

FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

John J. Vaughan (CRD No. 1495636),

Respondent.

DISCIPLINARY PROCEEDING
No. 2012030373701

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Respondent John J. Vaughan, the former Chief Compliance Officer (“CCO”) of former member firm HFP Capital Markets LLC (BD No. 44351) (“HFP” or the “Firm”) failed to establish, maintain and enforce reasonable supervisory systems and procedures with respect to the following: (i) from September 2011 through March 2013 (the “Heightened Supervision Period”), Vaughan failed to establish, maintain and enforce reasonable supervisory systems for heightened supervision of HFP registered representatives; and (ii) from approximately May 2012 to at least February 2013 (the “Delegation Period”), Vaughan unreasonably delegated responsibility for conducting reviews of customer transactions to an inexperienced and inadequately trained junior employee, SW, who did not hold any principal registrations. By reason

of these violations, Vaughan violated NASD Conduct Rule 3010 and FINRA Rule 2010.

RESPONDENT AND JURISDICTION

2. Vaughan first became registered with FINRA as a General Securities Representative ("GSR") through a member firm on July 9, 1987. On February 1, 1993, Vaughan became registered as a General Securities Principal ("GSP") through that firm. Vaughan's registrations through that firm were terminated January 27, 1997. Thereafter, between January 1997 and July 2011, Vaughan was registered through seven different firms in various capacities.
3. Beginning July 11, 2011, Vaughan became registered through HFP as a GSR, GSP and as a Limited Representative – Investment Banking. Vaughan's registrations through HFP were terminated on April 1, 2013.
4. Although Respondent 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: (i) the Complaint was filed within two years after the effective date of termination of Respondent's registration with HFP, namely, April 1, 2013; and (ii) the Complaint charges him with misconduct committed while he was registered or associated with a FINRA member.

BACKGROUND

5. Vaughan joined HFP in July 2011 as a Compliance Manager, and reported to HFP's then-CCO. In September 2011, after that CCO departed from HFP, Vaughan was promoted to the role of CCO. Vaughan was HFP's CCO from September 2011 until

the time he left HFP, in March 2013, throughout the Heightened Supervision Period and the Delegation Period.

6. From September 2011 to May 2012, Vaughan was the only member of HFP's Compliance Department. Beginning in May 2012, Vaughan hired a junior employee, SW, who reported to Vaughan and who held the title "Compliance Manager."
7. During the Heightened Supervision Period and the Delegation Period, HFP was primarily engaged in a retail securities business with a focus on sales of high-yield bonds. HFP employed numerous registered representatives who were the subject of a significant number of customer complaints, arbitrations and disciplinary actions. In June 2014, HFP was expelled from FINRA membership and ordered to pay restitution of \$2,980,000 after consenting to findings that from December 2009 to February 2011 (prior to Vaughan joining the Firm), the Firm caused the fraudulent sale of a private placement and failed to have a reasonable basis to offer the private placement to the Firm's customers.

FIRST CAUSE OF ACTION

Failure to Establish, Maintain and Enforce a Reasonable Supervisory System for Firm-Imposed Heightened Supervision

(Violation of NASD Conduct Rule 3010 and FINRA Rule 2010)

Vaughan Failed to Timely Place Representatives on Heightened Supervision

8. The Department realleges and incorporates by reference paragraphs 1 through 7 above.
9. NASD Conduct Rule 3010(a) provides that "each member shall establish and maintain and enforce a system to supervise the activities of each registered representative,

registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable [FINRA] Rules.”

10. NASD Notice to Members 97-19, entitled “NASD Regulation and New York Stock Exchange Memorandum Discusses Sweep Report and Provides Guidance on Heightened Supervision Recommendations,” states, in relevant part, that:

[a] firm that hires one or more registered representatives with a history of customer complaints, disciplinary actions, or arbitrations, or that employs a registered representative who develops such a record during his or her employment, should recognize that it has heightened supervisory responsibilities that will require it, at a minimum, to examine the circumstances of each such case and make a reasonable determination whether its standard supervisory and educational programs are adequate to address the issues raised by the record of any such registered representative.

11. In addition, NASD Notice to Members 97-19 states that after an individual has been identified as requiring special supervision because of a history of complaints, disciplinary actions and arbitrations “firms should consider developing and implementing special supervisory procedures structured to address sales practice concerns that are raised by that history.”

12. As CCO and pursuant to HFP’s written supervisory procedures (“WSPs”), Vaughan was responsible for establishing, maintaining and enforcing a reasonable supervisory system for heightened supervision of registered representatives with a history of customer complaints, arbitrations and disciplinary actions.

13. During the Heightened Supervision Period, the WSPs established that HFP’s Compliance Department must conduct a review to determine whether a representative should be placed on heightened supervision if that representative had a history of three or more customer complaints within the past two years. The WSPs required the

Compliance Department, under Vaughan's supervision, to either: (i) prepare a written plan of heightened supervision; or (ii) for instances when it was determined not to place the representative on heightened supervision, prepare a memorandum addressing why existing supervision of the registered representative was adequate.

14. HFP registered representative JE was the subject of seven customer complaints and two customer arbitrations during the two year period of January 2010 through December 2011. Additionally, during that period, JE settled two arbitrations that were commenced prior to 2010. The complaints and arbitrations concerned allegations that included unauthorized trading, unsuitable recommendations and excessive trading. During 2012, JE was named in an additional customer arbitration alleging, among other charges, that JE engaged in fraud, made unsuitable recommendations and was negligent. Also during 2012, JE was the subject of an additional sales practice complaint alleging that JE engaged in unauthorized trading.
15. HFP registered representative MT was the subject of ten customer complaints during the two year period of January 2010 through December 2011, including five sales practice complaints, of which one complaint alleged unauthorized trading. During 2012, MT was the subject of two additional sales practice complaints.
16. HFP registered representative NE was the subject of eight customer complaints during the two year period of January 2010 through December 2011, including four sales practice complaints. One of these complaints alleged that NE made unsuitable recommendations. During 2012, NE was the subject of two additional sales practice complaints.

17. However, Vaughan unreasonably failed to place any of these representatives on heightened supervision until January 2013, after FINRA inquired about HFP's heightened supervision procedures in connection with FINRA's 2012 examination.
18. Further, Vaughan did not document that he considered whether JE, MT or NE should have been placed on heightened supervision before January 2013 or that he considered and documented any reasons why existing supervision of these representatives was adequate, including in the form of the memorandum required by the WSPs.

Vaughan Failed to Institute Adequate Written Heightened Supervision Plans

19. In January 2013, Vaughan prepared and signed written plans for heightened supervision for JE (dated January 18, 2013), MT (dated January 18, 2013) and NE (dated January 17, 2013). These plans remained in effect until at least March 2013, when Vaughan departed from HFP.
20. In addition, between 2011 and 2012, Vaughan placed three additional HFP representatives, each of whom had a history of at least three customer complaints within the previous two years, on heightened supervision, JS, JT and BF.
21. Vaughan placed JS on heightened supervision effective October 12, 2011.
22. Vaughan placed JT on heightened supervision effective January 17, 2012.
23. Vaughan placed BF on heightened supervision effective January 17, 2012.
24. Vaughan prepared and signed written plans for heightened supervision for JS, JT, and BF, each bearing the date on which the representatives was placed on heightened supervision. These plans remained in effect until January 2013.

25. During January 2013, Vaughan amended the written plans for heightened supervision for JS, JT and BF and signed each of the amended plans. The amended plans and the original plans contained identical terms for the heightened supervision of JS, JT and BF. JS's amended plan was dated January 17, 2013. JT's amended plan was dated January 18, 2013. BF's amended plan was dated January 18, 2013. The amended plans remained in effect until at least March 31, 2013, when Vaughan departed from HFP. The amended plans and the original plans for JS, JT and BF, collectively with the written plans of heightened supervision for JE, MT and NE, are referred to herein as the "Heightened Supervision Plans."
26. In each of the Heightened Supervision Plans, Vaughan failed to adequately address the risks presented by the representative's history of sales practice complaints. Vaughan also failed to take any other reasonable steps to ensure that the representatives were subject to adequate heightened supervision.
27. From the time that BF, JT and JS joined HFP in 2009 until the time that they were placed on heightened supervision, each of these representatives had been the subject of numerous customer complaints, including numerous sales practice complaints.
28. BF was the subject of 13 customer complaints, including seven sales practice complaints, of which three alleged that BF made unsuitable recommendations.
29. JT was the subject of 12 customer complaints, including five sales practice complaints, of which two alleged that JT made misrepresentations.
30. JS was the subject of 15 customer complaints, including 11 sales practice complaints. The sales practice complaints included three complaints against JS alleging

misrepresentations, two complaints alleging unauthorized trading and one complaint alleging unsuitable transactions.

31. In addition, from the time that they were placed on heightened supervision until March 2013, BF, JS, JT, MT and NE were each the subject of additional customer complaints and/or arbitrations and disciplinary actions.

- a. After Vaughan placed BF on heightened supervision, BF was the subject of two customer arbitrations and four sales practice complaints. Customers alleged that BF engaged in fraud, unsuitable transactions and unauthorized trading. Additionally, in February 2013, BF entered into a Consent Order with a state securities regulator revoking BF's securities registration in that state for various violations of that state's securities laws and rules, including making unjustified or untruthful representations, unsuitable recommendations and other unfair, misleading or unethical practices.
- b. After Vaughan placed JS on heightened supervision, JS was the subject of seven additional customer complaints, including six sales practice complaints of which one complaint alleged misrepresentations.
- c. After Vaughan placed JT on heightened supervision, JT was the subject of nine additional complaints, including six sales practice complaints. Four of the complaints against JT alleged unauthorized trading.
- d. After Vaughan placed MT on heightened supervision, MT was the subject of a customer arbitration concerning allegations that MT engaged in excessive trading and recommended unsuitable transactions.

e. On March 11, 2013, after Vaughan placed NE on heightened supervision and prior to Vaughan's departure from the Firm, a state securities regulator issued a Notice Letter of Intent to File a Complaint against NE. In October 2014, after Vaughan's departure from the Firm, NE entered into a Consent Order in that action resulting in a three month suspension of NE's securities license in that state and a \$45,000 fine. The Consent Order contained findings that during 2012, while associated with the Firm, NE made unjustified or untruthful representations and made an unsuitable recommendation.

32. Vaughan's Heightened Supervision Plans were not reasonably designed to detect potential sales practice abuses, and Vaughan failed to otherwise ensure that the representatives were adequately supervised. Although the WSPs suggested considering limiting the representatives to certain types of business and requiring pre-approval of the representatives' transactions with customers, Vaughan unreasonably failed to provide for either of these steps in the Heightened Supervision Plans, and failed to otherwise ensure that such steps were taken at any time during the Heightened Supervision Period. The representatives' business areas were not limited in any way and the representatives effected transactions without obtaining pre-approval.

33. Further, the Heightened Supervision Plans did not provide that supervisors would monitor the representatives' transactions on a daily basis, and Vaughan failed to otherwise ensure that such monitoring occurred. Additionally, although the WSPs required that the representatives' supervisors certify in writing that heightened supervision had been conducted, Vaughan did not provide for this requirement in the

Heightened Supervision Plans, or take steps to otherwise ensure that this certification occurred. The representatives' supervisors did not provide any such certification during the Heightened Supervision Period.

Vaughan Unreasonably Failed to Enforce the Terms of Heightened Supervision Plans

34. Vaughan also failed to enforce the terms of the Heightened Supervision Plans.
35. In each of the Heightened Supervision Plans, Vaughan required an HFP Branch Manager or the Compliance Department to contact various clients of the brokers placed on heightened supervision on a quarterly basis. The plans provided that the supervisors were to determine that the client was aware of account positions and satisfied with the service received.
36. Vaughan was responsible for enforcing this provision. However, he failed to do so and customers were not contacted.

Vaughan Unreasonably Delegated Supervisory Responsibilities to a Registered Representative after Placing the Representative on Heightened Supervision

37. After placing registered representative BF on a Heightened Supervision Plan during January 2012, Vaughan unreasonably continued to delegate supervisory responsibilities to BF until at least approximately July 2012. BF's supervisory responsibilities included supervision of two other registered representatives who had been placed on heightened supervision, JS and JT.
38. It was not reasonable for Vaughan to delegate supervisory responsibilities to BF in light of the customer complaints against BF.

39. By reason of the foregoing, Vaughan violated NASD Conduct Rule 3010 and FINRA Rule 2010.

SECOND CAUSE OF ACTION

**Failure to Establish, Maintain and Enforce a Reasonable Supervisory System for
Supervision of Review of Customer Transactions
(Violation of NASD Conduct Rule 3010 and FINRA Rule 2010)**

40. The Department realleges and incorporates by reference paragraphs 1 through 39 above.

41. During the Delegation Period, the WSPs provided that HFP's Compliance Department was responsible for reviewing transactions on a daily basis, including conducting reviews for suitability, unauthorized transactions and excessive commissions, including review of markups/markdowns.

42. During the Delegation Period, in his role as HFP's CCO, Vaughan was responsible for conducting the daily review of all transactions at HFP.

43. During the Delegation Period, Vaughan delegated supervisory responsibility for reviewing HFP's daily trade blotters to SW, an individual registered with FINRA as a GSR. SW did not hold any principal registrations. Vaughan hired SW in May 2012 as a "Compliance Manager." However, SW had only limited prior experience in the securities industry. Prior to joining HFP, SW had not performed any compliance functions.

44. Vaughan unreasonably delegated to SW the responsibility for identifying exceptions in HFP's trade blotters and bringing those exceptions to Vaughan's attention.

45. Further, Vaughan unreasonably failed to provide SW with adequate instructions and training. Vaughan failed to adequately identify the scope of the information that SW should review, and he failed to provide SW with adequate information about the method and manner for conducting the review.
46. Vaughan also failed to reasonably ensure that SW was performing the delegated reviews properly or otherwise ensure that they were taking place. Vaughan failed to adequately review or follow up on SW's work.
47. As a result of these failures, Vaughan failed to implement a reasonable system at HFP for reviewing customer transactions.
48. By reason of the foregoing, Vaughan violated NASD Conduct Rule 3010 and 2010.

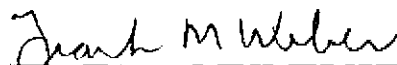
RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Respondent 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; and
- C. order that Respondent bear such costs of this proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.

FINRA DEPARTMENT OF ENFORCEMENT

Dated: March 27, 2015



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