

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2015048347902**

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

RE: Capital City Securities, LLC, Respondent
Member Firm
CRD No. 146001

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Capital City Securities, LLC 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 the 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

Capital City Securities, LLC ("Capital City" or "the firm") has been a FINRA member since May 2008. Capital City has approximately 4 branch offices and 16 registered representatives, and it is headquartered in Powell, OH.

Respondent does not have any relevant disciplinary history with the Securities and Exchange Commission, any state securities regulators, FINRA, or any other self-regulatory organization.

OVERVIEW

Between August 2015 and June 2016 (the “Relevant Trading Period”), Capital City failed to establish and maintain a supervisory system, and failed to establish, maintain and enforce written supervisory procedures, that were reasonably designed to achieve compliance with FINRA’s suitability rules. Specifically, the firm used a third-party automated trade surveillance application to supervise and review registered representative trading recommendations and strategies yet did not re-configure, modify, or alter that surveillance tool to monitor unique trading strategies like that of registered representative CK. Second, with respect to CK, the firm bifurcated responsibility for supervising his equity and options recommendations by product, even where those recommendations impacted the same customer account as part of a singular, active trading strategy. As a result, individual supervisors were unable to identify patterns and evaluate the trading strategy employed by CK, who effected quantitatively unsuitable transactions in five customer accounts over which he had discretionary trading authority. CK’s trading in these customer accounts generated cost-to-equity ratios and turnover rates ranging from 19.7% to 31.7% and 8.2 to 12.7, respectively. Through this conduct, Capital City violated FINRA Rules 3110 and 2010.

In addition, between July 30, 2015 and August 10, 2015, Capital City failed to conduct a reasonable due diligence review of a private placement by registered representative JM, in violation of FINRA Rules 3110 and 2010.

Finally, between July 22, 2015 and August 24, 2016, Capital City failed to preserve and maintain certain books and records required by Section 17(a) of the Securities Exchange Act of 1934 (“the Exchange Act”) and Rule 17a-4 promulgated thereunder (“SEA Rule 17a-4”). Specifically, Capital City failed to preserve and maintain over 200 of JM’s business-related electronic communications conducted through his personal email address. As a result, the firm violated Section 17(a) of the Exchange Act, Rule 17a-4 thereunder, and FINRA Rules 4511 and 2010.

FACTS AND VIOLATIVE CONDUCT

1. **Capital City Failed to Establish and Maintain a Supervisory System, and Failed to Establish, Maintain, and Enforce Written Supervisory Procedures, that were Reasonably Designed to Achieve Compliance with FINRA’s Suitability Rules.**

A. FINRA’s Rules

FINRA Rule 3110 requires member firms to establish and maintain a supervisory system, and to establish, maintain, and enforce written supervisory procedures, that are reasonably designed to supervise the activities of each registered representative, registered principal, and other associated person of the firm, and to achieve compliance with applicable securities laws and regulations and all applicable FINRA Rules. These rules include FINRA Rule 2111, FINRA’s suitability rule.

A violation of FINRA Rule 3110 also constitutes a violation of FINRA Rule 2010, which requires that member firms “observe high standards of commercial honor and just and equitable principles of trade.”

FINRA Rule 2111, FINRA’s suitability rule, imposes a “quantitative suitability” obligation that focuses on whether the number of transactions within a given timeframe is suitable in light of the customer’s financial circumstances and investment objectives. Excessive trading occurs, and is unsuitable, when a registered representative, while exercising control over a customer’s account, recommends a level of trading activity that is inconsistent with the customer’s investment needs and objectives. A broker with control over a customer’s account must have a reasonable basis for believing that a series of transactions he or she recommends is not excessive and unsuitable for the customer, even if the individual transactions are suitable when viewed in isolation. Supplementary Material .05(c) to FINRA Rule 2111 states that, “[n]o single test defines excessive activity, but factors such as the turnover rate, cost-equity ratio, and the use of in-and-out trading in a customer’s account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.”¹

B. Capital City’s Supervisory System

During the Relevant Trading Period, Capital City’s written supervisory procedures generally required oversight of the trades and recommendations made by its registered representatives. According to these procedures, the firm’s Chief Compliance Officer was responsible for reviewing equity trades, while the firm’s Registered Options Principal was responsible for reviewing options transactions. The firm’s written supervisory procedures did not address or create exceptions for the review of accounts that traded both equities and options, including those that were placed as part of a unified investment strategy. While the firm’s general procedures applied to all trades executed by its registered representatives, the firm also required a separate and heightened review of transactions in accounts over which representatives had discretionary trading authority: individual supervisors were required to conduct a quarterly review of discretionary accounts, with a specific focus on detecting excessive trading.

To supplement its written supervisory procedures, the firm’s supervisory system incorporated an automated trade surveillance application to review all trading through the firm. This application generated a series of escalating alerts for trades placed through the firm. These alerts occurred consistent with the applications’ default algorithms and parameters for trading surveillance, which assigned a numerical value and a color-coded “flag” (green, yellow, or red) to individual trades. In relying on the default settings, Capital City did not configure or modify the application to account for the specific scope of the firm’s business or the trading employed by its representatives, nor did it provide

¹ Turnover rate represents the number of times that a portfolio of securities is exchanged for another portfolio of securities. The cost-to-equity ratio measures the amount an account has to appreciate just to cover commissions and other expenses. In other words, it is the break-even point where a customer may begin to see a return. A turnover rate of six or a cost-to-equity ratio above 20 percent generally indicates that excessive trading has occurred.

any guidance to supervisors regarding how to interpret those alerts or conduct an inquiry when they occurred. Failing to tailor the firm's surveillance system, a key aspect of its supervisory system, to its business model rendered the firm's system for supervising for suitability unreasonable. A practical example of the impact follows.

C. Representative CK's Trading and Trading Strategy

CK² employed unique investment recommendations and trading strategies at Capital City, which were different from other registered representatives at the firm. CK employed an active trading strategy involving short-term, in-and-out trading of both equities and options. CK utilized this strategy in multiple customer accounts over which he had written authority from the customers for discretionary trading and active trading, which had been reviewed and approved by the firm. CK alone determined which specific securities to buy and sell, when to buy and sell them, and in what quantity to do so.

The frequency of the equity trades CK placed pursuant to his strategy, when combined with the frequency, size and nature of the options transactions he also placed, resulted in trading costs and fees over the Relevant Trading Period that were quantitatively unsuitable for his customers, and which made it nearly impossible for them to generate trading profits. For example:

- Between September 2015 and May 2016, CK effected 522 trades in JN's account, which had an average monthly account balance of approximately \$128,510.83. JN's account exhibited a turnover rate of 11.9 and a cost-to-equity ratio of 19.96%. JN's account incurred \$25,654.15 in trading costs. JN was a senior customer who had retired in 2012; JN's account with CK represented the entire value of JN's pension and 401k savings.
- Between September 2015 and March 2016, CK effected 272 trades in TO's account, which had an average monthly account balance of approximately \$22,714.38. TO's account exhibited a turnover rate of 12.7 and a cost-to-equity ratio of 31.68%. TO's account incurred \$7,194.86 in trading costs. TO was a senior customer; TO's account with CK represented the entirety of TO's individual savings.
- Between October 2015 and June 2016, CK effected 545 trades in CL's account, which had an average monthly account balance of approximately \$135,120.81. CL's account exhibited a turnover rate of 12.1 and a cost-to-equity ratio of 19.70%. CL's account incurred \$26,615.14 in trading costs.
- Between August 2015 and April 2016, CK effected 280 trades in SF's first account, which had an average monthly account balance of approximately \$24,621.26. SF's first account exhibited a turnover rate of 9.4 and a cost-to-equity ratio of 26.59%. SF's first account incurred \$6,547.07 in trading costs.

² CK entered into Acceptance, Waiver, and Consent No. 2015048347901 (Nov. 2019), in which CK was barred from associating with any FINRA member in any capacity for violating FINRA Rules 8210 and 2010.

- Between August 2015 and April 2016, CK effected 223 trades in SF's second account, which had an average monthly account balance of approximately \$8,590.34. SF's second account exhibited a turnover rate of 8.2 and a cost-to-equity ratio of 31.42%. SF's second account incurred \$2,699.47 in trading costs.

D. Capital City's Failure to Supervise CK

During the Relevant Trading Period, Capital City failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with FINRA's suitability rules with respect to CK, his trading and his active trading strategy. Specifically, the firm's system was not designed to identify and supervise frequent and costly in-and-out trading of both equities and options, which was CK's preferred investment strategy.

Although Capital City's supervisory system required a quarterly review of discretionary accounts to specifically focus on detecting and preventing excessive trading, the firm failed to provide any guidance to supervisory staff regarding how to conduct such a review. Moreover, the firm's system did not provide any supervisory tools designed to alert for excessive trading, commissions or cost over any period beyond a single day on a per-trade basis, and there was no reasonable method for firm supervisors to aggregate commissions and costs over time.

In addition, the firm's supervisory system was not reasonably designed for individual supervisors to review a trading strategy that utilized frequent in and out trading of both equities and options in a single account, a strategy utilized by CK in multiple accounts over an extended period of time. The firm's system bifurcated responsibility for trade reviews between supervisors based on transaction type, such that one supervisor reviewed equity trades and another reviewed options trades. This system did not account for investment strategies encompassing different product types or the overall trading in a single account, further inhibiting supervisors from conducting a meaningful review for patterns of trading that could result in excessive trading such as in CK's accounts.

Although the firm utilized an automated supervisory application to review transactions generally, the firm did not configure, modify or implement that application so that it could be used to detect patterns of excessive trading and quantitative unsuitability over time. That application created alerts for, among other indicators of risk, excessive commissions on a per-trade basis, but it did not aggregate or allow for the aggregation of commissions and/or overall trading costs beyond a limited trading period. Similarly, the application's default parameters for trading surveillance, which assigned a numerical value and a color-coded "flag" (green, yellow, or red) to individual trades, were likewise not configured to assess the long-term costs of a trading strategy used in an account over an extended period of time. Finally, the firm's supervisory application generated a very high volume of alerts for trades placed in actively traded accounts, which minimized their import, especially where, as here, the firm failed to provide guidance on how to interpret those alerts or require supervisory inquiry once those alerts were received.

As a direct result of the unreasonable supervisory system described above, Capital City failed to reasonably review and supervise the patterns and trends that would have identified CK's excessive trading in the accounts of JN, TO, CL, and SF, during the Relevant Trading Period. By virtue of the foregoing, Capital City violated FINRA Rules 3110 and 2010 from August 2015 to June 2016.

2. Capital City's Failure to Document and Supervise Reasonable Due Diligence in a Private Placement

With respect to private placements, FINRA Regulatory Notice 10-22 ("Reg. Notice 10-22") reminds firms of their obligations to conduct a reasonable investigation of the issuers and the securities they recommend.³ Reg. Notice 10-22 further reminds firms that they must have supervisory procedures under NASD Rule 3010⁴ that are reasonably designed to ensure, among other things, that the firm's personnel engage in an inquiry of a private placement that is sufficiently rigorous, that the firm's personnel perform a suitability analysis for customers under NASD Rule 2310,⁵ and that each private placement is properly supervised. In order to demonstrate that the firm has performed this reasonable investigation, a firm should retain records documenting both the process and results of the investigation. Such records, "may include descriptions of the meetings that were conducted in the course of the investigation, including meetings with the issuer or other parties, the tasks performed, the documents and other information reviewed, the results of such reviews, the date such events occurred, and the individuals who attended the meetings or conducted the reviews."

Capital City's written supervisory procedures obligated the firm to maintain due diligence documentation files on each private placement offered by the firm and outlined types of documentation to be included in the files. Capital City's procedures also obligated the firm to maintain documents demonstrating the basis upon which the determination of suitability was reached as to each customer.

Between July 30, 2015 and August 10, 2015, Capital City registered representative JM recommended and sold a Regulation D offering to a qualified institutional buyer. The Regulation D offering was a single transaction for \$10,000,000 of preferred stock shares of a publicly listed company to the qualified institutional buyer in a stock purchase agreement (SPA).

Capital City's due diligence file for this Regulation D offering contained only an email with a hyperlink to public EDGAR filings and the SPA, which contained the terms of the transaction itself. Capital City failed to document any process or results of a reasonable investigation into the issuer of the preferred stock shares, meetings, tasks performed, and

³ FINRA Regulatory Notice 10-22, *Regulation D Offerings, Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings* (April 2010).

⁴ FINRA Rule 3110 replaced NASD Rule 3010 effective December 1, 2014.

⁵ FINRA Rule 2111 replaced NASD Rule 2310 effective July 9, 2012.

documents and information reviewed as described by Reg. Notice 10-22 and required by the firm's written procedures.

As a result of Capital City's failure to document that it conducted reasonable due diligence of the subject Regulation D offering and thereby reasonably supervised the private placement, Capital City violated FINRA Rules 3110 and 2010.

3. Capital City's Failure to Maintain and Preserve Electronic Communications

FINRA Rule 4511 requires FINRA regulated broker-dealers to "make and preserve books and records as required under the FINRA rules, the Exchange Act and the applicable Exchange Act rules." Specifically, pursuant to Section 17(a) of the Exchange Act and SEA Rule 17a-4 thereunder, a FINRA member firm is required to, "preserve for a period of not less than three years, the first two years in an easily accessible place...[o]riginals of all communications received and copies of all communications sent by the member...(including inter-office memoranda and communications) relating to their business as such." Accordingly, FINRA member firms are required to maintain records of business-related electronic communications, including emails with customers or potential customers, and such records are required to be accurate.

A violation of Section 17(a) of the Exchange Act, SEA Rule 17a-4 thereunder, and FINRA Rule 4511 is also a violation of FINRA Rule 2010, which requires associated persons to observe high standards of commercial honor and just and equitable principles of trade.

JM was a registered representative of Capital City from July 22, 2015 to August 24, 2016. Although Capital City provided all employees with email accounts that were reviewed and retained by the firm, Capital City did not provide JM with a firm email account until August 3, 2015. Despite receiving a firm email account on August 3, 2015 and being advised by the firm at that time that he was required to use his firm-approved email address for all firm business, JM used his personal email account for over 200 business-related communications from July 22, 2015 until the time he left Capital City on August 24, 2016.⁶ During this period, JM used his personal email account to conduct securities business, including correspondence with potential securities customers and with potential issuers of private placement offerings. These communications included emails pertaining to sales literature, prospectuses, term sheets, and stock purchase agreements, as well as negotiations of sales terms and fees.

The firm was aware that JM was using a personal email account for business-related communications during this period, as JM forwarded certain messages from his personal email account to Capital City principals, even after August 3, 2015. Notwithstanding the firm's knowledge that JM was using his personal email to conduct business-related communications, Capital City failed to take steps to preserve those communications as

⁶ JM entered into Acceptance, Waiver, and Consent No. 2016048223001 (Feb. 2019), in which JM was fined \$5,000 and suspended in all capacities for 20 business days for violating FINRA Rules 4511 and 2010.

required by its own written supervisory procedures, Section 17(a) of the Exchange Act and SEA Rule 17a-4 thereunder.

By virtue of the foregoing, from July 22, 2015 to August 24, 2016, Capital City violated Section 17(a) of the Exchange Act, Rule 17a-4 thereunder, and FINRA Rules 4511 and 2010.

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

1. a censure, and
2. an order to pay restitution in the amount of \$53,174.51.

Respondent has submitted a sworn financial statement and demonstrated a limited ability to pay. In light of the financial status of Respondent, the sanctions do not include a monetary fine or pre-judgment interest on the restitution amount.

Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of \$53,174.51.

A registered principal on behalf of Respondent Capital City shall submit satisfactory proof of payment of restitution (separately specifying the date and amount paid to each customer listed on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent Capital City. The email must identify the Respondent and the case number and include a copy of the check, money order or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 days after acceptance of the AWC.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC, 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 below and in the manner described above, within 14 days of forwarding the undistributed restitution and interest to the appropriate state authority.

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

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.

Restitution payments to customers shall be preceded or accompanied by a letter, not unacceptable to FINRA staff, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

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

than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce it to submit this AWC.

Capital City Securities, LLC
Respondent

9/21/20
Date

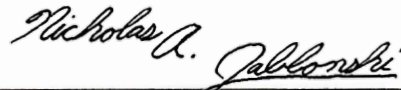
By: 

Todd E. Crawford
Chief Executive Officer

Accepted by FINRA:

9/23/2020
Date

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



Nicholas A. Jablonski, Esq.
Principal Counsel
FINRA Department of Enforcement
55 West Monroe Street, Suite 2700
Chicago, Illinois 60603-5052
(312) 230-5097 (Phone)

Attachment A

Customer

Restitution

Customer	Restitution
JN	\$23,261.97
TO	\$5,845.49
CL	\$24,067.05
TOTAL	\$53,174.51

Customer SF has previously reached an independent settlement with Capital City and CK; accordingly, no restitution is being ordered in this AWC for SF.