

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

Department of Enforcement,

Complainant,

v.

Cantone Research Inc.,
BD No. 26314,

and

Christine L. Cantone,
CRD No. 2687618,

Respondents.

Disciplinary Proceeding
No.2009020383002

Hearing Officer-MC

**ORDER ACCEPTING OFFER OF
SETTLEMENT**

Date: February 22, 2012

INTRODUCTION

Disciplinary Proceeding No. 2009020383002 was filed on August 8, 2011, by the Department of Enforcement of the Financial Industry Regulatory Authority (FINRA) (Complainant). Respondents Christine L. Cantone (Cantone) and Cantone Research Inc. (CRI) submitted an Offer of Settlement (Offer) to Complainant dated February 15, 2012. Pursuant to FINRA Rule 9270(e), the Complainant and the National Adjudicatory Council (NAC), a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA) have accepted the uncontested Offer. Accordingly, this Order now is issued pursuant to FINRA Rule 9270(e)(3). The findings, conclusions and sanctions set forth in this Order are those stated in the Offer as accepted by the Complainant and approved by the NAC.

Under the terms of the Offer, Respondents have consented, without admitting or denying the allegations of the Complaint, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, to the entry of findings and violations consistent with the allegations of the Complaint, and to the imposition of the sanctions set forth below, and fully understand that this Order will become part of Respondents' permanent disciplinary record and may be considered in any future actions brought by FINRA.

BACKGROUND

CRI has been a member of FINRA since 1990. The firm is located in Tinton Falls, New Jersey and conducts a general securities business. CRI employs twelve registered individuals and its registration with FINRA remains in effect. Therefore, the firm is subject to FINRA's ongoing jurisdiction.

Cantone first became registered with FINRA in 1996 as a General Securities Representative through CRI. She subsequently became registered as a Financial and Operations Principal, General Securities Principal, Municipal Securities Principal and Registered Options Principal. Since 2001, Cantone has been CRI's Vice-President, Chief Compliance Officer, and FINOP, having less than a 5% ownership interest in CRI. She presently remains registered with CRI, and therefore remains subject to FINRA's ongoing jurisdiction.

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:

SUMMARY

1. Cantone, Vice President and Chief Compliance Officer of CRI, failed to reasonably supervise registered representative Maxwell Baldwin Smith (Smith). As a result, Smith was able to continue engaging in a scheme through which he sold fictitious investments to CRI customers and misappropriated over \$1.6 million of their funds. Throughout the time period of Smith's association with CRI, Cantone was aware of certain "red flags" that should have alerted her to his misconduct. Cantone, however, failed to reasonably follow up on those indications of possible misconduct. For example, she simply accepted Smith's unverified representations about the large dollar deposits and withdrawals in one of his accounts at another member firm. Cantone's conduct violated NASD Conduct Rules 3010 and 2110 and FINRA Rule 2010.
2. CRI failed to establish and maintain a supervisory system and to establish, maintain and enforce Written Supervisory Procedures (WSPs) with regard to monitoring the activity of its registered representatives in outside brokerage accounts. Although CRI had procedures requiring the disclosure of outside brokerage accounts, the provision of duplicate statements for those accounts, and the questioning of registered representatives about suspect transactions in those outside accounts, the firm failed to provide for adequate follow-up or review of such suspect transactions. As a result of the firm's supervisory shortcomings, Smith was able to continue his fraudulent

scheme while he was registered with CRI. CRI's conduct violated NASD Conduct Rules 3010 and 2110 and FINRA Rule 2010.

BACKGROUND

Smith's Misappropriation Scheme

3. Smith first became registered with FINRA as a General Securities Representative through a former member firm in 1974. Subsequently, he was registered with a number of other member firms until December 2004.
4. From January 7, 2005 to April 3, 2009, Smith was registered with CRI as a General Securities Representative, Municipal Securities Representative and Municipal Securities Principal.
5. From 1992 through at least June 2008, Smith convinced seven individuals, including at least four elderly investors, to invest over \$9 million in securities he called Health Care Financial Partnership Direct Loans (HCF). Most of the seven individuals were customers of Smith at CRI, including LF, who was 95 years old at the time the Complaint was filed but is now deceased. LF gave Smith at least \$8.6 million to invest in HCF. While he was at CRI, Smith raised and misappropriated \$1.6 million from firm customers through the fraudulent scheme described below.
6. In documentation provided by Smith to the customers, Health Care Financial was described as a company "formed for the purpose of obtaining a high level of interest income through investment in a diversified portfolio of High Yielding income projects which have been sold to finance or refinance health care facilities, such as nursing homes and continuing care retirement centers for the elderly." Smith recommended the purchase of the loans as "an attractive investment for purchasers of

nursing home bonds.” Depending on the loan purchased, Smith promised the customers annual interest ranging from 7.5% to 9%. The terms of the loans ranged from 2 to 30 years.

7. At all times relevant to this matter, Smith maintained materials on-site at CRI pertaining to HCF and the CRI clients that invested in those loans. In addition, a CRI employee who served as Smith’s secretary maintained a file that contained, *inter alia*, materials pertaining to his customers’ investments in HCF. Smith’s secretary also typed documents, including correspondence for Smith regarding HCF. Because these materials were kept within CRI’s offices, Respondents had the ability to review these materials throughout the relevant time period.
8. At all times relevant to this matter, Smith maintained a brokerage account at ML, a FINRA member firm. This was titled as a joint account for Smith and his wife.
9. After Smith convinced them to invest in HCF, the customers withdrew funds from their brokerage and other accounts, and used personal checks to purchase HCF. In accordance with Smith’s instructions, the customers made their checks payable to ML and included an account number on those checks. The customers were unaware that the number was that of Smith’s ML account.
10. Smith did not invest the above-referenced funds on the customers’ behalf. Unbeknownst to the customers, Health Care Financial did not exist. Instead of investing the funds as promised, Smith misappropriated the customers’ money by depositing their checks into his ML account. He then transferred those funds to a personal bank account by writing large dollar checks payable to himself or to cash. Smith used some of the funds to make lulling payments--purportedly “interest

payments” on the customers’ investments in HCF. He also used the funds to purchase real estate, antiques and vacations for himself.

11. By misappropriating customer funds, Smith violated NASD Conduct Rules 2330 and 2110 and IM-2310-2.¹

**Failure to Supervise (Cantone)
(NASD Conduct Rules 3010 and 2110 and FINRA Rule 2010)**

12. During January 2005 through April 2009 (relevant time period), Smith worked in CRI’s office in Tinton Falls, New Jersey. In 2005, the office had about 30 employees and, by 2009, that number decreased to about 15.
13. When he began working at CRI, Smith was 65 years old and supposedly had a history of being a big producer at his previous firms.
14. Cantone had supervisory authority over Smith and was responsible for ensuring his compliance with firm procedures and applicable securities rules.
15. CRI’s written supervisory procedures required that newly registered representatives of the firm transfer any outside securities accounts to CRI. CRI’s procedures allowed exceptions to this policy if duplicate statements and confirmations were sent to CRI by the other member firm. The procedures also provided that employees would be contacted about transactions in outside accounts that were potentially contrary to rules or firm policy.
16. During the relevant time period, Cantone had the responsibility of enforcing the firm’s procedures regarding the monitoring and review of employee transactions in

¹ On February 1, 2010, without admitting or denying the allegations relating to his HCF scheme, Smith consented to the entry of FINRA’s findings and to the imposition of a bar in all capacities. In November 2009, Smith pleaded guilty to criminal charges, which included first-degree money laundering and mail fraud, arising from the scheme described herein. He is currently awaiting sentencing.

outside accounts. Cantone reviewed outside account statements for compliance with the securities laws and rules.

17. Cantone was also responsible for reviewing incoming and outgoing paper and electronic correspondence for CRI's registered representatives.
18. Upon his association with CRI, Smith disclosed his ML account. Cantone asked Smith to transfer the account to CRI. Smith objected, citing several reasons including that he needed to pay certain bills from the account.
19. Cantone acquiesced and permitted Smith to retain his account at ML.
20. Respondents began receiving statements for Smith's ML account in January 2005.
21. Cantone regularly reviewed the statements and thus was aware of deposit and checking activity in Smith's ML account.
22. These reviews alerted Cantone to unusually large deposits in Smith's ML account.
23. Cantone was also aware of and expressed concern to Smith about the aggregate amount of funds being received into the account. For example, in November 2005, Cantone noticed that the account had received \$925,000 over the course of the year and asked Smith about that figure. Moreover, Smith's year-end statements for the ML account showed the following activity, which Cantone was aware of:

Year	Funds Received	Checks Written
2005	\$1,075,000	\$847,500
2006	\$275,000	\$353,911
2007	\$635,408	\$469,901
2008	\$315,142	\$474,732

24. Cantone was aware that activity in the ML account was not consistent with the income Smith generated as a registered representative of CRI. CRI paid Smith

\$28,237.71 in 2005, \$14,242.31 in 2006, \$11,603.69 in 2007, and \$22,457.48 in 2008.

25. Concerned that Smith may have been engaging in outside business activities or private securities transactions, Cantone questioned Smith about the origin of the funds deposited into his ML account.
26. Cantone accepted Smith's explanation that the deposits were related to real estate sales or to his wife's supposed antique business. She requested no supporting documentation from Smith and made no other efforts to verify those representations.
27. Through her statement reviews, Cantone also noticed that, contrary to Smith's earlier representation that he needed to pay bills from the ML account, most of the withdrawals were checks written to Smith or to cash.
28. Cantone did not document her concerns with the deposits or check writing activity, the steps that she took to investigate those concerns, or Smith's responses to her inquiries.
29. Many of the amounts deposited in Smith's ML account corresponded to withdrawal amounts from his customers' accounts at CRI made shortly before the deposits. Cantone's review did not uncover the connection.
30. Even when presented with direct evidence of Smith's deposit of customer funds into his ML account, Cantone continued to rely on Smith's unverified representations. Specifically, in or about August 2005, CRI customer LF gave Smith a \$300,000 personal check payable to ML for investment in HCF. The check clearly identified customer LF as the maker, and the memorandum section indicated that the check was

for "HCare Fin. Pt. Loan [REDACTED] The check was made payable to ML and referenced a number which matched the number of Smith's ML account. Smith attempted to deposit the check into his ML account.

31. Due to insufficient funds in LF's account, the check was returned to Smith at the CRI office where Smith worked. LF's \$300,000 check was received by Cantone, who proceeded to question Smith about it. Smith told Cantone that the check was from a private placement transaction.
32. Cantone ended her inquiry there and failed to take any steps to verify Smith's claim. Despite being confronted with the fact that Smith was receiving customer funds in his personal brokerage account at ML, Cantone continued her practice of accepting Smith's unverified representations.
33. During December 2008, Cantone became aware of a series of e-mail correspondence between Smith's secretary and LF's accountant. That electronic correspondence referenced an outside e-mail address for Smith and information regarding investments in HCF that were gifted to LF's relatives.
34. Following her review of that e-mail correspondence, Cantone questioned Smith about LF's investments in HCF, and he told her that HCF was a bond purchased at a previous firm. Once more, however, Cantone failed to probe further or take reasonable steps to substantiate Smith's claim. She did not request any documentation from Smith or contact LF.
35. Cantone failed to reasonably supervise Smith. Among other things, she failed to reasonably respond to, and otherwise address, the "red flags" referenced above.

Cantone routinely relied on Smith's unverified representations without taking reasonable steps to assure herself that Smith was not engaging in misconduct with respect to CRI's customers. As a result of Cantone's failure to supervise Smith, he was able to continue his misappropriation scheme unabated during the time that he was registered with CRI.

36. By failing to reasonably supervise the activities of Smith, Cantone violated NASD Conduct Rules 2110 (for conduct before December 15, 2008) and 3010 and FINRA Rule 2010 (for conduct after December 14, 2008).

**Deficient Supervisory System and Procedures (CRI)
(NASD Conduct Rules 3010 and 2110 and FINRA Rule 2010)**

37. Although CRI had general procedures during the relevant time period requiring the disclosure of outside brokerage accounts, the provision of duplicate statements for those accounts, and the questioning of registered representatives about suspect transactions in those outside accounts, the WSPs lacked specific requirements and the firm otherwise failed to provide for reasonable follow-up or review of such suspect transactions, such as requesting documentation on questionable transactions, comparing deposit activity in the outside accounts to withdrawal activity in customer accounts, or speaking with customers.
38. As a result, CRI failed to establish and maintain a supervisory system and establish, maintain and enforce WSPs reasonably designed to achieve compliance with applicable securities laws and regulations with regard to monitoring the activity of its registered representatives in outside brokerage accounts.

39. Because of these supervisory failings, CRI violated NASD Conduct Rules 2110 (for conduct before December 15, 2008) and 3010 and FINRA Rule 2010 (for conduct after December 14, 2008).

Based on the foregoing, Respondents violated NASD Conduct Rules 2110 and 3010 and FINRA Rule 2010.

Based on these considerations, the sanctions hereby imposed by the acceptance of the Offer are in the public interest, are sufficiently remedial to deter Respondents from any future misconduct, and represent a proper discharge by FINRA, of its regulatory responsibility under the Securities Exchange Act of 1934.

SANCTIONS

It is ordered that:

- Respondent Cantone be suspended for three months from association with any FINRA member in a principal capacity;
- Respondents Cantone and CRI be jointly-and-severally fined \$10,000;
- Respondent CRI be censured and fined \$15,000; and
- Respondents Cantone and CRI pay partial restitution, on a joint-and-several basis, to the customers listed on Attachment A to the Order in the total amount of \$200,000.

Respondents agree to pay the monetary sanctions upon notice that the Offer has been accepted and that such payments are due and payable. Respondents have each submitted an Election of Payment form showing the method by which they propose to pay the fines imposed.

Respondent Cantone and a registered principal on behalf of Respondent CRI shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken

to effect restitution. Such proof shall be submitted to Jonathan M. Prytherch, Senior Regional Counsel, FINRA, 581 Main Street, Suite 710, Woodbridge, New Jersey 07095 either by letter that identifies Respondents and case number 2009020383002 or by e-mail from a work-related account of the registered principal of CRI to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the Offer.

If for any reason Respondents cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the Offer is accepted, or such additional period agreed to by a FINRA staff member in writing, Respondents shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Respondents shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

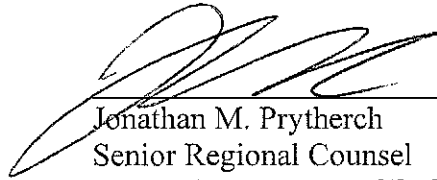
The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

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

SO ORDERED.

FINRA

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

A handwritten signature in dark ink, appearing to read 'JP', is written over a horizontal line.

Jonathan M. Prytherch
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FINRA Department of Enforcement
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Phone: (732) 596-2078
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ATTACHMENT A

Customer Name	Restitution Amount
Estate of LF	\$178,000
JS and SS	\$11,000
RT	\$5,200
ET	\$3,800
AM and MM	\$2,000