BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Fox Financial Management Corporation Carrollton, TX, Brian A. Murphy Frisco, TX, and James E. Rooney, Jr. Carrollton, TX, Respondents.	DECISION Complaint No. 2012030724101 Dated: January 6, 2017

FINRA member and its principals failed to record and supervise private securities transactions in which a registered representative participated for compensation. Held, findings affirmed and sanctions affirmed with modification.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Michael Manly, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondents: Daniel Tapia, Esq.

Decision

Fox Financial Management Corporation ("Fox"), Brian A. Murphy, and James E. Rooney, Jr. appeal a March 9, 2015 Extended Hearing Panel ("Hearing Panel") decision. The Hearing Panel found that the respondents failed to record on the firm's books and records, and did not supervise as if they were executed on behalf of the firm, private securities transactions in which a registered representative participated for compensation. The Hearing Panel further found that, as a result of the foregoing lapses, the respondents failed to establish and maintain a supervisory system and written supervisory procedures that were reasonably designed to achieve compliance with the federal securities laws and FINRA rules. For this misconduct, the Hearing Panel expelled Fox from FINRA membership, barred Murphy and Rooney in all principal capacities, and suspended Murphy and Rooney from association with any FINRA member in any capacity for three months and six months, respectively. The Hearing Panel also fined each of the respondents.

After a thorough review of the record, we affirm the Hearing Panel's findings. We also affirm the sanctions imposed by the Hearing Panel, but with modification.

I. Background

Fox became a FINRA member on August 3, 2005. The firm sold primarily private placements and life settlement funds. Fox filed a Uniform Request for Broker-Dealer Withdrawal (Form BDW) on December 24, 2013. On March 21, 2014, FINRA cancelled the firm's membership for failing to pay FINRA fees.

Murphy entered the securities industry in 2003. He was registered through Fox as a general securities representative and general securities principal from January 2007 to December 2013.[1] Murphy was, at all relevant times, Fox's chief compliance officer. He is not currently associated with a FINRA member.

Rooney entered the securities industry in 1988. He was the president and majority owner of Fox, and he registered through the firm as a general securities representative and general securities principal from May 2005 to December 2013.[2] On July 24, 2015, FINRA barred Rooney from association with any FINRA member in any capacity after he submitted a Letter of Acceptance, Waiver and Consent ("AWC") that included a finding that he failed to provide FINRA with documents and information requested during an examination.

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[1] From October 2011 to December 2013, Murphy also registered through Fox as an Operations Professional.

[2] Rooney too registered through Fox as an Operations Professional from October 2011 to December 2013.

II. Procedural History

This disciplinary matter began with a two-cause complaint filed by the Department of Enforcement ("Enforcement") on December 12, 2013. The first cause of action alleged that Fox, acting through Murphy and Rooney, failed to record on the books and records of the firm private securities transactions in which JEP, a registered representative, participated for compensation and did not supervise the transactions as if they were executed through the firm, in violation of NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2010.[3] The second cause of action alleged that Fox, again acting through Murphy and Rooney, and as a result of the foregoing misconduct, failed to establish and maintain a supervisory system and written supervisory procedures reasonably designed to achieve compliance with the federal securities laws and FINRA rules, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2010. The relevant period of alleged misconduct was July 2008 through October 2012.

On January 29, 2014, the respondents filed an answer in which they denied all allegations that their conduct violated FINRA rules, and they requested a hearing. Later, however, Fox, Murphy, and Rooney each stipulated to the facts on which Enforcement based its disciplinary complaint and admitted liability for the alleged misconduct.

On March 9, 2015, after holding a four-day hearing limited to the issue of sanctions, the Hearing Panel issued its decision finding that Fox, Murphy, and Rooney violated FINRA rules as alleged in the complaint and to which the respondents admitted. The Hearing Panel expelled Fox from FINRA membership and fined the firm $100,000. The Hearing Panel barred Murphy in all principal capacities, suspended him from association with any FINRA member in all capacities for three months, and fined him $25,000. Finally, the Hearing Panel barred Rooney in all principal capacities, suspended him in all capacities for six months, and fined him $50,000.

This appeal followed.

III. Facts

A. Fox's Procedures for Supervising Activity Away from the Firm

The record contains three iterations of Fox's written supervisory procedures that addressed the activities of its registered representatives away from the firm during the relevant period. The firm's August 7, 2008 procedures, approved by Rooney, required registered representatives to disclose in writing to Fox their planned participation in any private securities transaction or outside business activity, their role therein, and the compensation that they would receive in connection with the disclosed activity. The procedures further required a Fox principal to approve or disapprove any request to engage in the private sale of securities or any other business activity away from the firm. The procedures stated that the firm would conduct

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[3] The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

an annual review of any approved private securities transaction or outside business activity, and imposed further the requirement that any private securities transaction be recorded on a designated firm form. Under a section of the procedures addressing "Outside Investment Advisor Activities," Fox generally prohibited its registered representatives from engaging in any investment adviser activity outside the firm, unless the activity was through a Fox affiliated firm or the registered representative was the owner or principal of a registered investment adviser. For all investment adviser activity away from the firm, Fox reserved the right to request duplicate confirmations for any "transaction done by any representative" and stated that it would conduct an annual review of all outside investment adviser accounts.

Fox's December 31, 2008 written supervisory procedures contained the following notable amendments. First, they defined the phrase "private securities transaction" as "any securities transaction outside the regular course or scope of employment with [Fox] for which the associated person receives compensation." Second, the procedures defined the term "compensation" to include "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, but not limited to, commissions; finder's fees; securities or rights to acquire securities; rights of participation in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise, or expense reimbursement." Finally, the procedures required Rooney and Murphy to review and approve or disapprove all written requests to engage in a private securities transaction or an outside business activity, and they imposed on them both the obligation to "monitor" and record on Fox's books and records a registered representative's approved participation in a private securities transaction to ensure compliance with FINRA rules.[4]

Finally, Fox's October 22, 2011 written supervisory procedures further amended the definition of the phrase "private securities transaction" to include any securities transaction by a representative dually registered with Fox's affiliated registered investment adviser executed away from Fox for compensation.[5] The firm's procedures for outside business activities were also amended to add the requirement that the Fox principal who reviewed any registered representative's request to conduct an outside business activity "determine, and document in

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[4] The procedures stated that, if approved, Fox's compliance department would request in writing duplicate copies of account statements or other information concerning securities transactions executed away from the firm.

[5] Although the firm's written supervisory procedures continued to allow registered representatives to engage in investment adviser activities through Fox's affiliated adviser or a registered investment adviser owned by the representative, the revised procedures did not explicitly include in the definition of private securities transaction investment adviser activities by registered representatives, like JEP, who conducted business away from Fox through their own firm.

writing . . ., whether the activity qualifies as an outside business activity or whether it should be treated as an outside securities activity."[6]

B. JEP's Activity Away from Fox

JEP was registered as a corporate securities representative through Fox from May 14, 2008, to October 22, 2012. Murphy and Rooney jointly supervised JEP.

JEP was also the president and founder of a registered investment adviser, JP&A, Inc. ("JP&A"), a fee-based investment management and financial planning firm. JP&A invested the assets of its investment management clients, on a discretionary basis, in either one of two distinct model portfolios or in one of the three hedge funds discussed below.[7] JEP, or his business partner, AC, executed the securities transactions to create these portfolios. JP&A collected quarterly an annual advisory fee, determined by a percentage of the amount of assets under management, from its investment management clients.[8]

In addition to the investment adviser activity he conducted through JP&A, JEP served as the managing partner of P&C Partnership, LLC ("P&C"), the general partner of three hedge funds, the P&C Dividend Capture Fund 1, LP ("Dividend Fund"), P&C Global Fund, LP, and P&C Value Added Fund, LP.[9] The funds invested in dividend paying closed end funds, sector rotation strategies of domestic and global sectors, and timing strategies in domestic indexes. JP&A provided investment advisory services to and acted as the investment manager for each of these hedge funds. For these services, the funds paid JP&A quarterly a two percent annual management fee based on the amount of assets under management. The funds' limited partners also paid P&C 20 percent of their monthly net profits.[10]

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6 Fox's December 31, 2008 and October 22, 2011 written supervisory procedures both referenced FINRA notices that advised members and their associated persons that FINRA's rule governing private securities transactions reached to include the investment adviser activities, for compensation, of a registered representative away from the member firm. *See infra* n.14.

7 JEP was solely responsible for the formulation, monitoring, and supervision of investment advice to JP&A's clients.

8 JP&A also collected transaction-based compensation in connection with the sale of mutual funds and exchange-traded funds to its clients.

9 The offering documents for each of the hedge funds stated that fund interests were securities privately offered under Regulation D and exempt from the registration requirements of the Securities Act of 1933.

10 As managing partner of P&C, JEP received 60 percent of the profit-sharing fees that P&C collected from the funds' limited partners.

C. JEP's Disclosures to Fox

In July 2008, JEP completed an "Outside Activity Approval" form on which he disclosed to Fox that he devoted 20 to 30 hours per week to securities-related activity as a registered investment adviser through JP&A, and received $7,500 to $10,000 per month for this activity in the form "client fees" and "money managers' fees."

JEP advised Fox in March 2009 that he created the Dividend Fund to invest his assets and those of JP&A's clients. He disclosed this activity in writing in July 2009, when he completed another Outside Activity Approval form revealing the securities-related activity of P&C as the general partner of the Dividend Fund. JEP estimated he worked 10 hours per week and earned monthly compensation of $50,000 from this activity.

In addition to the Outside Activity Approval forms, JEP disclosed his outside activities to Fox by other means. On November 12, 2009, he completed an annual compliance questionnaire in which he answered "yes" the question "[a]re you currently employed by and/or do you receive compensation from any other person or entity other than your firm or a company affiliated with your firm?" JEP also answered "yes" the question "[a]re you currently acting as a general partner, manager, or wholesaler of any limited partnership, private placement, or any other investment?" In 2011, JEP completed two "Disclosure of Outside Business Activity Form[s]" that notified Fox that he was the president of JP&A, a registered investment adviser, and the managing general partner of P&C, respectively. JEP indicated on each of these forms that he received compensation from these activities.

D. Fox Approves JEP's Activity But Does Not Supervise It

Murphy signed the July 2008 Outside Activity Approval form, to indicate his approval and the firm's treatment of JEP's activity through JP&A as an outside business activity beyond the scope of JEP's relationship with Fox. Although he did not sign the form, Rooney was aware of JEP's activity and decided that Fox would treat the activity as an outside business activity and not as a private securities transaction. Neither Murphy nor Rooney conducted any inquiry into this activity, or the compensation JEP received as a result of it, beyond reviewing the information that JEP disclosed on the form. They did not record JP&A's securities transactions on the books and records of Fox, and they did not supervise the activity for compliance with the federal securities laws or FINRA rules.

Murphy also approved Fox's treatment of JEP's activity through P&C as an outside business activity beyond the scope of JEP's relationship with Fox.[11] Neither Murphy nor Rooney conducted any inquiry into this activity, or JEP's compensation from such activity, other than reviewing the information that JEP disclosed on the Outside Activity Approval form. Because Fox approved JEP's activity through P&C as an outside business activity, neither

[11] Rooney also was aware of JEP's activity as the managing member of P&C, and he consented to treating it as an outside business activity.

Murphy nor Rooney recorded on Fox's books and records any securities transactions related to the three hedge funds for which P&C served as general partner or supervised the activity for compliance with the federal securities laws or FINRA rules.

IV. Discussion

Fox, Murphy, and Rooney admit that they engaged in the violations of FINRA rules alleged in Enforcement's complaint. We therefore affirm the Hearing Panel's liability findings.

A. The Respondents Failed to Record and Supervise Private Securities Transactions

NASD Rule 3040 prohibits a person associated with a FINRA member from participating, in any manner, in a private securities transaction except in accordance with the rule's requirements.[12] NASD Rule 3040(a). These requirements include that an associated person, prior to participating in the transaction, must provide written notice to the member firm that describes in detail the proposed transaction and the person's proposed role in the transaction and states whether the person has or may receive selling compensation in connection with the transaction.[13] NASD Rule 3040(b). In the case of a private securities transaction involving selling compensation, the member receiving notice of the transaction must approve or disapprove the associated person's participation in the transaction in writing. NASD Rule 3040(c)(1). If the member approves the associated person's participation in the transaction, the member must also record the transaction on its books and records and supervise the person's participation in the transaction as if it had been executed on the member's behalf.[14] NASD Rule 3040(c)(2).

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[12] NASD Rule 3040 defines "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member." NASD Rule 3040(e)(1).

[13] "Selling compensation," for purposes of NASD Rule 3040, "means any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a securities, including, though not limited to commissions; finder's fees, securities or rights to acquire securities; rights to participate in profits, tax benefits, or dissolution proceeds, as a general partner or otherwise; or expense reimbursements." NASD Rule 3040(e)(2). FINRA construes the phrase "selling compensation" broadly. *See William Louis Morgan*, 51 S.E.C. 622, 627 (1993) ("The NASD deliberately made that definition wide in its scope, and intended it to include any item of value received.").

[14] FINRA has long advised its members and their associated persons that direct or indirect compensation, including asset-based management fees, a registered representative receives from participating as an investment adviser in the execution of securities transactions away from his FINRA member firm is "selling compensation" for purposes of NASD Rule 3040. *See NASD Notice to Members 94-44*, 1994 NASD LEXIS 39, at *6 (May 15, 1994). Where a member approves such activity, it must develop and maintain a recordkeeping system that, among other things, captures the transaction executed by the registered investment adviser on the member's

[Footnote continued on next page]

The respondents concede that JEP, from July 2008 to October 2012, participated in private securities transactions through JP&A and P&C for compensation, that they approved his participation in these activities, but that they failed, as required by NASD Rule 3040(c)(2), to record the transactions on the books and records of Fox or supervise the transactions as if they had been executed on the firm's behalf. We therefore affirm the Hearing Panel's findings that Fox, Murphy, and Rooney violated NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2010.[15]

B. The Respondents Failed to Maintain and Enforce the Firm's Supervisory System and Written Procedures

NASD Rule 3010 requires that each FINRA member establish and maintain a system, including written procedures, to supervise the activities of the persons that are associated with it and that is reasonably designed to achieve compliance with the federal securities laws and FINRA rules. *See* NASD Rule 3010(a)(1), (b)(1). A member must implement and enforce its supervisory system and written procedures reasonably in light of the circumstances presented. *See Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008). The supervisory duties imposed under NASD Rule 3010 include a responsibility to investigate and act upon "red flags" that reveal irregularities or the potential for misconduct. *Id.*

Fox, Murphy, and Rooney concede that they failed to implement and enforce reasonably the firm's supervisory system and written supervisory procedures as they related to private securities transactions. The respondents understood well, as a result of JEP's numerous disclosures to the firm during the relevant period, that JEP was engaged in securities-related activities away from Fox, for compensation, as a registered investment adviser through JP&A and as the de facto manager of at least one hedge fund through P&C. The respondents, however, failed to conduct a reasonable evaluation of these activities to determine whether the activities were properly characterized as outside business activities or whether they should be treated as outside securities activities subject to the requirements of NASD Rule 3040. Although Fox's written supervisory procedures stated that the firm would review annually the outside business activity and private securities transactions of its registered representatives, the respondents failed

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books and records and facilitates the member's supervision of that activity. *See NASD Notice to Members 96-33*, 1996 NASD LEXIS 39, at *3-4 (May 1996).

[15] FINRA Rule 2010, formerly NASD Rule 2110, states that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." A violation of any FINRA rule is also a violation of FINRA Rule 2010 or, prior to December 15, 2008, NASD Rule 2110. *See Blair C. Mielke*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927, at *2 n.1 (Sept. 24, 2015). FINRA Rule 0140 subjects associated persons to all rules applicable to FINRA members.

to do so. At no point, during the period that JEP was associated with Fox, did they conduct an independent examination of the compensation that JEP received from his activities away from Fox, the nature of the business he conducted through JP&A or P&C, the suitability of the investments or services offered by these entities to their clients or customers, or any advertising, brochures, correspondence, financial statements, or offering materials concerning JP&A's discretionary, investment advisory business or the hedge funds JEP managed through P&C. Murphy and Rooney instead summarily approved JEP's activities away from Fox as outside business activities, and the respondents thus did not request duplicate statements of JEP's securities transactions through JP&A or P&C, failed to record those transactions on the books and records of the firm, and abdicated all supervisory responsibility for them.

Based on the foregoing facts, we affirm the Hearing Panel's findings that Fox, Murphy, and Rooney violated NASD Rules 3010 and 2110 and FINRA Rule 2010.

V. Sanctions

The Hearing Panel expelled Fox from FINRA membership and fined the firm $100,000. The Hearing Panel barred Murphy in all principal capacities, suspended him from association with any FINRA member in any capacity for three months, and fined him $25,000. Finally, the Hearing Panel barred Rooney in all principal capacities, suspended him in all capacities for six months, and fined him $50,000. We affirm these sanctions, but with modification.

A. Relevant Disciplinary Histories

The Sanction Guidelines ("Guidelines") instruct us to "always consider a respondent's disciplinary history in determining sanctions."[16] Therefore, before we assess sanctions for the specific violations of FINRA rules for which the respondents are liable in this matter, we begin with a review of the relevant disciplinary histories of two of the three respondents, Fox and Rooney.[17]

In May 2009, Fox submitted an AWC to settle a FINRA disciplinary matter. Fox accepted a censure and a $7,500 fine based on findings that the firm failed to comply with FINRA's advertising rule.

Also in May 2009, the Texas State Securities Board initiated an enforcement action against Fox and Rooney that alleged, among other things, misrepresentations and omission in the sale of securities, sales of unregistered and unsuitable securities, a failure to maintain books and records, and a failure to enforce the firm's written supervisory procedures. In February 2010,

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[16] *See FINRA Sanction Guidelines* 2 (2015) (General Principles Applicable to All Sanction Determinations, No. 2), 6 (Principal Considerations in Determining Sanctions, No. 1) [hereinafter *Guidelines*].

[17] Murphy does not have any prior disciplinary history.

Fox and Rooney settled this matter by consenting to an order of reprimand that directed them to cease and desist from violating the Texas securities laws and to comply with various undertakings.

In October 2010, Fox and Rooney consented, through an offer to settle disciplinary charges brought by FINRA, to findings that they negligently failed to disclose material facts in connection with the sale of zero-coupon bonds secured by life settlements, violated escrow requirements pertaining to the holding of customer funds, and failed to supervise the sale of private placements. As a result of the settlement, FINRA censured Fox and fined the firm $40,000 and imposed on Rooney a 15-business-day suspension in all principal capacities and a $20,000 fine.

In July 2015, FINRA issued a final disciplinary decision that found Rooney failed to supervise a registered representative's private securities transactions for compliance with FINRA rules, failed to provide written notice to Fox of his own participation in private securities transactions, made an unsuitable recommendation to a customer, and misrepresented material information and used misleading sales materials when soliciting a customer's investment. For these violations, FINRA suspended Rooney in all capacities for 23 months, suspended in all principal or supervisory capacities for 18 months, fined him $72,500, and ordered him to requalify as a general securities representative and general securities principal.

Finally, in July 2015, Rooney submitted an AWC to settle a FINRA claim that he failed to provide FINRA with documents and information sought in connection with a cause examination. FINRA barred Rooney from associating with any FINRA member in any capacity as a result of this action.

The sanctions imposed previously on Fox and Rooney serve, in part, to frame our assessment of the sanctions imposed on them in this matter. As the Guidelines state, in order to deter and prevent future misconduct, sanctions imposed in the disciplinary process should be more severe for recidivists.[18] The disciplinary histories discussed above evidence an increasingly apparent disregard for fundamental regulatory requirements, including the supervisory obligations imposed under FINRA rules.[19] Having considered the foregoing matters in our assessment of sanctions, we judge them as further evidence that Fox and Rooney pose a risk to the investing public and severe sanctions are in order for their misconduct to confront those risks. *See John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 SEC LEXIS 1699, at *48 (June 14, 2013) ("FINRA properly considered these matters in assessing sanctions because they evidence a disregard for regulatory requirements and are further evidence that he poses a risk to the investing public absent a bar."); *Joseph Ricupero*, Exchange Act Release No. 62891, 2010 SEC LEXIS 2988, at *24 (Sept. 10, 2010) (considering respondent's disciplinary

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18 *See id.*, at 2 (General Principles Applicable to All Sanction Determinations, No. 2).

19 *See id.*

history and finding that it was further evidence that he poses a risk to the investing public should he re-enter the securities industry), *aff'd*, 436 F. App'x 31 (2d Cir. 2011).

B. Conduct Specific Sanctions

The Guidelines for violative private securities transactions do not address specifically a failure to record and supervise transactions, as required by NASD Rule 3040(c)(2), but instead direct adjudicators to consider the Guidelines for supervisory failures.[20] For failures to supervise, the Guidelines recommend a fine of the responsible individual of $5,000 to $73,000 and an independent monetary sanction of the firm.[21] In egregious cases, the Guidelines recommend that we consider suspending the responsible individual in any or all capacities for up to two years or imposing a bar and, in a case against a firm involving systemic supervision failures, a suspension or expulsion of the responsible FINRA member.[22]

As an initial matter, we agree with the Hearing Panel's decision to aggregate sanctions for both causes of misconduct in which each of the respondents have been found to have engaged.[23] The rule violations that occurred in this case were the result fundamentally of the respondents' supervisory failures. *See Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, Complaint No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *97 (FINRA NAC May 1, 2012) ("[W]e find that it is appropriate to impose a unitary sanction for these remaining violations because the remaining violations of FINRA rules all resulted from the broad and systemic supervisory failures at the Firm.").

We also concur in the Hearing Panel's conclusion that Fox, Murphy, and Rooney engaged in egregious misconduct. NASD Rule 3040 is designed to protect investors from unmonitored sales and to protect securities firms from exposure to loss and litigation in connection with sales made by persons associated with them. *See Jim Newcomb*, Exchange Act Release No. 44945, 2001 SEC LEXIS 2172, at *19 (Oct. 18, 2001). The rule plays a crucial role in FINRA's regulatory scheme, and its abuse calls for significant sanctions. *See Ronald W. Gibbs*, 52 S.E.C. 358, 365 (1995). The respondents deprived JEP's advisory clients and hedge

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20 *Guidelines*, at 15 n.2.

21 *Id.* at 103.

22 *Id.*

23 The Guidelines permit the aggregation or batching of similar violations for the purpose of assessing sanctions. *See id.*, at 4 (General Principles Applicable to All Sanction Determinations, No. 4). Numerous, similar violations may also warrant higher sanctions since the existence of multiple violations may be treated as an aggravating factor. *Id.*

fund investors of Fox's oversight and supervision.[24] *Cf. Harry Friedman*, Exchange Act Release No. 64486, 2011 SEC LEXIS 1699, at *34 (May 13, 2011) ("Such misconduct deprives investors of a brokerage firm's oversight, due diligence, and supervision, protections investors have a right to expect.").

In our assessment of sanctions, we are mindful of the presence of several aggravating factors. First and foremost, the respondents ignored repeated, regulatory warnings concerning their treatment and supervision of private securities transactions.[25] On May 28, 2010, FINRA staff sent Rooney a copy of an examination report that stated Fox failed to establish and maintain a system to supervise the activities of the firms' registered representatives and associated persons that was reasonably designed to achieve compliance with applicable securities laws and regulations.[26] Specifically, FINRA staff concluded, Fox failed to properly supervise the outside activities of its registered representatives, including JEP, to ensure that they did not engage in private securities transactions.[27] Similarly, in a letter addressed to Murphy dated July 25, 2011, SEC staff highlighted certain deficiencies and weaknesses identified during another examination of Fox, including a failure to supervise transactions for compensation under NASD Rule 3040. In this instance, the SEC noted that Fox was aware that JEP was engaging in an investment advisory business, including his participation in the execution of customer transactions to purchase interests in private funds and in the execution of portfolio transactions for which he earned advisory fees through entities that he owned. The SEC concluded that JEP's participation in these transactions for compensation subjected Fox to the requirement that it record and supervise the transactions under NASD Rule 3040. Finally, on June 11, 2012, FINRA staff sent Fox an examination report that identified several exceptions, including Fox's failure to comply with the requirements of NASD Rule 3040. FINRA staff found that JEP had participated in securities transactions for investment advisory and hedge fund accounts away from Fox for

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[24] In 2013, the SEC brought an action against JEP and JP&A. JEP and JP&A settled the matter based on findings that they improperly charged the three hedge funds for which JP&A served as investment manager for performance fees totaling $610,762 for clients that did not satisfy the requirements of a "qualified client" under the Investment Advisers Act of 1940. After JP&A repaid these clients, the SEC entered a cease and desist order censuring JEP and JP&A, and it imposed a $35,000 civil monetary penalty on the respondents. These facts serve to enhance the egregious character of the misconduct at issue here. *See Guidelines*, at 6 (Principal Consideration in Determining Sanctions, No. 11); *id.* at 103 (Principal Considerations in Determining Sanctions, No. 2); *cf. id.* at 14 (Principal Considerations in Determining Sanctions, Nos. 4, 7).

[25] *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 15.).

[26] The contents of FINRA's examination report were shared also with Murphy.

[27] On June 7, 2011, FINRA staff advised Rooney, in writing, that staff's examination findings and exceptions were referred to Enforcement for further disposition.

compensation. Staff noted, however, that Fox had not recorded these transactions on the books and records of the firm and there was no documentary evidence to show that any firm principal had conducted a supervisory review of JEP's activities. In each instance, Fox responded to the regulators' requests that the firm take corrective action with a level of obfuscation and intransigence that merits the sanctions we impose herein. *See Dep't of Enforcement v. Wedbush Sec., Inc.*, Complaint No. 2007009044, 2014 FINRA Discip. LEXIS 40, at *69-70 (FINRA NAC Dec. 11, 2014) ("The Firm's disciplinary history coupled with its failure to remedy regulatory reporting problems despite repeated warnings from regulators present a significant aggravating factor . . . ."), *aff'd*, Exchange Act Release No. 78568, 2016 SEC LEXIS 2794 (Aug. 12, 2016).

Second, we find it troubling that the respondents flouted FINRA rules over a lengthy period of time and that their misconduct evidences a pattern of misconduct that allowed JEP to engage in investment advisory activities for a large number of clients, involving significant assets, and some Fox customers.[28] Fox, Murphy, and Rooney failed to supervise JEP's private securities transaction during the entire four-year period he was associated with Fox. When JEP left Fox, JP&A had approximately 300 clients, of which approximately 60 were also customers of Fox, and managed assets of nearly $33 million on a discretionary basis.[29] At the same time, the three P&C hedge funds had assets of approximately $17.6 million. "Because proper supervision serves such an important role in protecting investors, egregious violations of supervisory rules often warrant the most severe sanctions." *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933, at *112 (July 2, 2013), *aff'd sub nom., Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014).

Finally, we find that the respondents' misconduct was at least reckless and exhibited a willful disinterest in regulatory responsibilities.[30] *See Murphy*, 2013 SEC LEXIS 1933, at *114 ("Given Birkelbach's complete failure to take reasonable supervisory steps in the face of obvious red flags, we agree with FINRA that Birklebach's supervisory failures appear to involve some degree of intent."). Rooney determined when JEP associated with Fox that Fox had no duty to supervise his activity as a registered investment adviser away from the firm. The respondents, when faced with repeated regulatory warnings to the contrary, and in spite of Fox's written supervisory procedures, persistently and defiantly disclaimed any supervisory responsibility for JEP's private securities transactions. The quality and degree of their implementation of Fox's supervisory system and procedures was thus trivial.[31] A casual assessment of the facts, coupled

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[28] *See Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 9, 18); *cf. id.* at 14 (Principal Considerations in Determining Sanctions, Nos. 1, 2, 3, 8).

[29] JP&A also provided financial planning services to a small number of clients on a non-discretionary basis. JP&A collected a fixed fee for its financial planning services.

[30] *See Guidelines*, at 7 (Principal Considerations in Determining Sanctions, No. 13).

[31] *See Guidelines*, at 103 (Principal Considerations in Determining Sanctions, No. 3).

with even a humble reading of published FINRA statements concerning the securities transactions of dually registered representatives that were cited in Fox's own written supervisory procedures, would have led even a novice securities professional to conclude, at a minimum, that JEP's securities transactions through JP&A required the firm's supervision.[32] The hearing testimony of both Murphy and Rooney, experienced securities professionals, nevertheless makes clear that they had no intention of causing Fox to comply with its regulatory requirements unless forced to do so through disciplinary action. *Cf. Wendy McNeeley*, Exchange Act Release No. 68431, 2012 SEC LEXIS 3880, at *62 (Dec. 13, 2012) (finding respondent's testimony and arguments on appeal reflected a continuing failure to grasp her role as a professional).

Based on the foregoing, we have determined that the sanctions imposed by the Hearing Panel are entirely fitting and remedial. Assuring proper supervision is critical to operating a broker-dealer. *See Rita H. Malm*, 52 S.E.C. 64, 68 n.13 (1994). "Regardless of its size or complexity, each member must adopt and implement a supervisory system that is *tailored specifically to the member's business* and must address the activities of all its registered representatives and associated persons." *NASD Notice to Members 99-45*, 1999 NASD LEXIS 20, at *5 (June 1999) (emphasis in original). Murphy and Rooney, however, plainly marginalized their role in supervising JEP's private securities transactions, which led to a clear breakdown in Fox's supervisory system.

We thus expel Fox from FINRA membership. *See DBCC v. Prime Investors, Inc.*, Complaint No. C04930065, 1995 NASD Discip. LEXIS 219, at (NASD NBCC Sept. 11, 1995) ("We believe that these respondents have demonstrated a serious lack of understanding of federal securities laws, and that public investors may be harmed by similar misconduct in the future if . . . firm [is not] expelled."). We also bar Murphy and Rooney from acting in any principal, or supervisory, capacity with any FINRA member.[33] *See Dep't of Enforcement v. Lane*, Complaint No. 20070082049, 2013 FINRA Discip. LEXIS 34, at *95 (FINRA NAC Dec. 26, 2013) ("[W]e find that Jeffrey Lane's supervisory failures were egregious and that he poses a risk to investors were he to act as a principal or supervisor again."), *aff'd*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558 (Feb. 13, 2015). We further suspend Murphy and Rooney from association in any capacity with any FINRA member for a period of three and six months, respectively, to address the seriousness of their misconduct as registered professionals, protect investors, and deter like-minded individuals. *See McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005) ("[T]he purpose of expulsion or suspension from trading is to protect investors, not to penalize brokers."); *id.* at 189 ("Although general deterrence is not, by itself, sufficient justification for expulsion or suspension, we recognize that it may be considered as part of the overall remedial

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32 *See id.* (Principal Considerations in Determining Sanctions, No. 1).

33 We thus amend the Hearing Panel's order barring Murphy and Rooney in any principal capacity to include a bar also in any supervisory capacity.

inquiry."). Finally, we fine Fox, Murphy, and Rooney, respectively, $100,000, $25,000, and $50,000 in accordance with the Guidelines for supervisory failures.[34]

The record does not support or reflect any mitigating considerations. As they did before the Hearing Panel, the respondents argue here that they relied reasonably on the advice of counsel when they determined that JP&A's securities-related activities away from Fox did not require their supervision. The evidence does not support this claim. *See Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *40 (Nov. 14, 2008) ("We believe that the respondent asserting such reliance must provide sufficient evidence . . . that the respondent made full disclosure to counsel, appropriately sought to obtain relevant legal advice, obtained it, and then reasonably relied on the advice."), *aff'd*, 347 F. App'x 692 (2d Cir. 2009). Neither Murphy nor Rooney consulted with counsel before they approved JEP's outside securities activities through JP&A and P&C as outside business activities beyond the reach of Fox's supervision in 2008 and 2009. Moreover, there is no evidence that they made full disclosure of the facts when they consulted counsel for the first time in 2010. It is not disputed that Murphy and Rooney failed to disclose any information concerning the compensation that JEP received from his activities away from Fox. And the respondents cannot produce any opinion letter or written advice from counsel. The advice they claimed to have received in this case was oral and, based on the hearing testimony, lacked substance.

In any event, an advice of counsel claim is not mitigating if it is premised on a strategy to avoid full compliance with applicable regulatory requirements. *Id.* at *49 (citing *Toni Valentino*, 57 S.E.C. 330, 338 (2004)). Given Murphy's and Rooney's responsibility as registered persons to comply completely with FINRA rules, their extensive industry experience, FINRA's published guidance, and the warnings that they received from both FINRA and the SEC, the respondents' purported reliance on counsel was in this case decidedly unreasonable. *See Dep't of Enforcement v. Berger*, Complaint No. C9B040069, 2006 NASD Discip. LEXIS 19, at *29-30 (NASD NAC July 28, 2006) ("The record does not demonstrate that Berger's reliance on counsel was reasonable."), *sanctions aff'd*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *40 (Nov. 14, 2008), *aff'd*, 347 F. App'x 692 (2d Cir. 2009).

VI. Conclusion

We affirm the Hearing Panel's findings that Fox, Murphy, and Rooney failed to record on the firm's books and records, and did not supervise, the private securities transactions of JEP, in violation of NASD Rules 3040(c)(2) and 2110 and FINRA Rule 2110. We also affirm the Hearing Panel's findings that the respondents failed to maintain and enforce the firm's supervisory system and written supervisory procedures, in violation of NASD Rules 3010 and 2110 and FINRA Rule 2110. Consequently, and in summary, we expel Fox from FINRA membership and fine the firm $100,000. We bar Murphy in all principal or supervisory capacities, suspend him from association with any FINRA member in any capacity for three

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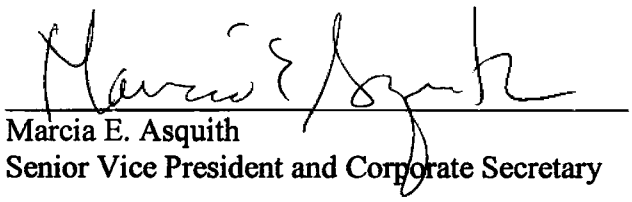
[34] *See Guidelines*, at 103.

months, and fine him $25,000. Finally, we bar Rooney in all principal or supervisory capacities, suspend him in all capacities for six months, and fine him $50,000. We affirm the Hearing Panel's order that the respondents pay, jointly and severally, hearing costs in the amount of $6,596.22. The expulsion, and principal and supervisory bars, imposed herein are effective upon service of the decision.

On Behalf of the National Adjudicatory Council,



Marcia E. Asquith
Senior Vice President and Corporate Secretary