

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2014039684601**

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

RE: Cadaret, Grant & Co., Inc., Respondent
CRD No. 10641

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, 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 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

Cadaret, Grant & Co., Inc. ("Cadaret" or the "Firm") is an independent broker-dealer headquartered in Syracuse, New York. The Firm provides brokerage and other services to customers through approximately 935 registered representatives located in approximately 503 branch offices. Approximately 776 of the Firm's registered representatives are also independent insurance agents who are permitted to sell insurance products not offered through the Firm.

RELEVANT DISCIPLINARY HISTORY

In December 2011, the Firm was censured, fined \$200,000, ordered to offer rescission to certain variable annuity ("VA") contract owners, and ordered to certify it had undertaken a comprehensive review of its policies and procedures concerning the suitability of VAs pursuant to an AWC. Among other things, the AWC found that from May 2006 to September 2008, the Firm recommended 19 unsuitable VA transactions, failed to supervise a registered representative's VA transactions, and failed to establish and maintain an adequate system to supervise purchases of VAs in violation of NASD Rules 2310, 2821, 3010, and 2110.

OVERVIEW

From January 2011 to December 2014, Cadaret failed to establish and maintain a supervisory system reasonably designed to supervise VA surrenders recommended or processed by the Firm's registered representatives where the surrenders were not part of an exchange or replacement done through the Firm in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.¹ Cadaret also failed to create and maintain books and records reflecting such VA surrenders in violation of NASD Rule 3110(a) and FINRA Rules 4511 and 2010.²

FACTS AND VIOLATIVE CONDUCT

Facts

Sales and Surrenders of VAs at Cadaret Generally

From January 2011 to December 2014 (the "relevant period"), Cadaret, through its registered representatives, offered VAs from approximately 130 insurance distributors for purchase by customers. Sales of VAs were a substantial portion of Cadaret's business, comprising more than 30% of the business generated by the Firm during the relevant period.

During the relevant period, Cadaret maintained policies and procedures related to the sale and supervision of new VA contracts, exchanges, and replacements. Those procedures required registered representatives to document each of these types of VA transactions and submit them to the Firm's home office for processing and principal review and approval. However, the Firm had no policies or procedures related to the review and approval of surrenders of VA contracts recommended or processed by its sales force unless the surrender was part of an exchange or replacement done through the Firm (hereinafter referred to as "Non-Exchange VA Surrenders").³ Rather, Cadaret's registered representatives were permitted to submit such VA surrender requests directly to the insurance companies for those policies. Cadaret did not require that Non-Exchange VA Surrenders be provided to or processed through the Firm.

¹ NASD Rule 3010 was superseded by FINRA Rule 3110 effective December 1, 2014. Accordingly, NASD Rule 3010 applies to Cadaret's conduct from January 2011 to November 30, 2014. FINRA Rule 3110 applies to conduct beginning on December 1, 2014.

² NASD Rule 3110(a) was superseded by FINRA Rule 4511 effective December 5, 2011. Accordingly, NASD Rule 3110(a) applies to Cadaret's conduct from January 2011 to December 4, 2011. FINRA Rule 4511 applies to conduct beginning on December 5, 2011.

³ Consistent with the Firm's policies and procedures, VA surrenders done in connection with an exchange or replacement through the Firm were reviewed by a principal as part of the overall transaction.

During the relevant period, the Firm also did not create and maintain records or documentation reflecting Non-Exchange VA Surrenders. When completing such surrenders, Cadaret representatives may have completed surrender request forms for submission to the relevant insurer, but the Firm did not require those forms be maintained by the representatives or provided to the Firm for record-keeping purposes.

During the relevant period, the Firm's registered representatives processed more than 500 Non-Exchange VA Surrender transactions for customers with aggregate contract values of approximately \$27 million. Those surrenders resulted in approximately \$1.5 million in aggregate surrender fees charged to the Firm's customers. None of the transactions were reviewed by a Firm principal for suitability or other potential sales practice concerns. Likewise, the Firm did not create or maintain records reflecting the vast majority of the Non-Exchange VA Surrenders.

Cadaret's Failure to Supervise VA Surrenders Resulted in Customer Harm

The potential consequences of Cadaret's failure to establish reasonable policies and procedures related to the review, approval, and documentation of Non-Exchange VA Surrenders are illustrated by the actions of BM, a former registered representative of the Firm.

In March 2011, CF, an elderly customer, acted upon BM's recommendation to surrender four VA contracts sold to her by Cadaret to invest in a charitable gift annuity ("CGA") offered by 54F, an entity with which BM was engaged in an undisclosed outside business relationship. At the time, CF's VA contracts were valued at approximately \$491,000 and represented nearly 60% of her total net worth. CF incurred \$36,242 in surrender fees when she surrendered her VAs, while 54F paid BM a commission of \$59,000 on her investment with 54F.⁴ BM did not disclose his commission to CF.

Before recommending the CGA investment to CF, BM failed to perform reasonable due diligence on 54F and the CGA. For approximately a year after CF's investment, 54F used some of her invested funds to finance its own operations. Over the course of the year, 54F also purchased three unauthorized indexed annuities totaling more than \$254,000 in CF's name – using forged signatures – and purportedly made \$200,000 in unauthorized charitable donations in CF's name. The charities that received the purported donations were all associated with either 54F, 54F employees or, in one case, another customer of BM.⁵

⁴ The surrenders also gave rise to significant tax consequences for CF.

⁵ While BM sold the 54F CGA rather than the individual component parts, his involvement in a transaction that included the sale of the three indexed annuities to CF also violated a Cadaret policy requiring indexed annuities to be sold through the Firm.

BM's recommendation to CF was unsuitable in light of his failure to perform adequate due diligence on 54F and the CGA. It was also unsuitable in light of CF's age, investment objectives, financial condition, the percent of her net worth the transaction represented, the large surrender fees she incurred, and the tax consequences of the transaction.

BM submitted the surrender requests for CF's VA policies directly to the insurers. Because Cadaret did not maintain procedures related to the review, approval, and documentation of Non-Exchange VA Surrenders, the Firm was unaware that CF had surrendered her VA contracts, incurring significant surrender fees in the process. The Firm likewise was unaware of CF's investment with 54F until she hired an attorney who complained to the Firm in August 2012. Had a Firm principal reviewed CF's surrender transactions, such a review might have led the Firm to discover the unsuitable nature of the recommendation, BM's failure to disclose his commission, and BM's undisclosed outside business relationship with 54F.

After receiving the complaint from CF's attorney in August 2012, the Firm conducted an internal investigation and terminated BM's registrations with the Firm in October 2012.

Through the efforts of her attorney, CF was able to recoup the portion of her 54F investment directed to unauthorized fixed annuity purchases made in her name. However, she has not been compensated for the \$200,000 in unauthorized charitable donations made in her name or the \$36,242 in surrender fees incurred when selling her VAs.

Violations

Cadaret Violated NASD Rule 3010 and FINRA Rule 3110

NASD Rule 3010 and FINRA Rule 3110 require each member to establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA Rules.

FINRA has previously issued guidance reminding member firms of their obligations to ensure VA surrender transactions are suitable. In 2002, FINRA issued a Regulatory and Compliance Alert which stated that the suitability rule "applies to any recommendation to sell a variable annuity regardless of the use of the proceeds, including situations where the member recommends using the proceeds to purchase an unregistered product such as an equity-indexed annuity." ("Reminder—Suitability of Variable Annuity Sales," *Regulatory & Compliance Alert* at 13 (Spring 2002).) In a 2005 Notice to Members addressing equity indexed annuities, FINRA reminded members about the suitability obligation as it

pertains to the surrender of VAs: “[A]ll recommendations to liquidate or surrender a registered security such as a mutual fund, variable annuity or variable life contract must be suitable.” (*Notice to Members 05-50* at 5 (August 2005).) In 2007, in addressing the supervision of recommendations after a registered representative changes firms, FINRA stated “Any recommendation to liquidate, replace or surrender a mutual fund or variable product must be suitable for the customer based upon the customer’s financial needs and investment objectives.” (*Notice to Members 07-06* at 4 (February 2007).) Also in 2007, in announcing the adoption of a new suitability rule for the purchase or exchange of deferred VAs, FINRA wrote that “FINRA’s general suitability rule (NASD Rule 2310) continues to apply to any recommendations to ... sell a deferred variable annuity.” (*Regulatory Notice 07-53* at 2 (Nov. 2007).) In December 2012, in addressing the “investment strategy” language in the new suitability rule, FINRA Rule 2111, FINRA reiterated that the rule applies to a recommendation “to liquidate securities to purchase an investment-related product that is not a security.” (*Regulatory Notice 12-55* at 4 (Dec. 2012) (emphasis added).)

During the relevant period, the Firm failed to establish and maintain a system reasonably designed to result in the supervision of VA surrenders recommended by the Firm’s registered representatives where the surrenders were not a part of an exchange or replacement processed through the Firm. In fact, the Firm was generally unaware when such surrenders took place. Nor did the Firm create or review records or reports reflecting, among other things, whether Non-Exchange VA Surrenders were solicited or unsolicited, whether such surrenders resulted in surrender charges, whether such surrenders gave rise to tax implications for the customers, whether such surrenders were used to fund the purchase of products or services not offered directly through the Firm, or any other information related to the suitability of such surrender transactions. Cadaret’s failure to identify Non-Exchange VA Surrenders precluded effective supervision over them. By failing to establish policies and procedures related to the review and approval of Non-Exchange VA Surrenders, the Firm violated NASD Rule 3010 and FINRA Rule 3110. By virtue of those violations, the Firm also violated FINRA Rule 2010.

Cadaret Violated NASD Rule 3110(a) and FINRA Rule 4511

NASD Rule 3110(a) and FINRA Rule 4511 require members to create and maintain accurate books and records that are required to be preserved under the Securities Exchange Act of 1934 and the applicable Exchange Act rules. Exchange Act Rule 17a-3(a) requires firms to make and keep current records (such as blotters), order memoranda, and confirmations reflecting all purchases and sales of securities. This includes variable annuity transactions. Since the surrender of a security is a sale, it must be recorded on the books and records of the member through which the transaction is generated.

During the relevant period, Cadaret did not create or maintain records reflecting Non-Exchange VA Surrenders.⁶ Accordingly, the Firm violated NASD Rule 3110(a) and FINRA 4511. By virtue of those violations, the Firm also violated FINRA Rule 2010.

OTHER FACTORS

On November 11, 2013, FINRA filed a formal complaint against BM in connection with BM's conduct described above. A disciplinary hearing was held in June 2014, at which multiple Firm employees testified as witnesses. FINRA acknowledges that Respondent provided substantial assistance to the Department of Enforcement in connection with the hearing by, among other things, voluntarily making several Firm employees available for multiple interviews and preparation sessions in advance of the hearing. The sanctions below reflect the credit that the Respondent has been given for the voluntary and substantial assistance beyond that required by FINRA Rule 8210 provided to FINRA in connection with the hearing.

- B. Respondent also consents to the imposition of the following sanctions:
1. Censure;
 2. A fine of \$75,000;
 3. Restitution is ordered to be paid to customer CF in the total amount of \$236,242, 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 March 9, 2011 until the date this AWC is accepted by the NAC; and
 4. To comply with the following undertaking: Cadaret shall conduct a comprehensive review of the adequacy of its policies, systems, and procedures (written or otherwise), with respect to: (i) the supervision of Non-Exchange VA Surrenders; and (ii) the creation and maintenance of books and records regarding the Non-Exchange VA Surrenders. Within 120 days of the issuance of a Notice of Acceptance of this AWC, an officer of the Firm shall certify in writing to Daniel Gardner of FINRA's Department of Enforcement that (i) the Firm has engaged in the comprehensive review described above; and (ii) as of the date of the certification, the Firm has in place a system and policies and procedures to address and correct the violations described in this AWC. The certification shall be accompanied by a description of the review undertaken pursuant to this undertaking. In addition, at the time the certification is provided, Cadaret will provide the Department of Enforcement with a copy of

⁶ As described above, registered representatives may have completed surrender request forms for submission to the insurers, but the Firm did not require those forms to be maintained or stored in a readily accessible location.

its policies and procedures relating to the supervision of, and record keeping for, the Non-Exchange VA Surrenders. The Department of Enforcement may, upon a showing of good cause and its sole discretion, extend the time for compliance with this provision.

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

A registered principal on behalf of Respondent Firm shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Daniel Gardner, FINRA Enforcement, 15200 Omega Drive, 3rd Floor, Rockville, MD 20850 either by letter that identifies the Respondent and the case number or by e-mail from a work-related account of the registered principal of Respondent Firm 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 Respondent cannot locate customer CF 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, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Respondent 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 and interest 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.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time hereafter, the monetary sanction(s) 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 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 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 it; 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 it;

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. Respondent 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.

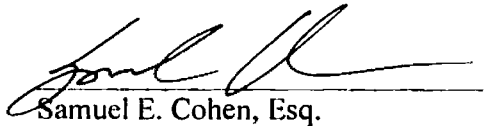
The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, 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.

06/12/2015
Date (mm/dd/yyyy)


Cadaret, Grant & Co., Inc.

By: Bl Johnson, SRP -
[Print Name and Title]

Reviewed by:

A handwritten signature in black ink, appearing to read "Samuel E. Cohen", is written over a horizontal line.

Samuel E. Cohen, Esq.

Counsel for Respondent

Marshall Dennehey Warner Coleman & Goggin

2000 Market Street, Suite 2300

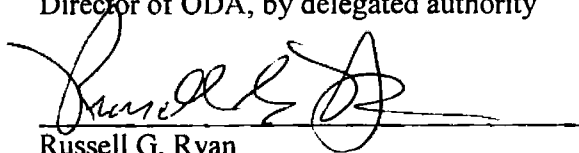
Philadelphia, PA 19103

(215) 575-2587

Accepted by FINRA:

5/28/2015
Date

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

A handwritten signature in black ink, appearing to read "Russell G. Ryan", is written over a horizontal line.

Russell G. Ryan
Sr. Vice President & Chief Counsel
FINRA Department of Enforcement
15200 Omega Dr., 3rd Floor
Rockville, MD 20850
(301) 258-8551