

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2017052543601**

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

RE: Cambridge Investment Research, Inc., Respondent
Member Firm
CRD No. 39543

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Cambridge Investment Research, Inc. ("Cambridge" 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 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

Cambridge, which became a FINRA member firm in 1995, is a full-service broker-dealer. The Firm, which operates on an independent contractor model, is headquartered in Fairfield, Iowa. Cambridge has approximately 4,200 registered representatives and 2,400 branch offices throughout the United States.

RELEVANT DISCIPLINARY HISTORY

On April 6, 2015, Cambridge entered into an AWC with FINRA in which it agreed to a censure and fine of \$250,000. The AWC charged the Firm with failing to apply "rollover" and exchange discounts to customers with eligible unit investment trust ("UIT") purchases, between January 4, 2008 and November 29, 2013, in violation of NASD Rules 3010, 2110 and FINRA Rule 2010.

OVERVIEW

At various times between July 2013 and January 2017, Cambridge failed to establish and maintain a supervisory system that was reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules, in three principal areas of the Firm's business:

- Between July 1, 2013 and December 31, 2014, the Firm failed to reasonably supervise short-term trading of UITs and mutual fund Class A Shares;
- Between February 1, 2014 and September 21, 2014, the Firm failed to reasonably supervise compliance with NASD Rule 2440 (for conduct before May 9, 2014) and FINRA Rule 2121 (Fair Prices and Commissions), which resulted in the Firm charging excess commissions on approximately 30 transactions; and,
- Between February 1, 2016 and January 31, 2017, the Firm failed to reasonably ensure that customers received available mutual fund breakpoint discounts.

Through this conduct, the Firm violated NASD Rule 3010 (for conduct before December 1, 2014), and FINRA Rules 3110 and 2010.

FACTS AND VIOLATIVE CONDUCT

FINRA Rule 3110 requires broker-dealers to establish and maintain a supervisory system, and to establish, maintain, and enforce written supervisory procedures that are reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD and FINRA Rules. NASD Rule 3010 imposed similar requirements before December 1, 2014.

Cambridge Failed to Reasonably Supervise Short-Term Trading of UITs and Mutual Fund Class A Shares.

Cambridge's system for supervising short-term trading in mutual fund Class A shares and UITs between July 1, 2013 and December 31, 2014, was not reasonably designed to achieve compliance with FINRA's suitability rule.

Mutual funds are composed of several classes of shares. Class A shares usually include an initial or "front-end" sales charge levied upon the purchase of shares, as well as annual, ongoing distribution and service fees that are typically 0.25 percent. The majority of the front-end charge is paid to the selling broker-dealer as a concession.² Class A mutual fund shares are intended to be held long-term because there are significant up-

² Class B and C shares typically do not carry a front-end sales charge but have significantly higher distribution and service fees (typically 1.00 percent) and may be subject to a contingent deferred sales charge ("CDSC").

front costs associated with the purchase of these products. A recommendation that an investor engage in short-term trading in Class A shares is potentially unsuitable because of these significant up-front costs.

Similarly, a UIT is an SEC-registered investment company that offers shares or “units” in a portfolio of securities in a public offering. Generally, a UIT’s portfolio is not actively traded. A UIT terminates on a specified maturity date, often after 15 or 24 months, at which point the underlying securities are sold and the resulting proceeds are paid to investors. During the relevant period between 2013 and 2014, a typical 24-month UIT imposed an initial sales charge of 1%, a deferred sales charge of 2.5%, and a creation and development fee of 0.5%. The latter two charges are typically assessed between the third and sixth month of the UIT’s duration. A registered representative who recommends the sale of a customer’s UIT position before the maturity date and rolls that investment into a new UIT causes the customer to incur increased sales charges. Because of the long-term nature of UITs, their structure, and up-front costs, short-term trading of UITs may be improper and raises suitability concerns.

Cambridge relied on an automated trade surveillance system as part of its system for identifying potentially unsuitable short-term trading or switch transactions in long-term products, including mutual fund Class A shares and UITs. This system generated alerts that required principal review of certain potential mutual fund and UIT switch transactions (the “Alert”). However, the Firm failed to provide sufficient guidance for principals to follow when an Alert was generated. As a result, the Firm’s principals were inconsistent in following up on the Alerts, such as by contacting customers to inquire about the reasons for the transactions to ensure that the customers understood the consequences of such transactions. Indeed, although the surveillance system generated 11,910 Alerts between July 1, 2013 and December 31, 2014, the Firm’s principals ultimately did not reject any of the transactions. The lack of sufficient guidance to Firm principals allowed at least one of the Firm’s representatives to engage in unsuitable short-term trading in mutual fund Class A shares.³

Moreover, the Firm’s system was unreasonable because it configured the Alert only to identify switch transactions and did not have any other electronic system to monitor for other potentially unsuitable short-term trading in mutual fund Class A shares and UITs that did not qualify as a switch transaction. Accordingly, potentially unsuitable short-term trades in UITs and mutual fund Class A shares not followed by a subsequent purchase of the same type of product did not receive reasonable supervisory review by the Firm’s principals between July 1, 2013 and December 31, 2014.

³ Specifically, a former Cambridge representative entered into an AWC with FINRA in March 2016 (AWC No. 2014040668202), in which he agreed to a suspension of fifteen business days and a \$5,000 deferred fine for recommending and executing fourteen sets of unsuitable mutual fund switches in three customer accounts between January 2011 and December 2013. That representative’s supervisor agreed to an offer of settlement (Offer No. 2014040668201) finding, among other things, that, during the period May 2012 through September 2013, he had “failed to take reasonable steps to adequately review and follow up on the flagged [short-term trades in mutual fund class A shares] prior to approving them.”

Second, the Firm's quarterly pattern report had many of the same limitations as the Alert. Specifically, a representative appeared on the pattern report if 10% or more of the representative's transactions during the calendar quarter triggered the Alert. However, as noted above, because the Alert was configured only to identify potentially unsuitable switch transactions, the pattern report, by extension, identified only patterns of potentially unsuitable switch transactions. The Firm had no other electronic system to monitor for potentially unsuitable patterns of short-term trading other than the pattern report. Moreover, if a representative appeared on this report, then Cambridge required that representative's supervisor to review a random sample of five short-term transactions in UITs and/or mutual fund Class A shares that occurred during the subject quarter. In some instances, supervisors failed to take prompt steps to follow up when a representative appeared on the report, and the reviewing supervisors never reversed any of the transactions they reviewed.

Finally, Cambridge required OSJ supervisors to ensure that customers signed letters to acknowledge switch transactions that triggered the Alert. The letters listed, among other items, any contingent deferred sales charge customers would have to pay on their original investment, additional front-end sales charges customers would have to pay on new purchases, an acknowledgement of potential capital gain tax liability, and a statement of whether the exchange investment increased risk, decreased risk or the risk remained the same. The Firm, however, did not reasonably enforce its written supervisory procedures and these letters were not always sent to customers after their transactions triggered the Alert. During branch inspections, Cambridge failed to identify that, in some cases, supervisors failed to obtain signed switch letters from customers.

By virtue of the foregoing, Cambridge violated NASD Rule 3010 (for conduct before December 1, 2014) and FINRA Rules 3110 and 2010.

After December 31, 2014, Cambridge enhanced its electronic trade surveillance system, as well as its written supervisory procedures, to specifically address short-term trading of mutual fund Class A shares and UITs. The Firm also hired additional staff with technological expertise dedicated to the ongoing maintenance and data integrity of the electronic trade surveillance system.

Cambridge Failed To Establish A Reasonable Supervisory System to Achieve Compliance with NASD Rule 2440 and FINRA Rule 2121.

On January 31, 2014, the Firm committed to FINRA that it would take "proactive steps to identify and prevent any commissions that may exceed the [Firm's] commission schedule." Cambridge monitored commissions through an alert in its automated trade surveillance system. However, this system was not reasonably designed to achieve compliance with FINRA's rules prohibiting the charging of excessive commissions because supervisors did not review transactions that triggered that alert unless the trade generated other alerts in addition to the alert for excess commissions. Between February 1, 2014 and September 21, 2014, Cambridge did not enhance its electronic surveillance system, which did not require approval by a supervisor of each potential excess

commission transaction, or adjust its written supervisory procedures with respect to excessive commissions. It was not until September 22, 2014 that the Firm adjusted its excess commission alert so that a supervisor reviewed each trade flagged for potential excess commission charges. As a result of this delay, Cambridge representatives executed 32 transactions between February 1, 2014 and September 21, 2014 that resulted in \$17,124 in excess commissions on 31 trades entered by Cambridge representatives, and a single trade in which the commission amount of \$25,000 was entered in error.⁴

FINRA staff identified these excess commissions in 2014, and thereafter Cambridge reimbursed its customers for those charges. Additionally, the Firm conducted a review of the default commission schedules contained in its written supervisory procedures to ensure the schedules were reasonable and in accordance with industry standards.

By virtue of the foregoing, Cambridge violated NASD Rule 3010 and FINRA Rule 2010.

Cambridge Failed to Identify and Apply Available Breakpoint Discounts for Eligible Customers.

Cambridge sells non-proprietary mutual funds with different classes of shares representing interests in the same portfolio of securities, but differing in the structure and amount of both sales charges paid directly by shareholders and continuous, asset-based fees assessed on each shareholder's investment. Share class features, including fees and expenses and available sales charge waivers, are described by each mutual fund in its prospectus and/or statement of additional information.

Many front-end load mutual funds offer breakpoint discounts. Generally, an investor can procure a breakpoint discount through a single purchase large enough to reach a breakpoint or, in the alternative, through multiple purchases in either a single mutual fund or mutual fund family. An investor may aggregate current purchases with prior purchases in one or more accounts over time to meet an applicable breakpoint threshold through "rights of accumulation." Many mutual funds also offer breakpoints through "letters of intent," which are written statements by investors of their intent to purchase a certain amount of mutual fund shares over a specified period, typically thirteen months. In addition, many mutual funds offer breakpoints after "householding" accounts, or by aggregating purchases in multiple accounts owned by the customer, or persons related to the customer, as long as the shares owned in each account are properly linked together. The specific criteria for breakpoints vary among different mutual funds and mutual fund families.

Between February 1, 2016 and January 31, 2017, Cambridge failed to implement a supervisory system reasonably designed to ensure that customers received available mutual fund breakpoint discounts, taking into account breakpoint schedules, rights of accumulation, householding of accounts, and letters of intent. The Firm's electronic trade surveillance system had an alert designed to identify potential mutual fund transactions where customers did not receive the benefit of available breakpoints. However, the Firm

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The Firm refunded the \$25,000 after FINRA identified the commission error.

could not demonstrate that its principals consistently reviewed transactions that triggered this alert unless that transaction generated other alerts that collectively met the minimum threshold required for supervisory review.

At FINRA's request, Cambridge reviewed all transactions that triggered the Firm's electronic surveillance alert for potential failures to provide available breakpoint discounts between May 20, 2015 and May 19, 2017. Of the 1,040 alerts not reviewed by a supervisor during that period, the Firm identified 274 transactions that resulted in customer overcharges of \$27,849. Cambridge reimbursed customers for commission overcharges between May 20, 2015 and May 19, 2017.

On May 19, 2017, Cambridge adjusted the breakpoint alert in its electronic trade surveillance system to require mandatory principal review of mutual fund transactions flagged as potentially failing to provide an available breakpoint to customers.

By virtue of the foregoing, the Firm violated FINRA Rules 3110 and 2010.

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

1. a censure; and
2. a fine of \$150,000

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

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or 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.

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 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 Respondent's permanent disciplinary record and may be considered in any future action 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. 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.

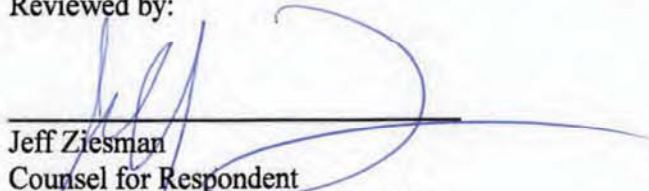
The undersigned, on behalf of the Respondent Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that it has agreed to the AWC's provisions voluntarily; and that 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 it to submit it.

Cambridge Investment Research, Inc.
Respondent

12/20/2019
Date (mm/dd/yyyy)

By: Seth Miller
Print Name: Seth Miller
Title: General Counsel

Reviewed by:


Jeff Ziesman
Counsel for Respondent
Bryan Cave Leighton Paisner LLP
1200 Main Street, Suite 3800
Kansas City, MO 64105-2122
Telephone: (816) 374-3225
Email: jeff.ziesman@bclplaw.com

Accepted by FINRA:

12/31/2019
Date (mm/dd/yyyy)

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

A handwritten signature in blue ink that reads "Seema Chawla". The signature is written in a cursive style with a horizontal line underneath it.

Seema Chawla, Senior Counsel
FINRA Department of Enforcement
120 West 12th Street, Suite 800
Kansas City, MO 64105
Telephone: (816) 802-4712
Facsimile: (816) 421-4519
Email: seema.chawla@finra.org