BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of	DECISION
Department of Enforcement,	Complaint No. 2009019042402
Complainant,	Dated: July 23, 2015
vs.	
James E. Rooney, Jr. Carrollton, TX,	
Respondent.	

Registered principal failed to supervise, engaged in a private securities transaction without providing written notice to his firm, made an unsuitable recommendation, made misrepresentations, and used misleading sales materials. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Kevin E. Pogue, Esq., Josephina Martinez, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Daniel Ebert Tapia, Esq.

TABLE OF CONTENTS

I. Rooney 1

II. Facts 2

A. Fox Representative HW Learns About NFOA 2

B. NFOA's Sales Literature Contained False and Misleading Representations 4

C. HW Solicits HB to Exchange an Annuity for an NFOA Installment Plan 5

D. HW Informs Rooney About NFOA 5

E. HW Makes Two Additional Sales of NFOA Installment Plans 6

1. OH 6

2. FK and EK 7

F. Lack of Written Notice or Written Approval 8

G. Rooney's Supervision of HW's Activities 10

1. Rooney's Supervisory Roles 10

2. Rooney's Inadequate Investigation of NFOA Installment Plans 11

3. Rooney Never Required HW to Provide Written Notice of His Sales of NFOA Installment Plans or Obtain Written Approval 13

H. Rooney Sells an NFOA Installment Plan 13

1. Rooney Solicits JN to Invest in an NFOA Installment Plan 13

2. Rooney Misrepresents Facts, and Uses Misleading Sales Literature, When Soliciting JN 14

3. Rooney Fails to Provide Written Notice to Fox of His Planned Sale of an NFOA Installment Plan 15

4. JN Agrees to Invest in an NFOA Installment Plan 15

J. Rooney Discovers Problems with NFOA, and Rooney and HW Attempt to Take Remedial Actions 16

K. Collapse of NFOA 17

III. Procedural History 18

IV. Discussion 19

A. Whether the NFOA Installment Plans Were Securities 19

1. Investment of Money 19

2. Is Led to Expect Profits 19

3. Efforts of Others 23

B. Supervision 25

1. General Standards 25

2. Rooney Failed to Supervise by Not Ensuring HW's Compliance with Written Notice and Approval Requirements for Private Securities Transactions 26

3. Rooney Failed to Supervise HW's Recommendations of NFOA Installment Plans for Compliance with the Suitability Requirements 29

4. Enforcement Failed to Prove that Rooney Failed to Supervise HW's Use of NFOA Sales and Advertising Materials for Compliance with Rules Governing Communications with the Public 31

C. Private Securities Transaction 32

D. Reasonable Basis Suitability 33

E. Misrepresentations 33

F. Misleading Sales Materials 34

V. Procedural Arguments 35

A. Delay in Initiating this Disciplinary Proceeding 35

B. Denial of Rooney's Request to Examine a FINRA Staff Attorney as a Witness 39

C. Statute of Limitations 40

VI. Sanctions 41

A. Supervision 41

B. Private Securities Transaction 45

C. Suitability 46

D. Misrepresentations 47

E. Misleading Sales Materials 47

VII. Conclusion 49

Decision

From February 2007 to April 2007, James Rooney ("Rooney") was responsible for supervising a registered representative, HW, who engaged in two private securities transactions of so-called "tax deductible installment plans" issued by National Foundation of America ("NFOA"). Rooney also solicited a customer, in his own private securities transaction away from his firm, to purchase an NFOA tax-deductible installment plan. Although these installment plans were purported to be "tax deductible" and to offer "guaranteed income," in reality the plans offered neither benefit but instead were a nationwide fraudulent scam perpetrated by NFOA.

In the proceedings below, a FINRA Extended Hearing Panel found that Rooney failed to supervise HW's sales of NFOA installment plans, in violation of NASD Rules 3010 and 2110. It also found that Rooney, when himself selling an NFOA installment plan to his customer, engaged in a private securities transaction without written notice to or written approval from his firm in violation of NASD Rules 3040 and 2110, made an unsuitable recommendation in violation of NASD Rules 2310 and 2110, misrepresented material facts in violation of NASD Rule 2110, and used misleading sales literature in violation of NASD Rules 2210(d) and 2110.[1] For these violations, the Extended Hearing Panel imposed on Rooney fines totaling $75,000, all-capacity suspensions totaling two years (to be served consecutively), an 18-month suspension in all supervisory capacities (to be served concurrently with the all-capacity suspensions), and a requirement that he requalify as a general securities representative and general securities principal.

On appeal, we affirm the Hearing Panel's findings, although our findings that Rooney failed to supervise and used misleading sales materials are on narrower grounds than the Hearing Panel's. We, however, modify slightly the total sanctions imposed by the Hearing Panel. We suspend Rooney in all principal or supervisory capacities for 18 months, impose all-capacities suspensions totaling 23 months, impose fines totaling $72,500, and order that he requalify as a general securities principal and general securities representative.

I. Rooney

Rooney entered the securities industry in 1988. From May 2004 through December 24, 2013, Rooney was registered with, and was a direct owner of, Fox Financial Management Corp. ("Fox" or "the Firm"), a small firm. During the time of the alleged misconduct, February through April 2007, Rooney was registered with Fox as a general securities representative and a general securities principal.[2] In 2007, Rooney also owned, and was president of, North Texas Insurance Group, an affiliate of Fox. Rooney is not currently registered with a broker-dealer, but he is currently registered in Texas as an investment adviser with Fox Wealth Advisers, LLC.

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

[2] When Fox terminated Rooney's registration in December 2013, he also was registered with Fox as an operations professional.

II. Facts

A. Fox Representative HW Learns About NFOA

Among the representatives that Rooney supervised was HW, who joined Fox in April 2006. HW also joined Rooney's insurance agency, North Texas Insurance Group.

Around the beginning of 2007, HW received a postcard from NFOA. NFOA was a Tennessee non-profit corporation, which sold contracts throughout the United States that promised a tax deduction and fixed payments, at an unspecified rate of return over a term chosen by the investor. Purchasers of NFOA contracts used cash or agreed to transfer ownership of stocks, real estate, or annuities to obtain an NFOA contract. NFOA represented itself to the public as a charitable organization.

According to HW, the postcard indicated that NFOA offered a product that allowed persons to donate their appreciated or illiquid assets and receive an income stream.[3] When HW received the postcard, HW's insurance customer HB, who was approximately 80 years old, was looking for a way to provide his wife with a sum of money from a fixed annuity he owned but was not pleased with the surrender penalties and taxes he would have to pay to do so.[4] When HB asked HW if there was a "better way," it prompted HW to contact NFOA to get more information.

HW spoke with an NFOA representative, who informed him about NFOA's installment plans, its asset exchange program, and how it applied to "donat[ions]" of annuities. The NFOA representative told HW the following: that NFOA was a tax-exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code; that an annuity owner could donate an annuity to NFOA; that NFOA would take a portion of the annuity "for the charitable part"; that the annuity owner would pick a time frame to receive his money back; and that NFOA would value the donated annuity at the "accumulated value" not the "surrender value." HW understood that these features meant that a participant could obtain a tax deduction and avoid high surrender fees when exchanging annuities for NFOA plans. HW, however, did not know what NFOA did

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[3] The postcard is not in the record. Paul Eggers ("Eggers"), the special deputy appointed to oversee the NFOA receivership (which is further described below) and who became familiar with NFOA's business practices, testified that NFOA mass-mailed postcards to registered and licensed agents advertising that NFOA would pay a 9% commission to an agent who had his client transfer to NFOA an existing annuity, which would be valued at the annuity's "full accumulated value," not its surrender value. HW testified that the "surrender value" of an annuity is the annuity's "accumulated value" minus the surrender penalty. *See* Insurance Information Institute, "What Are Surrender Fees," http://www.iii.org/article/what-are-surrender-fees (last visited Apr. 1, 2015) (explaining that when money is taken out of an annuity, there may be a penalty called a "surrender fee" or a "withdrawal charge").

[4] HW recalled that HB would have had to pay fees "in the 8, 9 percent range" to surrender his fixed annuity.

with the donated annuities, and HW did not discuss with the NFOA representative whether there was any penalty associated with an annuity exchange or surrender penalties.

Subsequent to that conversation, NFOA sent to HW a general brochure ("Brochure") and a flyer ("Flyer") describing NFOA and its "Tax Deductible Installment Plans" (referred to in this decision as "tax deductible installment plans" or "installment plans").[5] The Brochure made representations about NFOA's purported charitable focus and the tax benefits that came with it. It represented that NFOA "is a Tennessee 501(c)(3) public charity" that "provides simple plans that extend tax relief to individuals and families nationwide." The Brochure further claimed that "[w]hen you choose NFOA we are able to help millions of needy men, women, and children around the world," including "the hurting," "the homeless," "orphans," "those affected by recent natural disasters," and Africans suffering from AIDS.

The Brochure and Flyer also contained purported details about the installment plans. The Brochure explained that such installment plans offered "[g]uaranteed, fixed, tax-favored income for a guaranteed period of years," could be "funded with a variety of assets," and came with "[n]o market risks." The Brochure stated that "[w]hen you exchange an asset for a Tax Deductible Installment Plan you receive" a "Generous Income Tax Deduction" that "can be used to lower adjusted gross income . . . by up to 50%," "Tax Favored Income," a "substantial portion" of which is "tax-free in most cases," and "Guaranteed Income that Grows Each Year." The Brochure further explained that an annuity could be exchanged at its "full accumulation value" and that NFOA would "absorb[ ] all surrender penalties." The Flyer advertised similar benefits for those exchanging annuities for installment plans, including exchanges "at the [annuities'] accumulated value, not the surrender value," an "[i]mmediate tax deduction" that "lowers your adjusted gross income reported to the IRS by up to 50%," and "[g]uaranteed fixed income that grows each year."

The Brochure also made representations concerning the alleged safety of the installment plans. It indicated that "NFOA assures the safety of assets in many ways, including extensive internal controls to reduce the risk of losses and insurance" and that "[t]he safety and security of assets is paramount." It also touted NFOA's choice of SEI Private Trust as the institution that held the assets and indicated that SEI Private Trust segregated the assets of the participants in NFOA installment plans.[6]

Both the Flyer and the Brochure included illustrations. The Flyer's illustration described that a couple who transferred to NFOA an indexed annuity with a $113,000 accumulated value and a 10% surrender fee received: (1) a new NFOA installment plan issued for $113,000, the

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[5] Eggers testified that the Brochure and Flyer were "marketing materials that NFOA made available."

[6] The Brochure stated that SEI Private Trust was "chartered as a federal savings association limited to the exercise of trust and related powers," was "[p]ublicly held," and had a "35-year history," "$15.7 billion under management," and "[g]lobal assets . . . over $126 billion."

same amount as the accumulated value of the exchanged annuity; (2) $9,867 in annual payments guaranteed for 30 years, after a 10-year deferral period; (3) a $63,934 income tax deduction; and (4) a "Total Term Pay-out" of $296,010. Thus, the illustration portrayed that a hypothetical investor would receive far more than the surrender value of the exchanged annuity. The NFOA Brochure contained a similar illustration involving the purchase of an NFOA installment plan for cash.

B. NFOA's Sales Literature Contained False and Misleading Representations

Many of the claims in NFOA's sales literature were false and misleading. First, representations that NFOA was an approved 501(c)(3) organization were false, and representations that purchases of NFOA installment plans were tax-deductible were misleading. Although NFOA filed in January 2006 an application with the IRS to be recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, that application remained pending in 2007. Eggers testified that, while NFOA's application for 501(c)(3) status was pending, there was no guarantee that purchases of installment plans would be tax deductible. In 2008, after the relevant period, the IRS denied NFOA's application.

Second, although the NFOA sales materials claimed that the NFOA installment plans provided "guaranteed income" and touted their "safety and security," they did not disclose that investor funds were deposited in accounts subject to market risk. Generally, NFOA allocated 59% of NFOA's funds into fixed income securities, 40% into equities, and 1% in cash. In addition, Eggers testified that he found no evidence of any effort by NFOA to secure guarantees for the promised payments.

Third, contrary to representations in NFOA's sales materials, investor funds were not segregated. Rather, all funds received by NFOA were held in NFOA's name in three custodial accounts at SEI Investments, pursuant to NFOA's investment advisory agreement with Stonebridge Investment Counsel, Inc. ("Stonebridge").

Fourth, the representations in NFOA's sales literature about NFOA's purported charitable efforts were grossly misleading. As the IRS later found in its 2008 denial of NFOA's application for 501(c)(3) status, the money that NFOA reported to charitable programs in 2006 was "less than one half of one percent of the total revenues . . . reported," "the funds for charitable programs [were] approximately three percent of the total expenses reported to operate" NFOA in 2006, and NFOA's activities did not qualify as "charitable." Instead, the IRS found that NFOA's activities, which "consist primarily of performing services for individuals who wish to exchange assets for annuity plans as an estate planning tool," constitute "common commercial activities." Eggers testified it also came to light that NFOA's president used investor assets as his "personal piggy bank," using such funds for daily expenses, restaurant expenses, purchases from liquor stores, furniture, dock fees for his boat, the settlement of a dispute with his former company, and the purchase of a Las Vegas condominium.

C. HW Solicits HB to Exchange an Annuity for an NFOA Installment Plan

From January 2007 through April 2007, HW sold NFOA installment plans to four persons, none of whom were customers of Fox. The first customer was HB.[7]

Around February 22, 2007, HW told HB about the NFOA installment plans. HW also showed HB an NFOA-produced illustration that was specific to HB's circumstances. The illustration showed that HB could transfer his annuity to NFOA, take $50,000 in a lump sum immediate payment, exchange the $250,744 "remainder of that annuity" for an NFOA tax-deductible installment plan, defer payments for five years, and then have $32,249 paid annually to his daughter for the next ten years. The illustration summarized that HB would receive a total payout of $322,494 and would obtain a $73,376 tax deduction. HW could not recall if he showed HB the Brochure and the Flyer.

HW testified that HB was interested in how the NFOA installment plan would allow him to provide his daughter with money "over a period of time," but that HB "could care less about the tax deduction" and "didn't really care about" the income that would be generated. HB decided to exchange his annuity for an NFOA installment plan. HB signed the required paperwork, including a form that transferred his annuity to NFOA. HB "got his $50,000 within a couple of weeks," and HW received a $20,139 commission. HW testified that, at that time, "everything seemed to be fine."

D. HW Informs Rooney About NFOA

After HW sold an NFOA installment plan to HB, he mentioned NFOA to Rooney. Without going into any specifics, HW explained to Rooney why he had sold an NFOA installment plan and opined that he "thought it was a pretty good deal." HW also provided to Rooney the NFOA Brochure and Flyer, which Rooney reviewed.[8] At this point, Rooney should have been on notice of the need to conduct an inquiry into the nature and classification of the NFOA installment plans and whether there was a reasonable basis to recommend them to investors.

In late February 2007, Rooney and HW participated in a conference call with NFOA's president and other NFOA representatives.[9] Based on HW's testimony and the parties' stipulations, the call went as follows. NFOA representatives claimed that NFOA was recognized

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[7] While HW's first solicitation to HB contains relevant background information, it is not the direct subject of any of allegations in the complaint.

[8] At his on-the-record interview, Rooney testified that HW also was interested at that time in whether he could earn money through other Fox representatives' sales of NFOA installment plans.

[9] HW testified that a Fox representative, LT, was also on the call. In contrast, Rooney testified that LT and SB, who was Fox's operations manager and chief financial officer and the person who supervised Rooney's handling of his own accounts, were also on the call.

by the IRS as a charitable non-profit organization under Section 501(c)(3) of the Internal Revenue Code, and that customers who purchased NFOA installment plans could receive a tax deduction. NFOA representatives also discussed the "basics" of the installment plan contracts and how persons with illiquid assets who wanted their assets to "appreciate in value" could obtain some "liquidity" using those contracts. There was no discussion, however, about the charitable organizations NFOA supported, how NFOA planned to guarantee the income streams in the installment plans, the amounts of the tax deductions that would be available, how investor funds would be handled, how NFOA was able to issue plans at the full accumulated value of annuities that were exchanged, or whether there was any market risk involved. The only question that HW asked during the call was whether NFOA's president had ever been convicted of a crime, to which NFOA's president responded in the negative.

In Rooney's version of the call, which he provided during an on-the-record interview, he was more probing of the details of NFOA's installment plans, but nevertheless admitted that there were areas about which he did not ask or did not have an interest.[10] Without expressly addressing HW's and Rooney's different versions of what transpired on the conference call, the Hearing Panel generally relied on HW's version of the call.[11]

E. HW Makes Two Additional Sales of NFOA Installment Plans

1. OH

Pleased with how HB's transaction went, HW decided to solicit other customers to exchange annuities for NFOA installment plans, beginning in March 2007 with OH. OH, who was in his 70s, disliked that an annuity he owned—that HW had sold to him years before—was

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[10] According to Rooney, he asked NFOA how its product was "classified" and "what type of insurance product it was" and that NFOA "confirmed" that its products were "non-securities" and insurance products, "just like any other . . . fixed annuity or charitable remainder trust." He asked NFOA questions about how large a participant's tax deduction could be each year, why a participant's entire contribution was not tax deductible, how the "time value of money" affected the payment calculations, how the income tax deduction and tax-free payments were calculated, and "how [NFOA] arrived at a factor." Rooney recalled that NFOA indicated its funds would be invested "in short term bonds or something," represented itself to be a "charitable foundation," and never claimed it was an insurance company. At the same time, Rooney did not recall asking NFOA representatives if returns were guaranteed and admitted that "what [NFOA] did to try to generate a promised rate of return, you know, was really behind the scenes that we didn't have any interest in." Likewise, although he claimed to have asked which charities NFOA supported, Rooney was admittedly indifferent, summarizing that giving to NFOA was "like when you give money to the United Way. They're just a frontline, right? What they decide to do with your charitable donation is something that you trust the frontline to do."

[11] For purposes of this decision, we also credit HW's version of the call. But even if we were to credit Rooney's version, we would still find that his investigation into NFOA was deficient, as explained more below.

"not making enough income." HW completed and sent to NFOA an "illustration worksheet" showing, among other things, that the accumulated and surrender values of OH's existing annuity were $25,051.00 and $23,388.27, respectively, and that OH sought immediate monthly income of $200 for five years.

HW could not remember whether he provided the Brochure or Flyer to OH. HW testified, however, that he discussed with OH the points that were covered in the Brochure and Flyer, including that NFOA was a Section 501(c)(3) organization. In addition, HW discussed with OH a scenario whereby OH would exchange his annuity, take approximately $12,000 in a lump sum immediate payment, donate another $250 to charity, and put the "balance" in an NFOA installment plan. According to an NFOA-prepared "Installment Plan Flow Chart" and "1099 Statement," which HW provided to OH, OH would receive an "Immediate 5 Year Payout" installment plan valued at $12,608, $2,400 in annual income for five years, a "total payout" of $12,000, a "tax deduction" of $3,568, and "tax savings" of $892. Thus, for OH's $23,388.27 surrender value of his annuity, he was led to expect that he would receive $24,250, in addition to promised tax benefits. The 1099 Statement, which listed the dates and amounts of payments that would be made under the installment plan, displayed that $10,309 of the payments were "principal" and would be "reported as tax free," and that the remaining $1,690 of the payments were "interest" and would be "reported as ordinary income."

On March 6, 2007, OH signed a contract to exchange his annuity for an NFOA installment plan, under which OH was to immediately receive monthly payments of $200 for five years ($2,400 annually).[12] OH also signed a form requesting that the issuer of his annuity transfer ownership to NFOA. HW provided those forms to NFOA, and NFOA immediately sent the form requesting transfer of ownership to the annuity issuer. HW expected to receive a commission for his sale.

As explained more below, the issuer of OH's existing annuity never transferred ownership to NFOA and, although OH was supposed to immediately receive a lump sum immediate payment, he never did.

2. FK and EK

Around April 2007, HW solicited FK, who was in his 70s, to exchange an annuity for an NFOA installment plan. Around that time, FK was complaining about the low return on a fixed annuity he owned and that he wanted to "get something out of it."

HW submitted to NFOA an "illustration worksheet" with information about, among other things, the $59,136 accumulated value and $57,203 surrender value of FK's existing annuity and FK's preferences regarding the length of time income payments would be deferred and paid. In return, HW received an "Installment Plan Flow Chart" and a "1099 Statement" showing an

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[12] HW testified that NFOA investors were permitted to direct approximately one percent of an investment with NFOA to a charity. After discussing it with OH, HW sent a memorandum to NFOA requesting that the "small donation" be made to HW's daughter's school.

illustration for a "7 Year Flexible Deferred/3 Year Payout" installment plan. They showed that in exchange for his existing annuity, FK would receive an NFOA installment plan with a $59,136.46 "total value"—the same amount as the accumulated value of FK's existing annuity. It further showed that FK would receive no payments for seven years, an annual payout of $26,675.25 for the next three years, a "total payout" totaling $80,025.76, an $11,716 "tax deduction," and $2,929 in "tax savings." The 1099 Statement also detailed that of the $80,025.76 in payouts, $77,918.99 was "principal" and would be "reported as tax free," and $2,106.77 was "interest" and would be reported as "ordinary income."

Around April 25, 2007, HW presented the Installment Plan Flow Chart and the 1099 Statement to FK, and informed him that NFOA was a 501(c)(3) organization. HW was not asked at the hearing whether he provided the Brochure or the Flyer to FK or his spouse, EK.

On April 26, 2007, FK and EK signed an NFOA installment plan contract and agreement to exchange an annuity for a "flex deferred" NFOA installment plan, under which payments would be deferred for seven years and then paid for three years. FK and EK also signed a transfer of ownership form, authorizing the issuer of FK's annuity to transfer ownership to NFOA. HW sent both forms to NFOA. As with his other sales of NFOA installment plans, HW expected to receive a commission for his sale to FK and EK.

As explained more below, the issuer of FK's existing annuity never transferred ownership of the annuity to NFOA.

F. Lack of Written Notice or Written Approval

The record demonstrates that HW did not provide written notice or receive written approval to participate in sales of NFOA installment plans, but that he did provide some level of verbal notice and received some level of verbal approval.

HW provided the following relevant testimony. HW admitted that he did not make a written request to his firm for permission to engage in sales of NFOA Installment Plans or receive written approval. Before his first sale to HB, HW briefly spoke with a Fox compliance employee, BM, about NFOA. BM asked HW if the NFOA product was a security. HW responded that it was not a security but "a donation to charity, fundraising basically," to which BM replied, "if it's not a security, why are you telling me this" and "if it's not a security, don't worry about it." BM asked to see paperwork related to HW's belief that the product was not a security and HW "probably just gave him the [NFOA] brochure."

As described above, HW mentioned NFOA to Rooney after selling an NFOA installment plan to HB in February 2007, provided to him the Brochure and the Flyer, and participated with Rooney in a conference call with NFOA. In addition, a few days after HW's sale to HB, and before his sales to OH and FK/EK, HW verbally informed BM that "I might do this again" and "would feel better if you added this to my [outside business activities]." BM said "okay," and on March 1, 2007, the words "National Foundation of America, 10-15 hours per week" were added to the "other business" section of HW's Form U4, which already listed "North Texas Insurance

Group: Fixed Insurance Products" as an outside activity.[13] This is the second point at which Rooney should have reacted to HW's sales and conducted due diligence into NFOA.

HW did not complete an outside business activities approval form for his NFOA-related activities, despite HW's belief that the NFOA installment plans were insurance products and that Fox's procedures required that representatives provide written notice of their outside business activities. HW testified that "it didn't seem like it mattered" because he already had insurance approved as an outside business activity.

HW testified that he never received approval to engage in a securities transaction in connection with his sales of NFOA installment plans but, at the same time, that Rooney "and others" at Fox verbally informed him that it would be acceptable to sell NFOA installment plans. Consistent with HW's testimony, the record contains no documentary evidence that HW provided written notice of his sales of NFOA installment plans or that Fox provided HW with written approval of his sales, apart from a brief amendment to HW's Form U4 that contained no level of specificity or detail.

Similarly, Rooney admitted at the hearing that he did not require HW to provide written notification of his participation in sales of NFOA installment plans, that neither he nor the Firm approved HW's sales, that there was no documentation on his part of any approval of HW's participation in the sales, and that he participated on a conference call with HW and NFOA representatives. Rooney's hearing testimony in this regard was largely consistent with both HW's testimony and the lack of any documentary evidence of written notice or approval, and it contained significant admissions against his own interest.[14]

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[13] The Form U4 shows that SB, the Firm's operations manager and chief financial officer, approved the Form U4 amendment on behalf of Fox. Subsequently, the outside activities section of HW's Form U4 would be changed a couple of times. On March 20, 2007, it was amended to delete all references to NFOA. Rooney speculated during his on-the-record interview that the NFOA sales were previously included because it "was a new product and we're trying to over explain it" and subsequently deleted because they were already "covered under insurance sales." On May 9, 2007, "National Foundation of America" was again added to the outside activities section of HW's Form U4, which Rooney speculated "appear[ed] to be a mistake." At his on-the-record interview, Rooney initially said he was responsible in 2007 for making updates to the outside activities section of Forms U4, but then claimed, after being shown the changes to HW's Forms U4, that SB was responsible for Form U4 filings.

[14] Prior to the hearing at an on-the-record interview, Rooney offered markedly different testimony concerning whether HW provided written notice and received written approval of his sales. Rooney testified that HW submitted an outside activity approval form requesting to sell NFOA, that he could not recall if HW submitted that form to him or SB, that either he or SB approved that written request, that HW's Form U4 was amended to reflect NFOA as an outside activity, that "Fox . . . approved [HW's] participation in the sale of NFOA [installment plans] as an insurance product through North Texas Insurance Group," and that he had spoken with HW "at length" about the NFOA installment plans. Likewise, Rooney testified at his on-the-record

[Footnote continued on next page]

Based on the lack of documentary evidence of written notice or written approval, HW's testimony, and Rooney's admissions against interest, we find that HW never submitted written notice of his sales of NFOA installment plans and, consequently, never received written approval from anyone at Fox to engage in such sales. At the same time, we find that HW provided verbal notice of his sales, albeit in a manner that conveyed few relevant details about his proposed transactions, his proposed role, or his expected compensation. We also find that HW received verbal approval from Rooney, SB, and BM to engage in such sales as an outside business activity.

G. Rooney's Supervision of HW's Activities

1. Rooney's Supervisory Roles

During 2007, Rooney had various supervisory roles at Fox. He was president, chief compliance officer, branch office manager of Fox's only branch, and the person responsible for supervising all of Fox's registered representatives, including HW.[15]

Rooney was delegated specific supervisory responsibilities in Fox's written supervisory procedures ("WSPs"). The parties stipulated that, with respect to private securities transactions, the WSPs required its associated persons to provide written notice to the Firm prior to participating in any private securities transactions, describing in detail the proposed transaction, the person's proposed role therein, and whether the person had received or may receive selling compensation in connection with the transaction. The parties further stipulated that the WSPs further required the designated supervisory principal to approve or disapprove in writing any associated person's request to engage in the private sales of securities outside of their normal association with the Firm, and that Rooney was one of two supervisory principals designated or delegated with this supervisory responsibility concerning approving or disapproving written requests to engage in private sales of securities.[16]

[cont'd]

interview that he believed that North Texas Insurance Group and NFOA entered into a selling agreement.

[15] During 2007, there were approximately eight registered representatives at Fox.

[16] To engage in outside business activities, Fox's WSPs similarly required representatives to submit a written proposal detailing all activities that the individual intended to engage in, including where activities would be conducted, the times and dates, and the scope. Fox's "outside activity approval" form contained a section titled "notification of response" indicating that the Firm, upon receiving notice of proposed outside business activities, would either approve or disapprove them. The WSPs also provided in a section titled "Outside Activities" that "[u]nless approved in writing by the Supervisory Principal, no registered representative may be employed or accept compensation from another broker dealer, insurance company or investment related company . . . other than through [Fox]." At his on-the-record interview, Rooney testified

[Footnote continued on next page]

Rooney also had relevant supervisory responsibilities concerning compliance with the rules governing the suitability of recommendations and the use of sales literature and advertising. With regard to suitability, Rooney admitted that as Fox's branch manager and compliance officer in 2007, he was responsible for ensuring that due diligence was conducted with respect to recommended products. Rooney also was designated with responsibility to approve all sales literature and advertising prior to use.

2. Rooney's Inadequate Investigation of NFOA Installment Plans

As explained above, Rooney was aware, from at least late February 2007, that HW intended to engage in additional solicitations and sales of NFOA installment plans away from the Firm and expected to receive commissions. And in early March 2007, Rooney should have been aware that Fox had added NFOA to HW's Form U4 as an outside business activity. Despite this and his responsibility to conduct due diligence on products that Fox representatives recommended, Rooney conducted an inadequate investigation into NFOA.

Rooney testified at his on-the-record interview that he spoke with HW "at length" about the NFOA installment plans, discussed the product's characteristics with Fox's vice president of estate planning, LT, and also discussed it with SB. Rooney explained that he talked to LT because of his background in insurance and that they discussed similarities between NFOA's installment plans, charitable gift annuities, and charitable remainder trusts. As discussed above, Rooney also reviewed NFOA's marketing materials and talked to NFOA's president and representatives on a conference call that, as HW testified, was not very probing.

There is no evidence, however, that Rooney took any other steps to investigate NFOA prior to HW's sales to OH and KK/EK or, as described more below, his own sale of an NFOA installment plan. Indeed, Rooney admitted at the hearing that "I didn't perform the due diligence." For example, although he claimed that he thought the NFOA installment plans were insurance products, there is no evidence that Rooney performed any investigation to determine whether the NFOA installment plans were insurance products and not securities. Although the Brochure and the Flyer that Rooney reviewed promised "guaranteed" income, there is no evidence that Rooney investigated the nature of those guarantees. Although Rooney understood that the tax deductibility of purchasing an NFOA installment plan was contingent on IRS approval of NFOA as a Section 501(c)(3) organization and believed NFOA's representations that it had received such approval, he never contacted the IRS or examined the IRS website to

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[cont'd]

that if someone at Fox wanted to engage in "an outside business," such person would come to him. Rooney did not specify whether Fox representatives also would come to him for approval of private securities transactions.

confirm whether NFOA was an approved organization under Section 501(c)(3).[17] Rooney also admitted that he never contacted the entity that previously employed NFOA's president.

While Rooney conceded that he did not conduct due diligence, he testified that when HW informed him about NFOA's products in February 2007, he "immediately" asked JF, Fox's lawyer (and, up to a certain point, Rooney's lawyer in these proceedings), to conduct due diligence on NFOA, including to investigate whether NFOA's installment plans were securities. Rooney claimed that he did not know what JF did "behind the scenes," but speculated that he "spent the next month" trying to contact NFOA's president on the phone, "maybe writing the IRS," or "maybe filling out a form or something asking . . . what the status was." The Hearing Panel, however, expressed doubt in Rooney's testimony that he asked JF to conduct due diligence at the time he was informed about NFOA, and there is not substantial evidence in the record to warrant overturning that implicit credibility determination.[18] In any event, despite Rooney's claims that he asked his lawyer to conduct due diligence, he makes no claim that his lawyer reported back anything prior to HW's and Rooney's sales.[19]

Because Rooney made no reasonable efforts to investigate NFOA's representations, one of the things he did not discover is that, in September 2006—six months before HW's sales—the State of Washington Insurance Commissioner issued a cease and desist order against NFOA and two of its officers, including its president. That order, which was posted on a web site on September 28, 2006, stated among other things that NFOA and its officers had misrepresented to prospective agents and purchasers that NFOA had been granted an exemption under Section 501(c)(3) of the Internal Revenue Code.

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[17] Rooney claimed that he did not contact the IRS because he believed that an organization's 501(c)(3) status is "not public information." Eggers testified, however, that the IRS web site contains information about what organizations have been approved as 501(c)(3) organizations. Consistent with Eggers' testimony, the IRS web site currently allows "users to search for and select an exempt organization and check certain information about its federal tax status and filings." *See EO Select Check*, http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check; *Search for Charities*, http://www.irs.gov/Charities-&-Non-Profits/Search-for-Charities (last visited Apr. 1, 2015).

[18] Indeed, the person who was appointed as Fox's chief compliance officer after the events in question represented to FINRA that, prior to May 8, 2007—which was after all the relevant sales in this case—Fox "did not conduct an investigation [concerning the sale of NFOA products]." The chief compliance officer asserted that no investigation was done because "NFOA represented to Mr. Rooney that its product was not a security and because charitable gift annuities are routinely sold through insurance agencies."

[19] Eventually, and as a result of a later request by Rooney to investigate NFOA, JF informed Rooney that "this thing is not a 501(c)(3)." Rooney admitted that he did not receive this information until after HW's and his sales of NFOA installment plans occurred.

3. Rooney Never Required HW to Provide Written Notice of His Sales of NFOA Installment Plans or Obtain Written Approval

While it is unclear the extent to which Rooney may have discussed with HW whether the NFOA installment plans were securities,[20] as we find above Rooney did not require HW to provide written notification to Fox of his participation in sales of NFOA installment plans. Likewise, while HW received some level of verbal approval to engage in sales of NFOA installment plans as an outside business activity, Rooney never provided HW with written approval to engage in private securities transactions and never ensured that HW received such written approval from the other Fox supervisor who was authorized to approve private securities transactions.

H. Rooney Sells an NFOA Installment Plan

1. Rooney Solicits JN to Invest in an NFOA Installment Plan

Apart from his supervisory responsibilities, Rooney also was the assigned registered representative on approximately 20 Firm customer accounts. In March 2007, after learning of NFOA from HW and talking with NFOA's president, Rooney solicited JN to purchase an NFOA installment plan.[21]

JN was a customer of Fox, approximately 61 years old, and in ill health. Rooney helped JN "with everything," including handling his mail, buying his groceries, helping him redeem old savings bonds, and arranging for health care providers to visit his home. Rooney testified that JN had a net worth of approximately $2 million and wanted to plan for what would happen to his money in the event of his death. JN had an existing annuity that, according to Rooney, JN no longer wanted. The annuity had a surrender value of $55,314.87 and an accumulated value of $63,675.46.

Rooney thought the combined features of the NFOA installment plan might appeal to JN, including the "purported benevolence attached to it," the tax deduction, and the fact that his beneficiaries would not "get a chunk [of money] at one time." Rooney saw as a primary benefit that the NFOA installment plan would "provide [JN] . . . an immediate tax deduction to utilize while he was alive that could offset up to 50 percent of his income and lower his tax bill for his foreseeably short predicted lifespan." Rooney suggested in his on-the-record interview that he

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[20] HW offered conflicting statements concerning the extent to which Rooney discussed with him whether the NFOA installment plans were securities. At the hearing, HW claimed that he never discussed with Rooney whether the NFOA installment plans were securities. At his on-the-record interview, however, HW testified that he had a discussion with Rooney and LT about whether the products were securities and that Rooney at one point told him, "if it's not a security, it has nothing to do with Fox."

[21] Rooney's sale occurred after HW's sale to OH, and before HW's sale to FK/EK.

asked NFOA about specific scenarios for JN and about how the amounts of the tax-free installment payments were calculated.

2. Rooney Misrepresents Facts, and Uses Misleading Sales Literature, When Soliciting JN

When soliciting JN to exchange his annuity for an NFOA installment plan, Rooney told JN that NFOA was a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and that JN would obtain a tax deduction when exchanging his annuity. For the reasons explained above, however, Rooney's representation that NFOA was a tax-exempt organization was false, and Rooney's representation that JN was entitled to receive a tax deduction was misleading.

Rooney also presented JN with an explanatory statement titled, "Exchanging Annuities for NFOA Installment Plan Immediate 10-Year Period-Certain Income Stream" ("Explanatory Statement") and an NFOA Installment Plan "1099 Statement." The Explanatory Statement indicated that the NFOA installment plan "would allow . . . clients to enjoy a significant income tax deduction, which lowers their income tax liability, and creates spendable money, along with a fixed, secure income stream that is not subject to market fluctuations." The Explanatory Statement promised that an annuity exchange would involve an exchange of assets for a "guaranteed payout for a guaranteed period of time, a generous tax deduction, and many other benefits."

The Explanatory Statement also contained information specific for JN. It indicated that JN could exchange an existing annuity with an accumulated value of approximately $63,675.46 "with a 13% surrender penalty" for an NFOA installment plan that promised 10 years of annual income of $6,366.16 (or 10 years of monthly income of $530.51), beginning immediately upon transfer of JN's existing annuity. The Explanatory Statement further represented that the "total payout" over the life of the plan would be approximately $63,661.65, that the 13% surrender penalty "would be absorbed into the transaction by NFOA," and that an "income tax deduction" of $24,975 and a "total tax free" amount of $49,780.49 would result from the investment. Thus, NFOA led JN to expect that, in exchange for his annuity, which had a surrender value of $55,314, he would receive $63,661.65 plus tax benefits.

The Explanatory Statement did not: (i) reflect that the total payout amount included a return on principal; (ii) describe a rate of return; (iii) offer detailed descriptions of the tax deductions and tax savings; or (iv) explain how the tax figures were calculated.[22] It also did not disclose that NFOA was not an approved 501(c)(3) tax-exempt organization and that there was

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[22] The only tax-related assumption in the Explanatory Statement was that "your clients' income tax bracket is 25%." It also explained that "[w]hen applicable, clients have a total of 6 years in which to apply the deduction."

no guarantee an investment would qualify for a tax deduction.[23] As a result, the descriptions of the investment returns were at best oversimplified and exaggerated, and the descriptions of the tax savings and tax deductions were oversimplified, incomplete, and misleading.

3. Rooney Fails to Provide Written Notice to Fox of His Planned Sale of an NFOA Installment Plan

Rooney did not request in writing Fox's permission to engage in the sale of an NFOA installment plan to JN. Rooney testified that he believed the NFOA installment plans were "insurance products" and that he had "already amended [his] U4 when [he] joined [Fox] to reflect that [he] was an insurance agent and . . . sold insurance products." Although he provided no written notice, Rooney testified that SB, who supervised Rooney's activities with respect to his own customer accounts, was "very much aware of the sale of the NFOA product."[24] Consistent with that assertion, the evidence shows that SB was involved in obtaining illustrations from NFOA that pertained to JN and was aware, at some level, of Rooney's participation in the transaction. Rooney did not receive anything in writing from Fox approving his participation in NFOA sales.[25]

4. JN Agrees to Invest in an NFOA Installment Plan

JN agreed with Rooney's recommendation and, on March 20, 2007, JN signed an NFOA Installment Plan Contract and Agreement. Rooney signed the contract as the "Financial Advisor." The contract falsely stated that NFOA was recognized by the IRS as a charitable non-profit organization under Section 501(c)(3) of the Internal Revenue Code. JN also signed a service request that directed the insurance company that held his annuity to transfer ownership of his annuity to NFOA. Rooney also provided to JN a form to use to authorize NFOA to directly deposit funds that he would purportedly be earning into his account at Southwest Securities, which JN signed.

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[23] Rooney also provided JN with an NFOA Installment Plan "1099 Statement." Like the 1099 Statements provided to HW's customers, the 1099 Statement presented, for each year of JN's proposed Installment Plan: (1) the amount of each annual installment payment; (2) the amount that would be "reported as tax free" and that constituted "principal"; and (3) the amount that would be "reported as ordinary income" and that constituted "interest." For the reasons explained below, we find that Enforcement did not prove that the 1099 Statement was misleading.

[24] SB was authorized to raise any compliance-related issues pertaining to Rooney's account with the chief compliance officer of Fox's clearing firm, Southwest Securities.

[25] As explained above, Rooney claims to have asked the company's lawyer to conduct due diligence into NFOA. When Rooney was confronted about why he proceeded with his sale to JN despite not having received the results of his lawyer's due diligence investigation, Rooney testified that he "ha[d] no concerns" because "it takes several months at times to liquidate an annuity" and "that money is not going any time soon."

Rooney immediately forwarded the contract and transfer of ownership documents to NFOA. On March 22, 2007, NFOA forwarded to the insurance company that held JN's existing annuity a letter attaching the transfer of ownership documents and requesting that ownership of JN's annuity be transferred to NFOA. Rooney expected to receive compensation from NFOA in connection with his sale of the NFOA installment plan contract to JN.

J. Rooney Discovers Problems with NFOA, and Rooney and HW Attempt to Take Remedial Actions

On or about May 8, 2007, Rooney learned of an inquiry regarding NFOA by the Texas State Securities Board and asked JF to perform due diligence on NFOA.[26] On the same day, Fox's counsel called NFOA's president, who indicated that NFOA was experiencing regulatory issues, including state-issued cease and desist orders, and was not an approved 501(c)(3) organization as it had claimed. JF, in turn, informed Rooney that NFOA was not an approved 501(c)(3) organization.[27]

Sometime after May 8, 2007, Rooney and JN contacted the insurance company that issued JN's existing annuity in an effort to cancel the transfer of ownership. Rooney learned that the insurance company had not transferred ownership of JN's annuity to NFOA because of its concerns about NFOA and, on the advice of its counsel, was not processing any transactions for NFOA's benefit. Rooney never received compensation from NFOA in connection with his sale to JN.[28]

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[26] Around the same time, HW also began to see warning signs with NFOA. HW's customer OH did not receive the lump sum cash payment he had requested. HW did not understand why it was taking so long and, sometime after April 26, 2007, contacted NFOA and the issuer of OH's existing annuity. NFOA told HW that the annuity was in the process of being transferred. In contrast, the annuity issuer gave HW the "runaround" and would not answer his questions. Instead, the issuer transferred HW to its in-house counsel, who asked HW questions that made him feel "really uncomfortable" and "freaked out."

[27] On May 18, 2007, the Texas State Securities Board issued an emergency cease and desist order against NFOA and its president and vice-president, among others. The order stated that NFOA and its president were, among other things, failing to disclose material facts including the risks related to the purchase of NFOA tax deductible installment plans, that they were subject to a September 18, 2006 cease and desist order issued by the Insurance Commissioner of the State of Washington, and that NFOA had not been granted recognition under Section 501(c)(3) of the Internal Revenue Code.

[28] JN ultimately surrendered his annuity and directed his insurance company to send the proceeds to his account at Southwest Securities. On July 11, 2007, the insurance company processed a full surrender of the annuity, and sent a check in the amount of $56,212.70 to Southwest Securities.

Fox also advised its personnel that they should not continue any association with NFOA. While Rooney did not speak with HW about the issues that had emerged concerning NFOA, JF informed HW that there might be a problem with NFOA and that he should reach out to anybody who bought NFOA contracts from him. HW immediately took steps to try to cancel OH's and FK/EK's NFOA installment plans. HW testified that he called NFOA and told it that "me and my clients wanted out."[29] HW testified that he also may have contacted the insurance companies that issued OH's and FK's annuities to try to stop the transfer of ownership of those annuities. HW never received written confirmation from NFOA that the installment plan contracts were cancelled, but he "assum[ed]" they were and claimed that OH and FK verified to him that their annuities never transferred to NFOA. HW also informed HB—the only customer of HW's whose annuity actually transferred to NFOA—about the situation, but there is no evidence that HW attempted to cancel HB's contract.[30]

K. Collapse of NFOA

Thereafter, NFOA quickly unraveled. On May 23, 2007, a Tennessee court granted the request of the Tennessee Department of Commerce and Insurance for an injunction and issued an ex parte order to seize NFOA's assets and to appoint Eggers as a special deputy. On June 21, 2007, the court placed NFOA into rehabilitation receivership and appointed the Tennessee Commissioner of Commerce and Insurance as a receiver. In August 2007, NFOA's receiver petitioned to convert the rehabilitation receivership into a liquidation because NFOA was insolvent and to prevent further harm to creditors, holders of NFOA contracts, and the public. At that time, the deficit between NFOA's assets and its liabilities was projected to be least $4.3 million. The receiver's petition noted that NFOA's records indicated that "approximately 326 illegal annuity contracts were issued by NFOA, induced by fraudulent representations" made by NFOA's president and other agents and investment advisers about the nature of the contracts and NFOA's legal status. In total, approximately 65 persons sold NFOA contracts in 25 states to 347 individuals, whose average age was 76 years old. The receiver's petition also informed the court that NFOA was the subject of multiple administrative regulatory actions enjoining it from conducting business and seeking payment of administrative civil penalties, and was the subject

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[29] HW also claimed he sent NFOA a written request to cancel OH's and FK's installment plans, but Eggers testified that he never found any evidence of such a letter when reviewing NFOA's files.

[30] On June 5, 2012, a FINRA Hearing Officer issued an order accepting HW's Offer of Settlement, in which he consented to findings, without admitting or denying the allegations, that he engaged in private securities transactions without approval, made unsuitable recommendations, made negligent misrepresentations, and committed advertising and sales literature related violations. HW consented to a four-month suspension, restitution of $37,060.49, and a $15,000 fine.

of private litigation instituted by contract holders.[31] In September 2007, the Tennessee court granted the receiver's petition and entered a final order of liquidation and injunction.

Eggers testified, as explained above, that NFOA's president had used NFOA's funds as his "personal piggy bank." On March 7, 2013, a federal jury convicted NFOA's owner of mail fraud, wire fraud, and money laundering related to his operation of NFOA. NFOA's president was sentenced to 31 years in prison. Throughout the scam, NFOA's owner solicited more than $30 million in assets from elderly individuals, and then used those assets to "fund his lavish lifestyle."

III. Procedural History

In March 2008, Enforcement commenced an investigation concerning Rooney's conduct. Following an investigation, which included requests for information and testimony, and a settlement with HW, on December 14, 2012, Enforcement filed a five-cause complaint against Rooney. Cause one alleged that Rooney failed to supervise HW's NFOA-related activities, in violation of NASD Rules 3010 and 2110. In particular, cause one alleged that Rooney's supervisory failures included failing to: (1) ensure compliance with FINRA's rules governing private securities transactions and Fox's own policies and procedures; (2) conduct adequate and reasonable due diligence regarding NFOA and the products it offered; and (3) ensure compliance with FINRA advertising regulations. The other causes of action related to Rooney's sale of an NFOA installment plan to JN. Cause two alleged that Rooney participated in that sale without providing prior written notice to his firm, in violation of NASD Rules 3040 and 2110. Cause three, titled "Reasonable Basis Suitability," alleged that Rooney recommended the NFOA contract to JN without an adequate and reasonable basis for believing that the recommendation was suitable for JN, in violation of NASD Rules 2310 and 2110. Cause four alleged that Rooney negligently made material misrepresentations to JN, in violation of NASD Rule 2110. Cause five alleged that Rooney distributed misleading sales literature to JN, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110. On January 7, 2013, Rooney filed an answer that generally denied the allegations, claimed that the NFOA installment plans were not securities, and asserted lack of fair procedure, laches, and statute of limitations as affirmative defenses.

After conducting a three-day hearing, the Extended Hearing Panel issued its decision on August 11, 2014, finding Rooney liable for all alleged causes of action, and imposing separate sanctions for each of the five causes. In total, the Hearing Panel imposed on Rooney fines totaling $75,000, all-capacity suspensions totaling two years (to be served consecutively), an 18-month suspension in all supervisory capacities (to be served concurrently with the all-capacity suspensions), and a requirement that he requalify as a general securities representative and general securities principal. Rooney then filed this appeal.

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[31] By that time, NFOA was the subject of administrative regulatory actions in Alabama, Florida, Texas and Washington. In July 2007, it was the subject of administrative regulatory actions in Iowa and California.

IV. Discussion

A. Whether the NFOA Installment Plans Were Securities

In defense against several of the allegations, including the allegations concerning private securities transactions violations and the suitability of the recommendations, Rooney argues that the NFOA installment plans were not securities. The record, however, demonstrates otherwise.

"Congress' purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called." *SEC v. Edwards*, 540 U.S. 389, 393 (2004) (quoting *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990)). "To that end, it enacted a broad definition of 'security,' sufficient 'to encompass virtually any instrument that might be sold as an investment,'" including an "investment contract." *Id.* While the Exchange Act does not define "investment contract," the Supreme Court has established that an investment contract is a "contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946). More recently, the Commission has noted that the Supreme Court has affirmed that an 'investment contract' under *Howey* is "a contract or scheme for the 'placing of capital or laying out of money in a way intended to secure income or profit from its employment.'" *Joseph J. Vastano, Jr.*, 57 S.E.C. 803, 813 n.21 (2004) (quoting *Edwards*, 540 U.S. at 394). This definition of investment contract "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Edwards*, 540 U.S. at 393. The three elements of the *Howey* test are met here.

1. Investment of Money

The "investment of money" prong requires a showing that the purchaser gave up "some tangible and definable consideration in return for an interest that had substantially the characteristics of a security." *Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-560 (1979)); *see also Warfield v. Alaniz*, 569 F.3d 1015, 1021 (9th Cir. 2009) (quoting *SEC v. Rubera*, 350 F.3d 1084, 1090 (9th Cir. 2003) (explaining that the key question on the "investment of money" prong is whether the investor "commit[s] his assets to the enterprise in such a manner as to subject himself to financial loss"). A person's "investment" need not take the form of cash. *See Int'l Bhd. of Teamsters*, 439 U.S. at 560 n.12; *Warfield*, 569 F.3d at 1021 (holding that purchasers paid cash, securities or other assets to purchase charitable gift annuities). As Rooney concedes, purchasing the NFOA installment plans involved an investment of money. The customers involved here all exchanged property—their existing annuities—for NFOA installment plans. Those existing annuities had defined surrender values. Moreover, investors "risked financial loss due to the (now realized) possibility that [the issuer] would not be able to honor its promises." *Warfield*, 569 F.3d at 1021.

2. Is Led to Expect Profits

Investors are led to expect "profits" when they are led to expect income or return, including, for example, dividends, other periodic payments, or the increased value of the investment. *Edwards*, 540 U.S. at 394. Fixed returns are included in "profits." *See id.* at 394 (noting that "investments pitched as low-risk (such as those offering a 'guaranteed' fixed return)

are particularly attractive to individuals more vulnerable to investment fraud"). The inquiry is an objective one "based on what the purchasers were led to expect." *Warfield*, 569 F.3d at 1021-22 (internal quotation marks omitted) (noting that courts frequently examine the promotional materials associated with an investment or transaction); *Teague v. Bakker*, 35 F.3d 978, 987-990 & n.12 (4th Cir. 1994) (stating that "[i]t would make little sense for the existence of a 'security' to turn solely on whether those who actually invest do so without regard to profit" and finding that products could not be excluded from securities laws on the grounds that plaintiffs claimed they intended them to be for personal use, where the products' promotional materials emphasized the profit potential, referred to the products as investments, and offered purchasers the possibility of realizing capital appreciation).

Based on information in the NFOA-prepared installment plan flow charts, the Explanatory Statement, and the 1099 Statements, along with evidence concerning the value of the customers' existing annuities that they sought to transfer to NFOA, OH, FK, and JN were led to expect that they would receive more than the surrender values of their existing annuities, whether measured by the initial values that NFOA assigned to their existing assets or the "total payout" that NFOA promised over the life of the contract. Likewise, these investors also were informed that they could receive significant "tax deductions" and "tax savings" when exchanging their annuities for NFOA installment plans. *Affco Invs. 2001 LLC v. Proskauer Rose LLP*, 625 F.3d 185, 190 n.4 (5th Cir. 2010) (holding that tax benefits qualify as profits under the *Howey* test); *Warfield*, 569 F.3d at 1024 (holding that there was an expectation of profits in charitable gift annuities where, among other things, "the periodic payments *and tax benefits* could deliver a return on the initial payment") (emphasis added); *SEC v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 583 (2d Cir. 1982) (expectation of profit requirement was met where investment was promoted largely for the tax advantages it offered); II Louis Loss, Joel Seligman, Troy Paredes, *Securities Regulation* 1079 (5th ed. 2014) ("[T]he promotion of an investment 'largely for tax advantages' has been found to provide 'an expectation of profits.'") (citing cases).[32]

In addition to the investor-specific sales literature that was provided to OH and FK/EK, NFOA's general sales literature—NFOA's Brochure and Flyer—also generally led investors in NFOA installment plans to expect similar kinds of profits. NFOA's Brochure explained that NFOA installment plans came with "guaranteed, fixed, tax-favored income for a guaranteed period of years," "installment payments," and a "generous income tax deduction." The Brochure explained that annuities could be exchanged at the "full accumulation value," meaning that investors could exchange an annuity that was worth only the surrender value and immediately receive an investment valued at the higher, accumulation value. The Brochure included an illustration of an annuity exchange showing a "total payout" that was higher than the initial value of the purchased installment plan. Likewise, the Flyer contained similar representations and an

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[32] The illustrations that were provided to OH, FK and JN were typical of those provided to other investors. In this regard, Eggers testified that "[i]n most cases, the illustrations that were provided to participants in NFOA installment plans showed that "the investor would be receiving a sum greater at the termination of their contract than the value of the asset that they were putting in." This was the case, for example, with HW's first NFOA customer, HB.

illustration showing that one could exchange an annuity for the full accumulated value, "receive annual payments guaranteed for 30 years," receive a "total term pay-out" that was 2.6 times larger than the existing annuity's accumulated value, and claim a tax deduction that was 56% of the existing annuity's accumulated value.

Rooney argues that when analyzing whether there was an expectation of profits, it is "misleading" to measure profits based on the transferred annuities' surrender value because it "reduce[s] the value of the assets by transactional costs." In support, Rooney cites *Clover Capital Mgmt.*, 1986 SEC No-Act. LEXIS 2883 (Oct. 28, 1986), which he claims shows that "the SEC requires netting transaction and management costs in determining profits." He further argues that, for JN, the "transaction costs" (i.e., the surrender fee on JN's existing annuity) "would have exceeded" any expectation of profits because "JN would have still had to pay that."

These arguments fail. First, the premise of Rooney's argument incorrectly treats the surrender of the investor's existing annuity and the purchase of the NFOA installment contract as a single transaction. For purposes of determining whether a product is a security, one does not generally look to the investor's profit or loss on any prior instrument or asset liquidated or exchanged to purchase the new instrument. Otherwise, the analysis of whether something is objectively a security would be impracticable and investor-specific. The regulatory classification of the NFOA installment plans cannot turn on the profit or loss sustained on the exchanged asset.[33]

Second, the way the NFOA installment plans were marketed, investors were led to believe that when exchanging annuities, NFOA would "absorb" the surrender fee so that the purchaser would obtain the full accumulation value. Thus, for an investor with an existing annuity, it would have been more profitable to exchange that annuity for an NFOA installment plan at accumulation value rather than, for example, liquidate the annuity and use the lower, surrender value to purchase a corporate bond. Rooney's claim that the investor "still had to pay" the surrender fee is inconsistent with what investors were led to expect.[34]

Rooney also disputes that the tax benefits associated with the NFOA installment contracts count as "profits" within the meaning of the investment contract test, citing the Supreme Court's

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[33] Moreover, *Clover Capital Management* is inapposite. In that no-action letter, SEC staff stated that an investment adviser's advertisements could not use model or actual portfolio results that do not reflect, among other things, the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client would have paid or actually paid. 1986 SEC No-Act. LEXIS 2883, at *5-6. Nothing in that no-action letter, however, discusses the costs of liquidating a prior investment in order to purchase a model portfolio.

[34] Rooney likewise argues that the NFOA installment plan was an "estate planning tool" for JN and that NFOA-prepared materials show that the total payout on JN's installment plan would be less than the value of the annuity he was transferring. But the displayed value of JN's existing annuity on the NFOA-prepared materials was not the surrender value of his existing annuity.

decision in *United Housing Foundation, Inc. v. Forman*. *Forman*, however, involved different circumstances. At issue in *Forman* was whether shares of stock entitling a purchaser to lease an apartment in a state subsidized and supervised nonprofit housing cooperative were securities. 421 U.S. 837, 840 (1975). In analyzing whether there was an expectation of profits for purposes of the investment contract test, *Forman* held that the portion of plaintiffs' monthly housing rental charge that applied to interest, with its consequent deductibility for tax purposes, was not profits. *Id.* at 855 ("These tax benefits are nothing more than that which is available to any homeowner who pays interest on his mortgage."). In contrast to *Forman*—which one district court has distinguished as "involv[ing] tax benefits which were incidental to the 'investors' main objective of securing housing"—the purported tax benefits of the NFOA installment plans were among the primary reasons advertised by NFOA for purchasing the plans. *See Kolibash v. Sagittarius Recording Co.*, 626 F. Supp. 1173, 1178 (S.D. Ohio 1986) (distinguishing *Forman*); Loss, Seligman & Paredes, *supra*, at 1079.

Rooney claims that other cases besides *Forman*, including *Sunshine Kitchens*, *Braniff Airways*, *Wells*, and *Coan* have held that a tax deduction is not "profit" for purposes of the investment contract test when it "is the sole purported economic benefit to the customer."[35] Rooney similarly argues that other cases—including *Goodman*, *Professional Associates*, *Newmyer*, *Stone*, *Stowell*, and *Warfield*—show that "where tax deductions were important to purchasers and could be an inducement to purchase," the investment contract test is met only where "investors still ha[ve] an expectation of profit from the actual operation of the enterprise and a hope to make a positive return on investment."[36] These arguments, however, are all

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[35] *See Sunshine Kitchens v. Alanthus Corp.*, 403 F. Supp. 719, 722 (S.D. Fla. 1975) (holding that an agreement to purchase computers and computer-leasing services did not involve "profits" to come from the efforts of others, where the plaintiff's "inducement for entering into the computer transaction was the hope of favorable federal income tax benefits" through a tax shelter and "a loss, not a profit"); *Braniff Airways, Inc. v. LTV Corp.*, 479 F. Supp. 1279, 1286 (N.D. Tex. 1979) (stating that there was "significant doubt" concerning whether a company's participation in a consolidated tax return, in which the tax benefits through such participation were significant in amount, central to a tax management plan, and "available to any corporation that participates in a consolidated income tax return," constituted "profits" within the meaning of the investment contract test); *Wells v. Jackie Fine Arts, Inc.*, Case No. C-2-86-0374, 1987 U.S. Dist. LEXIS 15947, at *6-8 (S.D. Ohio 1987) (holding that the anticipated tax benefits from the purchase of a tax shelter investment in an art master were not "profits" within the meaning of the investment contract test); *Coan v. Bell Atl. Sys. Leasing Int'l Inc.*, 813 F. Supp. 929, 938-39 (D. Conn. 1990) (holding that tax benefits from a sale/leaseback arrangement were not profits where they "resulted from the plaintiff's accounting practices, rather than the defendant's ability to perpetuate the investment scheme").

[36] *See Goodman v. Epstein*, 582 F.2d 388, 407-08 n.57 (7th Cir. 1978) (holding that limited partnership interests were securities where, even if the venture was anticipated to produce initial losses with associated tax benefits, the business venture was "entered into with an expectation of eventual profitability"); *SEC v. Prof'l Assoc.*, 731 F.2d 349, 356 (6th Cir. 1984) (holding that joint ventures were securities where, although defendants claimed that joint venturers were

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inapposite because the tax benefits that were purported to come with an investment in the NFOA installment plans were *not* the sole primary economic benefits of those plans. Indeed, investors were led to expect both a stream of interest income (reflective of the accumulated value, not the surrender value of the exchanged annuity) and the eventual return of principal, in addition to the promised tax benefits. *See, e.g.*, *Warfield*, 569 F.3d at 1020-21 (holding that charitable gift annuities, from which investors expected to receive both "a monthly income stream" and "substantial tax benefits," were securities). And unlike cases like *Sunshine Kitchens* and others that Rooney cites, there is no evidence that the NFOA installment plans were designed to generate short-term tax losses or were marketed as a tax shelter, or that the purported tax benefits were to result from NFOA purchasers' accounting practices. Rather, NFOA's promise to generate a stream of principal and interest payments (reflective of the accumulated value of investors' existing annuities), while simultaneously carrying out the charitable activities upon which the additional tax benefits were based, constituted the expectation of profit under *Howey*.

3. Efforts of Others

Finally, the profits that investors in the NFOA installment plans expected came from the efforts of others, and Rooney makes no argument otherwise. NFOA and its investment adviser, Stonebridge, controlled how NFOA invested investor proceeds. Because the three parts of the *Howey* test are satisfied, the NFOA tax deductible installment plans were installment contracts and, therefore, securities.[37]

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interested in tax credits, defendants had previously represented to the IRS that the investors' motives were profit, a prerequisite for investment tax credit); *Newmyer v. Philatelic Leasing, Ltd.*, 888 F.2d 385, 394 (6th Cir. 1989) (holding that there was a genuine issue of material fact concerning whether lease and security agreements were securities where it could not be ruled out that, apart from promised tax benefits, investors hoped to realize profits); *Stone v. Kirk*, 8 F.3d 1079, 1086 n.4 (6th Cir. 1993) (holding that joint ventures, notwithstanding promised tax benefits, were investment contracts where defendant admitted that he expected the ventures to make money by selling records); *Stowell v. Ted S. Finkel Inv. Serv., Inc.*, 489 F. Supp. 1209, 1221 (S.D. Fla. 1980) (holding that limited partnership interests were securities where, although the tax benefits were a "substantial consideration" in the plaintiffs' decisions to invest in the coal mining venture, the expected profits "were to come from the sale of the estimated two million tons of coal which were to be mined"); *Warfield*, 569 F.3d at 1024 (holding that there was an expectation of profits in charitable gift annuities where it was possible, depending on how long the purchaser or designated beneficiary lived, for the purchaser to profit and that "the periodic payments and tax benefits could deliver a return on the initial payment").

[37] Despite how *Howey* articulated the installment contract test, the Commission has held that a "common enterprise" is "not a distinct requirement for an investment contract under *Howey*." *Johnny Clifton*, Exchange Act Release No. 69982, 2013 SEC LEXIS 2022, at *32 n.55 (July 12, 2013) (citing *Anthony H. Barkate*, 57 S.E.C. 488, 495 n.13 (2004), *aff'd*, 125 F. App'x

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892 (9th Cir. 2005)). Thus, our finding that the NFOA installment plans were securities does not rely on a finding that there was a common enterprise. But even if a "common enterprise" were a required element, the NFOA installment plans did involve a common enterprise. Courts have established three distinct tests for whether a common enterprise exists: "horizontal" commonality, "broad vertical" commonality, and "strict" or "narrow" vertical commonality. All three types of commonality exist here.

Horizontal commonality is "defined by the pooling of investment funds, shared profits, and shared losses." *SEC v. Life Partners, Inc.*, 87 F.3d 536, 543 (D.C. Cir. 1996); Loss, Seligman, & Paredes, *supra*, at 1069 (explaining that horizontal commonality involves "a pooling of investments"); *see Clifton*, 2013 SEC LEXIS 2022, at *32 n.55 (indicating that a "pooling of interests among more than one investor" would suffice to demonstrate a common enterprise, were the common enterprise test required). Here, horizontal commonality existed because NFOA pooled investors' funds in three custodial accounts that were not segregated by individual investor, and investors shared in the losses.

"*Broad vertical commonality*" requires that the "fortunes of all investors be dependent upon the promoter's expertise" or "efforts." Loss, Seligman, & Paredes, *supra*, at 1071 (citing cases); *SEC v. ETS Payphones, Inc.*, 408 F.3d 727, 732 (11th Cir. 2005) (holding that the "broad vertical commonality" test requires a showing that "the investors are dependent upon the expertise or efforts of the investment promoter for their returns") (internal quotation marks omitted); *cf. Revak v. SEC Realty Corp.*, 18 F.3d 81, 87-88 (2d Cir. 1994) ("In an enterprise marked by vertical commonality, the investors' fortunes need not rise and fall together; a pro-rata sharing of profits and losses is not required."). NFOA selected Stonebridge as NFOA's investment adviser, and reviewed and approved the investment policy statement that governed how NFOA's assets would be treated. In contrast, investors in the NFOA installment plans played no part in how their assets were invested. Broad vertical commonality existed.

Finally, "*strict vertical commonality*" (also called "*narrow vertical commonality*") exists where the "fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." Loss, Seligman, & Paredes, *supra*, at 1074-1075 (quoting *SEC v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476, 482 n.7 (9th Cir. 1973)); *see Barkate*, 57 S.E.C. at 495 n.13 (indicating that "strict" or "narrow" vertical commonality would suffice to demonstrate a common enterprise, were it a required element). Strict vertical commonality "does not require a pooling of investments . . . , but it does require more than evidence of 'merely furnishing counsel to another for a commission.'" Loss, Seligman, & Paredes, *supra*, at 1075. Strict vertical commonality existed with the NFOA installment plans. When NFOA was forced into a liquidation receivership, NFOA had millions less in assets than liabilities, and investors were not able to receive back all of their invested funds. Eggers testified that investors received only 85% of their losses back. Thus, investors' fortunes were clearly tied to those of NFOA's success.

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B. Supervision

The Hearing Panel found that Rooney failed to supervise HW's activities, in violation of NASD Rules 3010 and 2110. We affirm these findings, but on narrower grounds than the Hearing Panel. As explained below, we agree with the Hearing Panel that Rooney failed to supervise HW's sales of NFOA installment plans for compliance with rules requiring written notice of private securities transactions and suitable recommendations. We disagree, however, with the Hearing Panel's finding that Rooney failed to supervise for compliance with the rules governing communications with the public.

1. General Standards

"Assuring proper supervision is a critical component of broker-dealer operations." *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008) (citing *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 SEC LEXIS 1407, at *27 (June 29, 2007)). NASD Rule 3010(a) provides that "[e]ach member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with

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Although neither party has addressed the issue, we have also considered, given Rooney's purported belief that the NFOA installment plans were insurance products, whether they were the kinds of annuities that are excluded from the definition of security. Section 3(a)(8) of the Securities Act of 1933 ("Securities Act") provides that the Securities Act shall not apply to "[a]ny . . . annuity contract . . . issued by a corporation subject to the supervision of the insurance commissioner . . . of any State . . . of the United States." Furthermore, an instrument that is described in Section 3(a)(8) of the Securities Act has been held not to be a security subject to the antifraud provisions of the Securities Exchange Act of 1934. *See Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1130-31 (7th Cir. 1986); *see also The Luzerne Cnty. Ret. Bd. v. Makowski*, 627 F. Supp. 2d 506, 546 (M.D. Pa. 2007) (citations omitted) (explaining that the SEC "has unequivocally interpreted section 3(a)(8) to have been adopted . . . to *exclude* from 'security status' those insurance contracts that come within section 3(a)(8)"). Pursuant to Securities Act Rule 151, a safe harbor for falling within the Section 3(a)(8) exemption are annuity contracts that meet three conditions: (1) the annuity has been issued by a corporation subject to the supervision of the insurance commissioner of any State or Territory of the United States or the District of Columbia; (2) the insurer assumes the investment risk under the contract; and (3) "[t]he contract is not marketed primarily as an investment." Although the record demonstrates that the NFOA installment plans were issued by a Tennessee corporation subject to the supervision of the Tennessee insurance commissioner (as evidenced by the commissioner's appointment as NFOA's receiver), there is no evidence that NFOA assumed the investment risk under the contract (especially considering that investors lost money when NFOA was liquidated), and the NFOA marketing materials show that the installment plans were marketed as an investment.

applicable securities laws and regulations, and with applicable NASD Rules." NASD Rule 3010(b) provides, in pertinent part, that "[e]ach member shall establish, maintain, and enforce written procedures . . . to supervise 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 Rules of NASD."

NASD Rule 3010 has been applied to require that supervisors exercise "reasonable" supervision. *See, e.g.*, *Pellegrino*, 2008 SEC LEXIS 2843, at *33-36.[38] "The standard of 'reasonable' supervision is determined based on the particular circumstances of each case." *Id.* at *33 (citing *John A. Chepak*, 54 S.E.C. 502, 513 n.27 (2000)). The "presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not assure compliance." *Pellegrino*, 2008 SEC LEXIS 2843, at *43 (citing *Kresge*, 2007 SEC LEXIS 1407, at *41 n.37); *Frank J. Custable, Jr.*, 51 S.E.C. 855, 861 (1993) (finding a failure to supervise reasonably where applicants "failed to apply even their standard supervisory procedures"). In addition to requiring an adequate supervisory system, "[t]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." *Pellegrino*, 2008 SEC LEXIS 2843, at *33 (quoting *Michael T. Studer*, 57 S.E.C. 1011, 1023-24 (2004), *aff'd*, 260 F. App'x 342 (2d Cir. 2008)). "Once indications of irregularity arise, supervisors must respond appropriately." *Id.* (citing *La Jolla Capital Corp.*, 54 S.E.C. 275, 285 (1999); *see also World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 SEC LEXIS 56, at *43 (Jan. 6, 2012) ("When indications of impropriety reach the attention of those in authority, they must act decisively to detect and prevent violations of the securities laws.") (citation omitted), *aff'd*, 739 F.3d 1243 (9th Cir. 2014).

2. Rooney Failed to Supervise by Not Ensuring HW's Compliance with Written Notice and Approval Requirements for Private Securities Transactions

NASD Rule 3040(b) provides that, prior to participating in any private securities transaction (also called "selling away"), an associated person shall provide written notice to the member firm with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction. NASD Rule 3040(c)(1) requires that, in the case of a transaction in which an associated person has received or may receive selling compensation, a member which has received notice pursuant to NASD Rule 3040(b) shall advise the associated in person in writing stating whether the member (A) approves the person's participation in the proposed transaction or (B) disapproves the person's participation in the proposed transaction. A corollary is that where the individual receives or may receive selling compensation from participating in a private securities transaction, NASD Rule 3040 also requires that the individual obtain the firm's written approval before proceeding with the private

[38] Pursuant to NASD Rule 0115, persons associated with a member shall have the same duties and obligations as a member under NASD Rules.

securities transaction. *Dep't of Enforcement v. Mielke*, Complaint No. 2009019837302, 2014 FINRA Discip. LEXIS 24, at *24-25 & n.21 (FINRA NAC July 18, 2014), *appeal filed*, SEC Admin. Proc. File No. 3-16022 (Aug. 19, 2014). NASD Rule 3040(c)(2) provides that if the member firm approves a person's participation in a transaction pursuant to NASD Rule 3040(c)(1), the transaction shall be recorded on the books and records of the member and the member shall supervise the transaction as if the transaction were executed on behalf of the member.

Fox's WSPs required its associated persons to comply with this rule and required a designated supervisory principal to approve or disapprove in writing any associated person's request to engage in the private sales of securities outside of their normal association with the Firm. Rooney was one of two supervisory principals designated or delegated with this supervisory responsibility. He was also the supervisor of Fox's registered representatives, including HW.

Rooney was aware from at least late February 2007 that HW intended to engage in solicitations and sales of NFOA installment plans away from the Firm and expected to receive compensation for those sales. He also should have been aware that HW's Form U4 was amended on March 1, 2007, to specifically include NFOA as an outside business activity. Despite this knowledge, Rooney did not require HW to provide written notification to Fox of his participation in sales of NFOA installment plans, as required by NASD Rule 3040. Rooney also took no steps to ensure that HW would not sell NFOA installment plans before obtaining written approval from Fox. Rooney's failure to require HW to submit written notice of his participation in NFOA installment plans, and his failure to ensure that HW received written approval from an appropriate supervisor—either himself or the other designated supervisor—was not reasonable supervision. *Cf. ACAP Fin., Inc.*, Exchange Act Release No. 70046, 2013 SEC LEXIS 2156, at *34 (July 26, 2013) (finding failure to supervise where supervisory personnel undertook no efforts to determine whether unregistered securities were eligible for sale without registration, other than relying on the absence of a restrictive legend and the efforts of its clearing firm), *aff'd*, No. 13-9592, 2015 U.S. App. LEXIS 5384 (10th Cir. Apr. 3, 2015); *Robert E. Strong*, Exchange Act Release No. 57426, 2008 SEC LEXIS 467 at *18 (Mar. 4, 2008) (finding that respondent failed to supervise where he did not implement the firm's procedure requiring pre-approval of trades in an analyst's account and failed to respond to evidence of misconduct in analyst's account).

Rooney claimed throughout this proceeding that he believed the NFOA installment plans were insurance products, not securities, and that NASD Rule 3040 did not apply. But Rooney was aware of the risk that the NFOA installment plans might be classified as securities,[39] and yet

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[39] That Rooney was aware of this risk is shown by his claim that he asked other Fox employees and NFOA representatives whether the product was a security. Moreover, Rooney must have known that participants in NFOA plans were required to invest something of value, he admittedly reviewed NFOA sales literature clearly showing how NFOA led investors to expect profits, and he must have been aware (based on his own sale) that such profits were to come only

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determined not to follow the Firm's WSPs without first taking reasonable steps to assure himself that the NFOA installment plans would not be classified as securities. For example, when asked if he ever contacted NFOA's investment adviser, MM of Stonebridge, to investigate the nature of NFOA's guarantees, Rooney testified that he did not recall MM and had never heard of him. Similarly, at his on-the-record interview, Rooney had "no current recollection" of NFOA's investment adviser or NFOA's custodian (SEI), or of contacting either one. Contacting the investment adviser and the custodian could have provided Rooney with insight into whether the expected profits would come from the efforts of others and whether investor assets were pooled. Rooney also testified that he could not recall if he had ever contacted the Texas State Insurance Commissioner to see if NFOA or its president was licensed to sell insurance.[40]

Rooney's claimed due diligence efforts were insufficient. Rooney claimed that he relied on NFOA's purported representation that their installment plans were not securities, but Rooney "was not entitled to rely on the representations of the issuer" that products were not securities "and had a duty to make an adequate independent investigation." *Phillippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 2631, at *25 (Nov. 8, 2006). Rooney also asserted that he asked his lawyer to investigate whether the NFOA products were securities, but Rooney made no claim that his lawyer ever provided him with any legal opinion on that particular issue. In fact, Rooney pointed to only one possible independent source of authority that the NFOA plans were not securities: a purported letter from the Texas Insurance Commissioner stating that the NFOA installment plans were an "exempt insurance product." But Rooney never proffered a copy of such letter. Instead, the only letter authored by the Texas Insurance Commissioner to which he did have access made no representations that the NFOA plans were not securities but asked only whether NFOA's products were "qualified charitable gift annuities" under the Texas Insurance Code. In addition, the record contains a cease and desist order from the Texas State Securities Board finding that the contracts were securities. Accordingly, Rooney failed to supervise for HW's compliance with the rule governing private securities transactions.[41]

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from the efforts of others. Moreover, NFOA's sales literature, which Rooney reviewed, made no claim that the installment plans were insurance products and not securities.

[40] While we do not suggest that it was necessary for Rooney to take the specific steps like contacting the custodian or the investment advisor to investigate whether the NFOA installment plans were securities, Rooney has not proffered evidence of any reasonable investigative steps that he did take.

[41] We further note that even if Rooney believed that the NFOA installment plans were not securities, his supervisory failures remain evident considering that HW still would have been required by NASD Rule 3030 to provide Fox with prompt written notice of his outside business activities in the form required by his member firm, yet Rooney did not require that he do so. The fact that HW's approved outside business activities already included selling "fixed insurance" through North Texas Insurance Group would not have relieved HW of his obligations to provide

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3. Rooney Failed to Supervise HW's Recommendations of NFOA Installment Plans for Compliance with the Suitability Requirements

Enforcement alleged, and the Hearing Panel found, that Rooney's supervisory violations also were based in his failure to perform adequate due diligence of the NFOA installment plans that HW sold. We agree.

NASD Rule 2310(a), which governs the suitability of recommendations to customers, provides that "[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." One of the requirements of the suitability rule is that a broker must have a "reasonable and adequate basis" for any recommendation he makes. *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *30 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012). Meeting that standard, in turn, requires conducting a "reasonable investigation" into recommended securities. *Id.* at *27, 28, 31 (stating that a broker "violates the suitability rule when he fails to conduct a reasonable investigation," that "[a] representative's recommendation carries the implicit representation that it was 'responsibly made on the basis of actual knowledge and careful consideration,'" and that "[t]his understanding must include the 'potential risks and rewards' and potential consequences of such recommendation") (citations omitted); *see also Michael Frederick Siegel*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459, at *28 (Oct. 6, 2008) (holding that "[t]he reasonableness of any recommendation is predicated on a registered representative's understanding of the potential risks and rewards inherent in that recommendation" and that "a broker may violate the suitability rule if he fails so fundamentally to comprehend the consequences of his own recommendation that such recommendation is unsuitable for any investor") (internal quotation marks and citations omitted), *aff'd in relevant part*, 592 F.3d 147 (D.C. Cir. 2010); *Distribution by Broker-Dealers of Unregistered Securities*, Exchange Act Release No. 6721, 1962 SEC LEXIS 74, at *8 (Feb. 2, 1962) ("[T]he making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation."); *see also NASD Notice to Members 03-71*, 2003

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written notice of his outside business activities involving NFOA because the Rule's notice obligations entail a product-by-product analysis precisely to encourage the correct classification of outside business activities. *See NASD Notice to Members 01-79*, 2001 NASD LEXIS 85, at *7, 10-11 (Dec. 2001) (discussing the requirements of NASD Rules 3030 and 3040, urging registered persons "not to make the assessment of whether a particular note is a security, but to give their firms the opportunity to determine whether sale of the note is merely an outside business activity or the sale of a security," and cautioning member firms that "[p]roblems may arise . . . when insurance sales persons, who are also registered as Series 6 representatives, are not required . . . to report certain outside business activities, such as the sales of other insurance products") (Emphasis added).

NASD LEXIS 81, at *5-7 (Nov. 2003) (explaining that "performing appropriate due diligence is crucial to a member's obligation to undertake the required reasonable-basis suitability analysis" and that "[t]he type of due diligence investigation that is appropriate will vary from product to product" but that "there are some common features that members must understand" including, in pertinent part, the issuer's creditworthiness, the creditworthiness and value of any underlying collateral, principal, return, or interest rate risks, and the tax consequences of the product).

Rooney was required to conduct due diligence into NFOA. As we found above, one or more persons at Fox verbally approved HW's outside sales of NFOA installment plans, for which HW expected to receive compensation, and those products were securities. Pursuant to NASD Rule 3040(c), member firms are required to supervise an associated person's participation in a private securities transaction in which an associated person has received or may receive selling compensation. It was Rooney's admitted responsibility to review transactions for suitability of recommendations, including by conducting a due diligence investigation into the recommended product.

Rooney's investigation of NFOA, however, was unreasonable to supervise for the suitability of recommending NFOA installment plans. Rooney reviewed some NFOA sales literature that HW provided to him, and Rooney spoke with some of NFOA's officers and representatives. Based on that minimal investigation, Rooney assumed that NFOA was a Section 501(c)(3) tax-exempt organization, that exchanges of annuities or assets for NFOA installment plans were tax-deductible, and that NFOA installment plans offered "guaranteed income." But Rooney accepted NFOA's representations at face value and made no effort to verify them. For example, Rooney did not ask NFOA's officers and representatives questions that probed the bases of NFOA's representations that annuity exchanges were tax deductible and that the promised income was "guaranteed." Rooney did not inquire about how NFOA planned to guarantee the income streams in the installment plans, the amounts of the tax deduction that would be available, how investor funds would be handled, how NFOA was able to issue plans at the full accumulated value of annuities that were exchanged, or whether there was any market risk involved. In fact, even if we were to accept Rooney's version of his call with NFOA in which he asked about some aspects the NFOA installment plans, Rooney was admittedly indifferent about many of the relevant details.[42]

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[42] Rooney's indifference was on full display at his on-the-record interview. Asked whether he asked NFOA how it would invest the assets it obtained, Rooney testified that "there was no consideration on our part of how it was invested" and that "I didn't care how much of it went to charity." Asked whether NFOA ever told him that the returns were not guaranteed, Rooney could only guess—when NFOA was insolvent and it was clear that investors would not receive all of their money—that "I'm sure that they had somebody in charge of guaranteeing the return." Asked whether there was an indication of the percentage of assets that NFOA gave to charity, Rooney said, "I don't think it would be a consideration." Rooney also was not concerned with which charities NFOA purportedly supported, summarizing that "[w]hat [NFOA] decide[s] to do with your charitable donation is something that you trust the frontline to do." Rooney also testified that "what [NFOA] did to try to generate a promised rate of return, you know, was

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Outside of talking to NFOA representatives and reading NFOA's sales literature, Rooney identified no other steps that he took to investigate NFOA and verify its representations. He admittedly did not contact the IRS to investigate the status of NFOA's 501(c)(3) exemption. He did nothing more to probe or explore NFOA's promises of "guaranteed" income. He did not discover that, just six months before HW's sales, the State of Washington Insurance Commissioner had issued a cease and desist order against NFOA stating that NFOA and its officers had misrepresented to prospective agents and purchasers that NFOA had been granted an exemption under Section 501(c)(3) of the Internal Revenue Code. And as found above, Rooney did not ask his lawyer to conduct a due diligence investigation until after all the sales at issue.

Had Rooney conducted a reasonable investigation—including a basic internet search concerning NFOA—he would have learned that NFOA was not approved as a 501(c)(3) organization, that there was no guarantee that purchases of NFOA installment plans were tax deductible, and that NFOA's investors' funds were pooled in three custodial accounts that were subject to market risk. By essentially conducting no meaningful investigation into NFOA or its installment plans, Rooney did not understand the potential risks inherent in the NFOA installment plans and, thus, failed to reasonably supervise for whether HW had a reasonable basis for recommending the installment plans. *Cf. Cody*, 2011 SEC LEXIS 1862, at *30 (finding that representative "fail[ed] to gain an understanding of essential features" of securities he recommended, where he had only a limited discussion with his firm's principal that focused on yield, maturity date, and rating, failed to evaluate other factors that could affect their value, and failed to learn which tranche he was recommending, the associated subordination risks, details about the assets collateralizing the securities, or other factors that would affect the securities' risks and liquidity); *Pellegrino*, 2008 SEC LEXIS 2843, at *35 (finding that respondent failed to supervise for compliance with suitability rule by, among other things, failing to respond to evidence that customers did not understand the riskiness of recommended products).

4. Enforcement Failed to Prove that Rooney Failed to Supervise HW's Use of NFOA Sales and Advertising Materials for Compliance with Rules Governing Communications with the Public

The Hearing Panel also found that Rooney's supervisory failures included a failure to adequately supervise the content and dissemination of NFOA sales literature and advertising materials. We reverse this particular finding.

In its complaint, Enforcement alleged that Rooney failed to supervise for whether the Brochure and the Flyer complied with NASD Rule 2210. Specifically, Enforcement alleged that the Brochure and the Flyer did not meet the content standards in NASD Rule 2210, that Rooney "knew or should have known that HW presented to investors and/or potential investors copies of

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really behind the scenes that we didn't have any interest in." When asked whether he contacted the Texas State Securities Board to see if NFOA was licensed to sell securities in Texas, Rooney testified that he did not know if he did or if he relied on a client having contacted them.

the NFOA Brochure and the NFOA Flyer," that Rooney "failed to review [such materials] for compliance with NASD advertising rules," and that he "failed to approve and/or disapprove use" of such materials "prior to its distribution to members of the public in connection with HW's NFOA sales." Enforcement's complaint and pre-hearing brief indicate that its allegations in this regard relate only to HW's use of the Brochure and the Flyer, and only when soliciting OH and FK/EK.

We agree with Enforcement's contention that the NFOA Brochure and Flyer—which, among other things, falsely represented NFOA to be a 501(c)(3) organization, misleadingly suggested the availability of a tax deduction, provided no basis to evaluate the promised amounts of tax deductions and tax-free payments, and falsely indicated that income payments were "guaranteed"—would not have met the standards applicable to communications with the public set forth in NASD Rule 2210. The record, however, does not demonstrate that HW ever used the Brochure or the Flyer when soliciting OH or FK/EK. HW, who was called by Enforcement as its witness, testified that he could not recall whether he provided such materials to OH or FK/EK, and Enforcement made no attempt to impeach that particular testimony. Because the record does not show that HW used the Brochure or the Flyer, there is no basis on which to find that Rooney failed to supervise HW's use of the materials. Thus, our findings that Rooney failed to supervise are grounded solely on our findings that Rooney failed to reasonably supervise for compliance with the rules governing private securities transactions and suitability.

C. Private Securities Transaction

The Hearing Panel found that Rooney failed to provide written notice to Fox of his participation in soliciting JN to exchange his existing annuity for an NFOA installment plan, in violation of NASD Rules 3040 and 2110. We affirm.

Rooney solicited JN's purchase of an NFOA installment plan and actively participated in the transaction in numerous ways. He explained to JN the characteristics of the NFOA installment plan. He obtained from NFOA, and presented to JN, the Explanatory Statement and the 1099 Statement, and discussed these materials with JN. He provided JN with the NFOA contract, the request to transfer the ownership of his existing annuity, and a form authorizing the NFOA installment payments to be directly deposited into JN's checking account. Rooney signed the contract as JN's financial advisor, and forwarded all the materials to NFOA.

Rooney, however, did not provide written notice to Fox concerning his participation in the transaction with JN as required by NASD Rule 3040.[43] And although he expected to receive selling compensation, he participated in the transaction without approval from Fox.

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[43] When asked why not, Rooney answered, "it's sort of a strange relationship, because I'd be asking myself." During the relevant period, however, there was another person besides Rooney who had authority to approve requests to engage in private securities transactions, and Rooney's activities with regard to his own accounts were supervised by SB.

Accordingly, Rooney participated in a private securities transaction in violation of NASD Rules 3040 and 2110.[44]

D. Reasonable Basis Suitability

As explained in detail above, Rooney did not conduct a reasonable investigation into NFOA or the NFOA installment plans. Had he done so, Rooney would have learned that NFOA was not approved as a 501(c)(3) organization, that NFOA was misrepresenting to the public that it was an approved 501(c)(3) organization, that there was no assurance that purchases of NFOA installment plans would be tax-deductible, that NFOA was the subject of a cease and desist order in the state of Washington, that NFOA had nothing in place to ensure its promises of guaranteed income, and that investor funds were deposited in custodial accounts subject to market risk. As a result, when Rooney recommended that JN exchange his annuity for an NFOA installment plan, he did so without understanding the potential risks and rewards inherent in the NFOA installment plans. As a result, his recommendation to JN lacked reasonable basis suitability, in violation of NASD Rule 2310 and 2110.

E. Misrepresentations

The Hearing Panel found that Rooney misrepresented material information to JN when soliciting him to exchange an annuity for an NFOA installment plan, in violation of NASD Rule 2110. We affirm.

A broker who makes material misrepresentations to customers engages in unethical conduct that is inconsistent with just and equitable principles of trade, in violation of NASD Rule 2110. *Dep't of Enforcement v. Kapara*, Complaint No. C10030110, 2005 NASD Discip. LEXIS 41, at *20-21 (NASD NAC May 25, 2005) (citing *Dep't of Enforcement v. Timberlake*, Complaint No. C07010099, 2004 NASD Discip. LEXIS 11, at *16 (NAC Aug. 6, 2004) ("It is axiomatic that a broker who makes material misrepresentations and omissions to customers is engaging in unethical conduct.")). "Whether information is material is dependent upon the significance the reasonable investor would place upon the representation." *Kapara*, 2005 NASD Discip. LEXIS 41, at *19 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)). "A fact is material if there is a substantial likelihood that a reasonable investor would have considered the fact important in making an investment decision, and disclosure of the omitted fact would have significantly altered the total mix of information available." *Donner Corp. Int'l*, Exchange Act Release No. 55313, 2007 SEC LEXIS 334, at *30-31 (Feb. 20, 2007).

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[44] Rooney has emphasized throughout these proceedings that JN's existing annuity was never transferred to NFOA. But this does not excuse Rooney's violation. Rooney did everything that was required to consummate JN's purchase of an NFOA installment plan, including forwarding to NFOA the signed contract and the form authorizing the issuer of JN's annuity to transfer ownership. That the annuity never actually transferred had nothing to do with Rooney. *Cf. Dist. Bus. Conduct Comm. v. Russo*, Complaint No. C3A910070, 1992 NASD Discip. LEXIS 66, at *20-21 (NASD NBCC June 29, 1992) (holding that representative participated in a private securities transaction despite that investor never agreed to invest).

When soliciting JN, Rooney represented that NFOA was a tax-exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code and that JN would be entitled to receive a tax deduction in connection with an exchange of his annuity for an NFOA installment plan. For the reasons set forth above, these representations were false or misleading. Whether an investment is tax deductible is obviously material to a reasonable investor. Indeed, Rooney conceded that the tax deductibility of the NFOA installment plans was one of the primary selling points when he sold the product to JN. *Cf. CapWest Sec., Inc.*, Exchange Act Release No. 71340, 2014 SEC LEXIS 205, at *23-24 (Jan. 17, 2014) (finding that misleading and exaggerated statements regarding the tax consequences of tenancy-in-common investments was material information); *Ira Weiss*, 58 S.E.C. 977, 1002-1003 (2005) (holding that information about an investment's tax-exempt character was material to investors because they would have wanted to know whether their interest earnings might be taxable, thereby reducing any returns), *aff'd*, 468 F.3d 849 (D.C. Cir. 2006). Rooney's misrepresentations were at least negligent, considering that he made them without conducting the reasonable investigation into NFOA's claims that he was supposed to conduct. *Cf. Frank W. Leonesio*, 48 S.E.C. 544, 548 (1986) (holding that a securities salesperson "may not rely on the self-serving statements of an issuer" but "has a duty to make an adequate independent investigation . . . to ensure that his representations to customers have a reasonable basis"). Accordingly, Rooney made material misrepresentations to JN, in violation of NASD Rule 2110.

F. Misleading Sales Materials

The Hearing Panel found that Rooney presented to JN misleading sales materials, specifically the Explanatory Statement and the 1099 Statement, in violation of NASD Rules 2210(d)(1)(A), 2210(d)(1)(B), and 2110. We affirm as to the Explanatory Statement, but reverse as to the 1099 Statement.

NASD Rule 2210(d)(1)(A) provides that "[a]ll member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service," and that "[n]o member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communication to be misleading." NASD Rule 2210(d)(1)(B) provides that "[n]o member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public," and that "[n]o member may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading."

Rooney presented to JN, a Fox customer, the Explanatory Statement and the 1099 Statement, and there is no dispute that these materials were "communications with the public" within the scope of NASD Rule 2210. Enforcement alleged, and the Hearing Panel found, that the Explanatory Statement and the 1099 Statement did not satisfy the content standards of NASD Rule 2210.

The Explanatory Statement included statements concerning income that at best were overly simplified and exaggerated, and at worst omitted material facts. The Explanatory Statement presented an illustration suggesting that, in exchange for an annuity with an accumulated value of approximately $63,675.46, a client could receive an NFOA installment

plan that provided "annual/monthly income" of $6,366/$530.51 with a "total payout" over the life of the 10-year plan of $63,661.65. The Explanatory Statement, however, failed to reflect that these figures included a return on principal or explain the rate of return. Such basic facts about the returns of the NFOA installment plans would have been important to a reasonable investor deciding whether to invest.

The Explanatory Statement also included statements about the purported tax savings and tax benefits of an NFOA installment plan that did not comply with the NASD Rule 2210 content standards. The illustration in the Explanatory Statement represented that JN could receive an income tax deduction of $24,975 and "Total Tax Free" income of $49,780 over the life of the installment plan, and that the "Percentage of Income Tax-Free Increases Each Year." The Explanatory Statement, however, omitted that NFOA was not an approved Section 501(c)(3) tax-exempt organization, that there was no guarantee of a tax deduction, and that the purported tax-free income consisted solely of a return of principal. The Explanatory Statement also provided minimal explanations concerning how the promised tax benefits for JN were calculated.[45] As a result, the statements about the purported tax savings and tax benefits omitted material facts, were misleading, and did not provide a sound basis for evaluating the NFOA installment plans. For these reasons, Rooney's use of the Explanatory Statement when soliciting JN was in violation of NASD Rules 2210(d)(1)(A) and (d)(1)(B) and 2110.

With respect to the 1099 Statement, Enforcement alleged in its complaint only that a column titled "reported as tax free" "created the false impression that the amounts listed represented tax free income." But the 1099 Statement did not identify or label the dollar amounts in that column as "income" but as "principal." And next to the "reported as tax free" column was a column labeled "reported as ordinary income" and "interest," which clearly did present income figures. Indeed, even Eggers—Enforcement's witness—testified that the 1099 Statement "report[ed] what the interest was and what the return of capital was." Thus, we find that the 1099 Statement did not create a false impression that the amounts in the "reported as tax free" column represented tax free *income*. Thus, our findings that Rooney violated NASD rules governing communications with the public are based only on his use of the Explanatory Statement.

V. Procedural Arguments

A. Delay in Initiating this Disciplinary Proceeding

The bulk of Rooney's arguments on appeal relate not to the merits, but to alleged procedural flaws. Rooney argues that the disciplinary proceeding was not fair because of Enforcement's delay in bringing it. As part of his argument, Rooney contends that two of the four time frames that the SEC and the NAC have considered when evaluating delay-related

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[45] The only tax-related assumptions in the Explanatory Statement were that "your clients' income tax bracket is 25%" and that "clients have a total of 6 years in which to apply the deduction." The Explanatory Statement provides no other details concerning how it calculated the amount of the income tax deduction.

arguments were longer than the comparable time frames in *Jeffrey Ainley Hayden*, 54 S.E.C. 651 (2000), a disciplinary proceeding that the SEC dismissed because of an unfair delay in filing the complaint. Rooney also argues that equitable circumstances related to the delays warrant dismissal, asserting that "[t]he sole cause for the unconscionable delay was Enforcement," that relevant documents are lost, that memories of key witnesses have faded, and that JN died before Rooney had the opportunity to obtain his statement. As explained below, we reject Rooney's delay-related fairness defense.

Section 15A(b)(8) of the Exchange Act requires that self-regulatory organizations, such as FINRA, provide a fair procedure for the disciplining of associated persons of member firms. Several Commission cases have addressed the effect that a delay by a self-regulatory organization in the filing of a complaint may have on the overall fairness of the proceeding. These decisions have established "the consistently-held principle that no statute of limitations applies to disciplinary actions of SROs" and that there are no "bright line rules about the impact of the length of a delay in filing a complaint on the fairness of the disciplinary proceedings." *Mark H. Love*, 57 S.E.C. 315, 322-23 (2004). Rather, the fairness of the proceeding is determined based "on the entirety of the record" and looks to whether the respondent has shown that his "ability to mount an adequate defense was harmed by any delay in the filing of a complaint against him." *Id.* at 324-325.

While the Commission has rejected the application of a mechanical test in assessing overall fairness, it has considered, as part of its review of the entirety of the record, a variety of time lags, including the times between the filing of the complaint and: (i) the initial misconduct; (ii) the last misconduct; (iii) notice to the SRO of the misconduct; and (iv) the initiation of the investigation.[46]

The first two of these time lags are clear. The time between the initial misconduct (February 2007, when Rooney was on notice that HW may be engaging in private securities transactions) and the filing of the complaint (December 2012) was five years and ten months. The time between the last misconduct (April 2007, when Rooney failed to supervise HW's sale to FK/EK) and the filing of the complaint was five years and eight months. The parties dispute the length of the other two time lags. Without discussing those arguments in detail here, we find that: (i) the time lag between when FINRA was on notice of the misconduct—which we pin to when a FINRA Enforcement unit made an internal referral to FINRA's Department of Enforcement in November 2007[47]—and when it filed the complaint was five years and one

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[46] Rooney contends that the "most important" of these time frames for a fairness determination are the time lag between FINRA's notice of the misconduct to the filing of the complaint and the time lag between the initiation of the investigation to the filing of the complaint. But Rooney has cited no cases, nor are we aware of any, in which the Commission has expressed that any of the relevant time frames are more important than the others.

[47] Rooney argues that an August 2007 e-mail that Eggers sent to FINRA containing a list of agents and advisers who sold NFOA contracts that included Rooney and HW shows that FINRA was put on notice of Rooney's misconduct in August 2007. There is no evidence, however, that,

[Footnote continued on next page]

month; and (ii) the time lag between when FINRA initiated its investigation—which we view as when FINRA first sent a Rule 8210 request that specifically referenced Rooney—and when it filed the complaint was four years and nine months.

These time lags were both shorter and longer than the comparable time lags in *Hayden*, which the SEC dismissed because of "inherently unfair" delays. *Hayden*, 54 S.E.C. at 653-654 (finding that the charges were brought 14 years after the first act of misconduct, over six years after the last incident of misconduct, five years after the NYSE was informed about the misconduct, and three years and six months after commencing its investigation). Some of the time lags were also similar in length to comparable time lags in *Morgan Stanley*, which the NAC dismissed based on unfair delays. *See Dep't of Enforcement v. Morgan Stanley DW, Inc.*, Complaint No. CAF000045, 2002 NASD Discip. LEXIS 11, at *15-17 (NASD NAC July 29, 2002) (finding that the charges were brought against respondent eight years after the first act of misconduct, seven years after the last incident of misconduct, five years and nine months after NASD was on notice of the misconduct, and four years and nine months after NASD commenced its investigation).

A comparison to the time lags in other cases to those involved here, however, "does not, in itself, resolve the fairness question." *Love*, 57 S.E.C. at 323; *see also Morgan Stanley*, 2002 NASD Discip. LEXIS 11, at *33 (considering fairness principles in addition to time lags). "[I]n assessing overall fairness," the SEC has "never employed a mechanical test," and the time frames examined in other cases are not "limits defining the border of fairness in SRO proceedings." *Love*, 57 S.E.C. at 324. Rather, the Commission also considers whether the applicant's "ability to mount an adequate defense was harmed by any delay in the filing of a complaint against him."[48] *Id.* at 325. Likewise, to succeed with a defense of laches, Rooney

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prior to November 2007, FINRA was aware of any allegations that Rooney or HW violated FINRA rules, that Enforcement had focused its attention on any specific individuals or firms within its jurisdiction, or that its fact-gathering concerning sales of NFOA installment plans was anything but preliminary. The internal referral in November 2007, however—from Enforcement's "Preliminary Investigations Group" to the Department of Enforcement—identified Rooney, HW, and others as registered with a FINRA member firm, was a stepped-up level of enforcement priority and reflected focused enforcement attention on Rooney.

[48] Both the SEC and the NAC have recognized that in certain situations, excessive time delays may be enough, by themselves, to make a proceeding unfair, even without a showing of actual harm resulting from the delays. *Hayden*, 54 S.E.C. at 653-54; *Morgan Stanley*, 2002 NASD Discip. LEXIS 11, at *17 ("[E]ven without a showing of actual harm, it can be inherently unfair to require respondents to face the prospect of potential claims for prolonged and indeterminate periods of time."). The Hearing Panel stated, however, that an unfair delay argument "must show that the alleged delay resulted in substantial prejudice to [the] ability to mount a defense." In support, the Hearing Panel noted that, in *Department of Enforcement v. Kaweske*, Complaint No. C07040042, 2007 NASD Discip. LEXIS 5, at *39 (NASD NAC Feb.

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"must demonstrate a lack of diligence by [FINRA] and that he has been prejudiced." *Robert Tretiak*, 56 S.E.C. 209, 230 (2003).

Rooney makes various claims of prejudice, but none are persuasive. Rooney argues that he was prejudiced because JN died before the proceeding commenced.[49] But Rooney has not established how JN's testimony would have been material. Rooney's private securities transactions violations are based on his admitted failure to provide written notice of his private activity to his firm. Rooney's suitability violation is based on whether he had a reasonable basis for offering the NFOA installment plans to any investor, not just to JN. Our finding that Rooney used misleading sales materials is based on the sales literature itself and Rooney's admission that he used such sales literature when soliciting JN. Whether these materials are misleading is an objective test that would not be affected by JN's testimony. And our findings that Rooney made misrepresentations to JN are based on Rooney's stipulation that he falsely informed JN that NFOA was a tax-exempt organization. Rooney does not explain how JN's testimony would have materially affected the findings of violations or the sanctions, nor do we see how JN's testimony could have done so.[50] *Compare Love*, 57 S.E.C. at 325 (rejecting argument that prejudice resulted from the death of a former customer before the complaint was filed where NASD's decision was based on undisputed evidence and where the customer's testimony "ultimately was not material").

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12, 2007), we stated that the SEC has emphasized since its decisions in *Hayden* and *William D. Hirsh*, 54 S.E.C. 1068 (2000), that the proponent of a delay-related fairness defense "must demonstrate that he or she was prejudiced by the allegedly undue delay." For that proposition, we referenced *Feeley & Willcox Asset Mgmt. Corp.*, 56 S.E.C. 1264, 1268-69 (2003). While *Feeley* held that the applicant was required to demonstrate that actual prejudice resulted from the delays in resolving the disciplinary proceeding, the Commission clearly did not view the delays in *Feeley* as approaching those at issue in *Hayden*. *Feeley*, 56 S.E.C. at 1267-68 (holding that *Hayden* is "not on point" because "a portion of the conduct alleged . . . occurred as late as . . . the same year this proceeding was instituted"). Moreover, in a case decided subsequent to *Feeley*, the Commission distinguished *Hayden* by noting that there was no showing of actual harm or prejudice in that case, yet made no suggestion that *Hayden* no longer reflected the Commission's current views. *Love*, 57 S.E.C. at 324 n.21. For these reasons, we caution against interpreting our decision in *Kaweske* as holding that a showing of actual prejudice is *always* required to mount an unfair delay defense. That said, the delays involved here do not approach the levels that would, by themselves, warrant dismissal in the absence of actual prejudice.

[49] JN died on February 25, 2009, prior to the hearing.

[50] In addition, because (as explained below) we find that Rooney's efforts to cancel JN's NFOA contract is mitigating, we are effectively taking into account any mitigating effect that JN's testimony would have provided.

Rooney also argues that he was prejudiced by his "faded memory" between the time of the conduct in question and when he testified at both an on-the-record interview and the hearing. Much of the findings of Rooney's violations, however, are based on documentary evidence and the parties' stipulations. Moreover, as Enforcement counsel correctly pointed out during closing argument below, Rooney was able to testify in detail about many of the events occurring in 2007, suggesting that his memory was not faded but selective. *Cf. Michael J. Marrie*, 56 S.E.C. 760, 798 (2003) (rejecting claim of prejudice based on witnesses' poor memory where they "had no difficulty recalling exculpatory facts"). And other than generally asserting that it was "unreasonable to expect precise recollections," Rooney has provided no guide concerning which portions of his testimony are not reliable due to his purportedly faded memory. *See, e.g.*, *Anthony A. Adonnino*, 56 S.E.C. 1273, 1293 (2003) (finding no prejudice despite applicants' claim that delay impaired memories because applicants did not point to specific instances of specific memory losses), *aff'd*, 111 F. App'x 46 (2d Cir. 2004).

For similar reasons, we reject Rooney's argument that he was prejudiced by the loss of documents before the complaint was filed. The only document that Rooney has claimed was lost is a document once purportedly possessed by Allianz reflecting "JN's cancellation of his proposed NFOA contribution." Even assuming such a document existed and was lost, its materiality—as far as we can tell from Rooney's limited description of it—would have related only to whether Rooney took steps to cancel the transfer of ownership of JN's annuity. But the parties have stipulated that, sometime following May 8, 2007, when Rooney learned NFOA had been falsely representing itself as an approved 501(c)(3) organization, Rooney and JN contacted Allianz, in an effort to cancel the transaction, and there is no dispute that JN's annuity was never transferred to NFOA. Because there is no indication that the purportedly lost document would have added anything material in addition to what the parties have stipulated, Rooney has not demonstrated any prejudice resulting from purported "lost documents."

In total, the delays by themselves were not so extreme that dismissal is warranted in the absence of any prejudice. Because Rooney has failed to show how the delays resulted in any prejudice, we find no unfairness resulting from the delays.

B. Denial of Rooney's Request to Examine a FINRA Staff Attorney as a Witness

Rooney also argues that the proceeding was unfair because the Hearing Officer did not permit him to call Josefina Martinez, one of Enforcement's lawyers, as a witness. Rooney notes that Martinez took notes of her interview with JN showing that JN would have been an unfavorable witness for Enforcement and a favorable witness for Rooney. Rooney argues that he should have been permitted to examine Martinez about her interview with JN because JN died before the hearing and JN's version of the events was "highly important."

The Hearing Officer acted within her discretion, however, in denying Rooney's request to call Martinez as a witness. Pursuant to FINRA Rule 9263, the Hearing Officer "shall receive relevant evidence, and may exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unduly prejudicial." Although Rooney bases his request for Martinez's testimony on the notes Martinez took of her interview with JN, these notes are already in the record, and nothing in those notes suggests that Martinez had any relevant information to provide.

Martinez's notes reflect that JN stated that Rooney "is totally honest." Enforcement does not dispute, however, that JN held the opinion that Rooney was honest. Moreover, JN's opinion of Rooney's honesty is not relevant to whether Rooney violated FINRA rules or the appropriate sanctions for any such violations.

Martinez's notes reflect that JN told her that Rooney "discovered that tax-free status was not legit." But given the parties' stipulation to this fact, further evidence about it through Martinez's testimony would be cumulative.

Martinez's notes reflect that JN said that Rooney "never transferred any $," "never made investment," and "put in a purchase order contingent on proof of tax free status." Here too, further evidence about these statements through Martinez would be immaterial or cumulative. The parties stipulated to the relevant aspects of JN's NFOA transaction: that JN signed an NFOA installment plan contract and agreement, that Rooney signed the contract as the financial advisor; that Rooney submitted to NFOA JN's executed contract and agreement and documents authorizing the transfer of ownership of his exiting annuity, that NFOA forwarded to the insurance company that held JN's annuity a letter attaching the transfer of ownership documents; and that ownership of JN's existing annuity never transferred to NFOA. JN's statement that Rooney "never transferred any $" is cumulative of these facts. JN's statements that Rooney "never made investment" and "put in a purchase order contingent on proof of tax free status" are not relevant because they are inconsistent with the stipulations[51] as well as documentary evidence about the transaction, none of which reflects any contingencies. Accordingly, Rooney has not demonstrated that any unfairness resulted from the Hearing Officer's denial of his request to call Martinez as a witness.

C. Statute of Limitations

Rooney argues that this disciplinary proceeding exceeded the statute of limitations in 28 U.S.C. § 2462. Rooney's argument lacks merit.

The statute of limitations in 28 U.S.C. § 2462 provides that an "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued." Section 2462, however, "does not apply to FINRA disciplinary proceedings because FINRA is not a government entity." *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *92-93 (July 2, 2013), *aff'd sub nom. Birkelbach v. SEC*, 751 F.3d 472 (7th Cir.

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[51] "Stipulations entered into freely and fairly shall not be set aside except to avoid manifest injustice," and Rooney makes no attempt to avoid the stipulations he entered into. *Dep't of Enforcement v. U.S. Rica Fin., Inc.*, Complaint No. C01000003, 2003 NASD Discip. LEXIS 24, at *29 (NASD NAC Sept. 9, 2003) (quoting *Henry v. Comm'r of Internal Revenue*, 362 F.2d 640, 643 (5th Cir. 1966)); *Joseph Abbondante*, 58 S.E.C. 1082, 1088 n.12 (2006) ("Stipulated facts serve important policy interests in the adjudicatory process, including playing a key role in promoting timely and efficient litigation; we will honor stipulations in the absence of compelling circumstances."), *aff'd*, 209 F. App'x 6 (2d Cir. 2006).

2014). "Indeed, [the Commission] ha[s] repeatedly held that 'the disciplinary authority of private self-regulatory organizations . . . such as [FINRA] is not subject to any statute of limitation.'" *Id.* (quoting cases).

Rooney argues, however, that his argument finds support in *Fiero v. FINRA*, 660 F.3d 569 (2d Cir. 2011). He argues that "[i]n the past the SEC has accepted FINRA's argument that disciplinary proceedings were contractual and not subject to limitations," but that *Fiero* "rejected FINRA's contractual authority arguments for its disciplinary proceedings." Both premises of Rooney's argument, however, are flawed. The five cases Rooney cites in which the SEC held that 28 U.S.C. § 2462 does not apply to FINRA disciplinary proceedings were *not* rooted, as Rooney claims, on contract-based theories, but in the well-established fact that FINRA is not a government agency. *See Hirsh*, 54 S.E.C. at 1077-78 n.11; *Stephen J. Gluckman*, 54 S.E.C. 175, 186 & n.35 (1999); *Shamrock Partners, Ltd.*, 53 S.E.C. 1008, 1016 n.15 (1998); *Henry James Faragalli, Jr.*, 52 S.E.C. 1132, 1144-1145 (1996); and *Larry Ira Klein*, 52 S.E.C. 1030, 1039 (1996). Likewise, contrary to Rooney's argument, *Fiero* did not concern the conduct of FINRA's disciplinary proceedings, let alone any time-based limitations on FINRA's authority to bring disciplinary actions. Rather, *Fiero* addressed whether FINRA has authority to bring court actions to collect disciplinary fines once imposed.[52] 660 F.3d at 571. Accordingly, we reject Rooney's statute of limitations argument.

VI. Sanctions

In assessing sanctions, we consider the FINRA Sanction Guidelines ("Guidelines"), including the Principal Considerations in Determining Sanctions set forth therein and any other case-specific factors. We also consider the seriousness of the offenses, the potential for repetition, and the deterrent value to the respondent and others. *See McCarthy v. SEC*, 406 F.3d 179, 190 (2d Cir. 2005).[53]

A. Supervision

For Rooney's supervision violations, the Hearing Panel fined Rooney $25,000, suspended him for 18 months in any supervisory capacity, and required him to requalify as a general securities principal. As explained below, we affirm.

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[52] Nothing in *Fiero*, for example, prohibits FINRA from assessing disciplinary fines or revoking the registration of any member or associated person who fails to pay a disciplinary fine, as a means of protecting the public.

[53] As an initial matter, we reject Rooney's argument that the Hearing Panel erred by applying the most recent version of the Guidelines that existed at the time of the Hearing Panel's decision, rather than the version that existed at the time of the misconduct. The Guidelines "are effective as of the date of publication, and apply to all disciplinary matters, including pending matters." *FINRA Sanction Guidelines*, at 8 (2013) (Applicability) [hereinafter Guidelines]. In any event, there were no changes to the relevant Guidelines between 2007 and 2014.

For failing to supervise, the Guidelines recommend a fine between $5,000 and $50,000, and to consider suspending the responsible individual in all supervisory capacities for up to 30 business days. In egregious cases, the Guidelines recommend suspending the responsible individual in any or all capacities for up to two years or barring the individual.[54] The Guidelines contain three principal considerations specific to supervision failures: (1) whether respondent ignored "red flag" warnings that should have resulted in additional supervisory scrutiny and whether the individuals responsible for the underlying misconduct attempted to conceal the misconduct from respondent; (2) the nature, extent and character of the underlying misconduct; and (3) the quality and degree of supervisor's implementation of the firm's supervisory procedures and controls.[55]

Failing to supervise, as well as the underlying misconduct that Rooney failed to supervise, are all serious violations. "[T]he responsibility of broker-dealers to supervise their employees is a critical component of the federal regulatory scheme." *Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *62 (Feb. 13, 2015); *Murphy*, 2013 SEC LEXIS 1933, at *112 & n.155. Rooney's failure to supervise for compliance with the private securities transactions rule—which resulted in HW selling a fraudulent product to elderly investors—"illustrates the potential for harm to public investors through private securities transactions." *Siegel*, 2008 SEC LEXIS 2459, at *36. Likewise, the suitability rule is a critical tool to protect investors and the public interest. *Cody*, 2011 SEC LEXIS 1862, at *86-87; *Siegel*, 2008 SEC LEXIS 2459, at *46 ("[T]he purpose of the suitability rule is to protect customers from potentially abusive sales practices by ensuring that a registered representative has reasonable grounds for believing that his recommendation is suitable.").

It is an aggravating factor that Rooney has relevant disciplinary history.[56] In October 2010, Rooney settled a FINRA disciplinary matter and consented, without admitting or denying the allegations of the complaint, to the entry of findings that, from November 2007 to January 2008, Fox, acting through Rooney: (1) sold zero coupon bonds while negligently omitting material facts; (2) participated in two private placement offerings of zero coupon bonds that were required to be registered but which were not; (3) sold zero coupon bonds using a limited liability company that was not permitted to serve as an escrow agent; (4) used a private placement memorandum that misrepresented that proceeds from the sales of zero coupon bonds would not be commingled with those of any entity when, in fact, they were; (5) conducted a flawed test of the Firm's supervisory controls by failing to review the Firm's private placement business; and (6) failed to produce evidence of how the Firm supervised Rooney. The order approving the settlement indicated that these actions were in violation of Section 15(c) of the Exchange Act and Rule 15c2-4 thereunder, Section 17(a) of the Exchange Act and Rule 17a-4 thereunder, and NASD Rules 2110, 3010(b), 3012(a)(2)(C) and 3013. For these violations, Rooney consented to

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54 *Guidelines*, at 103.

55 *Id.*

56 *Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 1).

a 15-business-day suspension in any principal capacity and a $20,000 fine. Order Accepting Offer of Settlement, *Dep't of Enforcement v. Fox Financial Management Corp.* (entered Oct. 29, 2010), *available at* http://www.finra.org/Industry/Enforcement/DisciplinaryActions/FDAS/ (Disciplinary Actions Online).[57]

The record reflects numerous other aggravating factors related to Rooney's supervisory failures. Rooney was aware that HW was planning to sell NFOA installment plans, was aware of a risk that the products were securities, knew that he had not received any written request from HW to engage in those transactions, and knew that, if the products were securities, he was responsible for conducting reasonable due diligence and had not done so. These were circumstances that compelled additional supervisory scrutiny by Rooney to understand the classification of the NFOA installment plans, ensure that HW provided the Firm with prior written notice of those transactions, did not sell the products without written approval, and possessed an adequate and reasonable basis for recommending the product.[58] Rooney's utter failure to do so was reckless.[59]

Another aggravating factor is the nature, extent, size and character of HW's underlying misconduct.[60] Over a period of three months, HW engaged in unsupervised, unsuitable sales of more than $85,000 in NFOA installment plans to three elderly customers.[61] NFOA was found to have violated state securities and insurance laws in connection with its sales of the installment plans at issue.[62] HW sold the NFOA installment plans directly to customers.[63]

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[57] It appears, based on an exchange during the hearing, that the Hearing Panel did not consider the October 2010 settlement as relevant disciplinary history because the underlying events occurred after the events at issue here. This is not a proper ground, however, for not considering disciplinary history. *See Dep't of Enforcement v. Sears*, Complaint No. C07050042, 2009 FINRA Discip. LEXIS 4, at *14-15 (FINRA NAC July 23, 2009) (considering disciplinary history to include state regulatory action that concerned conduct occurring after the events at issue).

[58] *Guidelines*, at 103 (Principal Considerations in Determining Sanctions, No. 1).

[59] *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 13). We have considered whether Rooney's purported belief that the NFOA installment plans were insurance products suggests that he acted with a less culpable state of mind, both when failing to supervise HW and when selling an NFOA contract to JN. It does not because, as explained above, he lacked any reasonable basis for that belief.

[60] *Id.* at 103 (Principal Considerations in Determining Sanctions, No. 2).

[61] *Id.* at 14 (Selling Away, Principal Considerations in Determining Sanctions, Nos. 1, 2, 3).

[62] *Id.* (Selling Away, Principal Considerations in Determining Sanctions, No. 4).

[63] *Id.* at 15 (Selling Away, Principal Considerations in Determining Sanctions, No. 11).

Moreover, the quality and degree of Rooney's implementation of the Firm's controls was low.[64] Despite that Rooney was HW's direct supervisor, was one of two persons at the Firm with the responsibility to approve requests to engage in private securities transactions, was responsible for investigating the securities that the Firm's representatives recommended, and had direct knowledge of HW's planned sales, Rooney took no steps to require that HW provide detailed notice of his transactions, and conducted an inadequate investigation of NFOA. He failed to conduct even the most basic levels of due diligence. Rooney's general lack of regard for, and failure to accept responsibility for complying with, FINRA's rules and regulations and his own firm's policies and procedures is highly troubling.

It is mitigating that once Rooney discovered the existence of an inquiry into NFOA by Texas, he charged his lawyer with investigating, who in turn discovered that NFOA was not a tax-exempt organization and warned Fox's representatives not to have dealings with NFOA.[65] This, in turn, enabled HW to take steps to try to cancel the NFOA installment plans for some of his customers. Apart from this, we find no other mitigating factors.

Rooney argues that the Hearing Panel erred by not considering that Rooney has had no customer arbitrations or complaints filed against him in 25 years. Such facts, however, are not mitigating. *Kent M. Houston*, Exchange Act Release No. 71589, 2014 SEC LEXIS 614, at *30 (Feb. 20, 2014) ("[A] lack of disciplinary history is not mitigating for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional."); *see also Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 SEC LEXIS 3936, at *27 (Nov. 4, 2009) ("The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate [the] misconduct."), *aff'd*, 416 F. App'x 95 (2d Cir. 2011). In any event, as explained above, Rooney *has* a relevant disciplinary history.

Considering the numerous aggravating factors and only one mitigating factor, Rooney's recidivism, and his "demonstrated insouciance and indifference towards his responsibilities," we find that Rooney "poses a serious risk to the investing public." *Scott Epstein*, Exchange Act Release No. 59328, 2009 SEC LEXIS 217, at *75 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010). A strong sanction is warranted to deter Rooney from engaging in supervisory violations again, and to deter others from engaging in similar violations. Although our findings of supervisory violations are on slightly narrower grounds than the Hearing Panel's findings, the number of HW's solicitations and the scope of the potential harm that went unsupervised remains the same. Accordingly, we fine Rooney $25,000, suspend him from associating with

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[64] *Id.* at 103 (Principal Considerations in Determining Sanctions, No. 3).

[65] *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 4) (instructing adjudicators to consider whether the respondent "voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct").

any member firm in any principal or supervisory capacities for 18 months, and order that he requalify as a general securities principal.[66]

B. Private Securities Transaction

For Rooney's private securities transaction with JN, the Hearing Panel fined Rooney $10,000, suspended him for three months in all capacities, and required that he requalify by qualification examination. We affirm these sanctions.

For private securities transactions, the Guidelines recommend imposing a fine between $5,000 and $50,000. To determine the appropriate suspension, bar or other sanction, the Guidelines explain that "[t]he first step . . . is to assess the extent of the selling away, including the dollar amount of the sales, the number of customers and the length of time over which the selling away occurred."[67] For dollar amounts of sales up to $100,000—as with Rooney's private securities transaction—adjudicators should consider imposing a suspension from 10 business days to three months.[68] The Guidelines further indicate that adjudicators should consider the Principal Considerations in Determining Sanctions and the General Principles applicable to all Guidelines and that the "[t]he presence of one or more mitigating or aggravating factors may either raise or lower the . . . sanctions" from the described ranges.[69]

As for the "first step" considerations, Rooney sold an NFOA installment plan to one customer, in the amount of $63,675. Many of the same factors that made HW's private securities transactions serious—that the NFOA installment plan involved a violation of state securities laws, that the NFOA installment plan was sold directly to customers, that it resulted in the potential for monetary gain, and that the absence of customer harm was due largely to the diligence of the issuer of the exchanged annuity—also aggravate Rooney's private securities transaction.[70] Had Rooney given his Firm detailed, written notice of his sale, the Firm would have had the opportunity to consider whether to permit his sale, to supervise it, and possibly prevent even the risk of injury to JN. It is also aggravating that Rooney sold the installment plan to a customer of his member firm.[71]

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66 The suspension of Rooney in all *supervisory or principal* capacities is in contrast to the Hearing Panel's suspension, which was limited to suspending Rooney in all *supervisory* capacities.

67 *Guidelines*, at 14.

68 *Id.*

69 *Id.*

70 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 17), 14-15 (Principal Considerations in Determining Sanctions, Nos. 4, 11).

71 *Id.* at 15 (Principal Considerations in Determining Sanctions, No. 8).

It is mitigating that, when Rooney learned that NFOA was not a 501(c)(3) organization, he attempted to cancel JN's contract. It is also somewhat mitigating that Rooney verbally informed his supervisor, SB, of his planned sale.[72] The record demonstrates that SB was directly involved in the transaction, including corresponding with NFOA and obtaining illustrations that were specific to JN. The import of this is lessened, however, given that there is no indication that Rooney provided SB with the specific information required by NASD Rule 3040. *See Keyes*, 2006 SEC LEXIS 2631, at *26. We are also mindful that Rooney sold away on only one occasion.

Considering the aggravating factors involved and almost no mitigating ones, we find that Rooney's private securities transaction violation warrants sanctions towards the upper tier of the relevant suspension range as well as a proportionate fine. We therefore fine Rooney $10,000 and suspend him for three months in all capacities from associating with any member firm in any capacity. And given his apparent failure to appreciate that the private securities transactions requirements applied to him as president of the Firm, we also order that Rooney requalify by qualification examination as a general securities representative.

C. Suitability

For Rooney's unsuitable recommendation of an NFOA installment plan to JN, the Hearing Panel fined Rooney $25,000, suspended him from associating with any member firm in any capacity for 18 months, and ordered that he requalify as a general securities representative by examination. We affirm.

For suitability violations, the Guidelines recommend imposing a fine between $2,500 and $75,000, and a suspension between 10 business days and one year. In egregious cases, the Guidelines recommend imposing a longer suspension of up to two years or imposing a bar.[73]

There are several aggravating factors that make Rooney's suitability violation egregious. We have already noted that Rooney has a disciplinary history, that the nature of his transaction involved a $63,675 sale, and his conduct had the potential for his monetary gain. While there is no indication that Rooney was trying to harm his customer, his failure to conduct due diligence was more than just a mere oversight. Rooney knew he was responsible for conducting due diligence investigations of products that the Firm approved, must have understood what a reasonable due diligence investigation consists of, and must have known that the limited due diligence efforts he performed—simply reading NFOA's sales literature, having an unprobing conversation with NFOA's president and representatives, and taking no steps to independently verify NFOA's representations—were an unreasonable investigation that left him without a reasonable basis for recommending the installment plans to any investor. Moreover, we find it further aggravating that Rooney made his unsuitable recommendation to a customer who was severely ill and who depended on Rooney for handling many personal affairs.

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72 *Id.* (Principal Considerations in Determining Sanctions, No. 9).

73 *Id.* at 94.

We have already noted that it is mitigating that Rooney, after learning of a problem with NFOA, tried to cancel JN's NFOA contract.[74] We have also considered that Rooney made only one unsuitable recommendation to one customer.[75]

Having considered these factors, we find that Rooney's suitability violation was egregious and that the Hearing Panel's sanctions were appropriate. Thus, for his suitability violations, we fine Rooney $25,000, suspend him from associating with any member firm in any capacity for 18 months, and order that he requalify as a general securities representative by examination.

D. Misrepresentations

For Rooney's misrepresentations, the Hearing Panel fined Rooney $10,000 and suspended him for one month from associating with any member firm in any capacity. We affirm.

The Guidelines for misrepresentations or material omissions of fact differ depending on whether the misconduct was "negligent" or "intentional or reckless." For negligent misconduct, the Guidelines recommend imposing a fine between $2,500 to $50,000, and imposing a suspension in any or all capacities of up to 30 business days. For intentional or reckless conduct, the Guidelines recommend imposing a fine between $10,000 to $100,000, a suspension from 10 business days to two years, and, in egregious cases, the consideration of a bar.[76]

When soliciting JN, Rooney falsely represented that NFOA was a tax-exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code and that JN would be entitled to receive a tax deduction in connection with an exchange of his annuity for an NFOA installment plan. At the very least, these representations were negligent. A simple Internet search, or contacting the IRS, would have revealed that his representations about the tax benefits of the investments were false and that the State of Washington had issued a cease and desist order stating how NFOA was misrepresenting its 501(c)(3) status. Many of the same aggravating and mitigating factors present for Rooney's suitability violations are equally relevant to his misrepresentations. Having considered these factors, we find that a $10,000 fine and a one-month suspension are appropriate to remedy his misrepresentations.

E. Misleading Sales Materials

For Rooney's use of misleading sales materials when soliciting JN to invest in an NFOA installment plan, the Hearing Panel fined Rooney $5,000, suspended him for two months, and required that he requalify as a general securities representative. We reduce these sanctions.

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74 *Id.* at 4 (Principal Considerations in Determining Sanctions, No. 4).

75 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 18).

76 *Id.* at 88.

The Guideline concerning communications with the public violations contains several recommendations concerning fines. For "failing to comply with Rule standards or the inadvertent use of misleading communications," the Guidelines recommend a fine between $1,000 to $20,000. For "intentional or reckless use of misleading communications," the Guidelines recommend a fine between $10,000 to $100,000.[77]

The Guideline also contains recommendations for a suspension, bar, or other sanctions. For "failure to comply with rule standards," the Guidelines recommend suspending the responsible person for up to 60 days. For "use of misleading communications with the public," the Guidelines recommend to "consider suspending the responsible person in any or all capacities for up to two years." The Guidelines further recommend, in cases involving numerous acts of intentional or reckless misconduct over an extended period of time, suspending the responsible person in any or all capacities for up to two years or imposing a bar.[78]

There are several aggravating factors. Rooney's use of the Explanatory Statement was reckless. Many of the problems with the document go to the core characteristics of the NFOA installment plan and were evident on their face or when read in conjunction with the 1099 Statement, including the lack of a description of the basis for the tax calculations, the failure to denote that the income was largely a return of principal, and the failure to include any rate of return. With nearly two decades of experience in the industry at the time of the misconduct, Rooney must have understood how the Explanatory Statement failed to provide a sound basis for evaluating the facts regarding the NFOA installment plan. Moreover, as explained above, Rooney should have discovered that the claimed tax deduction was false.

Our assessment of the sanctions for Rooney's use of misleading sales materials is also influenced by many of the same aggravating and mitigating factors that are present with Rooney's other violations related to his sale to JN, as fully described above. We are mindful that Rooney's violation involved a single page of misleading sales literature, and that our findings of violation are narrower than those of the Hearing Panel, and this warrants a reduction in the sanctions for Rooney's violation. For Rooney's use of misleading sales literature, we impose a $2,500 fine, a one-month suspension, and a requirement that Rooney requalify as a general securities representative.[79]

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[77] *Guidelines*, at 79-80.

[78] *Id.*

[79] In arguing that all of the sanctions imposed on him were unfair, Rooney notes that no disgorgement remedy was sought against him. But he offers no explanation for why that should be mitigating, nor do we see any reason why it should be. Indeed, disgorgement would not be an appropriate remedy because Rooney did not earn any ill-gotten gains as a result of his misconduct. Moreover, the fact that Rooney did not profit from his misconduct does not negate the numerous other aggravating factors that exist.

VII. Conclusion

Accordingly, we find that Rooney failed to supervise, engaged in a private securities transaction, made an unsuitable recommendation, made misrepresentations, and used misleading sales materials. For these violations, we suspend Rooney in all capacities for a total of 23 months (to be served consecutively), suspend him in all principal or supervisory capacities for 18 months (to be served concurrently with the all-capacities suspensions), fine him $72,500, and order him to requalify as a general securities representative and general securities principal. Finally, we affirm the $5,865.21 costs imposed by the Hearing Panel. Appeal costs are not imposed.[80]

On behalf of the National Adjudicatory Council,

Marcia E. Asquith
Senior Vice President and Corporate Secretary

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