

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

THORNES & ASSOCIATES, INC.  
INVESTMENT SECURITIES,  
(CRD No. 40868),

and

JOHN THOMAS THORNES  
(CRD No. 2097878),

Respondents.

DISCIPLINARY PROCEEDING  
No. 2012030567401

HEARING OFFICER: LBB

**ORDER ACCEPTING OFFER OF  
SETTLEMENT**

Date: July 18, 2013

**INTRODUCTION**

Disciplinary Proceeding No. 2012030567401 was filed on May 20, 2013, by the Department of Enforcement of the Financial Industry Regulatory Authority (FINRA) (Complainant). Respondents John Thomas Thornes and Thornes & Associates, Inc. Investment Securities submitted an Offer of Settlement (Offer) to Complainant dated July 1, 2013. 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**

**Thornes & Associates, Inc. Investment Securities** "TAIIS" of the "Firm") has been a member of FINRA since August 22, 1996. Since at least November 2002, Respondent Thornes has been the owner of 75 percent or more of TAIIS. TAIIS is based in Redlands, California and has six registered representatives. TAIIS conducts business in corporate equity securities, corporate debt securities, mutual funds, U.S. government securities, municipal securities, and life insurance and annuities. TAIIS is also a dually registered as an Investment Adviser with the State of California as of December 26, 2001. TAIIS currently has approximately 1100 accounts with assets under management totaling approximately \$120 million.

**John Thomas Thornes** has worked at TAIIS or its predecessor since shortly after graduating college in 1990. Thornes first became registered with a FINRA member firm, the predecessor of TAIIS, as a General Securities Representative (Series 7) in January 1992. In 1996, he and his brother purchased TAIIS from his father, who founded the Firm, and subsequently his father retired from the securities business. From August 22, 1996 to the present, Thornes has been registered through TAIIS as a General Securities Representative. Additionally, since July 9, 1998, he has been registered with TAIIS as a General Securities Principal (Series 24), and since December 2, 2011, he has been registered with TAIIS as an Operations Professional (Series 99). Since at least August 2008, Thornes has served as the

Firm's President, Chief Compliance Officer (CCO), Director and Secretary. Since at least February 2011, Thornes has also served as the Firm's Anti-Money Laundering Compliance Officer (AMLCO). As of April 15, 2013, Thornes resigned his positions as President and CCO.

## **FINDINGS AND CONCLUSIONS**

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

### **SUMMARY**

1. From December 2010 through January 2013 (the "Relevant Period"), Respondent Thornes converted customer assets in two customer trust accounts he effectively controlled. Through at least 50 transactions he falsely characterized as loans, Thornes transferred approximately \$4.2 million from the trust accounts to two of his friends, CB and KL. The purported loans were undocumented, unsecured, and have never been repaid. The two trusts, one of which was established to provide care for a senior citizen suffering from Alzheimer's, and the other to provide educational scholarships to high school graduates attending college, have been largely depleted of their assets. Thornes, the President of Respondent TAIIS, was the registered representative for both trusts and served as the Trustee of the senior citizen trust, while Thornes' mother, under Thornes' influence or control, acted as the trustee for the educational scholarship trust. By breaching his ethical obligations and fiduciary duties as trustee for the senior citizen trust, Thornes violated FINRA Rule 2010, and by converting and improperly using funds from both trusts, TAIIS, through Thornes, and Thornes individually, violated FINRA Rules 2150(a) and 2010.

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<sup>1</sup> In a multi-respondent case where not all respondents are settling, please add the following: The findings herein are pursuant to Respondent [name]'s Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

2. To fund the transfers, Thornes further depleted the assets of the customer trust accounts in two ways. First, he recommended that each trust use margin, at interest rates ranging between 3.75 percent to 6 percent. Second, he sold off the trusts' conservative investments. These transactions were unsuitable for the trusts and violated NASD Rule 2310 and FINRA Rules 2111 and 2010.

3. As Thornes was aware, his friends CB and KL used the funds for extravagant purposes including chartering a private jet, gambling at a local casino, purchasing a vacation home, and purchasing a luxury automobile. These purported loans were to be repaid by CB within a one-year period, together with interest at a rate of between 15 percent and 20 percent per annum. After April 2012, although several of the loans were overdue and CB advised Thornes his accounts were frozen as a result of tax liens, Thornes continued to transfer trust funds to his friends through January 2013.

4. Thornes did not issue some of the checks from the brokerage trust accounts directly to CB. Instead, he exchanged over \$1 million of brokerage trust checks for cashier's checks and cash, which concealed the source of funds received by CB and allowed CB to evade an asset freeze and use some of the funds at a casino. These actions, as well as transfers from trust accounts to CB and KL for no legitimate purpose, were red flags of suspicious activity that should have been detected and reported through the Firm's anti-money laundering (AML) compliance program. However, TAIIS, by and through Thornes, and Thornes individually, failed to implement policies and procedures that could reasonably be expected to detect and cause the reporting of suspicious activity, and failed to implement policies, procedures and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder, and therefore violated FINRA Rules 3310(a) and 2010.

5. Thornes has served as trustee for the senior citizen trust since May 2007 but has willfully failed to report his role as trustee on FINRA Form U4, in violation of NASD Rule 2110 and IM-1000-1, and FINRA Rules 2010 and 1122 and Article V, Section 2(c) of the FINRA By-Laws.

## **FACTS**

### **I. Thornes Converts the Assets of the BJS Trust Brokerage Account Through Fictitious Loans**

#### **A. The BJS Trust Brokerage Account**

6. From August 1996 until April 2013, Thornes was broker of record on a brokerage account at TAIIS (“BJS Trust Brokerage Account”) for a trust established for the benefit of BJS (“the BJS Trust”). In May 2007, he replaced BJS as trustee, which gave him control of the assets of the BJS Trust, consisting of the BJS Trust Brokerage Account at TAIIS and the trust’s bank account at Union Bank (“BJS Trust Bank Account”).

7. BJS is a 77-year-old retired homemaker who was diagnosed with Alzheimer’s disease in or about 2005. Throughout the Relevant Period, she has suffered from dementia and lived at home with 24-hour nursing care. The BJS Trust was established in 1992 after the death of her husband. The trust was intended to provide for BJS’s health, support, and maintenance. In May 2007, the Amended and Restated BJS Revocable Trust (BJS Trust) provided that after BJS’s death the remainder of her estate was to be distributed to her four children and two grandchildren.

8. Since at least December 2010 and continuing through February 2012, the investment objectives for the BJS Trust Brokerage Account were conservative growth and income. Since March 2012, the investment objectives for the BJS Trust Brokerage Account were listed as balanced and conservative growth, with a “low” risk tolerance.

9. Under the terms of the BJS Trust, the Trustee shall provide the entire income and principal as the Trustee considers necessary for BJS's health, education, support, maintenance, comfort, welfare, or happiness. The BJS Trust also provides, in relevant part, that "[t]he Trustee shall have all the rights, powers and privileges that an absolute owner of the same property would have subject to the Trustee's fiduciary obligations . . . ."

**B. Thornes Places The BJS Trust Brokerage Account on Margin and Liquidates Assets to Make Payments to his Personal Friend, CB**

10. Beginning in April 2011, Thornes placed the BJS Trust Brokerage Account on margin, at an initial interest rate of 3.75 percent, to enable him to make fictitious loans directly to Thornes' personal friend, CB. At that time, the BJS Trust Brokerage Account had a net asset value of \$2,085,843.87, composed of \$138,820.18 in cash (6.66%), \$363,808.70 in municipal bonds (17.44%), and \$1,583,214.99 in mutual funds (75.90%).

11. Thornes was introduced to CB by a long-time friend, KL, in 2010. Thornes had opened an account for CB at TAIIS in January 2011, but it had no activity until March 2012.

12. From April 2011 to January 2013, Thornes used margin to make 25 disbursements totaling \$1,701,443.90 from the BJS Trust Brokerage Account to CB.

13. Thornes claimed these transfers were loans to be repaid by CB within a year, together with interest at a rate of between 15 percent and 20 percent per annum. Thornes made these purported loans pursuant to a supposed oral agreement with CB. Thornes did not receive any signed promissory notes from CB or any other documentation to reflect any of the 25 purported loans. Furthermore, Thornes did not receive any security interest in any real or personal property from CB to secure any of the loan amounts. Thornes continued to make purported loans from the BJS Trust Brokerage Account even after the earlier loans became due but were not repaid.

14. Thornes' transfers of funds from the BJS Trust Brokerage Account to CB's account, along with other suspicious activity such as transfers from the educational trust fund to CB alleged below, triggered an inquiry from TAIIS's clearing firm, FC on June 6, 2011. During the initial six weeks of disbursements to CB, between April 12, 2011 and May 26, 2011, Thornes caused the BJS Trust Brokerage Account to wire \$630,000 to CB's bank account. This wire activity was suspicious when compared to the previous activity in the BJS Trust Brokerage Account.

15. Despite FC's inquiry, on June 20, 2011 and June 21, 2011, Thornes initiated two more wire transfers totaling \$190,000 from the BJS Trust Brokerage Account to CB. On June 28, 2011, Thornes responded to FC's inquiry and acknowledged to FC that the loans were outside of the investment objectives of the BJS Trust and agreed to cease making loans from the BJS Trust Brokerage Account. After June 21, 2011, Thornes did not make any further payments from the BJS Brokerage Trust Account to CB while the account was held at FC.

16. In September 2011, FC notified TAIIS that it was terminating its clearing agreement in part due to concerns about Thornes' transfer of funds from the BJS Brokerage Trust Account to CB, and in part based upon significant money movements in other customer accounts related to transfers to CB.

17. On February 13, 2012, FC transferred all of the securities and margin balance in the BJS Trust Brokerage Account to RCS, TAIIS's new clearing firm. As of February 29, 2012, the asset value of the BJS Trust Brokerage Account was \$2,155,455.11, less a margin balance of \$757,557.76, for a net asset value of \$1,397,897.35. The net asset value was almost \$700,000 less than it had been on April 1, 2011, when Thornes began using margin loans to convert Trust funds and to transfer them to CB.

18. Notwithstanding FC's earlier concerns, Thornes resumed transferring funds from the BJS Brokerage Account to CB after TAIIS switched to its new clearing firm. Beginning in late June 2012, Thornes began using margin at RCS's higher interest rate of six percent to purportedly make unsecured and undocumented loans to CB from the BJS Trust Brokerage Account. Specifically, between June 21, 2012 and January 11, 2013, Thornes made 19 disbursements totaling \$881,443.90 from the BJS Trust Brokerage Account to CB. At the outset of these renewed disbursements, CB had made no principal or interest payments on the prior six loans totaling \$820,000, made between April 12, 2011 and June 21, 2011, all of which were past due.

19. The BJS Trust's use of margin, which was Thornes' decision and was solely for the purpose of funding payments to CB, caused the BJS Trust to incur unnecessary charges and unnecessary risk. Between April 2011 and March 2013 the BJS Trust Brokerage Account incurred margin interest charges totaling approximately \$72,702.70. TAIIS earned a share of the margin interest charges along with its clearing firms, FC and RCS. In August 2012, the equity in the BJS Trust Brokerage Account was \$1,928,106.43, and the margin balance peaked at \$856,568.52, which was inconsistent with the low risk tolerance for this account.

20. To fund disbursements to CB, Thornes also liquidated the BJS Trust Brokerage Account's more conservative investments, mostly municipal bond funds that provided income to the BJS Trust. For example, during the two-month period from September 2012 through October 2012, Thornes, as Trustee for the BJS Trust, made six disbursements totaling approximately \$465,000 from the BJS Trust Brokerage Account to CB. Because there was no additional margin available to support these disbursements, Thornes sold securities totaling

\$596,226.75 held in the BJS Trust Brokerage Account. Most of the proceeds were then transferred to CB.

**C. To Assist CB in Evading an Asset Freeze, Thornes Uses BJS Trust Funds to Obtain Cashier's Checks Payable Directly to Third Parties on CB's Behalf**

21. In order to transfer the funds from the BJS Trust Brokerage Account to CB, Thornes usually first wired funds from the BJS Trust Brokerage Account to the BJS Trust Bank Account. Between June 21, 2012 and January 11, 2013, Thornes initiated 16 outgoing wire transfers totaling \$777,000 and issued two brokerage checks totaling \$37,000 to the BJS Trust Bank Account. Thornes then either withdrew cash from the bank account, which he personally gave to CB, or had the bank issue cashier's checks payable to various third party vendors on behalf of CB, including the following:

- a. San Manuel Casino totaling \$663,000;
- b. Capital One and HSBC credit card companies totaling \$20,500;
- c. Car Cash Loans totaling \$4,816;
- d. California State University of Fullerton totaling \$3,088;
- e. Cornerstone Landscaping totaling \$1,830;
- f. Verizon Wireless totaling \$1,203; and
- g. San Bernardino Pool Services totaling \$250.

22. Additionally, on August 20, 2012, Thornes initiated a wire transfer from the BJS Trust Brokerage Account, on behalf of CB, in the amount of \$67,443.90 to The Early Air Way, LLC, a private jet charter company.

23. As CB earlier advised Thornes, he needed cashier's checks made out to third parties in order to avoid an asset freeze by state and federal tax authorities. By providing CB

with cashier's checks made out to third parties or cash, Thornes knowingly assisted CB in evading asset freeze restrictions with respect to those funds.

24. In addition to paying CB's vendors directly, Thornes gave CB cash. During the seven-week period from June 12, 2012 to July 31, 2012, Thornes gave CB cash totaling approximately \$45,000 from the BJS Trust Brokerage Account.

25. In January 2013, Union Bank notified Thornes it was closing the BJS Trust Bank Account due to concerns it had after reviewing Thornes' suspicious activity in the account.

**D. Through the Conversion of Trust Assets, Thornes and TAIIS Earned Fees and Commissions from the BJS Trust Brokerage Account, Which Has Been Largely Depleted of Assets**

26. During the Relevant Period, TAIIS earned a portion of the margin fees charged to the BJS Trust Brokerage Account, and TAIIS and Thornes both earned commissions on sales of assets from the account.

27. As trustee of the BJS Trust, Thornes also earned trustee fees. For the period from January 2011 to December 2012, Thornes charged the BJS Trust a total of \$35,580.49 in trustee fees, which Thornes disbursed from the BJS Trust Brokerage Account to Thornes' joint brokerage account held at TAIIS.

28. From January 2011 through September 2011, Thornes calculated his trustee fees based upon the net asset values reflected on the BJS Trust Brokerage Account statements, which did not include the outstanding loan balance to CB. From October 2011 through December 2011, however, Thornes began adding the outstanding loan balance to CB to the net asset value, which had the effect of increasing his trustee fees. From January 2012 through December 2012, Thornes used the asset values, which included margin balances, instead of the net asset values, enabling him to earn still higher trustee fees during that period.

29. As of March 31, 2013, the asset value of the BJS Trust Brokerage Account was \$1,078,038.09, less a margin balance of \$691,005.71, for a net asset value of \$387,032.38. This constituted a decrease of approximately \$1.7 million — an 80 percent decrease from the account value of \$2,085,843.87 as of March 31, 2011. The decrease resulted entirely from Thornes' unsecured and undocumented — and ultimately unpaid — purported loans to CB. All of the transactions in the BJS Trust Brokerage Account and BJS Trust Bank Account were made by Thornes acting solely as trustee, and without the knowledge or consent of BJS.

30. To date, none of the \$1,701,443.90 that Thornes caused to be disbursed from the BJS Trust Brokerage Account to CB has been repaid. To date, CB has not paid any principal or interest on the \$1,701,443.90, which Thornes caused to be disbursed to CB from the BJS Trust Brokerage Account as purported unsecured and undocumented loans. Additionally, no principal payments have been made, and no interest payments have been made, to any extent, by anyone else. Consequently, all principal and interest remain unpaid to the BJS Trust.

## **II. Thornes Converts the Assets of the HS Brokerage Account Through Fictitious Loans**

### **A. The HS Trust Brokerage Account**

31. From August 1996 through at least April 2013, Thornes has been the registered representative of record for the HS Trust Brokerage Account.

32. The HS Trust was created by the will of a long-time friend of Thornes' parents, RLH, who is now deceased. The trust instrument requires that the income from the trust be used to provide educational scholarships to college students.

33. Thornes' mother, DT, who is 82 years old, has served as trustee since taking over the role from Thornes' father in 1997. During the Relevant Period, Thornes exercised control over the investment decisions of the HS Trust.

34. Since at least December 2010 and continuing through February 2012, the investment objectives for the HS Trust Brokerage Account were long-term growth and income. Since at least March 2012, the investment objectives for the HS Trust Brokerage Account have been preservation of principal and income, with a “minimal” risk tolerance.

**B. Thornes Places The HS Trust Brokerage Account on Margin and Liquidates Assets to Make Payments to his Personal Friend, CB**

35. Beginning in December 2010, Thornes recommended to DT that the HS Trust Brokerage Account use margin, at an initial interest rate of 3.75 percent, to enable the HS Trust to make purported loans directly to CB, and to KL on behalf of CB. Thornes has known KL for 19 years and has served as broker of record on KL’s account since at least 1998. CB directed Thornes to disburse funds to KL, which CB would purportedly be responsible to repay.

36. As of November 30, 2010, the HS Trust Brokerage Account had a total net asset value of \$3,054,867.70, composed of \$114,687.94 in cash (3.75%); \$1,557,695 in common stock (50.99%); \$188,000.03 in corporate bonds, municipal bonds and certificates of deposits (6.15%); \$1,067,819.92 in mutual funds (34.95%); and \$126,664 in fixed-rate preferred stocks (4.15%).

37. From December 2010 to January 2013, Thornes recommended and caused DT, as the Trustee for the HS Trust, to use margin to make 25 disbursements totaling \$2,488,327 from the HS Trust Brokerage Account to CB, and to KL on behalf of CB.

38. Like the disbursements from the BJS Trust Brokerage Account alleged above, Thornes claimed the 25 transfers were loans to be repaid by CB within a year, with interest at a rate of between 15 percent and 20 percent per annum. Thornes made these fictitious loans pursuant to a supposed oral agreement with CB. Thornes did not receive any signed promissory notes from CB or any other documentation to reflect any of the 25 purported loans. Furthermore, Thornes did not receive any security interest in any real or personal property from CB to secure

any of the loan amounts. Thornes continued to make purported loans from the HS Trust Brokerage Account even after the earlier loans became due but were not repaid.

39. As alleged above, Thornes' unusual transfers of funds from the BJS Trust Brokerage Account and the HS Trust Brokerage Account led TAIIS's clearing firm, FC, to contact Thornes on June 6, 2011 and question him about specific disbursements from the trust accounts to CB. With respect to the HS Trust Brokerage Account, between December 2010 and July 2011, Thornes caused DT to make disbursements from the HS Trust Brokerage Account to CB totaling \$360,000 by initiating wire transfers to CB and exchanging brokerage checks to purchase cashier's checks for CB. Additionally, between December 2010 and April 2011, Thornes caused DT to make disbursements totaling \$1,243,000 from the HS Trust Brokerage Account to KL, purportedly characterized as loans to CB, as follows:

- a. On December 28, 2010, Thornes caused the HS Trust Brokerage Account to journal \$800,000 to KL's joint brokerage account at TAIIS for KL to purchase a house in Big Bear, California. No security interest was provided to HS Trust, and the property has since been sold with no repayment of the purported loan.
- b. On January 5, 2011, Thornes caused the HS Trust Brokerage Account to wire \$350,000 to KL's checking account at Citibank, N.A.
- c. On March 31, 2011, Thornes caused the HS Trust Brokerage Account to wire \$93,000 to KL's checking account at Citibank, N.A. for KL to purchase a BMW automobile.

40. FC advised Thornes that the transfers to CB and KL were unusual account activity and were inconsistent with the HS Trust's goal of supporting academic achievement.

Subsequently, as alleged above, FC notified TAIIS that it was terminating its clearing agreement with TAIIS in September 2011, in part due to concerns over Thornes' transfer of funds from the HS Trust Brokerage Account to CB and KL. On February 13, 2012, FC transferred all of the securities and margin balance in the HS Trust Brokerage Account to RCS, TAIIS's new clearing firm. As of February 29, 2012, the asset value of the HS Trust Brokerage Account was \$2,458,604.43, less a margin balance of \$1,283,597.56, for a net asset value of \$1,175,006.87.

41. As with the BJS Trust, notwithstanding FC's earlier concerns, Thornes resumed making purported loans to CB from the HS Trust Brokerage Account after TAIIS switched to its new clearing firm. Beginning on or about August 3, 2012, Thornes, acting through DT, began using margin at RCS's interest rate of six percent to resume making unsecured and undocumented loans to CB from the HS Trust Brokerage Account. Specifically, between August 3, 2012 and January 30, 2013, Thornes made 18 disbursements totaling \$885,327 from the HS Trust Brokerage Account to CB. At the outset of these renewed disbursements, CB had made no principal or interest payments on the prior seven purported loans totaling \$1,603,000, which were made between December 2, 2010 and July 14, 2011, all of which were past due.

42. The HS Trust's use of margin, which Thornes recommended to the trustee and was solely for the purpose of funding payments to CB, caused the BJS Trust to incur unnecessary charges and unnecessary risk. Between December 2010 and March 2013, the HS Trust Brokerage Account incurred margin interest charges totaling approximately \$126,159. TAIIS earned a share of the margin interest charges along with its clearing firms, FC and RCS. In March 2012, the equity in the HS Trust Brokerage Account was \$2,417,708.39, and the margin balance peaked at \$1,256,721.32, which was inconsistent with the investment objectives of preservation of principal and income, and minimal risk tolerance, for this account.

43. To fund certain disbursements to CB, Thornes also liquidated the HS Trust Brokerage Account's existing, suitable investments that provided income to the HS Trust. For example, during the two-month period from December 2012 through January 2013, Thornes recommended to DT that HS Trust Brokerage Account make ten loans to CB totaling approximately \$562,000. Because there was no additional margin available to support these disbursements, Thornes recommended to DT that HS Trust sell securities, including common stock, preferred stock and mutual funds, often at a loss, to fund the loans to CB. The sell transactions resulted in net proceeds totaling \$1,093,453.65 and realized losses to HS Trust in the amount of \$168,236.12.

**C. To Assist CB in Evading an Asset Freeze, Thornes Uses HS Trust Funds to Obtain Cashier's Checks Payable Directly to Third Parties on CB's Behalf**

44. As with the BJS Trust Brokerage Account, Thornes' disbursements from the HS Trust Brokerage Account were usually used to purchase cashier's checks from a bank, which Thornes then provided to CB. The cashier's checks were made payable to various third party vendors on behalf of CB, with at least \$262,327 payable to San Manuel Casino.

45. Between December 2, 2010 and January 30, 2013, in order to transfer assets from the HS Trust Brokerage Account to CB, Thornes withdrew funds from the HS Trust Brokerage Account, by causing DT to issue 20 brokerage checks totaling \$1,035,327 to Security Bank of California, where HS Trust and Thornes maintained bank accounts. Thornes then exchanged, or caused to be exchanged, the brokerage checks at Security Bank of California into cashier's checks for CB's behalf, with each cashier's check made payable per CB's instructions.

46. For certain funds disbursed from the HS Trust Brokerage Account between August 15, 2012 and January 30, 2013, Thornes deposited the funds into his personal joint bank

account in order to obtain 18 separate cashiers' checks totaling approximately \$782,962, which he made payable according to CB's instructions.

**D. Through the Conversion of Trust Assets, Thornes and TAIIS Earned Fees and Commissions from the HS Trust Brokerage Account, Which Has Been Largely Depleted of Assets**

47. During the Relevant Period, TAIIS earned a portion of the margin fees charged to the HS Trust Brokerage Account, and TAIIS and Thornes both earned commissions on sales of assets from the account.

48. Thornes' mother, DT, earned \$4,000 per month in trustee fees from the HS Trust during the Relevant Period.

49. As of March 31, 2013, the asset value of the HS Trust Brokerage Account was \$387,893.31, less a margin balance of \$247,755.16, for a net asset value of \$140,138.15. Thus, by March 31, 2013, the net asset value had decreased by approximately 95 percent from its value of \$3,054,876.70 as of November 30, 2010. This decrease resulted from Thornes' recommendations to utilize margin and liquidate more conservative securities holdings to make undocumented and unsecured fictitious loans to CB and KL.

50. To date, none of the approximately \$2,488,327 that Thornes recommended and caused DT to disburse from the HS Trust Brokerage account to CB, or to KL on behalf of CB, has been repaid. To date, CB has not paid any principal or interest on the \$2,488,327, which Thornes caused to be disbursed to CB, or to KL on behalf of CB, from the HS Trust Brokerage Account as purported unsecured and undocumented loans. Additionally, no principal payments have been made, and no interest payments have been made, to any extent, by anyone else.

### **III. Thornes and TAIIS Fail to Investigate Red Flags of Suspicious Activity**

51. During the Relevant Period, Thornes was TAIIS's AMLCO and the individual responsible for implementing TAIIS's written AML policies and procedures. As the Firm's AMLCO, Thornes was required to monitor for potentially suspicious activities and red flags. Under the direction of the AMLCO, the Firm was required to further investigate the suspicious activity or red flags and when appropriate, file a Suspicious Activity Report ("SAR"). Such investigation could include gathering additional information internally or from third-party sources.

52. As part of TAIIS's AML program, the Firm's procedures identified, among others, the following as potential red flags:

- a. customer with no discernible reason for using the firm's services;
- b. wire activity that is unexplained, repetitive, unusually large or shows unusual patterns or with no apparent business purpose;
- c. transaction patterns show a sudden change inconsistent with normal activities;
- d. unusual transfers of funds or journal entries among accounts without any apparent business purpose; and
- e. payments to third-parties without an apparent connection to the customer.

53. Between December 2010 and January 2013, in six customer accounts in which Thornes was the broker of record, there were multiple red flags such as those identified above, and third-party wire transfers, which TAIIS, by and through Thornes, and Thornes failed to investigate to ensure compliance with the Firm's obligations to comply with AML requirements and the Firm's procedures. Furthermore, TAIIS failed to investigate Thornes' participation in suspicious activity in his customer accounts that were the source of the red flags. Moreover, Thornes should have considered the suspicious activity review conducted by TAIIS's clearing

firm, in June 2011, regarding the unusual activity in Thornes' six customer accounts as a significant red flag warranting further investigation under the Firm's anti-money laundering procedures.

*HCG Customer Account*

54. In January 2011, customer HCG, a profit sharing plan, opened an account with TAIIS, with Thornes as the registered representative. Three days later, \$150,000 was wired into the account, and on the same date, wired out to a third party, KL. This activity triggered multiple "red flags" listed in the Firm's procedures because no securities positions were ever purchased or held in the HCG account, and the outgoing wire was to a third party.

*LD Customer Account*

55. On February 9, 1999, LD, a friend who was introduced to Thornes by KL, opened an individual account at TAIIS with Thornes as the broker of record.

56. On January 24, 2011, CB deposited a Citibank cashier's check in the amount of \$105,000 into LD's TAIIS account. Eleven days later, Thornes caused an outgoing wire in the amount of \$100,000 to KL's Citibank checking account. These transactions were red flags because: (i) prior to January 2011, LD's account was inactive and held no cash or securities positions; (ii) the incoming wire was a large amount and from a third party (CB); and (iii) the outgoing wire was a large amount going to a third party (KL).

*BJS Trust Brokerage Account*

57. Between January 2010 and March 2011, there was only one withdrawal in the BJS Trust Brokerage Account in excess of \$10,000, and there was no wire activity. Starting in April 2011, as alleged above, there was suspicious activity related to large, repetitive outgoing wires caused by Thornes from the BJS Trust Brokerage Account to CB, a third party, with no

apparent connection to the BJS Trust. During the two month period from April 12, 2011 to June 21, 2011, Thornes caused six large outgoing wire transfers from the BJS Trust Brokerage Account to CB, each exceeding \$50,000, which reflected an unusual pattern for a trust account for an elderly customer.

58. On August 20, 2012, Thornes, on behalf of CB, caused an outgoing wire transfer in the amount of \$67,443.90 from the BJS Trust Brokerage Account to the bank account of a private jet charter company. This transaction was a red flag because the funds were wired to a third party with no apparent connection to the BJS Trust.

59. CB's practice of repeated requests that transfers from the BJS Trust Brokerage Account take the form of cash or cashier's checks made out to designated third parties, as opposed to direct transfers from the account, was a red flag that CB may be attempting to disguise the source of the funds or evade an asset freeze.

#### *HS Trust Brokerage Account*

60. On December 28, 2010, Thornes journaled \$800,000 from the HS Trust Brokerage Account to a third party joint brokerage account held by KL. The \$800,000 journal from the HS Trust Brokerage Account was a red flag because it was an unusually large transfer of funds to KL, a third party, without any apparent business purpose for the transaction. Additionally, this activity was a red flag because it was inconsistent with the normal activities in this account during the previous 12-month period, in that there had not been any large journal entries transferring funds from the HS Trust Brokerage Account to any other customer accounts.

61. Between January 2011 and March 2011, Thornes caused two large outgoing wire transfers, in the amounts of \$350,000 and \$93,000, from the HS Trust Brokerage Account to KL's bank account. Between January 2011 and July 2011, Thornes caused two large outgoing

wire transfers in the amounts of \$180,000 and \$30,000 from the HS Trust Brokerage Account to CB's bank account. These four outgoing wires were unusual disbursements from the HS Trust Brokerage Account because each wire transaction was for a large amount, and all of the wired funds were sent to a third party with no apparent connection to the HS Trust scholarship fund.

62. CB's practice of repeated requests that transfers from the HS Trust Brokerage Account take the form of cashier's checks made out to designated third parties, as opposed to direct transfers from the account, was a red flag that CB may be attempting to disguise the source of the funds or evade an asset freeze.

#### *KL Joint Customer Account*

63. The above-alleged December 28, 2010 incoming journal of \$800,000 that Thornes caused from the HS Trust Brokerage Account to KL's joint account at TAIIS was a red flag, because this account previously had a zero balance and no securities activities. One day later, on December 29, 2010, Thornes, as the broker of record for this account, caused two outgoing wires from KL's joint brokerage account of \$775,000 to an escrow company bank account and \$24,950 to KL's bank account. This series of transactions constituted a red flag because the source of funds for KL's outgoing wires was the HS Trust Brokerage Account, a scholarship fund to which KL had no apparent connection, and the outgoing wires were unusually large amounts.

#### *CB Customer Account*

64. CB opened a brokerage account with TAIIS in January 2011. There was no activity in the account until March 22, 2012, when suddenly CB began writing checks against the account. CB's check-writing activities should have raised a red flag to TAIIS because CB did not have any funds on deposit in his account. Furthermore, CB's additional activities in this account raised further red flags when on April 4, 2012 CB deposited a \$100,000 check into this

account, which bounced. As a result, some of the \$157,120 in checks CB wrote that were drawn on this account were dishonored. CB never deposited any additional funds in this account to cover the outstanding checks, and as result, CB's activities caused TAIIS to incur a liability in the amount of approximately \$94,000 for CB's unsatisfied debit balance.

65. Thornes and TAIIS, by and through Thornes, permitted these suspicious activities to occur without conducting an adequate investigation into the activities and documenting its review to determine whether to file a SAR.

**FIRST CAUSE OF ACTION**  
**Conversion and Improper Use of Funds**  
**(Violations of FINRA Rules 2150(a) and 2010 by**  
**Respondents TAIIS and Thornes Regarding the BJS Trust)**

66. From April 2011 to January 2013, TAIIS, by and through Thornes as the Firm's President, and Thornes individually, and as broker of record, converted and improperly used \$1,701,443.90 belonging to the BJS Trust, for purposes that were inconsistent with his duties as Trustee of the BJS Trust, for the benefit or use of Thornes, TAIIS, CB, or other third parties on behalf of CB.

67. Thornes falsely characterized these transfers as loans. None of the funds have been repaid, and Thornes had no reasonable expectation that the funds would be repaid.

68. As a result of the foregoing conduct, TAIIS, by and through Thornes, and Thornes individually, violated FINRA Rules 2150(a) and 2010.

**SECOND CAUSE OF ACTION**  
**Conversion and Improper Use of Funds**  
**(Violations of FINRA Rules 2150(a) and 2010 by**  
**Respondents TAIIS and Thornes regarding the HS Trust)**

69. From December 2010 and January 2013, TAIIS, by and through Thornes as the Firm's President, and Thornes individually, and as broker of record, recommended, controlled

and caused DT as Trustee of the HS Trust to allow Thornes to convert \$2,488,327 belonging to the HS Trust to his own use and allow Thornes to improperly use customer funds of HS Trust for purposes that were inconsistent with the terms and purposes of HS Trust, for the benefit or use by Thornes, TAIIS, CB, KL, or other third parties on behalf of CB.

70. Thornes falsely characterized these transfers as loans. None of the funds have been repaid and Thornes had no reasonable expectation that the funds would be repaid.

71. As a result of the foregoing conduct, TAIIS, by and through Thornes, and Thornes individually, violated FINRA Rules 2150(a) and 2010.

**THIRD CAUSE OF ACTION**  
**Failure to Observe High Standards of Commercial Honor and**  
**Just and Equitable Principles of Trade and Breach of Fiduciary Duties**  
**(Violations of FINRA Rule 2010 by Respondent Thornes regarding the BJS Trust)**

72. Thornes, as the Trustee of the BJS Trust, breached his fiduciary duties and ethical obligations owed to BJS Trust, by not acting in the best interest of the BJS Trust. Rather, Thornes placed his own interests and the interests of CB and other third parties on behalf of CB, ahead of the BJS Trust by utilizing high margin and causing the BJS Trust Brokerage Account to make risky unsecured and undocumented fictitious loans to Thornes' personal friends.

73. Thornes engaged in a course of conduct inconsistent with high standards of commercial honor and just and equitable principles of trade. His actions enabled him to use, control and dissipate the assets of the BJS Trust in a manner that harmed the BJS Trust. His pattern of deceitful and unethical conduct was violative of FINRA Rule 2010.

**FOURTH CAUSE OF ACTION**  
**Unsuitable Recommendations — Qualitatively Unsuitable**  
**(Violations of NASD Rules 2310 and FINRA Rules 2111 and 2010 by**  
**Respondents TAIIS and Thornes regarding the HS Trust**  
**Brokerage Account and BJS Trust Brokerage Account)**

74. Thornes, as the registered representative of the HS Trust Brokerage Account, had a duty to recommend only suitable investments to the Trustee of the HS Trust.

75. Between December 2010 and January 2013, Thornes recommended speculative transactions in the HS Trust that included repeated and high use of margin, resulting in interest charges, in order to transfer funds to purportedly make unsecured and undocumented loans. As a result of Thornes' recommendations to take large margin loans and to liquidate conservative securities holdings, in part, to facilitate the alleged unsecured and undocumented loans to CB, or to others on behalf of CB, Thornes largely depleted the HS Trust Brokerage Account assets within about a 28-month period. Moreover, Thornes' recommendations that the HS Trust repeatedly use high levels of margin and liquidate conservative securities holdings to make unsecured and undocumented loans, were inconsistent with the risk level and investment objectives of the HS Trust, which were minimal risk and preservation of principal and income, respectively.

76. Thornes recommended and effected these transactions in the HS Trust Brokerage Account without reasonable grounds for believing those transactions were suitable for the HS Trust in light of the information known to him about trust's purpose, and the financial situation and needs of HS Trust.

77. Thornes, as the registered representative of the BJS Trust Brokerage Account, had a duty to recommend only suitable investments for the account.

78. Between April 2011 and January 2013, Thornes recommended speculative transactions in the BJS Trust Brokerage Account that included repeated and high use of margin, resulting in interest charges, in order to transfer funds to purportedly make unsecured and undocumented loans. Additionally, as a result of Thornes' recommendations to take large margin loans and liquidate conservative securities holdings, in part, to facilitate the alleged unsecured loans to CB or to other third parties on behalf of CB, Thornes largely depleted the BJS Trust Brokerage Account assets within a two-year period. Moreover, Thornes' recommendations that the BJS Trust repeatedly use high levels of margin and liquidate conservative securities holdings to make unsecured and undocumented loans, were inconsistent with the risk level and investment objectives of the BJS Trust Brokerage Account, which were low risk, in order to maintain assets for the health and benefit of BJS, and for the limited investment objectives of conservative growth and income.

79. Thornes recommended and effected these transactions in the BJS Trust Brokerage Account without reasonable grounds for believing those transactions were suitable for the BJS Trust in light of the information known to him about trust's purpose, and the financial situation and needs of the BJS Trust.

80. By making and effecting unsuitable recommendations to the HS Trust Brokerage Account and the BJS Trust Brokerage Account, TAIIS, acting through Thornes, and Thornes individually, violated NASD Rule 2310, and FINRA Rules 2111 and Rule 2010.

**FIFTH CAUSE OF ACTION**  
**Failure to Implement the Firm's AML Procedures and**  
**to Comply with Anti-Money Laundering Rules**  
**(Violations of FINRA Rules 3310(a) and**  
**2010 by Respondents TAIIS and Thornes)**

81. FINRA Rule 3310 requires all member firms to “develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the firm’s compliance with the requirements of the Bank Secrecy Act (31 U.S.C. § 5311, *et seq.*), and the implementing regulations promulgated thereunder by the Department of the Treasury.” FINRA Rule 3310(a) specifically requires FINRA members to “establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of” suspicious activity and transactions.

82. Concurrent with its adoption of the predecessor to FINRA Rule 3310 (NASD Rule 3011), in April 2002, FINRA issued Notice to Members 02-21, which reminded broker-dealer firms of the requirements of their AML procedures, including that AML procedures apply to

- a. Monitoring of account activities, including but not limited to, trading and the flow of money into and out of the account, the types, amount, and frequency of different financial instruments deposited into and withdrawn from the account, and the origin of such deposits and the destination of withdrawals; and
- b. Monitoring for, detecting, and responding to “red flags.”

83. Pursuant to NTM 02-21, it is incumbent upon broker-dealers to identify and investigate any “red flags” associated with customer account activity. NTM 02-21 provides a list of examples of “red flags” associated with certain customer account activities that may be

considered suspicious and require further due diligence investigations before proceeding with the transactions.

84. Between December 2010 and January 2013, Thornes was the Firm's AMLCO and the individual responsible for implementing TAIIS's written AML policies and procedures. As the Firm's AMLCO, Thornes was required to monitor for potentially suspicious activities and red flags. Under the direction of the AMLCO, the Firm was required to further investigate the suspicious activity or red flags, and such investigation could include gathering additional information internally or from third-party sources, freezing the account or, where appropriate, filing a SAR.

85. Between December 2010 and January 2013, in six customer accounts in which Thornes was the broker of record, namely the BJS Trust, the HS Trust, CB, KL, HCG, and LD, there were multiple red flags as identified above, and third party wire transfers, in which TAIIS, by and through Thornes, and Thornes failed to investigate to ensure compliance with the Firm's obligations to comply with AML requirements and the Firm's procedures. Furthermore, TAIIS failed to investigate Thornes' participation in suspicious activity in his customer accounts that were the source of the red flags.

86. In addition to the foregoing conduct, TAIIS, by and through Thornes, and Thornes failed to implement policies and procedures that could have been reasonably expected to detect and cause the reporting of suspicious activity or otherwise reasonably designed to achieve compliance with the Bank Secrecy Act (31 U.S.C. § 5311, *et seq.*) and the implementing regulations thereunder. TAIIS, by and through Thornes, and Thornes, individually, therefore violated FINRA Rules 3310(a) and 2010.

**SIXTH CAUSE OF ACTION**  
**(Violation of NASD Rule 2110, IM-1000-1, FINRA Rules 2010 and 1122 and Article V,**  
**Section 2(c) of the FINRA By-laws by Respondent Thornes)**

87. At all times relevant to the Complaint, Questions 13 on FINRA Form U4 asked:

Are you currently engaged in any other business either as a proprietor, partner, officer, director, employee, trustee, agent, or otherwise? (Please exclude non investment-related activity that is exclusively charitable, civic, religious or fraternal and is recognized as tax-exempt.)

88. Any registered representative that affirmatively answers “yes” to Question 13 on Form U4, is required provide details including the name of the other business, whether the business is investment-related, the nature of the other business activity, the title of the position held or the relationship with the other business, the date when the business relationship started, the approximate number of hours a month devoted to the other business and the number of hours devoted to the other business during securities trading hours, and a brief description of the duties performed for the other business.

89. Between May 2007 and April 2013, while Thornes was registered with TAIIS, he acted as the Trustee for the BJS Trust and received compensation. While Trustee, he also functioned as registered representative of the BJS Trust.

90. While registered with TAIIS, Thornes willfully failed to amend his Form U4 to disclose material information, namely, that he engaged in other business activity as a trustee of the BJS Trust.

91. By willfully failing to amend his Form U4, Thornes violated NASD Rule 2110 and IM-1000-1, and FINRA Rules 2010 and 1122 and Article V, Section 2(c) of the FINRA By-Laws.

Based upon the foregoing, Respondents violated NASD Rule 2310 and FINRA Rules 2150(a), 2111 and 2010, and Thornes willfully violated NASD Rule 2110 and IM-1000-1, FINRA Rules 2010 and 1122, and Article V, Section 2(c) of the FINRA By-Laws

Based upon these considerations, the sanctions hereby imposed by the acceptance of the Offer are in the public interest, are sufficiently remedial to deter Respondents 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 Respondents be sanctioned as follows

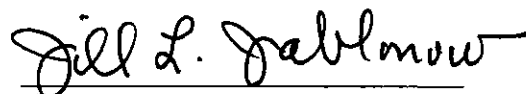
1. Thornes & Associates, Inc. Investment Securities is expelled from FINRA Membership.
2. John Thomas Thornes is barred from association with any FINRA member in any capacity.

The sanctions imposed herein shall be effective on a date set by FINRA staff. Pursuant to FINRA Rule 8313(e), the bar and expulsion shall become effective upon approval or acceptance of this Order.

SO ORDERED.

FINRA

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



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