

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013035242501**

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

RE: Blue Capital Securities, Inc., Respondent
Member Firm
BD No. 38901

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Blue Capital Securities, Inc. ("BCS" or "Respondent") 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 Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accept and consent, 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

BCS was approved as a FINRA member firm on September 27, 1995.

The firm employs 13 registered persons and operates from three branch offices, including its primary office located in New York, New York. The firm engages in a general securities business including retailing corporate equity securities over the counter, selling corporate debt securities and selling interests in mortgages or other receivables.

RELEVANT DISCIPLINARY HISTORY

BCS has no prior disciplinary history with the SEC, FINRA, any other self-regulatory organization or any state securities regulator.

OVERVIEW

This case involves several violations arising from BCS's involvement in the business of selling mortgage backed securities ("MBS") and collateralized mortgage obligations ("CMOs") during 2012. BCS entered this business line for the first time in August 2012 when several new registered representatives joined the firm. During 2012, in connection with selling CMOs, BCS provided marketing materials for a proposed CMO transaction to at least six customers. Those marketing materials failed to adequately disclose certain risks in violation of FINRA Rules 2210 and 2010. BCS also failed to provide required CMO educational materials prior to the firm's sales of CMOs to at least seven retail customers in violation of IM-2210-8 and FINRA Rule 2010.

Additionally during 2012, in connection with BCS's MBS and CMO business, violated books and records rules and FINRA's Trade Reporting and Compliance Engine ("TRACE") rules.

BCS also violated NASD Conduct Rule 3010 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Background on CMOs

A CMO is a security that is collateralized by mortgage backed securities ("MBS"). A MBS, in turn, is an undivided interest in a pool of mortgages. The principal and interest from the mortgages underlying the MBS are used to pay CMO investors principal and/or interest, depending on the type, or "tranche" of CMOs owned. CMOs are classified, in part, based on the entity that guarantees them. CMOs guaranteed by the Government National Mortgage Association ("Ginnie Mae" or "GNMA"), a government agency, have reduced credit risk because they are said to carry the "full faith and credit" U.S. government guarantee. CMOs issued by Ginnie Mae, along with those guaranteed by Fannie Mae and Freddie Mac, both government-sponsored entities, are referred to as "agency" CMOs. CMOs come in myriad varieties, each with its own yield, price volatility and risk characteristics. CMOs are risky and sensitive to changes in market interest rates.

1. Advertising Rule Violations – Content Standards

BCS entered the MBS and CMO business in or about August 2012 after several new registered representatives who specialized in this business joined BCS from two other FINRA member firms. Certain customers serviced by these registered representatives, and whose accounts held MBS and CMOs, transferred their accounts to BCS from the registered representatives' prior firm. A number of these customers held a CMO known as GNR 2004-22 SH, a Ginnie Mae backed agency CMO. The customers had owned this CMO since in or about 2004.

In late 2012, BCS recommended to customers who owned the GNR-2004-22-SH CMO the possibility of engaging in a restructuring transaction, whereby the customers who held the CMO would sell the security. The GNR 2004-22-SH CMO would then be split into two separate securities and the customers would then purchase one piece of the newly created securities, an Inverse Interest Only ("Inverse IO") CMO.¹

In or about October and November 2012, BCS provided at least six customers a seven page document explaining the proposed restructuring transaction. This marketing material, however, failed to present a balanced discussion of risks. The document did not provide any details about the risks of investing in CMOs generally, or Inverse IO CMOs specifically. The document did not state that Inverse IO's are highly sensitive to changes in interest rates and changes in the prepayment rates of the mortgage loans underlying the CMOs and that the structure of Inverse IOs exaggerates the effect of prepayments on cash flows and market value. Similarly, the document also did not state that Inverse IO CMOs presented risks that investors could lose their entire principal. The document also did not discuss liquidity risks and did not state that the market for the Inverse IOs might be highly illiquid and that it could be difficult for customers to sell the Inverse IO.

By reason of the foregoing, BCS violated NASD Conduct Rule 2210(d)(1)(A) and FINRA Rule 2010.

2. Advertising Rule Violation – CMO Educational Material

IM-2210-8 (Communications with the Public About CMOs), now FINRA Rule 2216, provides that "[b]efore the sale of a CMO to any person other than an institutional investor, a member must offer to the customer educational material that includes," a discussion of various characteristics and risks of CMOs, the structure of a CMO, the relationship between mortgage loans and mortgage securities, questions an investor should ask before investing, and a glossary of terms.

In November 2012, BCS failed to timely provide these education materials to at least seven customers prior to the firm's sale of a CMO to those customers. Specifically, BCS failed to provide the materials prior to the customer's participation in the restructuring transaction referenced above where the

¹ Inverse IOs are structured so that interest payments made to investors move in the opposite direction of an interest rate index, such as LIBOR. Inverse IOs sell at a discount to their notional principal amount. As the notional principal amortizes and prepays, the cash flow and market value of an Inverse IO declines. As with IOs, Inverse IO tranches can expire worthless if the related principal balance is paid off prior to the maturity date of the security. Inverse IOs, along with other high risk tranches of CMOs are only suitable for "sophisticated investors" with a "high-risk profile." *Members' Obligation to Customers When Selling Collateralized Mortgage Obligations (CMOs)*, NASD NTM 93-73.

customers sold the GNR 2004-22-SH CMO and purchased the newly created GNR 12-130 GS Inverse IO CMO.

By reason of the foregoing, BCS violated IM-2210-8 and FINRA Rule 2010.

3. Books and Records Violations

During 2012, FINRA staff conducted two separate reviews of order memoranda with respect to the firm's transactions in Securitized Products:

- a. During a review period of July 2012 through December 2012, order memoranda in 59 out of 59 sampled transactions (100 percent) were incomplete or contained inaccuracies. In 59 instances, order tickets failed to identify the registered representative who entered the order; in 53 out of 59 instances (90 percent) the order tickets contained inaccurate order execution times; and in 45 out of 59 instances (76 percent), order tickets were marked "unsolicited" when this was not the case.
- b. A separate review of 36 order memoranda for transactions effected by the firm during a period of October through December 2012 identified 30 out of 36 instances (83 percent) in which BCS order tickets contained inaccurate execution times. Twenty-five out of the 30 identified instances represented order memoranda not previously identified in the July 2012 through December 2012 review period set forth above.

The conduct described in sections 3.a. and b. above constitutes separate and distinct violations of Exchange Act Rule 17a-3, and FINRA Rules 4511 and 2010.

4. Inaccurate Reporting to TRACE

FINRA staff conducted two separate reviews of BCS's TRACE reporting compliance:

- a. During a review period of July 2012 through December 2012, BCS failed to accurately report 51 out of 51 sampled TRACE-eligible transactions (100 percent) in Securitized Products that the firm reported to TRACE. BCS reported inaccurate times of order receipt, order entry and order execution for these transactions.
- b. During a separate review period of October 2012 through December 2012, BCS reported inaccurate execution times to TRACE for 31 out of 82 TRACE-eligible transactions (38 percent) in Securitized Products.

The conduct described in sections 4.a. and b. above constitutes separate and distinct violations of FINRA Rule 6730(c).

5. Failure to Report and Late Reported Transactions to TRACE

FINRA staff's two separate reviews of BCS's TRACE reporting compliance identified the following:

- a. During a review period of July 2012 through December 2012, BCS failed to report eight out of 59 sampled TRACE-eligible transactions (13.6 percent) in Securitized Products to TRACE.
- b. During a review period of October 2012 through December 2012, BCS failed to report to TRACE 36 transactions in TRACE-eligible Securitized Products within 15 minutes of the time of execution. These 36 transactions constituted 44 percent of the total number of transactions in TRACE-eligible Securitized Products that the firm reported to TRACE during the review period.

The conduct described in section 5.a. and b. above constitutes separate and distinct violations of FINRA Rule 6730(a) and a pattern or practice of late reporting without exceptional circumstances in violation of FINRA Rule 2010.

6. Inadequate Supervisory System

From at least August 2012 through December 2012, BCS failed to establish, maintain and enforce a reasonable supervisory system, including establishing reasonable written supervisory procedures, with respect to the firm's sales of MBS and CMOs, and with respect to the firm's TRACE reporting for Securitized Products.

Specifically, BCS failed to have systems and procedures in place to ensure that disclosure documents for CMOs were timely provided to customers. As a result, BCS failed to ensure that customers who purchased the GNR 2004-22-SH CMO discussed above received an Offering Circular for the transaction from BCS's clearing firm. BCS also failed to have adequate written procedures with respect to delivery of CMO educational materials and, supervisory review of CMO transactions.

BCS's systems and procedures for TRACE reporting were also inadequate. The firm's WSPs in effect from August 2012 to December 2012 did not reflect current TRACE reporting requirements with respect to both the types of securities that needed to be reported to TRACE and the time period following trade execution in which transactions must be reported to TRACE. Additionally, the firm's procedures failed to provide for a procedure or method for BCS supervisors to document or evidence supervisory reviews of TRACE reporting.

By reason of the foregoing, BCS violated NASD Conduct Rule 3010 and FINRA Rule 2010.

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

- a Censure; and
- a fine in the amount of \$50,000.

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

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

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

II.

WAIVER OF PROCEDURAL RIGHTS

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

- A. To have a Complaint issued specifying the allegations against Respondent;
- 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, Respondent 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.

Respondent 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

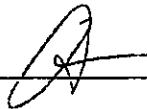
Respondent understands that:

- 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 Respondent; and
- C. If accepted:
 - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. Respondent 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. Respondent 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 Respondent's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. I understand that I 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 Respondent, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; 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 Respondent to submit it.

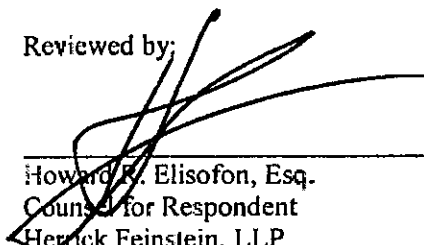
5/8/15
Date (mm/dd/yyyy)

Blue Capital Securities, Inc.

By: 

Name: David Margene
Title: CEO

Reviewed by:


Howard R. Elisofon, Esq.
Counsel for Respondent
Herrick Feinstein, LLP
2 Park Avenue
New York, NY 10016
(212) 592-1437

Accepted by FINRA:

June 3, 2015

Date

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


Frank M. Weber
Senior Regional Counsel
FINRA Department of Enforcement
Brookfield Place
200 Liberty Street
New York, New York 10281
Phone: (212) 858-4324
Facsimile: (212) 858-4770