

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2012030436501**

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Broker Dealer Financial Services Corp. ("BDFS"), Respondent
CRD No. 8073

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, BDFS submits this Letter of Acceptance, Waiver, and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against BDFS alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. BDFS hereby accepts and consents, without admitting or denying the findings, 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, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

BDFS is headquartered in West Des Moines, Iowa. It has approximately 270 registered representatives located in more than 130 branch offices throughout the country. It has been a FINRA member since 1979 and is subject to FINRA's jurisdiction pursuant to Article IV, Section 6 of FINRA's by-laws.

RELEVANT DISCIPLINARY HISTORY

None.

OVERVIEW

Between March 1, 2009 and April 30, 2012, BDFS failed to establish and maintain a supervisory system, including written procedures, that was reasonably designed to ensure that the firm's sales of leveraged or inverse exchange-traded funds (collectively "nontraditional ETFs") complied with applicable securities laws and NASD and FINRA rules. In particular, BDFS did not investigate nontraditional ETFs before allowing its registered representatives to recommend them to customers, did not train its personnel in the appropriate use of

nontraditional ETFs, and did not adequately supervise and monitor nontraditional-ETF activity in customer accounts. Through this conduct, BDFS violated NASD Conduct Rule 3010 and FINRA Rule 2010.

Also between March 2009 and April 2012, BDFS – acting through some of its registered representatives – recommended nontraditional ETFs to more than 200 customers. Because the firm had not previously investigated the features and risks associated with nontraditional ETFs, it lacked a reasonable basis for believing that the nontraditional ETF transactions it recommended were suitable for any investor. Through this conduct, BDFS violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010.

FACTS AND VIOLATIVE CONDUCT

A. BDFS violated NASD Conduct Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a reasonable supervisory system, including written procedures, concerning sales of nontraditional ETFs.

From March 1, 2009 to April 30, 2012, BDFS violated NASD Rule 3010(a) and FINRA Rule 2010 by not implementing a supervisory system, including written procedures, that was reasonably designed to ensure the suitability of non-traditional ETF sales.¹

NASD Rule 3010(a) states that each member shall establish and maintain 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 NASD and FINRA Rules. Final responsibility for proper supervision rests with the member.

NASD Rule 3010(b)(1) states that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules.

In June 2009, FINRA issued Regulatory Notice 09-31, which dealt specifically with nontraditional ETFs. Among other things, Regulatory Notice 09-31 reminded broker-dealers that NASD Rule 2310 requires a firm to have a reasonable basis for believing that a product is suitable for any customer before recommending any purchase of that product. Thus, the notice stated, “a firm must

¹ Nontraditional ETFs are complex products that differ from other ETFs in that they seek to return a multiple of the performance of the underlying index or benchmark, the inverse of that performance, or both, and use swaps, futures contracts, and other derivative instruments to achieve these objectives.

understand the terms and features” of nontraditional ETFs, “including how they are designed to perform, how they achieve that objective, and the impact that market volatility, the ETF’s use of leverage, and the customer’s intended holding period will have on their performance.”²

Despite this explicit guidance, BDFS failed to exercise due diligence in investigating nontraditional ETFs before permitting its brokers to recommend them to customers. At no time during the review period did BDFS assign a committee or persons to review or approve nontraditional ETFs before sale by the firm’s registered representatives, nor did it undertake any firm-wide measures to research nontraditional ETFs until the Firm had sold them to customers for nearly four years.

BDFS also failed to provide its personnel with adequate training regarding non-traditional ETFs. Between March 2009 and April 2012, BDFS did not ensure that its registered representatives and their supervisors knew the salient characteristics and risk factors of nontraditional ETFs. BDFS did not require that its principals or registered representatives complete product-specific training on nontraditional ETFs before recommending them to customers.

BDFS’s supervisory review of nontraditional-ETF activity in customer accounts was also inadequate. From March 2009 through April 2012, BDFS did not implement adequate procedures requiring it or its personnel to monitor either the length of time customers held open positions in nontraditional ETFs or the effect of extended holding periods on those positions. Beginning in July 2010, the firm’s written supervisory procedures contained a brief mention of nontraditional ETFs, including a reference to FINRA Regulatory Notice 09-31, but among other things merely identified “considerations when recommending ETFs” and did not caution against recommending nontraditional ETFs to customers with moderate or conservative risk profiles. Moreover, the firm’s sales-exception reports and other supervisory tools did not differentiate between nontraditional ETFs and any other exchange-traded securities.

Accordingly, BDFS violated NASD Rule 3010(a) and (b) and FINRA Rule 2010.

B. BDFS, through some of its registered representatives, violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010 by recommending nontraditional ETFs to certain customers without fully understanding the features and risks associated with the products.

NASD Conduct Rule 2310 requires that a broker-dealer and its registered representatives, before recommending a security to any customer, must have an “adequate and reasonable basis” for any recommendation that they make. This is a prerequisite to any recommendation because “a broker cannot determine

² *F.J. Kaufman and Co.*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (Dec. 13, 1989).

whether a recommendation is suitable for a particular customer unless he has a 'reasonable basis' to believe that the recommendation could be suitable for at least some customers."

FINRA Rule 2111, which superseded NASD Rule 2310 on July 9, 2012, reiterates the longstanding "reasonable basis" suitability obligation and "requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors."³

A broker-dealer lacks a reasonable basis to recommend a security to its customers if it or its representative fails to investigate the security's characteristics sufficiently to understand the potential risks and rewards of the transaction. Thus, to satisfy NASD Rule 2310 and FINRA Rule 2111, a broker-dealer must exercise due diligence to understand the nature of the recommended security. With respect to nontraditional ETFs, "this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETFs' use of leverage, and the customer's intended holding period will have on their performance."⁴

As noted above, BDFS allowed its brokers to recommend nontraditional-ETF transactions to customers without first conducting due diligence concerning the unique features and specific risks associated with nontraditional ETFs. Although the firm's supervisors, registered representatives, and compliance personnel had access to basic educational materials concerning exchange-traded products – which stated that nontraditional ETFs "are suitable only for sophisticated and speculative investors as well as institutional clients who fully understand the complexities of these products and the significant risks that exist in purchasing or trading in them" – BDFS did not require its brokers to complete any training or education regarding nontraditional ETFs before recommending those products to customers. During the relevant period, the firm relied on its general supervisory procedures to supervise transactions in nontraditional ETFs, but those procedures did not address the unique features and risks involved with these products.

Nonetheless, BDFS – acting through its registered representatives – recommended nontraditional ETFs to more than 200 retail customers between March 1, 2009 and April 30, 2012. During that time, BDFS customers bought and sold approximately \$170 million worth of nontraditional ETFs. Some of those transactions occurred in the accounts of customers who had not stated a desire to take aggressive risks with their investment accounts, or for whom investments with a high risk of loss of principal were otherwise inappropriate. These transactions, moreover, frequently resulted in customers holding nontraditional ETF positions for extended periods of time – often months and sometimes years.

³ FINRA Rule 2111.05(a).

⁴ NTM 09-31.

For example:

- In 2010, following the recommendation of a BDFS registered representative, a customer bought shares of two inverse, triple-leveraged ETFs for a total of \$7,544. The customer's stated net worth was under \$49,000 and primary investment objective was "conservative growth & income." The customer held the positions for two and a half years before selling them for a total of \$848 – a loss of nearly 90%.
- In early 2011, a BDFS registered representative recommended that a 73-year-old customer with a stated net worth of \$100,000-\$199,000 and a primary investment objective of "conservative growth & income" purchase an ETF designed to return three times the inverse of the daily performance of the Russell 1000 Financial Services Index. The customer purchased shares of the ETF for \$5,015 and held the position for more than three years before selling at a loss of \$4,535.24 – approximately 90% of the original purchase price.
- In late 2009 and early 2010, on the recommendation of a BDFS registered representative, a customer purchased 300 shares of an inverse, double-leveraged ETF for a total of \$12,768. The customer, who had a liquid net worth of less than \$49,000 and a primary investment objective of "conservative growth & income," held the shares for more than three years before selling them at a loss of \$8,586.82, which constituted nearly two-thirds of the original investment.

Accordingly, BDFS violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010.⁵

B. BDFS also consents to the imposition of the following sanctions:

- Censure
- A fine in the amount of \$75,000

BDFS agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. BDFS has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

BDFS specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

⁵ Before executing this AWC, BDFS made restitution totaling \$24,564.18 to five customers with conservative investment objectives who had suffered losses in nontraditional-ETF positions held for extended time periods. BDFS made four of the restitution payments on March 30, 2015, and the fifth restitution payment on April 9, 2015.

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.

II.

WAIVER OF PROCEDURAL RIGHTS

BDFS specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against it;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, BDFS specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

BDFS further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

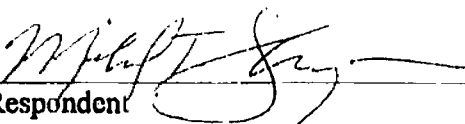
BDFS understands that:

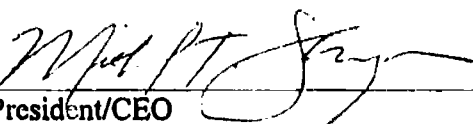
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against me; and
- C. If accepted:
1. This AWC will become part of its permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against me;
 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about BDFS's disciplinary record;
 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 4. BDFS may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. BDFS may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects BDFS's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of BDFS, certifies that a person duly authorized to act on its behalf has read and understood all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that BDFS has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce BDFS to submit it.

4.30.15
Date (mm/dd/yyyy)


Respondent
Broker Dealer Financial Services Corp.

By: 
President/CEO
Broker Dealer Financial Services Corp.

Reviewed by:

Attorney Name
Counsel for Respondent
Firm Name
Address
City/State/Zip
Phone Number

Accepted by FINRA:

05/21/15
Date

Signed on behalf of the
Director of ODA, by delegated authority

 for Adam Walker
Adam B. Walker
Senior Regional Counsel
FINRA Department of Enforcement
120 W. 12th Street, 8th floor
Kansas City, Missouri 64105
(816) 421-5700 / (816) 421-4519 (fax)

Statement of Corrective Action of Broker Dealer Financial Services Corp.

This matter concerns certain practices by Broker Dealer Financial Services Corp. (“BDFS”) regarding certain exchange-traded funds (“non-traditional ETFs”) during the period identified in the AWC, March 1, 2009-April 30, 2012 (“the relevant period”), which ended over three (3) years ago. Although, as indicated in the AWC, BDFS’s procedures during the relevant period contained a brief mention of non-traditional ETFs, these transactions comprised an extremely small portion of BDFS’s revenue during the relevant period. Nevertheless, BDFS, beginning in 2012, instituted a policy whereby it does not permit transactions involving non-traditional ETFs, except in instances in which a client wants to liquidate an open position. Consequently, the conduct at issue in this matter is unlikely to occur again in the future.

Further, as reflected in the AWC, BDFS has already made restitution to certain customers who suffered losses in their BDFS accounts relating to non-traditional ETFs. BDFS has also already provided FINRA with proof of such restitution payment amounts.

This Statement of Corrective Action is submitted by BDFS. It does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or FINRA Staff.