

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

Hearing Officer: MAD

**AMENDED ORDER ACCEPTING
OFFER OF SETTLEMENT
AS TO RESPONDENT KERN**

Date: November 1, 2012

INTRODUCTION

Disciplinary Proceeding No. 2010023367001 was filed on February 27, 2012, by the Department of Enforcement of the Financial Industry Regulatory Authority (FINRA) (Complainant). Respondent Charles W. Kern, III submitted an Offer of Settlement (Offer) to Complainant dated October 10, 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, Respondent has 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 understands that this Order will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA.

BACKGROUND

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.

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:¹

1. Charles W. Kern, III made unsuitable recommendations regarding options investments in the S&P 500 Euro Index and improperly used discretion to execute the options transactions in customer accounts.
2. 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").

¹ The findings herein are pursuant to Respondent Charles W. Kern's Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

3. 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.
4. In executing the S&P Combo Strategy, Kern bought the uncovered calls and puts with an approximately 30-day expiration period on the options.
5. 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.
6. 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.
7. 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.

8. 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. They additionally agreed that Kern would enter all of the options trades.
9. 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

10. 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.

11. 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.

12. 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

13. 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.

14. 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

15. 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

16. 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.

17. During the period from on or about May 1, 2008 through on or about October 18, 2008, Kern 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.
18. 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.
19. 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 in the options contracts.
20. Kern 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.
21. 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. JS incurred

a loss of approximately \$20,660.00 as a result of the unsuitable recommendations by Kern.

22. The conduct described above constitutes violations by Kern of NASD Conduct Rules 2310, 2860(b)(19), and 2110.

23. 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.

24. 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.

25. The conduct described above constitutes violations of NASD Conduct Rules 2510 and 2110 by Kern.

Based on the foregoing, Respondent Kern violated NASD Conduct Rules 2310, 2860(b)(19), 2510, and 2110.

Based on these considerations, the sanctions hereby imposed by the acceptance of the Offer are in the public interest, are sufficiently remedial to deter Respondent 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 Charles W. Kern, III be fined in the amount of \$10,000 and suspended for a period of three-months from association with any FINRA member in all capacities.

Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of \$46,212.55, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from October 1, 2008, until the date this Offer is accepted by the NAC.

Respondent shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Laura Leigh Blackston, Senior Regional Counsel, FINRA, 1100 Poydras Street, Suite 850, New Orleans, Louisiana 70163-1108, either by letter that identifies the Respondent and the case number and includes a copy of the check, money order or other method of payment or by e-mail, with pdf copies of the payment documentation, 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 Respondent 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, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to the FINRA staff member identified above and in the

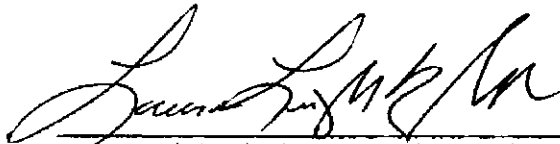
manner described above, within 14 days of forwarding the undistributed restitution and interest to the appropriate state authority.

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 black ink, appearing to read 'Laura Leigh Blackston', is written over a horizontal line.

Laura Leigh Blackston, Senior Regional Counsel
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ATTACHMENT A

Restitution is ordered to be paid to the following customers:

JS

[REDACTED]
[REDACTED]

\$20,660.00 plus interest as set forth in the Offer of Settlement.

WH and CH

[REDACTED]
[REDACTED]

\$25,552.55 plus interest as set forth in the Offer of Settlement.