

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

Jeffrey Dean Schrader
(CRD No. 3092638),

Respondent.

Disciplinary Proceeding
No. 2011029928701

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Jeffrey Dean Schrader (Schrader) made multiple misstatements to Enforcement regarding his participation, between 2009 and 2010 (the Relevant Period), in over \$145,000 worth of private securities transactions with three investors (the LSB Transactions). Schrader in fact participated in the LSB Transactions without providing written notice to, or receiving written approval from his FINRA-registered broker-dealer employer, Western International Securities, Inc. (Western or the Firm).

2. The securities that were the subject of the undisclosed transactions were three-year corporate notes issued by Liberty State Benefits of Pennsylvania, Inc. (LSB) that were purportedly secured by in-force life insurance policies owned by LSB (the LSB Notes). Investors were promised a 12% annual return rate.

3. LSB, however, was part of a Ponzi scheme perpetrated in part by LSB's senior management.

4. Unbeknownst to the Firm, Schrader received (i) approximately \$14,500 in commissions and fees from the issuer of these securities or the issuer's affiliate in connection with the LSB Transactions, and (ii) an additional \$97,100 from the same issuer and its affiliates labeled as commissions, fees and other remuneration.

5. All three investors purchased the LSB Notes based on Schrader's recommendation. Schrader, however, failed to conduct an adequate due diligence investigation of the LSB Notes that he recommended and sold to these three investors. Schrader therefore lacked a reasonable basis to recommend the purchase of this security.

6. On September 19, 2011, two of the investors who purchased the LSB Notes from Schrader complained to Western about their purchase. When confronted by Western on or about September 22, 2011 about his involvement in LSB transactions, Schrader made false statements to the Firm concerning the extent of his involvement in the sales of LSB notes, as well as the amount of compensation he received from LSB and its affiliated entities.

7. Additionally, Schrader provided false information to FINRA during a January 28, 2013 on-the-record interview concerning both the number of LSB transactions that he was involved in and the amount of selling compensation he actually received.

8. As a result, Schrader violated (i) NASD Rule 3040 and FINRA Rule 2010 by participating in private securities transactions without providing prior written notice to his FINRA registered broker-dealer employer; (ii) NASD Rule 2310 and FINRA Rule 2010 by recommending the purchase of a security without having a reasonable basis for such recommendation; (iii) FINRA Rule 2010 by making false statements to his FINRA-registered

broker-dealer employer, and (iv) FINRA Rules 8210 and 2010 by making false statements to FINRA during an on-the-record interview.

RESPONDENT AND JURISDICTION

9. Schrader entered the securities industry in June 1998 when he joined FINRA-registered firm RB in a non-registered position. During his association with RB, Schrader obtained the following securities licenses: Series 7 (August 1998), Series 63 (August 1998), Series 65 (June 1999), and Series 24 (February 2000).

10. In November 2005, Schrader left RB and joined MLPFS until his termination in March 2009.

11. In or about March 2009, Schrader became associated with Western as an independent contractor, where he is currently associated. Schrader conducts securities transactions on behalf of Western through his Firm-approved outside business Schrader Wealth Management.

12. Given his continued association with a FINRA-registered broker-dealer, Schrader remains subject to FINRA's jurisdiction for the purposes of this proceeding pursuant to Article V, Section 4 of FINRA's By-Laws.

FIRST CAUSE OF ACTION **Private Securities Transaction** **Violation of NASD Rule 3040 and FINRA Rule 2010**

13. Enforcement realleges and incorporates by reference paragraphs 1 through 12 above.

14. NASD Rule 3040 requires associated persons to provide written notice to their FINRA-registered broker-dealer employer prior to participating in any private securities transaction. The notice must describe in detail the proposed transaction and the person's

proposed role therein, and state whether he/she has received or may receive selling compensation in connection with the transaction.

15. According to NASD Rule 3040, a private securities transaction means any security transaction occurring outside the regular course of scope of an associated person's employment with a FINRA-registered broker-dealer.

16. Participation in a private securities transaction by an associated person includes not only making a sale, but also referring investors, introducing investors to an issuer, arranging or participating in meetings between investors and an issuer, or receiving a referral/finder's fee from the issuer.

Firm Written Supervisory Procedures

17. Western's written supervisory procedures in effect during the Relevant Period state that any private securities transactions occurring outside the regular course or scope of a registered representative's employment with Western must be pre-approved in writing by the Firm.

18. On or about March 19, 2009, and on or about December 26, 2009 (hereinafter the "December 2009 Certification"), Schrader completed and signed Western's annual compliance certification in which he certified that he received and read the Firm's written supervisory procedures.

Schrader's Disclosed Outside Business Activities – Sale of Life & Disability Insurance

19. In the December 2009 Certification, Schrader disclosed for the first time that he had been and was currently engaged in an outside business activity selling life and disability insurance for Liberty State Financial (Liberty).

20. Liberty was the parent company of LSB.

21. In or about January 2010, the Firm's Chief Compliance Officer issued a written approval of Schrader's outside business activities involving the sale of life and disability insurance on behalf of Liberty. However, the CCO cautioned Schrader in writing that he was prohibited from contacting Firm customers to discuss investments that had not been submitted in writing to Western for review by the Firm's compliance department.

Unapproved Sales of LSB Notes

22. Despite his familiarity with the Firm's WSPs concerning unapproved private securities transactions, and without providing any written notice to the Firm, Schrader nonetheless sold or otherwise participated in the sale to three investors of the secured three-year corporate notes issued by LSB.

23. According to its Private Placement Memorandum, the LSB Notes were securities, primarily secured by in-force life insurance policies purchased by LSB. The PPM stated that LSB was offering investors an "opportunity to invest in a company that purchases in-force life-insurance policies and interest in trusts owning such policies, from the owners thereof who are 70 years of age or older (so-called 'life settlement' transactions)." Moreover, the PPM stated that each of the life insurance policies purchased by LSB reportedly had a face amount between \$2 million and \$20 million and the prospective insureds were U.S. citizens with a net worth exceeding \$5 million, and whose life expectancy ranged between 24 and 180 months.

24. The PPM stated that investors in LSB received a "secured three-year note, at a simple interest rate of 12% per year, with limited rights of pre-maturity liquidation." The minimum subscription amount was \$50,000.

25. Schrader's commission rate for the sale of each LSB note was approximately 10 percent of the investment principal.

26. Sometime between April 2009, when customers LH and MI opened their brokerage account with Western, and July 2009, Schrader solicited LH and MI (collectively the HNs) to invest in the LSB Notes. LH and MI are husband and wife respectively.

27. Schrader told LH that the LSB Note was a life settlement product offering a high rate of return, and was risk-free.

28. In or about July 2009, based on Schrader's recommendation, the HNs liquidated several mutual fund positions in their Western brokerage account and used the entire proceeds to purchase a LSB Note from Schrader for \$75,000.

29. Schrader, however, never sought Western's permission to sell the LSB Note to the HNs, nor did he disclose his receipt of commissions to the Firm at or about the time of the payment.

30. Sometime during the Relevant Period, Schrader also solicited and recommended that EW purchase a LSB Note.

31. Schrader informed EW that the LSB Note was a good product that offered a return rate of 8%.

32. Based on Schrader's recommendation, EW purchased a LSB Note for approximately \$70,000.

33. In connection with these three investor transactions, Schrader received approximately \$14,500 in commission payments from LSB and/or its affiliated companies.

34. However, Schrader never sought Western's permission to sell the LSB Note to the three investors, nor did he disclose his receipt of commissions to the Firm at or about the time of their payment.

35. The acts, practices and conduct described above constitute a violation of NASD Rule 3040 and FINRA Rule 2010.

SECOND CAUSE OF ACTION
Reasonable Basis Suitability
Violation of NASD Rule 2310 and FINRA Rule 2010

36. Enforcement realleges and incorporates Paragraphs 1 through 35 above.

37. NASD Rule 2310 requires that in recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

38. NASD Rule 2310 also encompasses the doctrine of "reasonable basis" suitability, which requires a broker to have an adequate and reasonable basis for any recommendation that he makes. The "reasonable basis" test relates only to the particular recommendation, rather than to the particular customer.

39. During the Relevant Period, Schrader recommended that the HNs and EW purchase the LSB Notes.

40. However, prior to soliciting and selling the LSB Notes to the HNs and EW, Schrader failed to conduct reasonable due diligence into the LSB product.

41. Schrader's due diligence investigation primarily consisted of reviewing materials provided to him by LSB, which included the PPM, various articles concerning life settlement products, and a letter purportedly certifying that LSB owned three life insurance policies with a combined face value of \$25.5 million.

42. The PPM further provided that each life insurance policy purchased by LSB reportedly had a face amount between \$2 million and \$20 million, and that the prospective

insureds would have a life expectancy report showing a life expectancy of between 24 and 180 months. The Life Expectancy Report was to be completed by a life expectancy provider firm.

43. In addition, according to the PPM, LSB intended to "mostly purchase" beneficial interests in life insurance policies that were within the contestability period, *i.e.*, the first years after the policy was issued.

44. The PPM also stated that SLE, a purported licensed life settlement broker, was responsible for identifying life insurance policies for LSB to purchase. SLF was reportedly owned by RT, who also served as LSB's manager. The PPM reported that in his capacity as LSB's manager, RT was responsible for the selection of appropriate policy investments and ongoing administrative and day-to-day management functions.

45. Additionally, the PPM stated that LSB intended to hire Portfolio Managers who would be responsible for building and maintaining a data base for LSB to track documents, premium payments, death claims and other cash flow.

46. At or about the time Schrader recommended the LSB notes to the HNs and EW, he did not know the following information:

- a. whether or not RT possessed the professional experience to manage LSB or was in fact a licensed life settlement broker, and whether a conflict was posed by RT's positions with LSB and Senior Life Financial;
- b. how LSB arrived at a 12% return rate for its notes, apart from it coming from the cash flow from LSB;
- c. what life expectancy provider firm was retained by LSB in order to conduct a review of the insured's medical records prior to the purchase of the life insurance policies. Moreover, the PPM states that the prospective insureds would have a life expectancy report showing a life expectancy of between 24 and 180 months;
- d. how LSB would monitor the health of the senior insured and ensure that all premiums are paid as represented in the PPM; and
- e. what risks were posed by LSB's purchase of beneficial interests in life insurance policies within the two-year contestability period.

47. Schrader therefore lacked an adequate and reasonable basis for making the LSB note recommendation to the HNs and EW.

48. The acts, practices, conduct and omissions described above constitute separate and distinct violations of NASD Rule 2310 and FINRA Rule 2010.

THIRD CAUSE OF ACTION
Misstatements to Broker-Dealer Employer
Violation of FINRA Rule 2010

49. Enforcement realleges and incorporates by reference Paragraphs 1 through 48 above.

50. FINRA Rule 2010 requires each FINRA member "in the conduct of its business, [to] ... observe high standards of commercial honor and just and equitable principles of trade."

51. FINRA Rule 0140(a) states that "[p]ersons associated with a member shall have the same duties and obligations as a member under the Rules."

52. In his December 2009 Certification, Schrader disclosed to Western for the first time that he was engaged in an outside business activity selling life and disability insurance for LSB's parent company and would be compensated by commission.

53. However, in the December 2009 Certification, Schrader did not disclose to the Firm that he was engaged in sales of the LSB Note which – according to the PPM – was a security.

54. In or about September 2011, when confronted about his participation in the sale of the LSB Note to the HNs, Schrader falsely represented to the Firm's CCO that the HNs' sale constituted the only LSB Note-related transaction that he participated in.

55. At that time, Schrader also provided the Firm's CCO with copies of \$29,000 worth of checks issued to him by LSB, or its holding company, between August 2009 and July

2010, and falsely represented that the checks were commission payments received by Schrader in connection with his approved outside life insurance business.

56. In fact, these checks were merely part of the total commissions and fees Schrader received from LSB and/or its affiliated companies for participating in the sales of the LSB Notes. During the Relevant Period, Schrader received \$84,000 in commission payments and \$27,600 in fees or other compensation from LSB and/or its affiliated companies (including the \$14,500 received by Schrader in connection with the three investor purchases discussed herein).

57. The acts, practices, conduct and omissions described above constitute separate and distinct violations of FINRA Rule 2010.

FOURTH CAUSE OF ACTION
Providing False and Misleading Information to FINRA
Violation of FINRA Rules 8210 and 2010

58. Enforcement realleges and incorporates by reference Paragraphs 1 through 57 above.

59. FINRA Rule 8210 requires a "person subject to FINRA's jurisdiction ... to testify at a location specified by FINRA staff, under oath or affirmation administered by a court reporter ... with respect to any matter involved in the investigation, complaint, examination or proceeding." Rule 8210 prohibits a person subject to FINRA's jurisdiction from providing false or misleading information to FINRA in connection with an examination or investigation.

60. On January 28, 2013, pursuant to FINRA Rule 8210, Schrader appeared at FINRA's offices and provided sworn, on-the-record testimony (OTR).

61. At the outset of the January 2013 OTR, Enforcement instructed Schrader concerning his obligation under Rule 8210 to answer FINRA's questions completely and truthfully. Enforcement further instructed Schrader that his failure to do so could be the basis for

the initiation of a disciplinary proceeding that could lead to the imposition of sanctions, including a bar from the securities industry. At all such times, Schrader stated that he understood these instructions.

62. During the January 2013 OTR, Schrader answered Enforcement's questions about the compensation he received from LSB. Specifically, Schrader testified that he only received approximately \$7,000 in commissions from a single sale of the LSB Notes to the HNs:

Q: Apart from the commission payment that you had received from Liberty State Benefits [in connection with the HNs transaction], did you receive any other type of payments from them?

A: Payments like what?

Q: Any other commissions or any other types of remuneration for anything?

A: Not to my recollection, no. It would have just been commissions. It wouldn't have been anything else.

Q: The [HNs], they would have been – were they the only ones you sold this product to?

A: Correct. A gain, it was unsolicited but I'm accepting full responsibility for it.

63. However, in or about November 30, 2012, approximately two months before his FINRA OTR, Respondent was deposed under oath by the staff of the New Jersey Attorney General's Office (the November 2012 Testimony).

64. Significantly, in the November 2012 Testimony Schrader provided to New Jersey Attorney General Staff, Schrader admitted that he sold the LSB Notes to the HNs and EW, and received commission payments for merely being present while a LSB representative solicited and sold LSB notes to the following investors: HD, EP, MC and GC, and JW and MW. In the November 2012 Testimony, Schrader also admitted that he received approximately \$41,600 in commission payments in connection with the sales of LSB Notes, including:

- a. a \$3,000 commission check dated August 18, 2009;

- b. a \$7,900 commission check dated August 31, 2009 for sales of the LSB Note to MC and GC;
- c. a \$5,000 commission check dated January 5, 2010;
- d. a \$5,000 commission check, dated January 18, 2010;
- e. a \$3,100 commission check, dated January 22, 2010, for sales of the LSB Note to EP;
- f. a \$8,100 wire transfer on January 28, 2010 for commissions due;
- g. a \$5,000 wire transfer on February 19, 2010 for commissions due;
- h. a \$2,500 commission check dated April 20, 2010; and
- i. a \$2,000 commission check dated July 7, 2010.

65. Similarly, during the January 2013 OTR conducted by Enforcement, Schrader testified that the HNs asked him about the LSB Note and repeatedly described the sale to the HNs as "unsolicited" and a "one-off."

66. However, in his November 2012 Testimony, Schrader testified that during the course of a routine meeting with the HNs regarding their investments, Schrader was the one who initiated the discussion of the LSB Note as a possible investment opportunity for the HNs.

67. Accordingly, as set forth herein, the testimony described in Paragraphs 62 and 65 is false.

68. Such acts, practices and conduct described above constitute violations of FINRA Rules 8210 and 2010.

RELIEF REQUESTED

WHEREFORE, Enforcement respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Schrader 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 Schrader be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest; and
- C. order that Schrader 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: 12/12/13

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