

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2012030785401**

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

RE: Feltl & Company, Respondent
CRD No. 6905

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

I.

ACCEPTANCE AND CONSENT

- A. Feltl hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Feltl is headquartered in Minneapolis, Minnesota. It has approximately 114 registered representatives located in eight branch offices in Minnesota and Illinois. Its revenue is derived from securities commissions, as well as from underwriting and investment company activity. Feltl has been a FINRA member since September 1975 and is subject to FINRA's jurisdiction pursuant to Article IV, Section 6 of FINRA's by-laws.

RELEVANT DISCIPLINARY HISTORY

In August 2014, Feltl signed a letter of Acceptance, Waiver, and Consent in which FINRA alleged multiple failures by the firm between 2008 and 2012 concerning supervision of penny-stock transactions and annual testing and verification of supervisory procedures. FINRA alleged that this conduct violated Sections 15(g) and (h) of the Exchange Act (Section 15(g) became Section 15(h) on July 22, 2010); SEA Rules 15g-2, 15g-3, 15g-4, 15g-6, and 15g-9; NASD Rules 3010, 3012, 3110, and 2110; and FINRA Rules 3130 and 2010. Feltl agreed to accept a censure and to pay a \$1.0 million fine.

OVERVIEW

Between January 1, 2009 and September 30, 2012, Feltl failed to establish and maintain a supervisory system, including written procedures, that was reasonably designed to ensure that the firm's sales of leveraged or inverse exchange-traded funds (collectively, "nontraditional ETFs") complied with all applicable securities laws and NASD and FINRA rules. In particular, Feltl did not investigate nontraditional ETFs before its registered representatives recommended them to customers. Further, Feltl did not adequately train its personnel in the appropriate use of nontraditional ETFs and did not adequately supervise and monitor nontraditional-ETF activity in customer accounts. Through this conduct, Feltl violated NASD Conduct Rule 3010 and FINRA Rule 2010.

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

FACTS AND VIOLATIVE CONDUCT

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

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

NASD Rule 3010(a) states that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision rests with the member.

NASD Rule 3010(b)(1) states that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals,

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

and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules.

In June 2009, FINRA issued Regulatory Notice 09-31, which dealt specifically with nontraditional ETFs. Among other things, Regulatory Notice 09-31 reminded broker-dealers that NASD Rule 2310 requires a firm to have a reasonable basis for believing that a product is suitable for any customer before recommending any purchase of that product. Thus, the notice stated, "a firm must understand the terms and features" of nontraditional ETFs, "including how they are designed to perform, how they achieve that objective, and the impact that market volatility, the ETF's use of leverage, and the customer's intended holding period will have on their performance."

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

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

Feltl's supervisory review of nontraditional-ETF activity in customer accounts was also inadequate. From January 2009 through September 2012, Feltl did not implement adequate procedures requiring it or its personnel to monitor either the length of time customers held open positions in nontraditional ETFs or the effect of extended holding periods on those positions. Thus, during that time, the firm's sales-exception reports and other supervisory tools did not differentiate between nontraditional ETFs and any other exchange-traded securities.

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

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

NASD Conduct Rule 2310 required that a broker-dealer and its registered

representatives, before recommending a security to any customer, must have an "adequate and reasonable basis" for any recommendation that they make. This is a prerequisite to any recommendation because "a broker cannot determine whether a recommendation is suitable for a particular customer unless he has a 'reasonable basis' to believe that the recommendation could be suitable for at least some customers."²

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

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

As noted above, Feltl allowed its representatives to recommend nontraditional-ETF transactions to customers without first conducting due diligence concerning the unique features and specific risks associated with nontraditional ETFs. Feltl also did not adequately train or educate its representatives regarding nontraditional ETFs before permitting them to recommend those products to customers.

Nonetheless, Feltl – acting through some of its registered representatives – recommended nontraditional ETFs to hundreds of retail customers between January 1, 2009 and September 30, 2012. During that time, Feltl customers bought and sold approximately \$270 million worth of nontraditional ETFs. Many of these transactions occurred in the accounts of customers who had not stated a desire to take aggressive risks in their investment accounts, or for whom investments with a high risk of loss of principal were otherwise inappropriate. These transactions, moreover, resulted in customers holding nontraditional ETF positions for extended periods of time – often months and sometimes years. For example, in 2009, a Feltl registered representative recommended the purchase of 500 shares of an ETF designed to return two times the inverse of the daily performance of the Dow Jones U.S. Real Estate Index to an 82-year-old customer

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

³ FINRA Rule 2111.05(a).

⁴ NTM 09-31.

who ranked preservation of capital as the most important investment objective. The customer held the position for more than three years before moving the account to another firm, by which time the position's value had declined by approximately \$6,000 – roughly 90% of the original purchase price.

In early 2009, another Feltl registered representative recommended on two occasions that an 82-year-old customer purchase an ETF designed to return twice the inverse of the Dow Jones U.S. Financials Index. The customer held those positions for longer than a year before selling at a loss of approximately \$6,500 – 53% of the original purchase price. This customer ranked capital appreciation as the most important investment objective and preservation of capital as the second most important investment objective.

Finally, a Feltl registered representative recommended the purchase of an inverse double-leveraged ETF to an 80-year-old customer who held the position for 24 months before selling it at a 43% loss. This customer ranked capital appreciation as the most important investment objective.

Through this conduct, Feltl violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010.

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

- Censure
- A fine in the amount of \$225,000
- Restitution to be paid to certain of its customers in the amount of \$13,678.37.

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

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

Restitution is ordered to be paid by Feltl to the customers listed on Attachment A hereto in the total amount of \$13,678.37.

A registered principal on behalf of the respondent shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Adam Walker, Senior Regional Counsel, FINRA – District 4, 120 W. 12th Street, Kansas City, Missouri 64105, either by letter that identifies Feltl and AWC No. 2012030785401, or by e-mail from a work-related account of the registered principal of Feltl to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason Feltl cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, it shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Feltl shall provide satisfactory proof of this action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

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

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

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

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

III.

OTHER MATTERS

Feltl understands that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Feltl; and
- C. If accepted:
 - 1. This AWC will become part of its permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Feltl;
 - 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about Feltl's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. Feltl may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Feltl may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Feltl's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Feltl may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Feltl understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

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

avoiding the issuance of a Complaint, has been made to induce Feltl to submit it.

12/01/2014

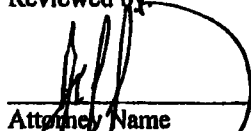
Date (mm/dd/yyyy)



Respondent
Feltl & Company

By: Thomas Steichen, General Counsel

Reviewed by:



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

Accepted by FINRA:

12-29-2014
Date

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



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

Statement of Corrective Action of Feltl & Company

This matter concerns certain practices by Feltl & Company (Feltl) regarding certain exchange-traded funds (non-traditional ETFs) during the period identified in the AWC, January 1, 2009-September 30, 2012 ("the relevant period"). These transactions comprised an extremely small portion of Feltl's revenue during the relevant period, and non-traditional ETFs have never been a focus of Feltl or its representatives, including during the relevant period.

Nevertheless, Feltl has implemented measures relating to the sales and holding periods for non-traditional ETFs. Feltl published a Compliance Alert in December 2012, which covered various regulatory and compliance issues relating to non-traditional ETFs and other complex products. This Compliance Alert was distributed to all of Feltl's registered personnel, both at the home office and in the field.

In addition, Feltl has provided a variety of training to its field sales force regarding complex products since the relevant period. This includes, but is not limited to, discussions regarding complex products at the firm's annual compliance meeting, along with training provided to Feltl branch offices by Feltl compliance personnel. Specifically, Feltl has provided non-traditional ETF training to its representatives and supervisors regarding the type of customers to whom such products should be sold, and how the length of certain holding periods can affect a customer's returns on such investment.

Finally, Feltl has instituted a practice in which it contacts representatives who have recommended non-traditional ETFs to clients, to ensure that the product is suitable for the customer and to remind the representative of the possible effects a holding period may have on the customer's return on that investment. Feltl also monitors for the trading of non-traditional ETFs by all registered personnel on a daily basis.

Feltl believes that these various practices and processes will ensure that non-traditional ETFs are sold to the appropriate clients, and that Feltl representatives and supervisors are properly trained regarding these products.

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

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ATTACHMENT A

CUSTOMER	RESTITUTION AMOUNT
1	\$1,709.50
2	\$78.84
3	\$4,539.20
4	\$2,323.00
5	\$984.00
6	\$255.16
7	\$3,788.67
TOTAL:	\$13,678.37