

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

JOHN JOSEPH VAUGHAN
(CRD No. 1495636),

Respondent.

Disciplinary Proceeding
No. 2012030373701

Hearing Officer — KBW

DEFAULT DECISION

August 17, 2015

Respondent violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain an adequate supervisory system for firm-imposed heightened supervision and an adequate supervisory system for review of customer transactions. Respondent is suspended in all principal capacities for six months and is fined \$20,000.

Appearances

Frank M. Weber, Esq., Gina M. Petrocelli, Esq., and Lara Thyagarajan, Esq., for the Department of Enforcement.

No appearance by or on behalf of John Joseph Vaughan.

DECISION

I. Introduction

FINRA's Department of Enforcement filed the attached Complaint with the Office of Hearing Officers against Respondent John Joseph Vaughan on March 27, 2015. From September 2001 through March 2013 (the "Relevant Period"), Vaughan was the Chief Compliance Officer of HFP Capital Markets LLC. The Complaint charges Vaughan with failure to establish and maintain: (1) an adequate supervisory system for firm-imposed heightened supervision, in violation of NASD Rule 3010 and FINRA Rule 2010 and (2) an adequate supervisory system for review of customer transactions, in violation of NASD Rule 3010 and FINRA Rule 2010. Vaughan failed to answer or otherwise respond to the Complaint.

On June 19, 2015, Enforcement filed a Motion for Entry of Default Decision and Supporting Memorandum of Law (“Default Motion”) with the Office of Hearing Officers. The Default Motion is supported by the Declaration of Frank M. Weber in Support of Motion for Entry of Default Decision and Request for Sanctions (“Weber Decl.”) and attached exhibits marked CX-1 through CX-7. Vaughan did not respond to the Default Motion.

II. Vaughan’s Background

In 2011, Vaughan became registered through HFP as a General Securities Representative, General Securities Principal, and Limited Representative-Investment Banking. From July 2011 to September 2011, Vaughan was a Compliance Manager reporting to HFP’s Chief Compliance Officer. When HFP’s Chief Compliance Officer left HFP in September 2011, HFP promoted Vaughan to Chief Compliance Officer. Vaughan remained Chief Compliance Officer of HFP until he left HFP in March 2013. Vaughan is not currently registered through or associated with a FINRA member firm.¹

III. Jurisdiction

Vaughan’s registration through HFP was terminated on April 1, 2013.² Since then, Vaughan has not been associated with or registered with FINRA through any member firm.³ FINRA has jurisdiction over this disciplinary proceeding, pursuant to Article V, Section 4 of FINRA’s By-Laws, because the Complaint alleges that he engaged in misconduct while he was associated with a member firm, and the Complaint was filed less than two years after he was last registered with FINRA.

IV. Origin of Investigation

This investigation arose from the 2012 cycle examination of former member firm HFP conducted by the Member Regulation Staff of FINRA’s District 10 office.⁴

V. Vaughan’s Default

Enforcement served the Complaint and Notice of Complaint (collectively, “First Notice”) and the Complaint and Second Notice of Complaint (collectively, “Second Notice”) in accordance with FINRA Rules 9131 and 9134. Enforcement served the First Notice on March

¹ Complaint (“Compl.”) ¶¶ 2, 4; Weber Decl. ¶ 9.

² CX-1.

³ Compl. ¶ 4.

⁴ Weber Decl. ¶ 5.

27, 2015, and the Second Notice on April 27, 2015. In each instance, Enforcement served Vaughan by both first-class mail and certified mail (return receipt requested) to Vaughan's current residential address as reflected in the Central Registration Depository ("CRD address").⁵ Enforcement also emailed the First Notice and the Second Notice to an email address that Vaughan had provided to FINRA staff during the investigation.⁶ Thus, Vaughan received valid constructive notice of this proceeding.

Pursuant to FINRA Rules 9215 and 9138(c), Vaughan's Answer was due within fourteen days of service of the Second Notice of Complaint, plus an additional three days because service was made by first class mail and by certified mail. Vaughan did not file an Answer.⁷

Accordingly, the Hearing Officer finds that Vaughan defaulted by failing to file an Answer to the Complaint. Therefore, the Hearing Officer deems the allegations in the attached Complaint admitted pursuant to FINRA Rules 9215(f) and 9269(a).

VI. Findings of Fact and Conclusions of Law

A. HFP

During the Relevant 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 customer complaints, arbitrations, and disciplinary actions.⁸

B. NASD Rule 3010

NASD Rule 3010(a) requires each member to establish and maintain a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations, NASD rules, and FINRA rules.

C. First Cause of Action – Failure To Establish And Maintain A Reasonable Supervisory System For Registered Representatives Requiring Heightened Supervision

Vaughan was responsible for establishing, maintaining, and enforcing a reasonable supervisory system for heightened supervision of registered representatives with a history of

⁵ Weber Decl. ¶¶ 11-15, 17-23. CX-2; CX-3; CX-5; CX-6.

⁶ Weber Decl. ¶¶ 13, 19; CX-4; CX-7.

⁷ Weber Decl. ¶¶ 16, 23.

⁸ Compl. ¶ 7.

customer complaints, arbitrations, and disciplinary actions. Vaughan failed to establish, maintain, and enforce such a supervisory system.⁹

During the Relevant Period, HFP's written supervisory procedures ("WSPs") required HFP's Compliance Department to 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. HFP's WSPs required the Compliance Department, under Vaughan's supervision, to either (1) prepare a written plan of heightened supervision, or (2) for instances when it was determined not to place the representative on heightened supervision, prepare a memorandum addressing why the existing supervision of the registered representative was adequate.¹⁰

1. Vaughan Unreasonably Delegated Supervisory Responsibilities For Two Registered Representatives Who Had Been Placed On Heightened Supervision

BF joined HFP in 2009. Between then and January 2012, BF was the subject of 13 customer complaints. In January 2012, Vaughan placed BF on heightened supervision. After placing BF on a heightened supervision plan, Vaughan unreasonably continued to delegate supervisory responsibilities to BF until approximately July 2012. BF's supervisory responsibilities included supervision of JT and JS, two registered representatives who had been placed on heightened supervision in 2012.¹¹

2. Vaughan Prepared Deficient Amended Heightened Supervision Plans for BF, JT, and JS

In January 2013, Vaughan amended the heightened supervision plans of BF, JT, and JS. The amended plans were not reasonably designed to detect potential sales practice abuses, and Vaughan failed to ensure that BF, JT, and JS were adequately supervised. Vaughan's failures included:

- Vaughan unreasonably failed to limit the representatives (either in the amended heightened supervision plans or otherwise) to certain types of business and to require pre-approval of the representatives' transactions with customers;
- although HFP's WSPs required that the representatives' supervisors certify in writing that heightened supervision had been conducted, Vaughan did not provide

⁹ Compl. ¶¶ 1, 12.

¹⁰ Compl. ¶ 13.

¹¹ Compl. ¶¶ 27, 37.

for this requirement in the amended heightened supervision plans or take steps to otherwise ensure that this certification occurred; and

- the amended heightened supervision plans that Vaughan prepared did not provide that supervisors would monitor the transactions of BF, JT, and JS on a daily basis, and Vaughan failed to otherwise ensure that such monitoring occurred.¹²

These deficient plans remained in effect until January 2013.¹³

3. Vaughan Failed To Timely Place JE, MT, And NE On Heightened Supervision

Vaughan unreasonably failed to place three other representatives (JE, MT, and NE) on heightened supervision in 2012 even though each had been named in at least seven customer arbitration complaints during the two years between January 2010 and December 2011. Only after FINRA inquired about HFP's heightened supervision procedures in connection with FINRA's 2012 examination, did Vaughan place JE, MT, and NE on heightened supervision. Further, contrary to HFP's WSPs, Vaughan did not document before January 2013 that he had considered whether JE, MT, or NE should be placed on heightened supervision or the reasons why the existing supervision of these three representatives was adequate.¹⁴

4. When Vaughan Placed JE, MT, And NE On Heightened Supervision, He Prepared Heightened Supervision Plans That Were Deficient

In January 2013, Vaughan prepared and signed heightened supervision plans for JE, MT, and NE. These plans suffered from the same deficiencies as the amended heightened supervision plans that Vaughan prepared for BF, JT, and JS. Accordingly the heightened supervision plans for JE, MT, and NE failed to adequately address the risks presented by the history of sales practice complaints against JE, MT, and NE. The heightened supervision plans for JE, MT, and NE remained in effect at least until March 2013, when Vaughan left HFP. In addition, Vaughan failed to take any other reasonable steps to ensure that the JE, MT, and NE were subject to adequate heightened supervision.¹⁵

¹² Compl. ¶¶ 10, 25, 32, and 33.

¹³ Compl. ¶ 24.

¹⁴ Compl. ¶¶ 14-18.

¹⁵ Compl. ¶¶ 19, 26, and 32.

5. Vaughan Unreasonably Failed To Enforce The Terms Of The Amended Heightened Supervision Plans For BF, JT, And JS And The Heightened Supervision Plans For JE, MT, And NE

Vaughan failed to enforce the terms of the amended heightened supervision plans for BF, JT, and JS and of the heightened supervision plans for JE, MT, and NE. In each plan, Vaughan required an HFP Branch Manager or the Compliance Department to contact on a quarterly basis various clients of the registered representative. The plans provided that the supervisors were to determine that the client was aware of account positions and satisfied with the service received. Vaughan was responsible for enforcing this provision. However, Vaughan failed to enforce this provision, and customers were not contacted.¹⁶

6. Conclusion

Vaughan violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a reasonably designed supervisory system for heightened supervision of HFP registered representatives.¹⁷

D. Second Cause of Action – Failure To Establish And Maintain A Reasonable Supervisory System For Review Of Customer Transactions

From approximately May 2012 to at least February 2013, Vaughan failed to establish and maintain a reasonably designed supervisory system at HFP for reviewing customer transactions. During this period, Vaughan was responsible for reviewing all transactions at HFP on a daily basis, including conducting reviews for suitability, unauthorized transactions, and excessive commissions (including markups and markdowns). Vaughan unreasonably delegated to an inexperienced and inadequately trained junior employee, SW, responsibility for conducting reviews of HFP's daily blotters, identifying exceptions in HFP's trade blotters, and bringing those exceptions to Vaughan's attention. Vaughan unreasonably failed to provide SW with adequate instructions, training, and supervision. In particular, Vaughan failed to:

- identify the scope of the information that SW should review;
- provide SW with adequate information about the method and manner for conducting the review; and
- reasonably ensure that SW was performing the delegated reviews properly.¹⁸

¹⁶ Compl. ¶¶ 34-36.

¹⁷ *Dep't of Enforcement v. The Dratel Group, Inc.*, No. 2008012925001, 2014 FINRA Discip. LEXIS 6, at *84 (NAC May 2, 2014) (individual who was responsible for firm's lax supervisory and compliance structure violated NASD Rule 3010(a) and (b) and just and equitable principles of trade).

¹⁸ Compl. ¶¶ 41, 42-47.

Based on the foregoing, Vaughan violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a reasonably designed supervisory system at HFP for reviewing customer transactions.

VII. Sanctions

A unitary sanction is appropriate for the two causes of action. The FINRA Sanction Guidelines (“Guidelines”) provide that “[a]ggregation or ‘batching’ of violations may be appropriate for purposes of determining sanctions in disciplinary proceedings . . . for similar types of violations.”¹⁹ Here, the two causes of action involve similar types of violations: failures to establish and maintain a reasonable system for the supervision of registered representatives while Vaughan was Chief Compliance Officer of HFP.

For failure to supervise, the Guidelines recommend the imposition of a fine ranging from \$5,000 to \$73,000 and a suspension of up to 30 business days in all supervisory capacities.²⁰ In egregious cases, the Guidelines recommend suspending the responsible individual in all capacities for up to two years or barring the responsible individual.²¹

Vaughan’s violations of NASD Rule 3010 and FINRA Rule 2010 were egregious because of the nature, number, and duration of the violations, and the risk that they posed to the investing public. For approximately six months, Vaughan unreasonably delegated supervisory responsibilities for two registered representatives who had been placed on heightened supervision to BF, even though Vaughan had placed BF on heightened supervision after BF had been named in 13 customer complaints. In January 2013, Vaughan prepared deficient amended heightened supervision plans for BF, JT, and JS. These amended heightened supervision plans remained in effect until at least March 2013, when Vaughan left HFP. Vaughan failed to place JE, MT, and NE on heightened supervision during 2012 despite the multiple customer complaints against them in 2010 and 2011. When Vaughan placed JE, MT, and NE on heightened supervision in January 2013, the heightened supervision plans were deficient. These deficient plans also remained in effect until at least March 2013. From January 2013 to March 2013, Vaughan unreasonably failed to enforce the terms of the amended heightened supervision plans for BF, JT, and JS and the heightened supervision plans for JE, MT, and NE. From May 2012 to at least February 2013, Vaughan failed to establish and maintain a reasonable supervisory system for review of customer transactions. In light of these facts, it is appropriate to suspend Vaughan for six months in all principal capacities and fine him \$20,000.

¹⁹ FINRA Sanction Guidelines at 4 (2015), available at www.finra.org/industry/sanction-guidelines.

²⁰ Guidelines at 103.

²¹ Guidelines at 103.

VIII. Order

John Joseph Vaughan violated NASD Rule 3010 and FINRA Rule 2010 by failing to establish and maintain an adequate supervisory system. For these violations, Vaughan is suspended in all principal capacities for six months and is fined \$20,000. If this Default Decision becomes FINRA's final disciplinary action, Vaughan's suspension shall commence at the opening of business on September 21, 2015, and end on March 20, 2016. The fine shall be due and payable if and when Vaughan re-enters the securities industry.



Kenneth Winer
Hearing Officer

Copies to: John Joseph Vaughan (*via email and first-class mail*)
 Frank M. Weber, Esq. (*via email and first-class mail*)
 Gina Petrocelli, Esq. (*via email*)
 Lara Thyagarajan, Esq. (*via email*)
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