FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. BRIAN SANDERS (CRD No. 2743309), Respondent.	Disciplinary Proceeding No. 2009016159111 Hearing Officer—LOM **HEARING PANEL DECISION** May 4, 2015

Respondent, Brian Sanders, the Chief Compliance Officer of his FINRA member firm, failed to reasonably supervise the activities of registered representatives at the firm in violation of NASD Rules 3010(a) and (b), NASD Rule 2110, and FINRA Rule 2010. For this misconduct he is barred from associating with any FINRA member firm in any capacity.

Respondent also failed to report numerous customer complaints to FINRA in violation of NASD Rules 3070 and 2110, and FINRA Rule 2010. For this misconduct he would be suspended for one year from acting in a principal capacity at any FINRA member firm and fined $25,000. In light of the bar, however, these sanctions are not imposed.

Appearances

Jonathan Golomb and Edwin T. Aradi, Rockville, Maryland, representing the Department of Enforcement.

Brian Sanders, Wading River, New York, representing himself.

I. NATURE OF THE CASE

The Department of Enforcement ("Enforcement") for the Financial Industry Regulatory Authority ("FINRA"), a self-regulatory organization for the securities industry, brought this disciplinary proceeding against Respondent, Brian Sanders, alleging two causes of action against him. The Complaint alleges violations of NASD Rules 3010(a) and (b) relating to supervision, NASD Rule 3070 relating to reporting customer complaints to FINRA, and NASD Rule 2110

and FINRA Rule 2010, which both require members and their associated persons to observe high standards of commercial honor and just and equitable principles of trade.[1]

First, Enforcement charged that Sanders, as the Chief Compliance Officer ("CCO") of his FINRA member firm, iTRADEdirect.com ("iTrade" or the "Firm"), failed to reasonably supervise registered representatives at the Firm. Enforcement alleged that Sanders failed to respond to red flags indicating the strong possibility that the Firm's registered representatives were opening accounts without authorization, engaging in unauthorized trading, and also engaging in excessive trading. Enforcement also alleged that he failed to subject registered representatives to heightened supervision when they should have been under the Firm's written supervisory procedures ("WSPs"). According to the Complaint, 13 brokers met the Firm's criteria for heightened supervision, but Sanders failed to subject at least a dozen to heightened supervision.

Second, Enforcement charged that Sanders failed to report numerous customer complaints to FINRA that he was required to report.

As discussed below, the Hearing Panel finds that Sanders committed the violations and imposes sanctions.

II. PROCEEDING

Initially, the charges against Sanders were part of a Complaint that included separate claims against three other respondents, [redacted], DP, and [redacted]. The three other respondents were registered representatives of the Firm who were charged with various sales practice violations, including unauthorized and excessive trading.

[redacted] defaulted and did not defend the charges against him. DP died prior to the hearing, and the claims against him were dismissed. The third respondent, [redacted], III, went to hearing along with Sanders. [redacted] was represented by counsel and presented a defense.

Sanders represented himself, vigorously denying liability throughout the pre-hearing phase of the proceeding and in his opening statement at the beginning of the hearing.[2] After

[1] FINRA is responsible for regulatory oversight of securities firms and associated persons who do business with the public. It was formed in July 2007 by the consolidation of NASD and the regulatory arm of the New York Stock Exchange. FINRA is developing a new "Consolidated Rulebook" of FINRA Rules that includes NASD Rules. The first phase of the new Consolidated Rulebook became effective on December 15, 2008. See FINRA Regulatory Notice 08-57 (Oct. 2008), http://www.finra.org/industry/notices/08-57. Because the Complaint in this case was filed after December 15, 2008, FINRA's procedural Rules apply to the proceeding. The applicable FINRA and/or NASD Conduct Rules are those that existed when the conduct at issue occurred. Both NASD and FINRA Rules apply to the conduct at issue in this matter because the conduct extended over a period of time when first NASD and then FINRA Rules applied. FINRA's Rules (including NASD Rules) are available at www.finra.org/industry/finra-rules.

[2] The hearing was held for two days in October 2014 (FINRA Disciplinary Proceeding No. 2009016159110). This decision refers to the transcript as "Hearing Tr." and cites the relevant page or pages. A reference to the transcript includes a parenthetical identifying the witness or speaker. For example, Sanders gave testimony on behalf of Spagnolo, and that testimony is cited "Hearing Tr. (Sanders) 444-95."

Sanders completed a lengthy opening statement, the Hearing Officer told him he would need to repeat some of what he said when he testified and could not merely rely on the opening statement.[3] He then announced, however, that he did not intend to present any evidence in his defense. He stated, "I have no intention of going through this whole hearing process." [4] He indicated that he felt he had gotten his "side of the story" on the record by making his opening statement.[5] He said, "This is not a good investment of my time or money. I just really have no interest in this at all. But I did want to get the truth out there, and I'm done."[6]

Enforcement immediately moved that Sanders be deemed in default. The Hearing Officer warned Sanders that if he left the hearing and was deemed in default it would be appropriate to find that the charges against him were true.[7] The Hearing Officer told Sanders he could, instead, continue participating in the proceeding. Sanders reiterated that he thought that would be "pointless" and a "waste of time."[8] He confirmed that he understood the consequences of failing to participate in the proceeding any further.[9] Despite that understanding, he left the hearing without presenting any evidence in his defense.[10] However, Sanders later returned to the hearing to testify on behalf of [redacted]. He was cross-examined in that context.

After the hearing with respect to the charges against [redacted] concluded, the Hearing Officer determined not to treat Sanders as having defaulted because he had actively defended himself and had participated in the hearing. The Hearing Officer issued an Order giving both Enforcement and Sanders additional time to supplement the record with respect to the charges against him.[11] The Order also severed the case against Sanders from the other case and gave Sanders' case a new disciplinary proceeding number. After the severance, Enforcement submitted two declarations accompanied by evidentiary materials and a memorandum in support of the charges against Sanders. Sanders did not submit anything.[12]

Pursuant to FINRA Rule 9221(c), the Hearing Panel has determined the claims against Sanders on the record as to him. That record includes everything in the record from the case prior to the severance of the charges against Sanders (Disciplinary Proceeding No.

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[3] Hearing Tr. (Sanders) 36-53.

[4] Hearing Tr. (Sanders) 54.

[5] Hearing Tr. (Sanders) 54.

[6] Hearing Tr. (Sanders) 54.

[7] Hearing Tr. (Golomb, Sanders, and Hearing Officer) 54-56.

[8] Hearing Tr. (Hearing Officer and Sanders) 55.

[9] Hearing Tr. (Sanders) 56.

[10] Hearing Tr. (discussion among counsel, Sanders, and Hearing Officer) 56-64.

[11] The full title of the Order is "Order Setting Schedule For Supplementing Record In Sanders' Case."

[12] Enforcement's submissions were the following: Department Of Enforcement's Memorandum In Support Of Charges" (referred to here as "Enf. Mem."), "Declaration Of Michael DiTrapani" (referred to here as "DiTrapani Decl."), and "Declaration Of Wendoly Velez." These materials refer to exhibits that Enforcement uses to support the charges. Some of the exhibits were submitted by Enforcement prior to severance of the Sanders case on November 13, 2014 (identified by the prefix "CX"), and others were new (identified by the prefix "SX").

2009016159110), along with Enforcement's submission after severance (Disciplinary Proceeding No. 2009016159111). The record includes the pleadings, Sanders' opening statement at the hearing (which is treated as the equivalent of a brief containing argument and as a proffer of what he would have testified), Sanders' sworn testimony at the hearing on behalf of [redacted], and Enforcement's submissions and exhibits supplementing the record with regard to the claims against Sanders. Those exhibits include, among other things, excerpts from sworn testimony that Sanders gave in on-the-record interviews ("OTRs") in connection with related matters.

III. FINDINGS

A. Jurisdiction

Sanders is no longer employed in the industry. However, FINRA still has jurisdiction to bring this proceeding against him. The two requirements imposed by FINRA's By-Laws (Art. V, Section 4) both exist here. First, the Complaint was filed less than two years after the effective date of termination of his last registration with a FINRA member. His termination date was October 12, 2012, and the Complaint was filed on December 30, 2013. Second, the Complaint charges Sanders with misconduct committed while he was registered or associated with a FINRA member firm, in this case while he was registered with iTrade.

B. Sanders

Sanders was registered with five firms between May 1996 and October 2012. One of those firms was iTrade, where he was registered from June 2005 until May 2010.[13] While at iTrade, Sanders was the Firm's Chief Compliance Officer. He also managed its Long Island office where it conducted the bulk of its business. He was the supervising principal for a large number (sometimes the majority) of the registered representatives in that office.[14]

Sanders has been the subject of two FINRA disciplinary proceedings, which he settled. The first involved charges brought against him when he was at another firm, prior to joining iTrade, for supervisory failures related to the prevention and detection of unauthorized trading. Pursuant to a March 2007 settlement of those charges, Sanders was suspended from acting in a principal capacity for ten business days and fined (jointly and severally with his then firm and another individual respondent) $17,500.[15] The second proceeding involved charges for conduct while he was at iTrade. The charges were that he failed to conduct adequate due diligence in connection with an initial public offering by iTrade's parent company. Pursuant to a November 2007 settlement, Sanders was suspended from acting in a principal capacity for ten business days and fined (jointly and severally with the Firm) $10,000.[16]

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[13] CX-1, at 5-6.

[14] SX-2 and SX-3 (Complaint and Order Accepting Offer Of Settlement in Disciplinary Proceeding No. E07200406101); Hearing Tr. (Sanders) 444-45.

[15] Matter No. E072004006101; SX-2 and SX-3.

[16] Matter No. 2005001745201; CX-1, at 15-16; SX-1.

C. Investigation

This proceeding against Sanders has its genesis in the 2008 and 2009 cycle examinations of iTrade. The examination staff identified issues and referred them to Enforcement for further investigation. Among the concerns were a high number of cancelled trades and a high number of exception reports indicative of possible excessive trading. Ultimately, Enforcement brought proceedings against iTrade and eleven individuals (including Sanders). Most of the cases involved sales practice violations such as unauthorized opening of accounts, unauthorized trading, and excessive trading.[17] The Firm was expelled from FINRA in a default decision issued on June 28, 2011, for opening accounts without customer authorization, unauthorized trading, suitability violations, false books and records, and other violations.[18]

D. The Firm's General Business Model

The Firm's representatives obtained business by "cold-calling" potential customers. The representatives used purchased lead cards. Each lead card contained some information about a potential customer, and, after a call to the prospect, a representative would write down additional information learned on the call. Sometimes representatives would call a potential customer repeatedly. Sometimes customers would ask for materials to be sent to them. Sometimes new accounts would be opened as a result of these efforts and trading initiated.[19]

In his opening statement, Sanders described the Firm as a "boiler room" operation.[20]

E. The Firm's Lack Of A Good Compliance Culture

The Firm lacked a good compliance culture. The problem started at the top, with Sanders as the Chief Compliance Officer. He evidenced little concern about potential unauthorized account opening, unauthorized trading, or excessive trading. Rather, he seemed to consider customer complaints and refusals to pay for trades as part of the ordinary course of the business and as something the Firm could not change. As discussed below, to the extent that the Firm, through Sanders, instituted some procedures to confirm customer authorization for trades, it did not use effective procedures and did not implement those procedures consistently.

Cold-calling in and of itself is not a violation of law or regulation, as Sanders pointed out in his opening statement. He said, "Cold calling is a legitimate way to get new customers. We are not Merrill Lynch. [Customers] are not calling us to open accounts. We have to go out and find the investors ourselves."[21]

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[17] CX-1, at 21-22; DiTrapani Decl. ¶¶ 3-8, 12-16; Hearing Tr. (DiTrapani) 280-81, 288-90.

[18] Disciplinary Proceeding No. 2009016059101.

[19] Hearing Tr. (Sanders) 478-80; Hearing Tr. (DiTrapani) 283-86.

[20] Hearing Tr. (Sanders) 36 ("First, I want to call iTrade operations a boiler room.").

[21] Hearing Tr. (Sanders) 36.

However, Sanders described an attitude toward customers that is incompatible with compliance and regulatory concerns regarding customer protection. He compared the aggressive pursuit of customers in the cold-calling process to hooking a fish. He said, "You have a fish on the hook and you have spoken to the guy, you may call him repeated [sic] because he exhibited some interest. So I'm going to call him back and see at some point I do have an investment to entice him to do business with us."[22] Sanders displayed no concern that some of the Firm's registered representatives had used high-pressure tactics not only to "hook" customers but to bully customers into ratifying and paying for unauthorized trades.

In Sanders' view, as expressed in his opening statement, customer "reneges" are common and inevitable in the cold-calling business. Customers first say they want to make a trade and then later refuse to pay, particularly if the investment has declined in value between the initial telephone authorization and the completion of the paperwork for the transaction. According to Sanders, even when iTrade instituted some confirmation procedures the Firm could not reduce the percentage of reneges below 18.5%.[23] He claimed in his testimony that when he investigated why a customer refused to pay for a trade he determined that 99% of the time "it was authorized and it's just a renege."[24] He also testified that 30% was a "pretty normal" renege rate for his office at iTrade.[25]

As reflected in Sanders' opening statement, iTrade did not encourage and support compliance. He described being rebuffed by management when he suggested that they wait until they received money from the customers before beginning to trade.[26] He also described the Firm's owner as not knowing what he was doing.[27] Although Sanders was the Chief Compliance Officer, he described himself as "just" the compliance officer. He displayed a sense that he could do nothing to change things at the Firm. He said, "I had to work with the cards I was dealt....You know, try as you may, you really have a hard time doing any better than that [18.5%]."[28]

Sanders himself reflected the lack of a compliance-oriented attitude at the Firm. Although he was responsible for compliance, he displayed a combative attitude toward FINRA regulatory staff. Because FINRA examiners apparently did not adopt Sanders' shoulder-shrugging attitude about reneges, he called them "thickheaded." He said, "I don't know how they don't understand. And then I realized it was more that they don't want to understand. They want to turn something that isn't a violation into a violation to extort money at some point when it comes time for, you know, fines or disciplinary actions or whatever. That was always my feeling, that you are taking something that is not a violation and trying to portray it as one."[29]

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[22] Hearing Tr. (Sanders) 37.

[23] Hearing Tr. (Sanders) 37-39

[24] Hearing Tr. (Sanders) 451.

[25] Hearing Tr. (Sanders) 457-58.

[26] Hearing Tr. (Sanders) 38-39.

[27] Hearing Tr. (Sanders) 52-53.

[28] Hearing Tr. (Sanders) 39.

[29] Hearing Tr. (Sanders) 42.

F. Supervisory Violation

(1) Sanders' Failure To Respond Appropriately To Red Flags

Customer reneges. Between April 2008 and the end of 2009, customers rejected over 18% of the initial trades in new accounts that iTrade submitted to its clearing firm.[30] Sanders acknowledged that the Firm could not get its customer reneges lower than 18.5% and that customer reneges as high as 30% were not uncommon for some representatives.[31] These rates of rejection were red flags that required inquiry.

The existence of situations that warranted investigation was confirmed by evidence that FINRA staff collected later. The staff collected declarations and responses to questionnaires regarding 36 different instances of alleged unauthorized opening of new accounts, accompanied by the placement of unauthorized initial trades. While these responses were not existing red flags at the time of the conduct at issue, they signified that there were many potential problems at the time that could have been uncovered by an appropriate inquiry and should have been investigated. Regardless of whether those situations involved actual unauthorized activity by registered representatives at the Firm, they reflect that there was a need for supervisory oversight and evaluation.

Sanders' testimony regarding his supervisory efforts was vague and unsupported by other record evidence. Even if taken at face value, his testimony shows that his supervisory efforts were haphazard and ineffective. He failed to exert any meaningful, consistent supervision.

Sanders described in his hearing testimony confirmation procedures he pursued with the hope of reducing customer reneges. He testified that he would take new account sheets before they were complete and call the customers to confirm that they had authorized the transactions. Each time he did this he said he would initial the new account sheet and time-stamp it.[32]

However, Sanders was vague about when he employed these procedures, and even by his own testimony he was inconsistent in applying the procedures. He thought that he was confirming at least some account openings in 2009, but he testified that he also might initial a new account information sheet without talking to a customer. He would do this if he left a confirming message on the customer's voice mail.[33] As a result, his initial on a new account sheet did not indicate that he spoke to the customer.[34]

When asked whether he initialed every new account information sheet as a principal regardless of whether there was a confirming call, Sanders was clueless, saying, "I'm trying to think how that worked. I don't know that we collected these all along, and I don't know if we

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[30] DiTrapani Decl. ¶ 6; SX-6.

[31] Hearing Tr. (Sanders) 39, 457-58.

[32] Hearing Tr. (Sanders) 469-73, 476.

[33] Hearing Tr. (Sanders) 473-74.

[34] Hearing Tr. (Sanders) 472-76.

started doing that when we had the issue in the reneges and that's when the signing and all that went on."[35] Sanders testified he did what he could but that his attempts to confirm new accounts accomplished little.[36]

Sanders was vague about whether and how he tracked customer reneges for individual representatives to determine if a representative had a suspicious pattern warranting further investigation or action. At his OTR on October 16, 2012, Sanders testified that "at some point" he was keeping track of the number of customer reneges for each representative but he did not know the "duration" of time that he did that. He did not know if he used a spreadsheet to do this. He did not know how many reneges might occur in a week on average. He testified that in any event he knew what he needed to know in his head.[37]

Sanders' process of investigating reneges after they occurred was similarly inadequate. His process involved little more than trying to call a few customers, largely unsuccessfully. Sanders testified at his October 16, 2012 OTR that he probably spoke to a few customers after they reneged but that mostly customers would avoid talking on the telephone again.[38] Sanders made it clear in his hearing testimony that he thought it was the customers, not the registered representatives at the Firm, who were untruthful. He testified, "In most cases, you can't get them [the reneging customers] on the phone. They are hiding from you. They are not paying for a trade that they know they authorized and they see you on caller ID and they are not picking up the phone ... or they come to the phone once and tell you don't call again. That kind of thing. They are not really looking to discuss what went on."[39]

Nor did Sanders exercise any special care with respect to registered representatives who had large amounts of customer reneges. Sanders testified that when he saw representatives with a lot of customer reneges he would speak to the representatives. He would exhort them "to do what you can to make sure you are really buttoning these [customers] up good, that there is no question they are opening a new account and buying stock here."[40] When he testified at his OTR, he could remember possibly placing only one representative on some kind of special supervision because of the high number of reneges, and then only a type of supervision that Sanders said was "[n]ot heightened supervision really."[41]

To some degree, Sanders' lack of concern about unauthorized account openings and unauthorized trading stemmed from a manifest misunderstanding of the incentives to engage in unauthorized transactions. Sanders acknowledged that customer reneges were bad. But he considered them bad because they cost the Firm and its registered representatives money, not because reneges signaled potential misconduct by the registered representatives under his

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[35] Hearing Tr. (Sanders) 490-91.

[36] Hearing Tr. (Sanders) 469-71, 489-92.

[37] SX-4, at 3-4.

[38] SX-4, at 7.

[39] Hearing Tr. (Sanders) 450.

[40] Hearing Tr. (Sanders) 470.

[41] SX-4, at 6-7.

supervision.[42] He claimed that registered representatives had no incentive to engage in unauthorized trading. He explained that the representatives bore various costs if a customer refused to pay for a trade, including a $50 cancellation fee, a $50 ticket fee, FedEx charges of $16 to $20 each way for the paperwork sent to the customer, and any loss on the trade—while the Firm retained any gain on the trade.[43]

Sanders failed to recognize that a registered representative might make up the costs of some unauthorized trades if the representative's volume was increased by persuading at least some customers to ratify trades they did not initially intend to authorize. Nor did he recognize that the high pressure tactics that led to unauthorized trades might yield a higher rate of authorized transactions, making up for some of the losses associated with customer reneges. Sanders also failed to recognize that the Firm itself had an incentive to permit unauthorized trading if it retained the gains on such trades without absorbing the costs or losses associated with them.

The Hearing Panel finds that, with respect to unauthorized account opening and unauthorized trading, Sanders abdicated his supervisory responsibilities. The inadequacy of Sanders' supervision in the face of high rates of customer reneges allowed the Firm's representatives to prey on customers free of restraint and, in practical terms, served the Firm's purposes.

Excessive trading. The Firm's clearing firm provided it with monthly exception reports that provided important information containing red flags of possible excessive trading. These reports showed each account that had met any of the following thresholds during the relevant month: a commission-to-equity ratio of 50% or more, total commissions of $10,000 or more, fifteen or more trades in the month, or a loss of 15% or more in the value of the account. The reports also showed the turnover rate for each account listed.[44]

As discussed below, turnover rates of six or more are presumptively indicative of excessive trading. The reports for iTrade showed that the Firm's representatives frequently engaged in potentially excessive trading in more than 700 accounts between March 2007 and April 2009. The reports showed turnover rates in many accounts in the tens or even hundreds—well over the presumptively excessive turnover rate of six.[45]

As discussed below, cost-to-equity and commission-to-equity ratios of 20% are considered indicative of wrongful conduct. The reports showed many accounts with cost-to-equity or commission-to-equity ratios between 20% and 50%. In at least 150 instances, the ratios were so high that they exceeded the 99.99% maximum ratio that could be reported by the clearing firm's reporting system. In those instances, the costs of trading, including commissions and margin costs, exceeded the value of the account.[46] In such situations, the active trading

[42] Hearing Tr. (Sanders) 470-71.

[43] Hearing Tr. (Sanders) 446-49. *See also* SX-4 and SX-5.

[44] DiTrapani Decl. ¶ 13; CX-32 through CX-58.

[45] CX-30, CX-31.

[46] DiTrapani Decl. ¶ 16; CX-30, CX-31.

benefited the representatives by increasing their commissions, to the detriment of the customers, who bore expenses far out of proportion to their assets.

The exception reports enabled a supervisor to identify and focus on particular representatives who might be churning their customers' accounts. Some of the Firm's registered representatives appeared on the reports repeatedly, as many as 30 or 40 times.[47]

Sanders was responsible for reviewing exception reports or making sure that they were reviewed.[48] He discounted them, however, as a tool for monitoring and supervising registered representatives. He said that he thought he knew more about whether trading was appropriate from his day-to-day interactions with the accounts. He testified at his OTR, "[S]tatistics are a handy tool, but I think I know more about the accounts just from seeing them day-to-day, than the information I get out of those reports."[49]

Sanders was not concerned about potential excessive trading activity.[50] He was asked whether there was any turnover ratio that he would consider potentially problematic because it was so high. He responded, "I really don't know from turnover ratios. I always looked at the bigger picture, I think. What the client signed up for. What the trades are."[51] He also took issue with the idea that a 20% commission-to-equity ratio was high. He said "You can't look at it that way. I know FINRA could look at it that way, but equity is determined by your success or failure in the account." He concluded that the ratio was a "bad measure."[52] Sanders testified in an OTR, "We're not really statistically based in our reviews of things. We're more real time in looking at the specific accounts...."[53] In OTR testimony, Sanders testified that he did not rely on any specific numbers to assess excessive trading. He said that he would recognize a problem because "it's like being in love ... you can't describe it necessarily, but you know it when you see it."[54]

Sanders did little, if anything, in response to the exception reports. He said that he never questioned a broker about the level of activity in an account, and he called "less than a handful" of customers to determine if the level of trading was too high.[55] The Hearing Panel finds that this was a completely inadequate response to the red flags confronting Sanders.

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[47] DiTrapani Decl. ¶¶ 15, 35-36; CX-30.

[48] SX-4, at 2; CX-3, at 21.

[49] SX-5, at 9.

[50] SX-4, at 9.

[51] SX-4, at 12.

[52] SX-4, at 17.

[53] SX-5, at 11-12.

[54] SX-5, at 11-12.

[55] SX-4, at 12-13.

(2) Sanders' Failure To Implement Heightened Supervision

The Firm's WSPs required Sanders to consider placing representatives who met certain criteria on heightened supervision. The criteria included representatives with three or more complaints, arbitrations, or actions alleging sales practice abuses within two years, and representatives employed by three or more other firms in the preceding five years.[56]

Thirteen brokers at the Firm's Long Island office met the criteria for heightened supervision. Some of those brokers substantially exceeded the threshold criteria for concern and heightened supervision. For example, one representative was the subject of seven complaints of sales practice abuses within only one year. Another representative had been employed by fourteen firms within the preceding five years. Six representatives had been employed by between four and nine firms within the last five years. Many of these representatives also were the subject of numerous active account exception reports, ranging from fifteen to fifty times. A number also were involved in accounts that had numerous customer reneges at the account opening. The customer reneges ranged from 15 for one representative to 27 for another and to a high of 31 for a third representative.[57]

Despite these circumstances indicating that heightened supervision was required, Sanders claimed in his opening statement that he did not have to put the registered representatives on heightened supervision. He claimed that the WSPs granted him discretion and that he reasonably determined that heightened supervision was unnecessary.[58] He declared in his opening statement that he knew many of the representatives for ten years or more and that "[t]here was nothing going on that I needed to worry about."[59] The Hearing Panel finds that Sanders failed to implement the Firm's WSPs regarding heightened supervision.

G. Failures To Report Customer Complaints

Sanders was responsible for reporting customer complaints on behalf of the Firm in compliance with NASD Rule 3070.[60] Between May 1, 2008, and December 31, 2009, the Firm received at least 53 written customer complaints, of which it reported pursuant to NASD Rule 3070(c) only 25. The complaints involved unauthorized trading (10), excessive trading or poor performance (12), and other significant misconduct.[61]

Sanders was aware of the unreported complaints, or he was reckless if he was not aware of them. Almost all the complaints were in the form of email communications between representatives and customers.[62] Sanders testified in his OTR that all incoming email traffic

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[56] CX-3, at 24.

[57] CX-30, CX-31, CX-59 through CX-72, CX-82; SX-6; DiTrapani Decl. ¶¶ 22 through 26.

[58] Hearing Tr. (Sanders) 42-45.

[59] Hearing Tr. (Sanders) 43.

[60] CX-3, at 17, 20; SX-5, at 2-3.

[61] CX-74, CX-75.

[62] CX-75.

came into a box for review by him or another colleague, specifically including all complaints sent to representatives by email. He claimed he reviewed customer complaints as they came in.[63] If Sanders reviewed but failed to report the 28 unreported complaints, his failure is inexplicable and inexcusable. If he simply missed them and was unaware of them, his failure still is not excusable. Sanders, as the CCO, was ultimately responsible for implementing and maintaining appropriate systems for receiving and reviewing customer complaints.[64] If he was unaware of more than half the complaints made during the relevant period, then he failed to have in place a reasonable system for dealing with customer complaints so that the Firm could comply with the reporting requirements.

During the same 2008-2009 period, Sanders himself signed three settlements of customers complaints on behalf of the Firm. At least two of the three settling customers spoke with Sanders directly, so he knew that these were settlements of customer complaints. Sanders did not report the underlying customer complaints involved in the three settlements.[65]

The Hearing Panel finds that Sanders' failure to report over half the written customer complaints received by the Firm during the relevant period was at a minimum reckless, if not knowing.

IV. ANALYSIS OF LIABILITY

A. Supervisory Violation

The Fourth Cause of Action in the multi-respondent Complaint alleges that Sanders committed supervisory violations of NASD Rules 3010(a) and (b) and 2110, along with FINRA Rule 2010.

NASD Rule 3010(a) requires each member firm to establish and maintain a system to supervise associated persons, and it details some of the requirements for the design of such a system. NASD Rule 3010(b) requires each member firm to establish, maintain, and enforce written supervisory procedures appropriate to its specific business and that are reasonably designed to achieve compliance with the applicable securities law and regulations, as well as FINRA's Rules.

The Securities and Exchange Commission ("SEC") has described the standard of conduct expected of supervisors, saying,

> The 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

[63] SX-5, at 4-5.

[64] CX-3, at 17-20.

[65] CX-76; DiTrapani Decl. ¶¶ 17-21.

investigation. Once indications of irregularity arise, supervisors must respond appropriately.[66]

A determination that a respondent failed to comply with his supervisory duties does not require a finding that a violation was committed by someone under the respondent's supervision.[67] The focus in a supervisory case like this one is on the nature and number of red flags and whether the respondent's response was reasonable in light of all the facts and circumstances. Inadequate supervision is inadequate supervision, regardless of whether those being supervised have been proven to have engaged in wrongdoing.

In this case, the Firm established WSPs that placed ultimate responsibility for supervision on Sanders, as the CCO. But Sanders failed, utterly and completely, to fulfill his supervisory duties.

In the face of numerous red flags of potential unauthorized account opening, unauthorized trades, and excessive trading, Sanders did nothing beyond exhorting the Firm's registered representatives to decrease the number of customer reneges. Renege rates running as high as 30% over an extended period of time were red flags he could not ignore.

Those rates are similar to renege rates that the SEC has held to require an immediate and intensive investigation. In *Monroe Parker*, the SEC said that a firm's high rate of reneges, close to 38% but sometimes as low as 26.99%, was "by any objective standard" a "red flag" that "should have indicated an urgent need for investigation of the [f]irm's sales practices."[68] The SEC continued, "We have frequently found that excessive reneges or cancellations are indicative of underlying compliance problems and may be evidence of violations. Our concern is heightened by the [f]irm's casual response to the excessive cancellations. Its failure to investigate or institute remedial measures demonstrates a lack of adequate supervision...."[69]

Similarly, the turnover rates or cost-to-equity rates that Sanders saw in numerous accounts were red flags requiring investigation. They represented a level of trading substantially in excess of 6%, which has been held indicative of excessive trading.[70]

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[66] *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008) (citations and quotations omitted). *See also Michael T. Studer*, Exchange Act Release No. 50543A, 2004 SEC LEXIS 3157, at *22 (Nov. 30, 2004).

[67] *E.g.*, *Robert J. Prager*, Exchange Act Release No. 51974, 2005 SEC LEXIS 1558, at *48 and n.52 (July 6, 2005) (citing NASD Notice to Members 98-96 (Dec. 1998) (stating that a violation of Rule 3010 can occur in the absence of an underlying rule violation)).

[68] *Monroe Parker Securities, Inc.*, Exchange Act Release No. 39057, 1997 SEC LEXIS 1885, at *11 (Sept. 11, 1997). In *Monroe Parker*, the SEC affirmed the SRO's denial of a member's request to have a restrictive agreement modified to allow the Firm to increase its number of registered representatives.

[69] *Id.* at *11-12.

[70] *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *60-61 and n.78 (July 2, 2013) (collecting cases).

In addition, despite red flags that more than a dozen registered representatives had a worrisome history of changing firms frequently, and/or a current pattern of trades rejected by clients, Sanders relied on his general sense from long acquaintance with the representatives that there was no problem. The SEC long ago made plain that red flags like the ones Sanders saw signal the need for heightened supervision. In *Custable*, the SEC disciplined a supervisory principal and firm for their failure to impose heightened supervision on a registered representative although they terminated him after only two months with the firm. The SEC pointed to two types of red flags that required them to impose heightened supervision: the registered representative had numerous unsettled trades (some of which signified that customers did not accept and pay for the trades), and the registered representative had a troubled history of complaints at his prior firm.[71]

Sanders was confronted with many more red flags than the supervisor in *Custable*, and he ignored them over a far longer period of time, extending from April 2008 to December 2009. The Hearing Panel concludes that Sanders was oblivious to his supervisory duties and violated NASD Rule 3010(a) and (b).

NASD Rule 2110 and FINRA Rule 2010 require that a member firm and its associated persons should observe high standards of commercial honor and conduct themselves consistent with just and equitable principles of trade. These identical Rules require members of the industry to conduct themselves with integrity, fairness, and honesty. It is well established that a violation of another NASD or FINRA Rule constitutes a violation of these Rules.[72] Accordingly, because Sanders violated NASD Rules 3010(a) and (b), he also violated NASD Rule 2110 and FINRA Rule 2010.

In its memorandum in support of finding that Sanders violated his supervisory duties, Enforcement addressed two affirmative defenses that Sanders raised in his Answer. The Hearing Panel rejects Enforcement's first argument, but finds that the second bolsters the Panel's conclusion that Sanders committed the violations alleged.

The first argument relates to Sanders' Eleventh Affirmative Defense, in which he asserted that he, and not the customers, should be believed with respect to whether the customers had authorized the transactions they later reneged upon. Enforcement argued that the customers have no reason to lie, implying that their claims should be automatically granted credence. The Hearing Panel rejects that kind of blanket grant of credibility. In any event, whoever told the truth regarding authorization, the customers or the registered representatives, it is irrelevant to the question of whether Sanders, the supervisor, responded appropriately to the numerous significant red flags facing him.

The second argument relates to Sanders' Twelfth Affirmative Defense, in which he asserted that the registered representatives had nothing to gain from opening accounts or purchasing securities without authorization. As noted above, as a factual matter the assertion is incorrect. Moreover, in another disciplinary proceeding, *Shevlin*, the same argument was

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[71] *Frank J. Custable, Jr.*, Exchange Act Release No. 33324, 1993 SEC LEXIS 3437, at *6-8 (Dec. 10, 1993).

[72] *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *42 (June 29, 2007).

rejected. In that proceeding, a Hearing Panel found "it more likely that [the respondent] was willing to take the chance that potential customers would not complain, and that he could retain them as customers."[73]

B. Reporting Violation

The Fifth Cause of Action alleges multiple failures by Sanders to report customer complaints and settlements of customer complaints in violation of NASD Rules 3070 and 2110, along with FINRA Rule 2010. NASD Rule 3070(c) requires that a member firm periodically report customer complaints to FINRA.

Uncontroverted facts establish that Sanders failed to report twenty-eight written customer complaints. Some of the unreported complaints were the subject of settlements in which Sanders himself was involved on behalf of the Firm. He committed the alleged violation of NASD Rule 3070. As discussed above, because he violated this SRO Rule, he also violated NASD Rule 2110 and FINRA Rule 2010.

V. SANCTIONS

A. Guidelines

The Hearing Panel's analysis of the appropriate sanctions starts with FINRA's Sanction Guidelines. The Guidelines contain recommendations for sanctions for many specific violations, depending on the circumstances. They also contain General Principles and overarching Principal Considerations that are applicable, as relevant, in all cases.[74] The Guidelines are intended to be benchmarks, not rigid requirements. This allows adjudicators to take into account all the facts and circumstances, with attention to the regulatory mission of FINRA—to protect investors and strengthen market integrity.[75]

B. Sanctions For Supervisory Violations

The Guidelines contain recommendations for supervisory violations. Although individuals may be suspended from acting in a supervisory capacity as a sanction for a supervisory violation, in egregious cases an individual may be barred. The Guidelines recommend a fine ranging from $5,000 to $50,000. In addition, the Guidelines specifically note that, as set forth in General Principle No. 6, adjudicators may also order disgorgement.[76]

The Guidelines related to supervisory violations specifically discuss three types of Principal Considerations that may bear on sanctions. One is whether the respondent ignored "red flags" signifying that additional supervisory scrutiny should have been applied. In this case, the

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[73] *Joseph Brian Shevlin, Jr.*, No. C10020075, 2003 NASD Discip. LEXIS 46, at *32 (OHO Oct. 2, 2003).

[74] FINRA Sanction Guidelines (2013) ("Guidelines"), http://www.finra.org/industry/sanction-guidelines.

[75] *See* Guidelines at 1, Overview.

[76] Guidelines at 5, 103.

Hearing Panel has found that Sanders was oblivious to numerous red flags—large numbers of customer reneges in connection with account openings and the initial trades in those accounts that suggested unauthorized trading; and turnover, cost-to-equity or commission-to-equity ratios that suggested excessive trading. The Panel also found that Sanders failed to impose heightened supervision, even though over a dozen registered representatives had the kind of history that required them to be more closely supervised.

Various factors cause the Hearing Panel to conclude that Sanders' supervisory failures were egregious. His failures continued for the entire relevant time period—April 2008 through December 2009. This was an extended period of time, not an isolated moment.[77] The red flags were numerous, obvious, and a sign of potentially rampant unauthorized and excessive trading by the Firm's registered representatives. But Sanders did so little in response to the red flags as to amount to the abdication of his supervisory responsibilities.[78] The underlying potentially violative conduct of the registered representatives put investors at risk. There were a large number of transactions that Sanders should have investigated.[79] Sanders took no responsibility for his misconduct and displayed little regard for regulatory concerns or customer protection.[80] Sanders failed to comply with the Firm's own WSPs regarding heightened supervision. That he was the Firm's CCO aggravates this failure to comply with the Firm's policies and procedures.

Moreover, Sanders has a disciplinary history that includes discipline for failure to supervise potential unauthorized trading at another firm. Because of that settlement, Sanders knew that cancelled initial trades—reneges—are considered a red flag of potential unauthorized trading. He also knew that it was unacceptable in the face of so many reneges to rely on the registered representatives without contacting the customers involved. That settlement concerned only twenty-three cancelled initial trades, not the hundreds that Sanders ignored in this case.[81]

In light of the facts and circumstances of the supervisory violations and Sanders' disciplinary history, the Hearing Panel does not believe Sanders is capable of conforming his conduct to the applicable regulatory requirements. Accordingly, in order to protect the investing public and deter Sanders and others from such misconduct, the Hearing Panel bars Sanders from associating with any FINRA member in any capacity. The SEC has recognized that a bar from the industry can be appropriate where the nature of a supervisory violation indicates that the violator is a serious risk to the investing public.[82]

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[77] Guidelines at 6, Principal Consideration 9.

[78] Guidelines at 7, Principal Consideration 13. Sanders's refusal to recognize what the red flags signaled amounted to intentional ignorance or willful blindness. At best, it was extremely reckless.

[79] Guidelines at 7, Principal Consideration 18.

[80] Guidelines at 6, Principal Consideration 2.

[81] SX-2, at 4-5.

[82] The SEC has upheld a bar from the industry where a supervisor failed to act appropriately in response to red flags raising a suspicion of unauthorized trading. *Murphy*, 2013 SEC LEXIS 1933, at *75-92, 111-20.

C. Sanctions For Reporting Violations

The Guidelines with respect to a failure to report information in violation of NASD Rule 3070 are detailed. They cover late reporting, false and misleading reporting, inaccurate reporting, and the complete failure to report. Regardless of whether this case is viewed as involving inaccurate reporting (because some customer complaints were reported) or a complete failure to report (because twenty-eight customer complaints were never reported), Sanders' misconduct qualifies as egregious, and in egregious cases of all types adjudicators may consider suspending the responsible principal in any or all capacities for up to two years or barring that person in all supervisory capacities. A fine of $5,000 to $100,000 may be imposed for inaccurate reporting or a failure to report.[83]

One of the Principal Considerations relevant to reporting violations instructs adjudicators to consider whether the unreported or inaccurately reported events would have established a pattern of potential misconduct. Another of the Principal Considerations relevant to reporting violations is the number of unreported incidents.[84] In this case, these Principal Considerations weigh in favor of stringent sanctions. The additional twenty-eight unreported customer complaints constituted more than half the complaints that should have been reported. In the circumstances here, that is a large number of unreported incidents. By more strongly establishing a pattern, the unreported complaints certainly would have contributed to and strengthened the conclusion that many of the Firm's registered representatives may have been engaging in misconduct.

The Hearing Panel determines that it would be appropriate to suspend Sanders from associating with any FINRA member firm in any and all capacities for one year and to fine him $25,000. The suspension is in the mid-range of suspensions; the fine is less than half the range of recommended fines.[85] However, in light of the sanction for the supervisory violation, these sanctions are not imposed.

VI. CONCLUSION

Brian Sanders violated NASD Rules 3010(a) and (b) and 2110, and FINRA Rule 2010. Accordingly, he is barred from association with any FINRA member in any capacity and ordered to pay costs in the amount of $5408.70, which includes a $750 administrative fee and the cost of the transcript.[86]

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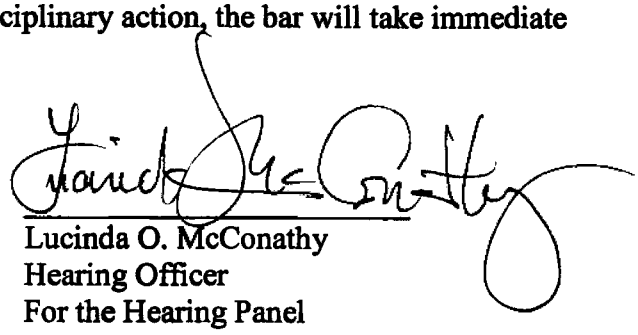
[83] Guidelines at 74.

[84] *Id.*

[85] The National Adjudicatory Council ("NAC") has cited the failure to report eleven customer complaints as a basis for barring a supervisor for FINRA Rule 3070 violations. The NAC declared that the unreported complaints of sales practice abuses would have revealed a pattern of misconduct. *Dep't of Market Regulation v. Kresge*, No. CMS030182, 2008 FINRA Discip. LEXIS 46 (NAC Oct. 9, 2008) (barring respondent in all capacities).

[86] The Hearing Panel has considered and rejects without discussion any other arguments made by the Parties that are inconsistent with this decision.

If this decision becomes FINRA's final disciplinary action, the bar will take immediate effect.



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