the evidence shows that, collectively, the seven highlighted customers suffered losses totaling $1,620,100 as a direct result of the unsuitable recommendations and fraudulent misconduct of Brookstone, Turbeville, and Kline during the period of July 2005 through July 2007.[82] We therefore order that Turbeville and Kline pay restitution, jointly and severally with Brookstone, to these customers in the following amounts.[83] *Cf. SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1476 (2d Cir. 1996) (permitting joint and several liability for securities violations). Brookstone and Turbeville shall pay restitution to the MRs, BC, and BV in the sums of $414,800, $22,100, and $3,700, respectively. And, Brookstone and Kline shall pay to CP, JG, the estate of HP, and SB restitution in the sums of $551,800, $342,100, $258,800, and $26,800, respectively.[84]

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[82] FINRA staff calculated these losses by totaling all account gains and losses during the relevant period, after adjusting for any deposits or withdrawals and excluding the performance of any investments other than CMOs. We find this to be an appropriate measurement or quantification of loss in this case. *Cf. United States v. Savoie*, 985 F.2d 612, 617 (1st Cir. 1993) ("[T]he preponderance standard must be applied in a practical, common-sense way. So long as the basis for reasonable approximation is at hand, difficulties in achieving exact measurements will not preclude a trial court from ordering restitution.").

[83] Restitution paid in this case shall include prejudgment interest, which shall accrue from July 31, 2007, until paid. The prejudgment interest rate shall be the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a). *Guidelines*, at 9 (Technical Matters).

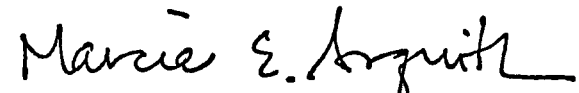
[84] During the hearing, the respondents testified that they had entered into settlements or were in settlement discussions with a few of these customers. The nature of the claims covered by these settlements and their amounts, however, are unclear from our review of the record. We therefore cannot determine the merits of the respondents' entitlement to an offset against the restitution ordered to be paid to customers. *Cf. Montford & Co.*, Investment Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *100 (May 2, 2014) ("The record contains no information about the basis for this suit or the settlement amount."). We therefore order that full restitution be paid to each of the customers, with such amounts offset by any sums that Brookstone, Turbeville, and Kline can prove that they have already paid to a customer for the misconduct at issue in this matter. *Cf. SEC v. Palmisano*, 135 F.3d 860, 863-64 (2d Cir. 1998) (modifying judgment "to provide that to the extent Palmisano pays or has paid restitution . . . , such payments will offset his disgorgement obligation under the present judgment"); *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 SEC LEXIS 3015, at *72 n.106 (Dec. 21, 2007) ("Repayments that Disraeli proves he made could offset his disgorgement."). Moreover, where customers cannot be located, unpaid restitution should be paid to the

[Footnote continued on next page]

VI. Conclusion

We affirm the Hearing Panel's findings that Brookstone, Turbeville and Kline made unsuitable recommendations to customers and committed fraud; Brookstone and Turbeville issued letters to customers that violated the content standards applicable to all FINRA member communications with the public; Brookstone and Locy failed to review customer discretionary accounts; and Brookstone, Locy, and Turbeville failed to enforce and maintain the firm's written supervisory procedures and supervise reasonably the activities of the firm's registered representatives. Consequently, and in summary, Brookstone is hereby censured and fined $1,000,000 for the foregoing violations; Turbeville and Kline are barred from associating with any FINRA member both for their violating FINRA suitability standards and for committing fraud; Locy is barred from acting in any supervisory or principal capacity, suspended in all capacities for a period of two years, and fined $25,000; and Brookstone, Turbeville, and Kline shall pay to their respective customers, jointly and severally, restitution totaling $1,620,100, plus prejudgment interest. We also affirm the Hearing Panel's order that Brookstone, Turbeville, Kline, and Locy pay, jointly and severally, hearing costs totaling $27,047.55, and we impose appeal costs, jointly and severally, of $1,610.38.[85]

On Behalf of the National Adjudicatory Council,



Marcia E. Asquith,
Senior Vice President and Corporate Secretary

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appropriate escheat, unclaimed property, or abandoned property fund for the states of the customers' last known residences.

[85] Pursuant to FINRA Rule 8320, the registration of any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be revoked for non-payment.