

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2016048196801**

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

RE: Kalos Capital, Inc., Respondent
FINRA Member Firm
BD No. 44337

Darren Michael Kubiak, Respondent
General Securities Representative
CRD No. 1239086

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondents Kalos Capital, Inc. ("Kalos" or "the Firm") and Darren Michael Kubiak ("Kubiak") submit 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 Kalos or Kubiak alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Kalos and Kubiak 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

Kalos has been a FINRA member firm since 1998. Kalos is located in Alpharetta, Georgia and has approximately 157 registered persons and approximately 67 branch offices. Kalos is a retail brokerage firm and operates on an independent contractor model.

Kubiak entered the securities industry in 1983, when he became associated with a FINRA member firm. Kubiak became registered as an investment company and variable contracts products representative in February 1984, as an investment company and variable contracts products principal in July 1984, and as a general securities representative in March 2008. Kubiak has been associated with Kalos since January 2007, and is subject to FINRA's jurisdiction.

RELEVANT DISCIPLINARY HISTORY

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

OVERVIEW

Between August 2011 and January 2015, Kubiak recommended the purchase of Leveraged and Inverse Exchange Traded Funds (LIETFs) to 17 customers without having a sufficient understanding

of the risks and features associated with the LIETFs and thereby failing to have a reasonable basis to make these recommendations. Kubiak recommended these customers purchase a total of 19 LIETFs, which the customers then held for an average of 722 days. Accordingly, between August 2011 and January 2015, Kubiak violated NASD Rule 2310 (for conduct prior to July 9, 2012) and FINRA Rules 2111 (for conduct on or after July 9, 2012) and 2010.

From August 2011 until April 2015, Kalos failed to establish, maintain and enforce a supervisory system, including written supervisory procedures (WSPs), reasonably designed to ensure compliance with NASD Rule 2310 and FINRA Rule 2111¹ in relation to the sale of LIETFs by its registered representatives. Additionally, Kalos failed to reasonably supervise Kubiak, the Firm's sole registered representative who sold LIETFs to customers, by failing to ensure that Kubiak had a reasonable basis to recommend LIETFs. As a result, between August 2011 and April 2015, Kalos violated NASD Rules 3010(a) and 3010(b) (for conduct prior to December 1, 2014) and FINRA Rules 3110(a), 3110(b) (for conduct on or after December 1, 2014) and 2010.

FACTS AND VIOLATIVE CONDUCT

The reasonable-basis suitability obligation under FINRA Rule 2111 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. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the member's or associated person's familiarity with the security or investment strategy. A member's or associated person's reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.²

Under FINRA Rule 2111, to make a suitable recommendation, representatives must first have an understanding of the potential risks and rewards inherent in that recommendation. Thus, a representative may violate the suitability rule if he or she has no reasonable basis to make the recommendation to any customer, regardless of the investor's wealth, willingness to bear risk, age, or other individual characteristics.

FINRA Rule 3110(a)³ provides that "[e]ach member shall 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 Rule 3110(b)(1) requires that "[e]ach member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules."

FINRA Rule 2010 requires that member firms and associated persons "observe high standards of commercial honor and just and equitable principles of trade." A violation of NASD Rules 2310 or 3010 or FINRA Rules 2111 or 3110 also constitutes a violation of FINRA Rule 2010.

¹ FINRA Rule 2111 superseded NASD Rule 2310 on July 9, 2012.

² FINRA Rule 2111.05(a) (Supplementary Material to Rule 2111).

³ FINRA Rule 3110 superseded NASD Rule 3010 on December 1, 2014.

Leveraged and Inverse ETFs

LIETFs are considered non-traditional ETFs because they seek to deliver returns that are multiples of the performance of the index or benchmark they track. Some non-traditional ETFs are “inverse” or “short” funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, LIETFs use swaps, futures contracts and other derivative instruments. Non-traditional ETFs are highly complex financial instruments that typically “reset” daily, meaning they are designed to achieve their stated objectives only on a daily basis. Due to the effects of compounding, their performance over longer periods can differ significantly from their stated daily objective. Therefore, non-traditional ETFs that reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session.

With respect to non-traditional ETFs, it is particularly important that registered representatives “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.”⁴

FINRA Regulatory Notice 09-31 also cautioned member firms about the need to establish a reasonable supervisory system “to ensure that their associated persons comply with all applicable FINRA and SEC rules when recommending any product, including leveraged and inverse ETFs,” and to implement written supervisory procedures that, among other things, require that associated persons perform appropriate customer-specific suitability reviews. The Notice provided specific guidance regarding the risks and suitability concerns associated with non-traditional ETFs, and the need for a supervisory system to address those issues.

Kubiak Failed to Perform Reasonable Due Diligence

Between August 2011 and January 2015, Kubiak recommended 19 LIETF purchases in 17 customer accounts. All of these transactions were solicited. The customers held these positions for periods ranging from 294 days to, in one case, almost six years. The average holding period was 722 days. These extended holding periods caused Kubiak’s customers to incur approximately \$98,000 in losses.

Kubiak failed to perform a reasonable basis suitability analysis of LIETFs to understand the unique features and specific risks associated with these products before offering the products to his customers. Specifically, he planned for the customers to hold the LIETF shares for a few weeks, even though that was contrary to the published guidance of these products. Moreover, Kubiak did not understand that LIETFs are generally expected to lose value over time and that losses are compounded because of how the LIETFs’ valuations are reset each day.

By virtue of the foregoing, Kubiak violated NASD Rule 2310 (for conduct prior to July 9, 2012) and FINRA Rules 2111 (for conduct on or after July 9, 2012) and 2010.

⁴ FINRA Regulatory Notice 09-31, *FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds*.

Kalos Failed to Establish and Maintain a Reasonably Designed Supervisory System and WSPs Regarding LIETFs

As described in FINRA Regulatory Notice 09-31, LIETFs typically are not suitable for retail investors who plan to hold them for more than one trading session. Regulatory Notice 09-31 reminds firms that, if they allow the sale of LIETFs, they must ensure that an appropriate reasonable basis suitability analysis occurs and train registered persons about the terms, features and risks of the product. Recommendations to customers must be based on a full understanding of the terms and features of ETFs, and firms must have adequate WSPs in place to ensure that these obligations are met.

FINRA Regulatory Notice 12-03 also emphasized the need for firms to conduct reasonable basis suitability analysis and training of registered persons when selling complex products such as LIETFs, and stated that firms "should consider developing procedures to monitor how the products performed after the firm approved them."⁵

From August 2011 until April 2015, Kalos failed to establish and maintain a supervisory system or WSPs reasonably designed to ensure that sales of LIETFs complied with applicable securities laws and regulations and NASD and FINRA rules. Kalos did not have WSPs reasonably tailored to address the unique features and risks associated with LIETFs. Instead, Kalos's WSPs described the general characteristics of LIETFs but did not specifically address suitability, supervision, or training related to the sale of LIETFs. Additionally, Kalos did not provide formal training to representatives before permitting them to sell the product to retail customers. Kalos also did not have procedures to monitor LIETFs for potentially unsuitable holding periods. As a result, Kalos did not sufficiently train Kubiak on the unique features and specific risks associated with LIETFs before he sold the product to customers. This caused Kubiak's customers to hold these products for unsuitably long periods. In April 2015, Kalos ended the sale of LIETFs by its registered representatives.

By virtue of the foregoing, Kalos violated NASD Conduct Rules 3010(a) and 3010(b) (for conduct prior to December 1, 2014) and FINRA Rules 3110(a), 3110(b) (for conduct on or after December 1, 2014) and 2010.

B. Respondents also consent to the imposition of the following sanctions.

For Kalos:

- a censure;
- a \$30,000 fine; and
- restitution in the amount of \$86,614 plus interest, as described below.

For Kubiak:

- a \$5,000 fine; and
- a three-month suspension from associating with any FINRA member firm in all capacities.

Respondents agree to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Respondents have submitted Election of Payment forms showing the methods by which they propose to pay the fine imposed.

⁵ FINRA Regulatory Notice 12-03, *Heightened Supervision of Complex Products*.

Respondents specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Kubiak understands that if he is barred or suspended from associating with any FINRA member, he becomes subject to a statutory disqualification as that term is defined in Article III, Section 4 of FINRA's By-Laws, incorporating Section 3(a)(39) of the Securities Exchange Act of 1934. Accordingly, he may not be associated with any FINRA member in any capacity, including clerical or ministerial functions, during the period of the bar or suspension (see FINRA Rules 8310 and 8311).

Kalos is ordered to pay restitution to the customers listed on **Attachment A** hereto in the total amount of \$86,614, 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 April 28, 2015 until the date this AWC is accepted by the NAC.

A registered principal on behalf of Kalos shall submit satisfactory proof of payment of restitution and pre-judgment interest (separately specifying the date and amount of each paid to each customer listed on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Kalos. 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 to the email address listed above no later than 120 days after acceptance of the AWC.

If for any reason Kalos cannot locate any customers 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, Kalos 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. Kalos 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.

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

Respondents specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against them;
- 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, Respondents specifically and voluntarily waive 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.

Respondents further specifically and voluntarily waive 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

Respondents understand 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 Respondents; and
- C. If accepted:
 - 1. This AWC will become part of Respondents' permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against them;
 - 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. Respondents 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. Respondents 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 Respondents': (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. Respondents may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondents understand 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 Kalos 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 Kalos to submit it.

Kalos Capital, Inc.

4 September 2019
Date

By: [Signature]

Respondent certifies that he has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; Respondent has agreed to the AWC's provisions voluntarily; and 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 him to submit this AWC.

9/5/2019
Date

[Signature]
Darren Michael Kubiak, Respondent

Reviewed by:

[Signature]
Alan M. Wolper
Counsel for Respondent
Ulmer & Berne, LLP
500 West Madison Street, Suite 3600
Chicago, Illinois 60661-4587
Phone: (312) 658-6564
E-Mail: awolper@ulmer.com

Accepted by FINRA:

9/6/2019
Date

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



Tino Lisella, Esq., Director
FINRA - Department of Enforcement
5200 Town Center Circle
Tower 1, Suite 200
Boca Raton, Florida 33486

Attachment A

Account No.	Restitution Amount
XXX-XX3786	\$9,171
XXX-XX4588	\$27,214
XXX-XX4634	\$2,895
XXX-XX6076	\$4,286
XXX-XX8589	\$6,638
XXX-XX4686	\$1,604
XXX-XX1342	\$1,784
XXX-XX1347	\$1,779
XXX-XX1354	\$1,762
XXX-XX1902	\$24,829
XXX-XX4053	\$1,197
XXX-XX4054	\$3,455