

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013038328301**

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

RE: 1st Discount Brokerage, Inc. (CRD No. 39164)
Respondent

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent 1st Discount Brokerage, Inc. ("1DB" or the "Firm") 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 1DB alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent 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

1DB has been a member of FINRA since December 1995. 1DB is headquartered in Lake Worth, Florida, maintains approximately 20 branch offices and has approximately 27 registered representatives.

RELEVANT DISCIPLINARY HISTORY

On January 23, 2012, the Securities and Exchange Commission issued an Order against 1DB for failing to supervise a registered representative who operated a Ponzi scheme. 1DB was censured and fined \$40,000.

On April 23, 2015, 1DB entered into an AWC relating to the Firm's failure to establish, maintain and enforce written supervisory procedures reasonably designed to ensure compliance with Section 5 of the Securities Act of 1933. 1DB was censured and fined \$60,000.

OVERVIEW

From January 2010 to December 2011 (the "Relevant Period"), 1DB failed to establish, maintain and enforce a reasonably-designed supervisory system and written supervisory procedures ("WSPs") regarding the sales of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Based on the foregoing, 1DB violated NASD Rule 3010 and FINRA Rule 2010.

Also, during the Relevant Period, 1DB violated NASD Rule 2310 and FINRA Rule 2010 by allowing representatives to recommend Non-Traditional ETFs (1) without performing reasonable diligence to understand the risks and features associated with them, and (2) that were unsuitable for certain customers based on their age, investment objectives and financial situation.

FACTS AND VIOLATIVE CONDUCT

A. 1DB Failed to Establish, Maintain and Enforce a Reasonably-Designed Supervisory System and WSPs Regarding Non-Traditional ETFs

1. Non-Traditional ETFs

Non-Traditional ETFs are designed to return a multiple of an underlying index or benchmark, the inverse of that benchmark, or both, over the course of one trading session – usually a single day. As a result, the performance of Non-Traditional ETFs over periods of time longer than a single trading session "can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time." *FINRA Regulatory Notice 09-31*. Because of these risks and the inherent complexity of these products, FINRA has advised broker-dealers and their representatives that Non-Traditional ETFs "are typically not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets." *Id.*

2. 1DB's Non-Traditional ETF Business

During the Relevant Period, approximately 50 1DB representatives traded Non-Traditional ETFs in customer accounts. These representatives executed 13,496 Non-Traditional ETF transactions totaling approximately \$358 million.

3. 1DB Failed to Adequately Supervise the Sale of Non-Traditional ETFs

a. 1DB had no WSPs and Lacked an Adequate System to Review Non-Traditional ETF Transactions

During the Relevant Period, 1DB had no WSPs addressing the suitability and supervision of Non-Traditional ETFs. 1DB's WSPs did not provide any guidance to supervisors to assist them in reviewing Non-Traditional ETF transactions in light of the unique features and risks of these products, including the daily reset and leverage features. In addition, 1DB did not have a system that enabled principals to readily identify Non-Traditional ETF transactions for review.

b. 1DB Failed to Provide Non-Traditional ETF Training

1DB failed to provide Non-Traditional ETF training to representatives and their supervisors. 1DB did not include the topic of Non-Traditional ETFs at its annual compliance meetings, continuing education programs, or in any other type of Firm training. In addition, 1DB did not require its principals or representatives to complete product-specific training on Non-Traditional ETFs before recommending them to customers.

c. 1DB Failed to Monitor Non-Traditional ETF Holding Periods

1DB had no supervisory system, such as the use of exception reports, to monitor holding periods for Non-Traditional ETFs. As discussed above, a primary risk with Non-Traditional ETFs is that, during times of volatility, they may diverge from their underlying index or benchmark and are very likely to lose value. 1DB's failure to have an adequate supervisory system to monitor holding periods for Non-Traditional ETFs resulted in customer losses.

Based on the foregoing, 1DB violated NASD Rule 3010 and FINRA Rule 2010.

B. Unsuitable Non-Traditional ETF Transactions

The reasonable-basis suitability obligation under NASD Rule 2310 requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA has stated, "[w]ith respect to leveraged and inverse 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 ETF's use of leverage, and the customer's intended holding period will

have on their performance.”¹ Nonetheless, IDB, through its registered representatives, failed to perform an adequate reasonable basis suitability analysis of Non-Traditional ETFs to understand the risks and features associated with Non-Traditional ETFs before offering them for sale to retail customers. The Firm also failed to re-evaluate the suitability of these products throughout the Relevant Period, notwithstanding the risks of Non-Traditional ETFs such as the risks associated with a daily reset, leverage and compounding.

In addition, IDB’s representatives solicited and effected Non-Traditional ETF purchases that were unsuitable for specific customers. As noted, Non-Traditional ETFs are complex and speculative securities. However, certain IDB representatives recommended these products to customers with conservative investment objectives, some of whom were elderly. Moreover, some of these customers held Non-Traditional ETF positions for extended periods of time. For example:

- a 58-year-old conservative customer with a stated net worth of between \$100,000 and \$500,00 held a solicited Non-Traditional ETF position for 363 days, resulting in a loss of \$1,727.94.
- a 72-year-old conservative customer with a stated net worth of between \$100,000 and \$500,000 held a solicited Non-Traditional ETF position for 509 days, resulting in a loss of \$5,088.64.
- a 59-year-old conservative customer with a stated net worth of between \$100,000 and \$500,000 held eight solicited Non-Traditional ETF positions for an average of 34 days (and for up to 64 days), resulting in a net loss of \$6,937.78.

Based on the foregoing, IDB violated NASD Rule 2310 and FINRA 2010.

B. IDB consents to the imposition of the following sanctions:

- censure; and
- a fine of \$50,000.

IDB is also ordered to pay restitution in the amount of \$39,060.18 to the customers listed in Attachment A hereto, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from January 1, 2012, until the date this AWC is accepted by the NAC.

A registered principal of IDB shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall

¹ See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products- Heightened Supervision of Complex Product* (January 2012), at 5-6.

be submitted to David F. Newman, Senior Regional Counsel, FINRA Department of Enforcement, 1601 Market Street, Suite 2700, Philadelphia, PA, either by letter that identifies IDB and the case number or by email from a work-related account of the registered principal of IDB 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 IDB cannot locate any customers identified in Attachment A after reasonable and documented efforts within 120 days from the date of the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, IDB shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund in the state in which the customer is last known to have resided. IDB shall provide satisfactory proof of such 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.

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

IDB has specifically and voluntarily waived any right to claim an inability to pay at any time hereafter the monetary sanction imposed in this matter.

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

I.

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 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, Respondent specifically and voluntarily waives any right to claim bias or prejudice 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 the Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent'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. 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. Respondent understands that they 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 the Firm, 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; that the Firm 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 the Firm to submit it.

1st Discount Brokerage, Inc.

16/17/2016
Date (mm/dd/yyyy)

By: William H. Corley
William H. Corley
President

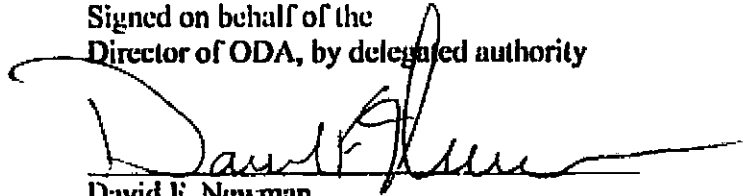
Reviewed by:

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Accepted by FINRA:

November 9, 2016
Date

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

A handwritten signature in black ink, appearing to read "David F. Newman", written over a horizontal line.

David F. Newman
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FINRA Department of Enforcement
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ATTACHMENT A
AWC NO. 2013038328301

CUSTOMER INITIALS	AMOUNT OF RESTITUTION
R.L.	\$1,105.91
S.M.	\$1,208.52
C.S.	\$2,951.05
J.S.	\$119.06
J.G-S.	\$6,752.15
W.C.	\$1,487.49
J.P.	\$2,940.77
A.T.	\$1,654.45
M.C.	\$205.30
J.K.	\$1,314.55
D.D.	\$1,727.94
H.K.	\$5,088.64
T.G.	\$6,937.78
S.M.	\$1,366.28
T.K.	\$1,180.05
G.J.	\$313.04
M.V.	\$265.17
A.B. FAMILY	\$2,442.03
TOTAL	\$39,060.18