

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

THE DRATEL GROUP, INC. (BD No. 8049),

and

WILLIAM M. DRATEL (CRD No. 843025),

Respondents.

COMPLAINT

DISCIPLINARY PROCEEDING
No. 2008012925001

The Department of Enforcement alleges:

SUMMARY

1. This case involves an unfair trade allocation scheme, commonly known as "cherry-picking," by Respondent William M. Dratel, the owner, President and sole broker of Respondent The Dratel Group, Inc. ("DGI"). From October 2005 through at least December 31, 2006, Dratel cherry-picked profitable day trades (i.e., a purchase and sale, or short sale and purchase to cover, of a security within a single trading day), and "overnight trades," (i.e., a purchase and sale, or short sale and purchase to cover, of a security within two consecutive trading days) for his own account while steering unprofitable trades to his discretionary clients' accounts. Dratel accomplished this by purchasing a security in DGI's firm account and then delaying the allocation of the security until after he saw whether it *had* appreciated in value. Dratel disproportionately allocated the profitable day trades and overnight trades (collectively

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“short term trades”) to his personal account and allocated unprofitable (or less profitable) short term trades to clients for whom he had discretionary trading authority.

2. During this 15 month period, there were no significant differences between the short term trades that Dratel allocated to his personal account and the short term trades that he allocated to his discretionary customers. Yet, during this period Dratel earned profits on over 80% of his personal short term trades, totaling over \$530,000 and resulting in a return of over 1000%, while his 25 most active discretionary customers (the “Discretionary Customers”) sustained losses on over 70% of their short term trades, collectively totaling a net loss of over \$180,000. Moreover, Dratel frequently took the first profitable short term trade of the day from the firm account for himself *before* allocating any short term trades to Discretionary Customers.

3. Because Dratel was DGI’s sole owner, principal and broker, he was able to carry out his scheme unchecked. Moreover, in carrying out the scheme, Dratel improperly time stamped blank order tickets and completed them, or caused them to be completed, after a trade had been allocated, creating the false impression that the trades were allocated timely.

4. By engaging in the conduct alleged in this complaint, the Respondents violated antifraud and record-keeping provisions of the federal securities laws and NASD rules.

5. Moreover, Respondents failed to maintain and implement appropriate supervisory systems and procedures to prevent the improper post-execution allocation of trades. Until 2007, DGI had no supervisory systems or written supervisory procedures concerning the allocation of trades among discretionary accounts or the proper completion of order tickets. In 2007, DGI updated its written supervisory procedures. However, the updated procedures did not ensure that allocation instructions be formulated before the time a transaction was executed through the Firm Account or that the customer account name be placed upon the order ticket before a customer

order is executed. Accordingly, even the updated supervisory systems and written supervisory procedures were insufficient to prevent delayed allocations.

6. In addition, the Respondents committed several violations unrelated to cherry-picking, including (i) failing to record the time that equity orders were originated or received in seconds in violation of NASD Rule 6954; (ii) failing to update customer account information at least once every 3 years in violation of SEC Rule 17a-3(a)(17) and NASD Conduct Rule 3110(a); (iii) failing to obtain photo identification for new customer accounts opened in violation of 31 CFR 103.122(b)(2)(ii) and NASD Conduct Rule 3011(b); and (iv) failing to conduct annual independent testing of the firm's AML Compliance Program in violation of NASD Conduct Rule 3011(c).

RESPONDENTS AND JURISDICTION

7. DGI is a registered broker-dealer and has been a FINRA member since 1980. DGI conducts a general securities business from its main office located at 53345 Route 25 Building 10, #3 Southold, NY. During the relevant time period, DGI's main office was located at 300 Pantigo Place, Suite 118, East Hampton, NY. The firm also maintains one non-OSJ branch office at 90 Broad St., # 901, New York, NY 10004.

8. Dratel first became registered with FINRA in September 1977 through former member firm Bache Halsey Stuart Inc. He became registered through DGI, which was founded by his father, in March 1980. Since 2002, he has been the sole owner and broker at DGI. In addition, from 2002 through October 2007, he was also the sole principal pursuant to a waiver of the two-principal requirement. Throughout the relevant period, Dratel was unsupervised.

FACTS

DGI's Business and Operations

9. As noted above, during the relevant period, DGI had its main office in East Hampton, NY and a branch office in Manhattan. Dratel worked primarily from the East Hampton office. He employed an order clerk and a receptionist in Manhattan and a part-time secretary in East Hampton. DGI's clearing firm was Oppenheimer & Co.

10. The majority of Dratel's business consisted of managing the discretionary customer accounts and investing his personal account at DGI. Dratel had approximately 70 discretionary accounts, i.e., clients who gave Dratel authority to buy and sell securities for their accounts without their prior authorization. As of September 30, 2005, the discretionary accounts had total assets of approximately \$5 million. Dratel's personal account value was approximately \$47,000.

Dratel's Trading and Use of DGI's Firm Account

11. From October 2005 through December 2006, Dratel placed approximately 1,300 short term trades for his Discretionary Customers. The vast majority of the discretionary trades were aggregated or "bunched" orders, which were allocations of a block trade among two or more individual discretionary accounts. These orders were executed either in the firm's "Average Price Listed Account" or in its "Principal OTC Account" (collectively the "Firm Account"). Specifically, Dratel executed the purchase (or short sale) in the Firm Account and then allocated shares among the various Discretionary Customers.

12. During October 2005 through December 2006, Dratel placed approximately 520 trades for his personal account. The vast majority of those were short term trades, mostly day trades. Most of his personal short term trades were stand-alone orders, i.e., orders that were not

aggregated with any other order. Dratel's personal short term trades were substantially similar in size and type of security as those he made for his Discretionary Customers. Although most of Dratel's personal trades were stand-alone purchases of a single stock, he executed nearly all of his trades through the firm's Firm Account and then allocated the shares to his personal account.

13. The way in which Respondents purchased shares into the Firm Account and then allocated them to customer accounts was as follows: The Firm placed all of its orders for "real time" direct market transactions, *i.e.*, purchases into the Firm Account from the street, through Oppenheimer's market order management system, known as OMS. The Firm processed all of its internal allocations between the Firm Account and customer accounts (including Dratel's personal account) through a back-office system known as FiNet. Although these systems were Oppenheimer's systems, Oppenheimer provided DGI with direct access to its systems via terminals in DGI's offices. Thus, DGI could independently enter and allocate trades.

14. Although Dratel worked in East Hampton, the direct market transactions and trade allocations were actually processed by the clerk in the Manhattan office. For real time market purchases and sales, typically Dratel called the clerk before the market opened and throughout the day to give her the buy or sell orders to enter into OMS. The clerk entered those orders into OMS and told Dratel the execution price. The clerk gave Dratel the execution price and the order ID from the OMS execution report over the phone so that he could record it on the OMS order ticket.

15. The trade allocation process varied depending upon whether the trade was for customers or a stand-alone trade for Dratel. Customer allocations were typically done pursuant to written instructions that Dratel faxed to the clerk in Manhattan from East Hampton near or after the close of the market. This meant that Dratel gave the allocation instructions after he knew how

the stock had performed. In the case of day trades, allocations were typically processed after the position was closed out and the profit or loss was locked in. In the case of overnight trades, by waiting until the market closed to do allocations, Dratel knew how the stock had performed and whether the trade was likely to be profitable or unprofitable.

16. In addition, the order tickets reflecting the customer allocations stemming from bunched trades frequently were not actually completed until the following day. Specifically, when Dratel submitted a market purchase or sale order (as opposed to an allocation), he time stamped the OMS order ticket reflecting the time of execution, and several blank order tickets to be used for the allocations. At the end of the day, he would send the blank, time-stamped order tickets for allocations to customer accounts to Manhattan. Once the order tickets were received, the order clerk filled them out using the written allocation instructions previously provided.

17. For stand-alone trades to Dratel's personal account executed through the Firm Account, the process was different. In those instances, Dratel engaged in a practice similar to shorting or "going light" in which he would purchase shares in the Firm Account and later sell the same shares directly from his personal account to the street while the shares were still in the Firm Account. Specifically, Dratel would put in an order for the Firm Account to purchase shares of a particular stock. Later in the day, after he observed the stocks' performance, he would put in another order to have the same shares sold out of his own account, even though they had not been transferred to his personal account from the Firm Account. By doing this, Dratel was in effect allocating the trade to himself at the time he put in the order to sell shares from his personal account. Thereafter, he would reconcile the two accounts. Occasionally, Dratel executed "both sides" of a personal short term trade through the Firm Account. In those cases, the allocation was done after the position was closed.

Dratel's Profits and Discretionary Customers' Losses from Short term Trades

18. From January 2005 through September 2005, Dratel did approximately 25 short term trades in his personal account. During that time, he consistently incurred losses from short-term trading totaling approximately (\$26,000). In October 2005, Dratel's use of the Firm Account to trade for his personal account increased dramatically, and his profits from short term trading skyrocketed. By purchasing multiple stock positions without indicating the accounts to which those purchases should be allocated, Dratel was able to wait and see how the stocks performed before deciding whether to keep a trade for himself by allocating it from the Firm Account to his personal account or allocate it from the Firm Account to one or more discretionary accounts.

19. Dratel earned a return of over 1,000% from short term trading from October 2005 through December 2006. During that time period, Dratel had a net profit of over \$530,000 and approximately 83% of his short term trades were profitable

20. Dratel's short term trades for his Discretionary Customers' during 2005 and 2006 had opposite results:

- Between January 1, 2005 and September 30, 2005, the Discretionary Customers had a net profit of approximately \$51,000, compared to Dratel's net loss of approximately (\$26,000).
- However, between October 1, 2005 and December 31, 2006, the Discretionary Customers had a net loss of approximately (\$180,000) compared to Dratel's net profit of over \$530,000.

21. Moreover, between October 1, 2005 and December 31, 2006, only approximately 28% of the Discretionary Customer trades were profitable.

22. The following table further shows the wide disparity in short term trading results between Dratel and the Discretionary Customers for whom he did short term trading:

Date	Percent of Profitable Short Term Trades (Approximate)		Total Returns-Short Term Trades (Approximate)	
	Dratel	Customers	Dratel	Customers
Jan. 2005–Sept. 2005	40%	46%	(\$26,000)	\$50,000
Oct. 2005–Dec. 2006	83%	28%	\$530,000	(\$180,000)

23. Dratel had no reasonable basis for allocating the profitable (or less unprofitable) trades to his own account and the unprofitable (or less profitable) trades to his Discretionary Customers, and his actions were done to profit himself at the expense of his Discretionary Customers. There were, for example, no significant differences in Dratel's trading strategy - either in the type of security or in the size of the trades - between the short term trades Dratel allocated to his personal account and the short term trades Dratel allocated to his Discretionary Customers.

24. Dratel disproportionately allocated profitable trades to his personal account to the detriment of his individual Discretionary Customers.

25. Dratel did not disclose to his individual Discretionary Customers his cherry-picking scheme. Nor did he disclose to them the conflicts of interest that resulted because of his trading practices.

FIRST CAUSE OF ACTION

**(Manipulative, Deceptive or Other Fraudulent Devices – Section 10(b) of the Exchange Act and Rule 10b-5, NASD Conduct Rules 2120 and 2110)
(Respondents Dratel and DGI)**

26. The Department realleges and incorporates by reference paragraphs 1-25 above.

27. Respondents Dratel and DGI owed a fiduciary duty to each client over whose accounts they exercised discretionary trading authority.

28. As alleged more fully above, beginning no later than October 2005 through at least December 2006, Respondents directly and indirectly, by use of the means and instrumentality of interstate commerce, and of the mails in connection with the purchase or sale of securities, knowingly or recklessly: (a) employed devices, schemes or artifices to defraud their clients; (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices and courses of business which operated or would operate as a fraud upon purchasers of securities.

29. As part of, and in furtherance of the violative conduct described above, Respondents orchestrated a cherry-picking scheme and failed to disclose material information to their Discretionary Customers.

30. By reason of the conduct described above, Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and violated NASD Conduct Rules 2110 and 2120.

SECOND CAUSE OF ACTION

(Books and Records –Section 17(a) of the Exchange Act, SEC Rules 17a-3(a)(6) and (7), and NASD Conduct Rules 3110 and 2110) (Respondents Dratel and DGI)

31. The Department realleges and incorporates by reference paragraphs 1-30 above.

32. SEC Rules 17a-3(a)(6) and (7) require, in relevant part, that a memorandum of each order be made which includes the time of receipt, entry and execution, as well as the

account for which the order is entered. NASD Conduct Rule 3110 requires that member firms make and preserve books and records as required by SEC Rules 17a-3 and 17a-4.

33. As alleged more fully above, in connection with the cherry-picking scheme, Respondents falsified numerous order tickets to make it appear that they had allocated the cherry-picked trades at the time of the underlying purchase in the Firm Account, which was false.

34. In numerous instances, Dratel time stamped numerous blank order tickets at the time he made a purchase through the Firm Account. Later on, after he determined which account would be allocated the trade, either he or his staff, at his instruction, filled in the name of the account that was getting the trade.

35. In other instances, either Dratel or his staff, at his instruction, back-dated the time stamp on order tickets concerning allocations to make it appear that the allocations had taken place earlier.

36. By reason of the conduct described above, DGI willfully violated Section 17(a) of the Exchange Act and Rules 17a-3(a)(6) and (7) thereunder, and DGI and Dratel violated NASD Conduct Rules 3110(a) and 2110.

THIRD CAUSE OF ACTION

(Books and Records – NASD Conduct Rules 3110(j) and 2110) (Respondents Dratel and DGI)

37. The Department realleges and incorporates by reference paragraphs 1- 36 above.

38. NASD Conduct Rule 3110(j) (formerly 3110[d]) requires that, before a customer order is executed, the account name or designation must be placed upon the memorandum for each transaction. The rule became effective January 31, 2005.

39. From February 1, 2005 through at least December 31, 2006, Dratel or his staff, at his instruction, regularly delayed placing the names of the customers to whom trades were allocated on order tickets (the memorandum for the transaction) until after the order was executed.

40. By reason of the conduct described above, Respondents violated NASD Conduct Rules 3110(j) and 2110.

FOURTH CAUSE OF ACTION
(Recording of Order Information – NASD Rules 6954(a)
and (b)(16) and NASD Conduct Rule 2110)
(Respondent DGI)

41. The Department realleges and incorporates by reference paragraphs 1- 40 above.

42. NASD Rule 6954(a) and (b)(16) requires that a firm must record the time in hours, minutes and seconds that orders were originated or received on all equity order tickets.

43. From at least January 2005 through December 2007, DGI's time stamp machines did not record seconds. As a result, during this period DGI failed to record the time in hours, minutes and seconds that orders were originated or received on all equity order tickets.

44. By reason of the conduct described above, Respondent DGI violated NASD Rules 6954(a) and (b)(16) and NASD Conduct Rule 2110.

FIFTH CAUSE OF ACTION
(Supervisory System and Written Procedures –
NASD Conduct Rules 3010(a) and(b) and 2110)
(Respondents Dratel and DGI)

45. The Department realleges and incorporates by reference paragraphs 1- 44 above.

46. During the period from at least January 2005 through December 2007, Respondents failed to establish, maintain and enforce a supervisory system and written supervisory procedures that adequately addressed trade aggregation and trade allocation with respect to DGI's discretionary accounts and the manner in which client trades were to be executed.

47. Although the vast majority of DGI's trades purchased through the Firm Account were either aggregated orders or Dratel's short term trades, prior to 2007, DGI had no supervisory system or written supervisory procedures that addressed the issue of allocations in any manner whatsoever. Nor did DGI have a supervisory system or written supervisory procedures that addressed the issue of the proper completion of order tickets. As such, DGI failed to maintain and implement appropriate procedures for supervision in order to prevent the improper post-execution allocation of trades.

48. In 2007, DGI updated its written supervisory procedures, but the written supervisory procedures, and the firm's underlying systems and procedures, were still deficient. The new written supervisory procedures contained no procedures requiring or verifying that allocation instructions be formulated before the time a transaction is executed through the Firm Account. Nor did they require that before a customer order is executed, the account name or designation must be placed upon the order ticket. Accordingly, they did not seek to prevent delayed allocations.

49. Dratel had sole responsibility for the adequacy of DGI's supervisory system and procedures.

50. By failing to establish and maintain supervisory systems and by failing to establish, maintain, and enforce written procedures reasonably designed to achieve compliance

with applicable securities laws and regulations, Dratel and DGI violated NASD Conduct Rules 3010(a) and (b) and 2110.

SIXTH CAUSE OF ACTION

**(Books and Records – Section 17(a) of the Exchange Act,
SEC Rules 17a-3(a)(17), and NASD Conduct Rules 3110 and 2110)
(Respondents Dratel and DGI)**

51. The Department realleges and incorporates by reference paragraphs 1-50 above.

52. SEC Rule 17a-3(a)(17)(i) requires that every 36 months, a firm update information concerning a customer's name, tax identification number, address, telephone number, date of birth, employment status (including occupation and whether the customer is an associated person of a member, broker or dealer), annual income, net worth (excluding value of primary residence), and the account's investment objectives.

53. DGI's written supervisory procedures stated that new account documents are to be reviewed "on a quarterly basis to ensure that customer information is updated. Such review will be memorialized in writing in memorandum form."

54. Dratel had sole responsibility for reviewing and updating such customer information.

55. DGI, acting through Dratel, failed to periodically update customer account information for 42 of its accounts at least once every 36 months and failed to review new account documents on a quarterly basis and to memorialize the review. From at least November 2004 through January 1, 2008, DGI, acting through Dratel, failed to update customer account information for at least 42 accounts.

56. As a result, DGI willfully violated Violation of Section 17(a) of the Exchange Act and Rule 17a-3(a)(17) thereunder, and DGI and Dratel violated NASD Conduct Rule 3110(a) and 2110.

SEVENTH CAUSE OF ACTION
(Anti-Money Laundering Program –
NASD Conduct Rule 3110(a) and (c) and 2110)
(Respondent DGI)

57. The Department realleges and incorporates by reference paragraphs 1-56 above.

58. During the period from August 2006 through January 2008, DGI's Customer Identification Program required DGI to obtain photo identification when a new account was opened for a customer. During the period from August 2006 through January 2008, DGI failed to obtain photo identification for each of the eleven (11) new customer accounts opened, in contravention of 31 CFR 103.122(b)(2)(ii).

59. During the period from August 2006 through January 2008, DGI failed to conduct a test of its Anti-Money Laundering Compliance Program for 2006 and 2007.

60. As a result of the conduct described above, DGI violated NASD Conduct Rule 3110(a) and (c) and 2110.

RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

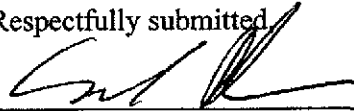
- A. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed, including that the Respondents be required to *disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;*

- B. order that the Respondents bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.
- C. Make *specific findings* that (i) Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and (ii) Respondent DGI willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

FINRA DEPARTMENT OF ENFORCEMENT

DATED: May 11, 2010

Respectfully submitted,



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