

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

EDWARD A. SALAZAR,
(CRD No. 2338244),

Respondent.

Disciplinary Proceeding
No. 20100224056

Hearing Officer—LOM

DEFAULT DECISION

March 12, 2012

Respondent violated NASD Rules 3040 and 2110 by selling securities without providing his firm advance written notice and obtaining the firm's approval. With respect to those transactions, he also violated NASD Rules 2310 and 2110 by failing to have an adequate basis for recommending the investment to his customers. For selling away, Respondent is suspended from associating with a FINRA-registered firm in any capacity for one year and ordered to pay \$1.1 million plus interest calculated from November 9, 2006 as restitution, \$77,000 in disgorgement of his commissions on the transactions, and \$25,000 as a fine. For the failure to have a reasonable basis for his recommendations, Respondent is suspended for one month from association with a FINRA-registered firm in any capacity and ordered to pay a \$5000 fine. The suspensions shall be served consecutively.

Appearances

Josefina Martinez, Senior Counsel, New York, New York, for the Department of Enforcement.

No appearance on behalf of Edward A. Salazar.

I. Introduction

FINRA's Department of Enforcement ("Enforcement") filed and twice served a Complaint against the Respondent, Edward A. Salazar ("Respondent" or "Salazar"), that Respondent never answered. The Complaint alleges violations of NASD Rules 3040, 2310, and

2110.¹ In support of the charges, Enforcement alleges that from April 2006 to November 2006 Respondent marketed and sold to a married couple, JA and AA, two A&O Bonded Life Settlements (“Life Settlements”) for a total of \$1.1 million without notifying his firm and obtaining prior written approval, thus depriving his firm of the ability to supervise or conduct due diligence on the investment. Respondent did not have an adequate basis for recommending the investment. Due diligence would have revealed a number of red flags regarding the viability of the product, the financial reliability of the company that issued the securities, and the qualifications of the promoters, who had substantial disciplinary histories. In 2009, the company offering the securities sought Chapter 11 bankruptcy protection, and in 2010 and 2011 three of the company’s principals were convicted in federal district court of securities fraud and conspiracy to commit money laundering in connection with the company’s activities. The couple lost their entire investment, but Respondent reaped \$77,000 in commissions.

Enforcement filed a Default Motion supported by a Declaration given by FINRA attorney Josefina Martinez (“Martinez Decl.”), and two exhibits marked CX-1 and CX-2. The facts set forth herein are based on that evidence, which is not in dispute, and the allegations of the Complaint, which, as discussed below, are deemed admitted as a result of Salazar’s default. For the reasons set forth below and pursuant to authority granted by FINRA Rule 9269(a), the Hearing Officer grants Enforcement’s default motion, finds that Respondent committed the violations alleged, and imposes sanctions.

¹ The Financial Industry Regulatory Authority, Inc. (“FINRA”) is responsible for regulatory oversight of securities firms and associated persons who do business with the public. It was formed in July 2007 by the consolidation of the NASD and the regulatory arm of the New York Stock Exchange (“NYSE”). FINRA is developing a new “Consolidated Rulebook” of FINRA Rules that includes NASD Rules. The first phase of the new consolidated rules became effective on December 15, 2008. See FINRA Regulatory Notice 08-57 (Oct. 2008). Because the Complaint in this case was filed after December 15, 2008, FINRA’s procedural rules apply. The conduct rules that apply are those that existed at the time of the conduct at issue. FINRA’s Rules are available at www.finra.org/Rules.

II. Origin Of Disciplinary Proceeding

Enforcement opened the matter based on a referral from FINRA's Strategic Initiatives Group in October 2010.

III. Jurisdiction

Respondent first entered the securities industry in 1993. Since that time he has been employed by twelve different FINRA registered broker-dealers. He was employed as a registered representative by Countrywide Investment Services, Inc. (the "Firm" or "Countrywide") from November 29, 2005, through February 13, 2007, and the misconduct in issue occurred while he was at Countrywide. Respondent is not currently associated with a FINRA-registered broker-dealer, but he was employed as a registered representative by a different FINRA-registered broker-dealer during much of 2009. On October 28, 2009, that broker-dealer filed a Uniform Termination Notice for Securities Industry Registration ("Form U5") reflecting Respondent's "voluntary" termination effective October 9, 2009.²

FINRA has jurisdiction over this disciplinary proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because the Complaint alleges misconduct that occurred while Salazar was a registered representative, and it was filed on October 5, 2011, within two years of the termination of Respondent's registration with a FINRA-registered firm.

IV. Procedural History And Grant Of Default Motion

On October 5, 2011, Enforcement served the Complaint and Notice of Complaint on Respondent by certified mail return receipt requested and first-class mail at Respondent's address as reflected in the Central Registration Depository ("CRD address"). The certified

² Martinez Decl. ¶¶ 4-6; CX-1; Compl. ¶¶ 8-10.

mailing was returned to Enforcement unopened and marked “unclaimed.” The first-class mailing was not returned.³ The Notice of Complaint informed Respondent that he was required to file an Answer by November 2, 2011. However, he filed no Answer.⁴

On November 7, 2011, Enforcement served the Complaint, original Notice of Complaint, and Second Notice of Complaint on Respondent by certified mail, return receipt requested, and first-class mail at Respondent’s CRD address. None of these copies has been returned to Enforcement. The Second Notice of Complaint informed Respondent that he was required to file an Answer by November 25, 2011. Respondent nevertheless failed to file an Answer.⁵

Under FINRA Rule 9134, service of a complaint is valid if sent to an individual respondent by certified mail at the person’s most recent residential address in the CRD. Accordingly, the Hearing Officer finds that the Complaint was validly served and that Respondent failed to Answer. Pursuant to FINRA Rules 9215(f) and 9269(a), the Hearing Officer grants Enforcement’s Default Motion and deems the allegations in the attached Complaint admitted.

V. Findings Of Fact And Conclusions Of Law As To Underlying Violations

A. Private Securities Transactions In Violation Of NASD Rules 3040 and 2110

The Rules. NASD Rule 3040 requires an associated person to provide written notice to his or her FINRA-regulated broker-dealer employer prior to participating in any private securities transaction, which is defined as any securities transaction outside the scope of the

³ Martinez Decl. ¶¶ 25- 27; CX-2. The due date was calculated in accordance with FINRA Rules 9215(f) and 9138(c). *Id.*

⁴ Martinez Decl. ¶ 28.

⁵ Martinez Decl. ¶¶ 29-31.

associated person's employment. The notice must describe in detail the proposed transaction, the person's proposed role in it, and any compensation the person might receive in connection with the transaction. Where a transaction could involve compensation to the associated person and the transaction is approved, the FINRA member firm will supervise the transaction as though it were executed on the firm's behalf. If the firm does not approve a proposed transaction involving compensation, the associated person is prohibited from participating in any manner, directly or indirectly.

NASD Rule 2110 requires the observance of "high standards of commercial honor and just and equitable principles of trade." It is well-established that a violation of other NASD and FINRA rules is inconsistent with the "high standards" required by NASD Rule 2110 and its successor FINRA Rule 2010 and so constitutes a violation of that Rule as well.⁶

The Violative Conduct. From April to November 2006, Respondent spoke to JA and AA, a married couple, a number of times about purchasing A&O Bonded Life Settlements.⁷ Neither JA nor AA was a customer of Respondent's Firm, but they had previously purchased an annuity from Respondent. Because Spanish was their native language and they had limited command of English, Respondent spoke to them in Spanish. KF, who did not speak Spanish,

⁶ See *Thomas W. Heath, III*, Exchange Act Rel. No. 59223, 2009 SEC LEXIS 14 (Jan. 9, 2009), *aff'd*, 586 F.3d 122 (2d Cir. 2009), *cert. denied*, *Heath v. SEC*, 2010 U.S. LEXIS 3029 (U.S. Apr. 5, 2010). See also *CMG Inst. Trading, LLC*, No. 2008012026601, 2010 FINRA Discip. LEXIS 7, at *3 n.2 (NAC May 3, 2010); *Dept't of Enforcement v. Trende*, No. 2007008935010, 2011 FINRA Discip. LEXIS 54, at *11 and nn.12 & 13 (OHO Oct. 4, 2011).

⁷ The Life Settlements were securities. Compl. ¶¶ 1, 27. The company offering the securities purchased existing life insurance policies from policy holders at a discount in exchange for the receipt of the death benefit payable upon the death of the insured. The company then resold these policies to investors, promising a 10%-12% return. Compl. ¶ 5. In late 2006, however, the principals of the company began using customer funds as a "slush" fund to pay personal expenses. Compl. ¶ 5.

accompanied Respondent on two occasions. KF was identified in some of the transaction documents as the agent of record.⁸

On November 9, 2006, JA and AA executed various documents in connection with their purchase of two A&O Bonded Life Settlements. They paid \$550,000 for each investment, funding the purchases by surrendering the annuity they had previously purchased from Respondent. In so doing, they incurred \$40,000 in surrender charges.⁹

Respondent did not provide his Firm prior written notice or seek the Firm's prior approval.¹⁰ He received approximately \$77,000 in connection with the transactions.¹¹ KF also received a payment of approximately \$44,000.¹²

The Hearing Officer finds that Respondent violated NASD Rules 3040 and 2110.

Sanctions. The FINRA Sanction Guidelines ("Sanction Guidelines") suggest consideration of a number of factors and recommend a range of sanctions for violations of NASD Rule 3040 and FINRA Rule 2010 (the identical successor to NASD Rule 2110). The first step in determining sanctions is to assess the extent of the selling away, including (among other considerations) the dollar amount of sales. Where the amount of sales exceeds \$1,000,000, as it does here, an adjudicator is to consider a suspension of at least 12 months to a bar.¹³

⁸ Compl. ¶¶14-16, 18, 24.

⁹ Compl. ¶¶ 23-24.

¹⁰ Compl. ¶¶ 2, 28.

¹¹ Compl. ¶ 25.

¹² *Id.*

¹³ FINRA Sanction Guidelines (2011), available at www.finra.org/oho (then follow "Enforcement" hyperlink to "Sanction Guidelines") at 14-15.

The second step is to examine the Principal Considerations for this type of violation.¹⁴ Several of the Principal Considerations are relevant here and support a severe sanction. The product sold was involved in securities fraud violations. The violative sales activity occurred repeatedly over the course of more than half a year and resulted in severe injury to the customers – who lost everything they invested in the Life Settlements.

The third step is to review the General Principles applicable to all violations.¹⁵ General Principle No. 1 requires that a sanction should be designed to deter future misconduct and improve overall business standards in the securities industry.¹⁶ In this case, Respondent evaded supervision and sold a product without performing the due diligence necessary to have a reasonable basis for recommending it. The violations are serious, and it is important that Respondent and others are deterred from such misconduct in the future in order to protect the investing public. This consideration also supports a severe sanction.

General Principle No. 5 indicates that restitution to injured investors should be considered where an identifiable person has suffered a quantifiable loss proximately caused by a respondent's misconduct.¹⁷ This case warrants restitution to JA and AA. Moreover, while there is no suggestion that Respondent had a proprietary interest in the product he sold, Respondent did receive a substantial benefit from the sales to JA and AA – \$77,000 in commissions.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Sanction Guidelines at 2.

¹⁷ Sanction Guidelines at 4.

Pursuant to Principle Consideration No. 17, applicable to all violations, disgorgement of these ill-gotten gains is appropriate.¹⁸

Accordingly, for violating NASD Rules 3040 and 2110, Respondent should be suspended for one year, make full restitution plus interest, pay disgorgement of all commissions received in connection with the Life Settlement transactions with JA and AA, and pay a \$25,000 fine.

B. Failure To Have A Reasonable Basis For Recommendation In Violation Of NASD Rules 2310 and 2110

The Rules. NASD Rule 2310 requires a member recommending an investment to have reasonable grounds for believing that the investment is suitable for a customer. The Rule expressly requires an investigation of the customer's financial situation, objectives and need. A broker-dealer can only determine whether a particular investment would be appropriate in light of the investor's circumstances and objectives if the broker has an adequate understanding of the investment he or she is recommending. Thus, there is a well-established duty to reasonably investigate recommended securities and to have a reasonable basis for recommending and marketing them – sometimes referred to as “reasonable-basis” suitability.¹⁹ A violation of NASD Rule 2310 is also a violation of NASD Rule 2110, because it is inconsistent with the duty to maintain “high standards” of commercial honor.²⁰

¹⁸ Sanction Guidelines at 7.

¹⁹ *Richard G. Cody*, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, at *26-32 and nn.8-16 (May 27, 2011). See also *Hanly v. SEC*, 415 F.2d 589, 595-596 (2d Cir. 1969); *Dep't of Enforcement v. Siegel*, No. C05020055, 2007 NASD Discip. LEXIS 20, at *38 (NAC May 11, 2007) (a “recommendation may lack ‘reasonable-basis’ suitability if the broker: (1) fails to understand the transaction, which can result from, among other things, a failure to conduct a reasonable investigation concerning the security; or (2) recommends a security that is not suitable for any investors.”), *aff'd*, Exchange Act Release No. 58737, 2008 SEC LEXIS 2459 (Oct. 6, 2008), *aff'd in relevant part*, 592 F.3d 147 (D.C. Cir. 2010), *cert. denied*, 2010 U.S. LEXIS 4340 (May 24, 2010).

²⁰ *Dep't. of Enforcement v. Evans*, No. 2006005977901, 2011 FINRA Discip. LEXIS 36, at *22 (NAC Oct. 3, 2011) (“A violation of NASD Rule 2310 also constitutes a violation of NASD Rule 2110.”). See also note 6, *supra*.

The Violative Conduct. Respondent failed to conduct adequate due diligence on the Lifetime Settlements or the company promoting and offering the investments. As a result, Respondent failed to learn a number of important facts bearing on the suitability of the Lifetime Settlements as an investment.²¹

For example, in marketing the Lifetime Settlements, Respondent told JA and AA that bonding insurance on the underlying life insurance policies had been obtained from Provident Capital Indemnity, Ltd. (“Provident”), a company in Costa Rica.²² He failed to learn that in 1992 California’s Insurance Commissioner barred Provident from selling unlicensed insurance in that state because the Commissioner found that the company had misrepresented the value of assets on its balance sheet. Similarly, Respondent failed to learn the criminal history of the owners of the company hired to assess the life expectancies of the insureds of the underlying policies. In November 2003, the owners were indicted on 21 counts of criminal violations of the Federal Food, Drug and Cosmetic Act; and in July 2005 they pleaded guilty in federal district court to aiding and abetting the introduction of a misbranded drug into interstate commerce with intent to mislead. Respondent failed to obtain information regarding the qualifications of the principals of the company offering the securities or to examine reports of the company’s financial status in order to ascertain the economic well-being of the company.²³ In 2009, the company sought Chapter 11 bankruptcy protection, causing Respondent’s customers, JA and AA, to lose their entire investment in the Life Settlements.²⁴

The Hearing Officer finds that Respondent violated NASD Rules 2310 and 2110.

²¹ Compl. ¶¶ 36-46.

²² Compl. ¶¶ 17.

²³ *Id.*

²⁴ Compl. ¶¶ 1, 26.

Sanctions. The Sanction Guidelines for a suitability violation range from a \$2,500 fine to a \$75,000 fine, and from a ten-business-day suspension in all capacities to a one-year suspension, or a bar in egregious cases.²⁵ The General Principles direct that any sanction be remedial in nature and protect the investing public by deterring misconduct. No evidence has been presented to suggest that Respondent was cognizant of the fraud underlying the Lifetime Settlements he sold to JA and AA. However, there were multiple red flags that would have put him on notice of the extreme degree of risk associated with this investment if he had done the due diligence he should have done. Respondent's failure to develop a reasonable basis for recommending A&O Bonded Life Settlements warrants a suspension in all capacities for one month and a \$5,000 fine.

VI. Order

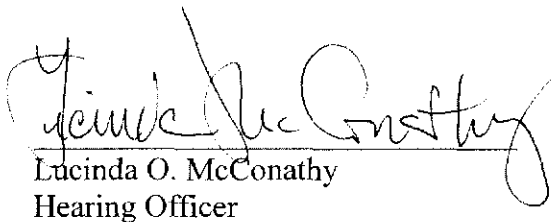
The Hearing Officer finds that Respondent, Edward A. Salazar, failed to file an Answer to a properly served Complaint. As a consequence, the Hearing Officer grants the Default Motion filed by the Department of Enforcements, holds Respondent in default, and deems the allegations in the Complaint to be true.

The Hearing Officer further finds that Respondent, Edward A. Salazar, violated NASD Rules 3040 and 2310, and 2110. Accordingly, the Hearing Officer Orders that Respondent: (i) be suspended from associating with any FINRA-registered firm in any capacity for a total period of 13 months; (ii) pay full restitution for the losses suffered by JA and AA, in the amount of \$1.1 million, plus interest calculated from November 9, 2006 (the date on which the customers

²⁵ Sanction Guidelines at 94.

executed the documents for the two transactions in issue);²⁶ (iii) pay disgorgement of commissions received in connection with the investments in issue in the amount of \$77,000; and (iv) pay a fine of \$25,000. The Hearing Officer further finds that Respondent, Edward A. Salazar, violated NASD Rules 2310 and 2110. Accordingly, the Hearing Officer Orders that Respondent: (i) be suspended for month and (ii) pay a fine of \$5000. This suspension is to run consecutively with the other suspension.

If this decision becomes FINRA's final disciplinary action in this matter (after the expiration of any appeal period), the suspension shall begin at the opening of business on Monday, April 16, 2012 (which is a date certain set by FINRA that is not earlier than 30 days after the decision becomes FINRA's final disciplinary action), and end at the close of business on Wednesday, May 15, 2013. The monetary sanctions shall be due and payable if and when Respondent re-enters the securities industry.



Lucinda O. McConathy
Hearing Officer

Copies: Edward A. Salazar (via first-class mail and overnight courier)
Josefina Martinez, Esq. (via first-class and electronic mail)
David R. Sonnenberg, Esq. (via electronic mail)

²⁶ The interest will be calculated at the rate established under Section 6621(a)(2) of the Internal Revenue Code, which is used by the Internal Revenue Service to determine interest due on underpaid taxes, is adjusted each quarter and reflects market conditions. 26 U.S.C. § 6621(a)(2). JA and AA are identified in the Addendum to this decision, which is served only on the parties.