

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090209303-02**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Internet Securities, Respondent
Member Firm
CRD No. 102800

and

Michael W. Beardsley, Respondent
General Securities Principal
General Securities Representative
Investment Banking Representative
CRD No. 2546470

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Internet Securities and Respondent Michael W. Beardsley submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondents alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondents hereby accept and consent, without admitting or denying the findings, 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, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Internet Securities has been a FINRA member since July 2000. The firm conducts a general securities business. It operates from one main office and employs approximately 14 registered representatives.

Beardsley entered the securities industry in September 1994 by filing a Form U4 to become associated with a FINRA member. He first became registered as a General Securities Representative in January 1995. Since January 1999, Beardsley has been the president and chief executive officer of Internet Securities,

where he has been registered since July 2000 as a General Securities Representative and General Securities Principal. In April 2010, he also became registered as an Investment Banking Representative. At all times relevant to this AWC, Beardsley was the Anti-Money Laundering Compliance Officer ("AMLCO") and Chief Compliance Officer ("CCO") for Internet Securities.

RELEVANT DISCIPLINARY HISTORY

In August 2010, FINRA accepted an AWC from Respondents, finding that they had conducted securities business while failing to maintain required minimum net capital, in violation of Exchange Act and FINRA rules. The AWC included sanctions of a 15 business-day principal suspension against Beardsley and a \$5,000 joint and several fine against Beardsley and Internet Securities.

OVERVIEW

Beardsley failed to exercise reasonable supervision over a registered representative of Internet Securities, resulting in numerous unsuitable recommendations to two customers. In addition, FINRA's 2011 cycle examination of Internet Securities identified varied and widespread supervisory failures by Beardsley and the firm.

FACTS AND VIOLATIVE CONDUCT

1. Failure to Supervise Registered Representative's Transactions

Between December 24, 2007 and December 15, 2008, MD, a former registered representative of Internet Securities, recommended and effected approximately 121 purchases and sales of certain exchange-traded funds (ETFs) for the accounts of customers CR and CV. The prospectuses for each of these ETFs clearly stated that they were designed to be held for no more than one day. Nevertheless, in the vast majority of transactions MD held them in the customers' accounts for much longer time periods. By this conduct, MD demonstrated that he had a fundamental misunderstanding of how the ETFs functioned, such that any recommendation he made pertaining to them could not have been based on reasonable grounds. Further, in light of the fact that the ETFs were essentially trading instruments employing speculative techniques like leveraging, MD had no reasonable grounds for believing that his recommendations were suitable for CR and CV, whose investment objectives did not include speculation or day trading but, rather, growth and income.

Between December 24, 2007 and December 15, 2008, Beardsley was MD's direct supervisor, responsible for reviewing and approving MD's securities transactions. Beardsley failed to exercise reasonable supervision over MD's recommendations of the aforementioned ETFs in the accounts of CR and CV, thereby allowing MD to conduct numerous, unsuitable

transactions. Consequently, for the period from December 24, 2007 through December 14, 2008, Beardsley violated NASD Conduct Rules 3010 and 2110, and for the conduct occurring on December 15, 2008, Beardsley violated NASD Conduct Rule 3010 and FINRA Rule 2010.

2. *Form Filings*

As CCO of Internet Securities, Beardsley was responsible for ensuring that Internet Securities filed all necessary Forms U4, Forms U5 and Rule 3070 reports.

CR and CV, along with one other individual, initiated an arbitration against Respondents and MD in connection with the above-referenced unsuitable transactions. Respondents timely amended Beardsley's Form U4 to disclose this arbitration. Respondents and MD settled the arbitration on or about February 17, 2011 for an amount exceeding \$25,000. Respondents did not amend Beardsley's Form U4 to disclose this settlement until July 7, 2011. By failing to amend Beardsley's Form U4 within 30 days of the settlement, Respondents violated Article V, Section 2 of the By-Laws and FINRA Rule 2010.

Respondents also timely amended MD's Form U4 to disclose the above-referenced arbitration. On December 11, 2009, Internet Securities filed a Form U5 for MD, indicating that he had been terminated as of November 19, 2009. However, the firm failed to amend MD's Form U5 to disclose the settlement of the arbitration until July 7, 2011. By failing to amend MD's Form U5 within 30 days of the settlement, Respondents violated Article V, Section 3 of the By-Laws and FINRA Rule 2010.

Pursuant to NASD Conduct Rule 3070(a), Respondents were required to report the above-referenced settlement to FINRA's 3070 system within ten business days. Respondents did not make the required report until July 8, 2011. Consequently, for the period from March 4, 2011 through June 30, 2011, Respondents violated NASD Conduct Rule 3070(a) and FINRA Rule 2010 and, for the period from July 1, 2011 through July 7, 2011, Respondents violated FINRA Rules 4530(a) and 2010.

3. *Failure to Supervise Private Placement Activity*

From April 21, 2008 through January 23, 2011, Respondents failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules as they pertain to sales of private placements. Specifically:

- a) Respondents failed to conduct reasonable investigations of four offerings to determine whether or not they were suitable for any customers. Instead of conducting an independent review of those offerings, Respondents relied on information provided by the

registered representative who proposed to sell the offering. Further, Respondents never reviewed the issuers' financials, nor did they attempt to obtain information about the issuers from any third-parties;

- b) Respondents failed to maintain documentation of their efforts to investigate the above-referenced offerings;
- c) Respondents allowed a registered representative to draft selling agreements associated with two of the above-referenced offerings, but the agreements provided for direct payment by the issuer to an entity owned by the registered representative rather than to Internet Securities;
- d) Respondents failed to implement any supervisory procedures to ensure compliance with Exchange Act Rule 15c2-4(b); and
- e) Respondents failed to implement any supervisory procedures to prevent general solicitation of investments in connection with offerings made pursuant to Regulation D.

By failing to implement a supervisory system reasonably designed to achieve compliance with all applicable securities laws, rules and regulations concerning sales of private placements, Respondents violated NASD Conduct Rules 3010 and 2110 for the period from April 21, 2008 through December 14, 2008 and, for the period from December 15, 2008 through January 23, 2011, Respondents violated NASD Conduct Rule 3010 and FINRA Rule 2010.

4. Failure to Enforce Written Procedures

From April 21, 2008 through January 23, 2011, Internet Securities' written procedures required Beardsley to obtain and review, on at least an annual basis, a written statement from each registered representative about his or her outside business activities. From April 21, 2008 through January 23, 2011, despite the fact that several registered representatives were actively engaged in outside business activities, Beardsley failed to obtain any such written statements.

From April 21, 2008 through January 23, 2011, Internet Securities' written procedures required Beardsley to request duplicate statements of all securities accounts held by the firm's employees at other institutions. The procedures further required Beardsley to obtain, on at least an annual basis, a written notification from each registered representative concerning all actual and anticipated outside securities activities. From April 21, 2008 through January 23, 2011, Beardsley did not request any duplicate statements of outside securities accounts held by firm employees. Further, he neither requested nor obtained any written notifications from firm

employees concerning their actual or anticipated outside securities activities.

By failing to enforce Internet Securities' written procedures pertaining to outside business activities and outside securities accounts, Beardsley violated NASD Conduct Rules 3010 and 2110 for the period from April 21, 2008 through December 14, 2008 and, for the period from December 15, 2008 through January 23, 2011, Beardsley violated NASD Conduct Rules 3010 and FINRA Rule 2010.

5. *Supervisory Control System*

From April 21, 2008 through January 23, 2011, Respondents failed to implement an adequate system of supervisory control policies and procedures. Among the deficiencies were the following:

- a) The procedures failed to describe the testing and verification that Internet Securities would conduct to ensure that its supervisory procedures were reasonably designed to achieve compliance with all applicable laws, regulations and rules;
- b) With respect to each calendar year of 2009 and 2010, Respondents failed to test the firm's supervisory procedures;
- c) The procedures used erroneous criteria for identifying producing managers and failed to describe how Internet Securities would supervise the customer account activity of producing managers, including producing managers who should be subject to heightened supervision pursuant to NASD Conduct Rule 3012(a)(2)(c);
- d) From April 3, 2009 through January 23, 2011, no one reviewed or supervised the customer account activity of Beardsley, who was a producing manager for purposes of NASD Conduct Rule 3012(a)(2)(A);
- e) The procedures failed to describe how Internet Securities would review and monitor transmittal of funds or securities from customers to third party accounts, from customer accounts to outside entities; from customer accounts to locations other than a customer's primary residence, and between customers and registered representatives;
- f) The procedures failed to describe how Internet Securities would review and monitor customer changes of address and the validation of such changes of address;

- g) The procedures failed to describe how Internet Securities would review and monitor customer changes of investment objectives and the validation of such changes of investment objectives; and
- h) Although the procedures stated that Internet Securities relied on the "Limited Size and Resources" exception in Rule 3012, the procedures made no mention of the firm's concomitant documentation requirement. Further, Respondents neither created nor maintained any such documentation.

By failing to implement an adequate system of supervisory control policies and procedures, Respondents violated NASD Conduct Rules 3012 and 2110 for the period from April 21, 2008 through December 14, 2008 and, for the period from December 15, 2008 through January 23, 2011, Respondents violated NASD Conduct Rule 3012 and FINRA Rule 2010.

6. *Annual Certification of Compliance and Supervisory Processes*

On September 20, 2009, Respondents completed an annual certification for calendar year 2009, in which Beardsley certified that he had reviewed a report evidencing Internet Securities' processes for:

- a) Establishing, maintaining and reviewing policies and procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations;
- b) Modifying such policies and procedures as business, regulatory and legislative changes and events dictate; and
- c) Testing the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with FINRA rules, MSRB rules and federal securities laws and regulations.

In fact, the report did not evidence any processes for testing the effectiveness of such policies, and no such testing was done.

On January 19, 2011, Respondents completed an annual certification for calendar year 2010, in which Beardsley certified that he had reviewed a report evidencing Internet Securities' processes for:

- a) Establishing, maintaining and reviewing policies and procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations;
- b) Modifying such policies and procedures as business, regulatory and legislative changes and events dictate; and

- c) Testing the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with FINRA rules, MSRB rules and federal securities laws and regulations.

In fact, the report did not evidence any processes for testing the effectiveness of such policies, and no such testing was done.

By completing the inaccurate certifications described above, Respondents violated FINRA Rules 3130 and 2010.

7. *Misrepresentation to an Issuer*

On March 30, 2010, Beardsley, on behalf of Internet Securities, executed an engagement letter committing the firm to serve as a placement agent for an issuer of limited partnership units. The letter, which was drafted by an Internet Securities registered representative, falsely represented that Internet Securities was *not* a registered broker-dealer. By misrepresenting Internet Securities' status to a securities issuer, Beardsley violated FINRA Rule 2010.

8. *Anti-Money Laundering Compliance Program*

Between December 17, 2009 and July 15, 2010, Respondents failed to enforce the firm's Customer Identification Program in that they completely failed to verify the identities of four customers. In so doing, Respondents violated NASD Conduct Rule 3011(b) and FINRA Rule 2010 for the period from December 17, 2009 through December 31, 2009 and, for the period from January 1, 2010 through July 15, 2010, Respondents violated FINRA Rules 3310(b) and 2010.

Respondents failed to conduct a test of Internet Securities' Anti-Money Laundering Compliance Program for calendar year 2009, in violation of NASD Conduct Rule 3011(c) and FINRA Rule 2010.

9. *Net Capital*

On December 14, 2010, Internet Securities conducted a securities business while failing to maintain its required minimum net capital of \$5,000. Specifically, on that date Beardsley signed a subscription agreement to complete a customer's purchase of securities. Internet Securities' total net capital on that date was approximately \$4,302, constituting a net capital deficiency of \$938. Respondents did not discover the deficiency until January 20, 2011.

By conducting a securities business while failing to maintain minimum required net capital, Internet Securities violated Exchange Act Rule 15c3-1 and FINRA Rule 2010.

B. Respondents also consent to the imposition of the following sanctions:

1. As to Beardsley only: a suspension from association with all FINRA members in all principal capacities for a period of one year;
2. As to Internet Securities only: a censure;
3. As to Internet Securities only: a \$12,500 fine;¹ and
4. As to Internet Securities only: an undertaking to retain at its sole expense, an outside consultant ("Consultant") not unacceptable to FINRA, who shall conduct a review and prepare a report concerning the adequacy of Internet Securities' supervisory, supervisory controls and compliance policies and procedures. The report shall make specific recommendations addressing any inadequacies identified by the Consultant, and Internet Securities shall act on those recommendations. Specifically:
 - a) Internet Securities shall retain the Consultant within 30 days of this AWC's acceptance;
 - b) Within one business day of retaining the Consultant, Internet Securities shall provide to FINRA a copy of an engagement letter detailing the Consultant's responsibilities;
 - c) Within 60 days of the date of execution of the engagement letter, Internet Securities shall provide to FINRA a copy of the Consultant's report setting forth the Consultant's recommendations;
 - d) Within 30 days of the transmittal of the Consultant's report, Internet Securities shall advise FINRA, in writing, that it shall adopt, implement and maintain all policies and procedures recommended by the Consultant; provided, however, that as to any recommendation of the Consultant which Internet Securities determines is, in whole or in part, unduly burdensome or impractical, Internet Securities may suggest an alternative policy or procedure designed to achieve the same objective or purpose as that of the recommendation of the Consultant. Internet Securities shall set forth in writing to FINRA such alternative procedure(s) and shall describe how such alternative procedure(s) achieves the same objective or purpose as the Consultant's original recommendation;

¹ Pursuant to the General Principles Applicable to all Sanction Determinations contained in the Sanction Guidelines, FINRA imposed a lower fine in this case after it considered the firm's size including, among other things, the firm's revenues and financial resources. See Notice to Members 06-55.

- e) Within 60 days of the transmittal of the Consultant's report, Internet Securities shall implement, and submit to FINRA an affidavit stating that it has implemented, the Consultant's recommendations and, to the extent applicable, any alternative procedures proposed pursuant to subparagraph I.B.3.d, above; and
- f) Over a period of eighteen months following the submission to FINRA of the affidavit described in subparagraph I.B.3.e above, on a quarterly basis, Internet Securities shall submit to FINRA an affidavit certifying that it remains current in its implementation of the Consultant's recommendations and, to the extent applicable, any alternative procedures proposed pursuant subparagraph I.B.3.d, above.

Beardsley understands that if he is barred or suspended from associating with any FINRA member in a principal capacity, he becomes subject to a statutory disqualification as that term is defined in Article III, Section 4 of FINRA's By-Laws, incorporating Section 3(a)(39) of the Securities Exchange Act of 1934, as amended. Accordingly, Beardsley may not be associated with any FINRA member in a principal capacity, during the period of the bar or suspension (see FINRA Rules 8310 and 8311). Furthermore, because he is subject to a statutory disqualification during the suspension, if he remains associated with a member firm in a non-suspended capacity, an application to continue that association may be required.

Beardsley has submitted a sworn financial statement and demonstrated an inability to pay. In light of Beardsley's financial status, no monetary sanction has been imposed against him.

Internet Securities agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Internet Securities has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

Internet Securities specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanction imposed in this matter.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondents specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against Respondents;

- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondents specifically and voluntarily waive any right to claim bias or prejudice of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondents further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondents understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondents;
- C. If accepted:
 - 1. this AWC will become part of Respondents' permanent disciplinary records and may be considered in any future actions brought by FINRA or any other regulator against Respondents;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondents' disciplinary records;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. Respondents may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondents may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondents' right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party; and
- D. Respondents may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondents understand that they may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

Beardsley, on behalf of himself and Internet Securities, certifies that he has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondents have agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Respondents to submit it.

08/25/2011
Date (mm/dd/yyyy)
08/25/2011
Date

Michael W. Beardsley
Michael W. Beardsley, Respondent

Internet Securities
Respondent

By: Michael W. Beardsley
Michael W. Beardsley, President & CEO

Accepted by FINRA:

10/3/2011
Date

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

John S. Han
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