

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

Charles W. Kern, III (CRD No. 2404048),

and

Thomas K. Haskins (CRD No. 4923808),

Respondents.

DISCIPLINARY PROCEEDING
No. 2010023367001

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Charles W. Kern, III and Thomas K. Haskins made unsuitable recommendations and material misrepresentations or omissions regarding options investments in the S&P 500 Euro Index. In addition, Kern falsified account documents for certain customers, making it appear that they were qualified for uncovered options trading when they were not. Finally, Kern improperly used discretion to execute the options transactions in customer accounts.

RESPONDENTS AND JURISDICTION

2. Charles W. Kern, III entered the securities industry on September 20, 1993, as a General Securities Representative of a member of FINRA. Kern, during all periods mentioned herein, was associated with member firm UBS Financial Services, Inc.

(the “Firm”), and was registered with FINRA under Article V of the By-Laws as a General Securities Sales Supervisor and a General Securities Representative. Kern is currently registered with another FINRA member firm.

3. Thomas K. Haskins entered the securities industry on March 21, 2005, as a General Securities Representative of a member of FINRA. Haskins, during all periods mentioned herein, was associated with member firm UBS Financial Services, Inc., and was registered with FINRA under Article V of the By-Laws as a General Securities Representative.
4. Although Haskins is no longer registered or associated with a FINRA member, he remains subject to FINRA’s jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA’s By-Laws, because (1) the Complaint was filed within two years after the filing of an amendment to Respondent Haskins’ Form U5 with UBS Financial Services, Inc., namely, March 1, 2010; and (2) the Complaint charges him with misconduct committed while he was registered or associated with a FINRA member.

Background

5. Prior to 2008, Kern had recommended covered options transactions to some of his customers. In 2008, Kern became aware of a strategy to produce monthly income using uncovered calls and puts on the S&P 500 Index (the “S&P Combo Strategy”).
6. The S&P Combo Strategy involved selling uncovered calls with a strike price approximately 10% above the market price of the S&P 500 Index and selling uncovered puts at a strike price approximately 10% below the market price of the

S&P 500 Index. If the calls and puts expired unexercised, the customer's account would retain the premiums paid for the sales of the calls and puts. If the calls or puts were exercised, the customer would be required to purchase the securities to cover the exercise of the options, and the purchase would be made at the market price.

7. In executing the S&P Combo Strategy, Kern bought the uncovered calls and puts with an approximately 30-day expiration period on the options.
8. The success of the S&P Combo Strategy was dependent on a market with little volatility. If the market deviated beyond the strike prices, the customers would lose money. In fact, the highest gains that a customer could achieve using the S&P Combo Strategy were equal to the amount of the premiums paid; however, the potential losses were unlimited.
9. Kern and Haskins worked as a team, sharing a single registered representative number. Kern and Haskins split their commissions on all business on an approximate 70/30 basis, with Kern retaining seventy per cent.
10. Kern explained the S&P Combo Strategy to Haskins, but did not explain that losses could be unlimited. In addition, Kern told Haskins that based upon past historical results, the strategy would be successful 90% of the time. Kern also stated that in the 10% of instances where the customers lost money, the losses would be limited to \$2,000 to \$3,000 per options transaction. Kern represented to Haskins that he would monitor the market and close out the positions prior to expiration and before the losses mounted.

11. Kern and Haskins agreed that Haskins would introduce the S&P Combo Strategy to customers and have the customers sign options trading disclosure forms and applications. Kern would complete information on the options trading disclosure forms and sometimes have follow-up meetings with the customers. Kern would also enter all of the options trades.
12. The Firm identified three different risk levels regarding options trading in its written supervisory procedures. Risk Level C was the highest risk level and required that a customer meet certain criteria before the customer could engage in uncovered calls and puts, such as those employed by Kern and Haskins in the S&P Combo Strategy. Clients had to meet all of the following requirements:

- Net worth of at least \$200,000;
- Liquid assets of at least \$100,000;
- Annual income of at least \$100,000;
- Account equity (“liquidating”) of at least \$25,000;
- Prior investment experience in options or futures;
- Aggressive/speculative as the primary risk profile;
- Under 70 years of age; and
- Signed margin loan agreement.

Customer WH and CH

13. Haskins met with WH and CH, a married couple, in the spring of 2008 and presented the S&P Combo Strategy to them. Haskins told WH and CH that they could expect

to earn monthly income of \$1,000 to \$2,000 each month, and, as represented to him by Kern, that the strategy would work 90% of the time. For the 10% of the time that the strategy did not work, Haskins told WH and CH that he and Kern had a system in place to limit losses. According to Haskins, losses would be limited to \$2,000 to \$3,000 per options transaction.

14. At Kern's direction, Haskins asked WH and CH to sign a "Client Qualification Form and Agreement for Options" ("Options Form") in blank. Although the Options Form asked for indication of liquid net worth, annual income, risk tolerance, and experience in trading options, among other things, Haskins told WH and CH not to fill in that information. WH and CH signed the blank form on May 19, 2008.
15. WH and CH were 61 and 62 years old. WH had completed the 8th grade and CH had completed high school. WH had worked in a textile mill, had become disabled, and retired. CH worked as a sewing machine operator. WH received \$14,400 annually in disability income. CH received annual income of approximately \$20,800. The couple had managed to save approximately \$75,000, which represented their entire liquid net worth. At the time WH and CH signed the Options Form, they had approximately \$75,000 invested with Kern and Haskins. WH and CH were conservative investors, did not know what options were, and could not afford to lose the modest savings that they had accumulated.
16. Despite the financial circumstances of WH and CH, Kern completed the Options Form to reflect annual income of \$90,000, liquid assets of \$200,000, option experience of five years, and an aggressive/speculative risk profile. Completed in this fashion, the Options Form met the Firm's criteria for uncovered options trading.

17. Between May and October, 2008, Kern and Haskins opened approximately 16 options positions without first contacting WH and CH. Kern did not contact WH and CH to obtain authorization for the trades on the dates that Kern entered the trades. The account was not a discretionary account and WH and CH had not provided prior written authorization for the trades. By the end of October 2008, WH and CH had incurred a realized loss of approximately \$25,552.55 due to the options trading.

Customer JS

18. Haskins inherited JS's account in 2005 after JS's registered representative ended his employment with the Firm. Until June 2008, JS's account was invested in U.S. Treasury Bonds and mutual funds. JS was 61 years old and was working as a clerk in a jewelry store. He was a conservative investor interested in capital appreciation. He had annual income of \$50,000 and liquid assets of \$150,000, with no additional assets comprising his net worth. He had no history of options trading, and could not afford to lose the limited amount he had saved for retirement.

19. Despite JS's conservative risk tolerance and limited net worth, Kern completed the Options Form in a manner to ensure that the Firm approved JS for trading uncovered options. Kern filled in the form to reflect a \$250,000 net worth, an aggressive/speculative risk tolerance, and five years of options trading experience.

20. When JS signed the Options Form in June 2008, he had an account balance of \$67,588.84. Between July and October 2008, Kern opened approximately 16 uncovered option positions in the account. By October 2008, JS had lost approximately \$20,660.00 due to the options trading. Kern did not contact JS to obtain authorization for the trades on the dates that Kern entered the trades. The

account was not discretionary, and JS had not provided prior written authorization for the trades.

Customers JD and ID

21. On or about May 13, 2008, JD and ID, a married couple, signed an Options Form in order to participate in the S&P Combo Strategy recommended by Kern and Haskins. Haskins initially met with JD and ID to explain the strategy. He stated that losses would be limited to \$2,000 to \$3,000 per options transaction and that systems would be used to keep the losses from escalating. He never told JD and ID that the losses could be unlimited. Kern later met with JD and ID and made the same omissions and misrepresentations made by Haskins.

22. In June 2008, JD and ID had approximately \$625,544.05 invested in an account with Kern and Haskins. From July 2008 through October 2008, Kern opened 19 uncovered option positions in the account of JD and ID without first contacting them. Kern did not contact JD and ID to obtain authorization for the trades on the dates that Kern entered the trades. The account was not a discretionary account, and JD and ID had not provided Kern with prior written authorization to enter the trades. From July 2008 through October 2008, JD and ID sustained realized losses of \$196,700.00.

Customers CA and SA

23. As of February 29, 2008, CA and SA had \$945,800.74 invested in an account with Kern and Haskins. On March 19, 2008, CA and SA completed an Options Form in order to begin trading options in the S&P Combo Strategy. Between March 2008 and October 2008, Kern opened 26 options positions in the account of CA and SA

without obtaining prior written authorization. Kern did not contact CA and SA to obtain authorization for the trades on the dates that Kern entered the trades. The account was not a discretionary account. Over the same time period, CA and SA realized a loss of \$530,379.33 due to the options trading.

FIRST CAUSE OF ACTION
NASD Conduct Rules 2310, 2860(b)(19), and 2110 –
Recommendations of Unsuitable Investments in the S&P Combo Strategy,
Against Kern and Haskins

24. The Department realleges and incorporates by reference paragraphs 1 through 23 above.
25. During the period from on or about May 1, 2008 through on or about October 18, 2008, Kern and Haskins recommended and effected the sale of uncovered puts and calls in the S&P 500 Euro Index as part of the S&P Combo Strategy to WH, CH, and JS.
26. Positions in uncovered calls and puts present unlimited risk of loss. A customer could lose his or her entire account and sustain additional margin debt through investment in uncovered calls and puts.
27. WH, CH, and JS had conservative risk tolerances, no experience in trading options, limited financial resources, and no ability to bear the risks associated with the positions recommended by Kern and Haskins in the options contracts.
28. Kern and Haskins had no reasonable basis to believe that the options transactions recommended to WH, CH, and JS were suitable given the financial circumstances, investment objectives, lack of knowledge and experience in financial matters, and

inability of the customers to bear the risks of the recommended positions in the options contracts.

29. From May 1, 2008 through October 18, 2008, WH and CH lost approximately \$25,552.55 as a result of the unsuitable recommendations made by Kern and Haskins. JS incurred a loss of approximately \$20,660.00 as a result of the unsuitable recommendations by Kern and Haskins.
30. The conduct described in paragraphs 24 through 29 constitutes violations by Kern and Haskins of NASD Conduct Rules 2310, 2860(b)(19), and 2110.

SECOND CAUSE OF ACTION
NASD Conduct Rule 2110 – Negligent Misrepresentation,
Against Kern and Haskins

31. The Department realleges and incorporates by reference paragraphs 1 through 30 above.
32. From on or about March 19, 2008 through on or about October 18, 2008, Kern and Haskins made material misrepresentations and/or omissions regarding risks and losses that could be incurred through investments using the S&P Combo Strategy.
33. In presenting the S&P Combo Strategy to JD and ID, Kern and Haskins failed to tell the couple that losses could be unlimited.
34. Kern and Haskins made material misrepresentations to JD and ID by telling them that the losses would be no more than \$2,000 to \$3,000 per options transaction and that Kern had systems in place to limit the losses if the S&P 500 Euro Index became too volatile.

35. In presenting the S&P Combo Strategy to WH and CH, Haskins failed to tell the couple that losses could be unlimited.
36. Haskins made material misrepresentations to WH and CH by telling them that the losses would be no more than \$2,000 to \$3,000 per options transaction and that Kern had systems in place to limit the losses if the S&P 500 Euro Index became too volatile.
37. In fact, investment in uncovered puts and calls can result in unlimited losses. Furthermore, Kern and Haskins had no stop losses in place or any other automatic method to limit losses.
38. A reasonable investor would consider the information concerning risks and potential losses to be important or view it as significantly altering the “total mix” of information regarding the investment in the S&P Combo Strategy.
39. By making the material misrepresentations and omissions described above, Kern and Haskins failed to observe high standards of commercial honor and just and equitable principles of trade.
40. The conduct described in paragraphs 31 through 39 constitutes violations of NASD Conduct Rule 2110 by Kern and Haskins.

THIRD CAUSE OF ACTION
NASD Conduct Rules 3110 and 2110 – Falsification of Account Documents/Books and
Records Violation, Against Kern

41. The Department realleges and incorporates by reference paragraphs 1 through 40 above.

42. During the period from on or about May 19, 2008 through on or about June 31, 2008, Kern falsified the Options Forms with respect to Customers WH, CH, and JS.
43. Kern directed Haskins to obtain customer signatures on blank Options Forms. The only categories of information filled in, prior to obtaining customer signatures, were the addresses and names of the customers.
44. After Haskins obtained the signatures of WH, CH, and JS on the Options Forms, Kern completed the forms in a manner that would assure the customers were approved for trading using the S&P Combo Strategy.
45. Kern misrepresented the options trading experience of WH, CH, and JS on the Options Forms, stating that the customers had five years experience in trading options. In fact, the customers had no experience trading options.
46. Kern also misrepresented the customers' primary risk profile on the Options Forms, stating the risk profile was aggressive/speculative. In fact, the customers were conservative investors.
47. In addition, Kern misrepresented WH and CH's liquid net worth, annual income, and overall net worth, significantly overstating each of the amounts.
48. Kern also overstated JS's net worth, representing it to be \$250,000, instead of the actual amount of \$150,000.
49. If Kern had completed the Options Forms with correct information, the Firm would not have approved WH, CH, and JS for trading uncovered puts and calls.

50. By inserting false information in the account forms of WH and CH and JS, Kern also caused the books and records of the Firm to be inaccurate, in violation of SEC Exchange Act Rule 17a-3.
51. In falsifying the Options Forms, Kern failed to observe high standards of commercial honor and just and equitable principles of trade.
52. The conduct described in paragraphs 41 through 51 constitutes violations by Kern of NASD Conduct Rules 3110 and 2110.

FOURTH CAUSE OF ACTION
NASD Conduct Rules 2510 and 2110 -- Use of Discretion,
Against Kern

53. The Department realleges and incorporates by reference paragraphs 1 through 52 above.
54. During the period from on or about April 2, 2008 through on or about October 18, 2008, Kern exercised discretion without prior written authorization in the accounts of WH, CH, JS, JD, ID, CA, and SA.
55. From April 2, 2008 through October 18, 2008, Kern opened 67 uncovered positions in the S&P 500 Euro Index in the accounts of WH, CH, JS, JD, ID, CA, and SA without first discussing the trades with the customers. Kern did not have a prior written agreement with the customers allowing him to use discretion, nor were the accounts accepted as discretionary by the Firm.
56. The conduct described in paragraphs 53 through 55 constitutes violations of NASD Conduct Rules 2510 and 2110 by Kern.

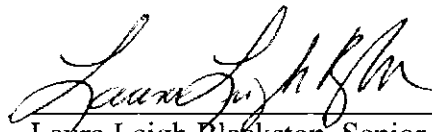
RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Respondents committed the violations charged and alleged herein;
- B. order that one or more of the sanctions provided under FINRA Rule 8310(a), including monetary sanctions, be imposed, including that Respondents be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;
- C. order that Respondents bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330;

FINRA DEPARTMENT OF ENFORCEMENT

Date: February 27, 2012



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