

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

DANIEL G. MAUGHAN
CRD No. 2561363,

Respondent.

Disciplinary Proceeding
No. 2017054755206

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. Respondent Daniel G. Maughan, while associated with Financial West Group (“Financial West” or the “Firm”), a FINRA-regulated broker-dealer, churned and excessively traded a customer’s trust account (the “IFT Account”). From October 2010 through January 2015 (the “Relevant Period”), Maughan executed approximately 1,648 trades, with a principal value of all purchases and sales in excess of \$70 million, in the IFT Account. The annualized cost-to-equity ratio—the percentage the account had to appreciate to break even—was 21.06. Maughan’s churning and excessive trading was quantitatively unsuitable and generated commissions and costs totaling approximately \$841,000 while causing the account to incur realized and unrealized losses of approximately \$812,000.

2. During the Relevant Period, Maughan also recommended qualitatively unsuitable trades in the IFT Account involving: (a) options and (b) non-traditional Exchange-Traded Funds

(“ETFs”) and an Exchange Traded Note (“ETN”) (collectively, “Exchange Traded Products” or “ETPs”).

3. By churning the IFT Account, Maughan willfully violated Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and Rule 10b-5 thereunder, and also violated FINRA Rules 2020 and 2010.

4. By excessively trading the IFT Account, Maughan violated NASD Rule 2310 (for transactions before July 9, 2012) and FINRA Rule 2111 (for transactions on or after July 9, 2012), and FINRA Rule 2010.

5. By recommending qualitatively unsuitable trades in the IFT Account, Maughan violated NASD Rule 2310 (for transactions before July 9, 2012), and FINRA Rule 2111 (for transactions on or after July 9, 2012), FINRA Rule 2360(b)(19)(A) and (B), and FINRA Rule 2010.

RESPONDENT AND JURISDICTION

6. Maughan became registered with a FINRA member in March 1997 as a General Securities Representative. Maughan was registered as a General Securities Representative with several member firms until May 2010 when he became registered with Financial West, working from its Brentwood branch office located in Los Angeles, California. Maughan was registered with Financial West as a General Securities Representative from May 18, 2010 until August 17, 2017.

7. Although Maughan is no longer registered or associated with a FINRA member, he remains subject to FINRA’s jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA’s By-Laws, because (1) the Complaint was filed within two years after August 17, 2017, which was the effective date of Maughan’s termination of registration from

Financial West, and (2) the Complaint charges Maughan with misconduct committed while he was registered or associated with a FINRA member.

FACTS

8. During the Relevant Period, Maughan managed approximately one dozen customer accounts with total assets of less than \$5 million. Maughan earned the majority of his commissions from his trading in the IFT Account.

Customers RI and JAI

9. In 2010, RI resided in California with his wife, JAI. RI and JAI each had a high school education, with only a few semesters of junior college. At the time they opened the IFT Account at Financial West, RI worked for a plumbing company and JAI worked part-time as a bookkeeper. RI and JAI provided financial assistance to their two adult children. In December 2012, RI lost his job at the plumbing company and remained unemployed until at least January 2015.

10. On January 18, 2010, while Maughan was registered with member firm WSI, his elderly customer, MD, passed away. RI and JAI inherited MD's estate, including the securities and cash in MD's account held at WSI.

11. Following MD's death, RI met Maughan at Maughan's office at WSI to update the account paperwork for the WSI account that RI and JAI inherited. During this meeting, RI specifically directed Maughan to keep the assets RI and JAI inherited in the WSI account invested conservatively—at the time RI and JAI inherited the account, the majority of the portfolio was invested in Unit Investment Trusts.

RI and JAI Open the IFT Account at Financial West

12. After Maughan joined Financial West in May 2010, RI and JAI began the process of transferring their inherited account from WSI to Financial West.

13. In September 2010, RI and JAI executed new account documents to open a family trust account, the IFT Account, for the benefit of RI and JAI and their children. RI and JAI were co-trustees of the family trust and, accordingly, acted as trustees for the IFT Account. The value of the IFT Account in October 2010 was approximately \$1.6 million.

14. When Maughan opened the IFT Account, he was aware that RI and JAI were unsophisticated investors, with limited investment experience and no prior investment experience in options. At that time, Maughan also was aware that RI and JAI's investment objectives for the account were primarily "income" and "growth." Additionally, as RI had previously told Maughan, RI wanted to maintain a "conservative" risk tolerance for the account. RI also informed Maughan that he did not want to deplete principal from the account in order to meet his and JAI's income needs.

15. Maughan correctly listed RI and JAI's investment objectives on the new account application at Financial West with "income" as the priority, followed by "growth." Maughan, however, incorrectly listed the additional investment objectives of "trading profits" and "speculation" ahead of "preservation of capital." Maughan also incorrectly listed RI and JAI's risk tolerance as "aggressive," instead of "conservative."

16. In September 2010, Maughan completed an options account request form for RI and JAI and requested that Financial West approve the IFT Account for "Level 2" options trading. "Level 2" options trading included covered writing of equity calls and the purchase of equity and index calls and puts.

Maughan Exercised *De Facto* Control Over the IFT Account

17. During the Relevant Period, Maughan exercised *de facto* control over, and made all trading decisions regarding the IFT Account, including which specific securities to buy and sell, the quantity of securities to buy and sell, and when to buy and sell the securities.

18. Following his opening of the IFT Account at Financial West, Maughan called RI (the primary contact person for the IFT Account) weekly to talk generally about the stock market; however, Maughan did not discuss any specific securities with RI. The weekly calls between Maughan and RI continued for about a year. Thereafter, the conversations dropped off, with Maughan calling RI only once every few weeks.

19. Because Maughan seldom advised RI about the particular transactions he was executing in the IFT Account, RI and JAI had little familiarity with the securities traded in their account, and they relied on Maughan to make all trading recommendations. During the Relevant Period, Maughan traded in approximately 295 different equities and other securities (not including options) in the IFT Account.

20. When the equity in the IFT Account began to decline in March 2011, Maughan requested that RI and JAI sign a margin agreement. Beginning in April 2011 and continuing through January 2015, Maughan traded securities in the IFT Account on margin.

Maughan Churned and Excessively Traded the IFT Account

21. During the Relevant Period, Maughan executed 1,143 trades (excluding options trades) in the IFT Account, consisting of 612 purchases with a total principal value of approximately \$33.4 million and 531 sales with a total principal value of approximately \$34.0 million. During this period, Maughan also executed 505 options trades in the IFT account, as discussed in more detail below.

22. During the Relevant Period, the annualized turnover rate in the IFT Account was 8.36 (excluding options) and the annualized cost-to-equity ratio was 21.06 percent.

23. Through his trading, Maughan caused the IFT Account to be charged commissions and other costs totaling approximately \$841,000.

Maughan's Unsuitable Trading in Options

24. During the Relevant Period, Maughan executed approximately 505 options transactions—including 324 buys and 181 sells—in the IFT Account. The principal value of the buys totaled approximately \$1.5 million and the principal value of the sells totaled approximately \$1.3 million. He did so even though RI and JAI had no prior experience in trading options, and no understanding of the options transactions that Maughan executed in the IFT Account.

25. Maughan traded options in approximately 142 different underlying securities with most of the opening options transactions executed within 30 days or fewer from the expiration dates of the options. Approximately one third of all options transactions Maughan executed in the IFT Account were held for 10 days or fewer.

26. The options trading in the IFT Account consisted mostly of short-term purchases in long equity calls through which Maughan was speculating on a bullish, short-term move in the underlying equity. A long call option strategy consists of buying a call option with the belief that the price of the underlying stock will appreciate significantly beyond the strike price before the option expiration date. Investors buy calls as a way to profit from growth in the underlying stock's price, without the risk and up-front capital outlay of outright stock ownership. If the underlying stock price does not move above the strike price before the option expiration date, the call option will expire worthless.

27. Maughan purchased a total of 286 long equity call options in the IFT Account, with most positions expiring as worthless or sold at a loss, including those described in the two following paragraphs.

28. Between June 24, 2014, and July 29, 2014, Maughan purchased long calls of Chicago Bridge & Iron Company (ticker symbol CBI) with a strike price of \$70, when CBI's stock price ranged from a low of \$60.65 to a high of \$69.98 during that period. Maughan purchased a total of 300 contracts of CBI Aug 16 2014 \$70 Calls that expired worthless on August 15, 2014 (with the closing stock price of \$58.32) causing a loss of approximately \$32,251.

29. Between March 21, 2014, and March 27, 2014, Maughan purchased long calls of NQ Mobile (ticker symbol NQ) with a strike price of \$20, when NQ's stock price ranged from a low of \$16.77 to a high of \$19.66 during that period. Maughan purchased 100 contracts of NQ April 19 2014 \$20 Calls that expired worthless on April 17, 2014 (with a closing stock price of \$12.90) causing a loss of approximately \$23,326.

30. From October 2010 through January 2015, Maughan also executed approximately 57 covered call write transactions in the IFT Account. Maughan executed covered call write transactions by selling call options on the underlying stocks held in the IFT Account. By writing call options on certain stock positions in the IFT Account, Maughan earned premium income on the options transactions.

31. From October 2011 through November 2012, Maughan also engaged in a strategy of writing covered calls against leveraged and inverse leveraged ETF positions that, in some cases, resulted in losses after an assignment of the call options and subsequent sales of the underlying ETF positions.

32. Financial West approved the IFT Account to trade in certain options strategies with limited risk and complexity. Maughan, however, recommended and executed some options transactions that exceeded the level of approval granted by Financial West for the IFT Account. In July 2011, Maughan executed vertical call spread trades in Yum! Brands Inc. (ticker symbol YUM), which qualified as a higher level of risk and a more complex options trading strategy than Financial West had approved for the IFT Account.

33. Because they were unsophisticated investors with no prior experience in trading options, RI and JAI did not understand Maughan's options trading in their IFT Account and were unable to evaluate the risks associated with the options trading strategies Maughan exercised in the account. Further, RI and JAI did not understand the speculative nature of the options trading Maughan exercised in the account.

34. Maughan's options trading in the IFT Account resulted in losses (not including corresponding stock losses) that totaled approximately \$234,000. Further, the commissions and costs charged on these options transactions totaled approximately \$143,000.

Maughan's Unsuitable Trading in ETPs

35. Between November 2010 and November 2012, Maughan also executed trades in the IFT account involving inverse leveraged and leveraged ETFs, that included: (i) Proshares Ultra S&P 500 ETF (ticker symbol SSO); (ii) ProShares UltraShort 20+ Year Treasury ETF (ticker symbol TBT); and (iii) Direxion Daily Large Cap Bear 3x Shares ETF (ticker symbol BGZ), which on June 29, 2012, changed to Direxion Daily S&P 500 Bear 3x Shares (ticker symbol SPXS). The prospectuses for these products stated that the funds do not seek to achieve their stated investment objectives over a period of time greater than a single day (one trading session). The prospectuses for these products also stated that investments in these funds are designed to be utilized only by knowledgeable investors who understand the potential

consequences of seeking daily leveraged and/or inverse leveraged investment results and who understand the risks associated with the use of leverage.

36. RI and JAI were inexperienced investors who knew nothing about these speculative and volatile products. As such, RI and JAI did not have an understanding of the inverse leveraged and leveraged ETF positions Maughan traded in their IFT Account. RI and JAI were also unaware that Maughan held these inverse leveraged and leveraged ETFs in their account for more than one trading session. Further, RI and JAI did not understand how inverse leveraged and leveraged ETFs worked, and the risks associated with the extended time Maughan held those positions in the IFT Account.

37. In August 2011, Maughan purchased 4,000 shares of SSO in the IFT Account for a debit of approximately \$198,602. An investment in the SSO fund sought daily investment results, before fees and expenses, that corresponded to twice (200 percent) the daily performance of the S&P 500 Index. Maughan held these shares of SSO in the IFT Account for a holding period that exceeded 50 days. In September 2011, he sold all the shares for a loss of approximately \$33,810.

38. On March 19, 2012, Maughan purchased 3,000 shares of TBT in the IFT Account for a debit of approximately \$63,158. An investment in TBT sought daily investment results, before fees and expenses, that corresponded to two times the inverse (-2x) of the daily performance of the Barclays Capital U.S. Treasury 20+ Year Bond Index. Maughan held the TBT shares in the IFT Account for a holding period that exceeded 80 days. On June 11, 2012, Maughan sold the TBT shares for a loss of approximately \$16,423.

39. In August 2012, Maughan purchased 2,000 shares of SPXS in the IFT Account for a debit of approximately \$38,113. The SPXS sought daily investment results of 300 percent

of the inverse (or opposite) of the performance of the S&P 500 Index. Maughan held these shares of SPXS in the IFT Account for a holding period that exceeded 60 days. Maughan sold 1,000 shares of SPXS per month in October 2012 and in November 2012 for a loss of approximately \$3,940.

40. Maughan's purchases in the IFT Account of SSO, TBT, and SPXS were inconsistent with RI and JAI's investment objective and risk tolerance.

41. In November 2010, Maughan also purchased 3,000 shares in a speculative ETN, Barclay's iPath S&P 500 VIX Short Term Futures Exchange Traded Note (ticker symbol VXX) for a debit of approximately \$40,023. The prospectuses for VXX set forth numerous risks and cautioned investors that the product may not be suitable for investors that are not willing to be exposed to fluctuations in volatility in general and in the prices of futures contracts on the Chicago Board Options Exchange Volatility Index (VIX).

42. Maughan did not explain to RI and JAI, the risks or volatility associated with an investment in VXX. In addition, Maughan held VXX in the IFT account for multiple trading sessions, for approximately 38 days, and did not sell the VXX until December 2010, resulting in a loss of approximately \$11,145.

43. Maughan's purchase of VXX in the IFT Account was inconsistent with RI and JAI's investment objective and risk tolerance.

RI and JAI Close the IFT Account

44. On November 30, 2014, RI and JAI sent Maughan an email instructing him to stop buying and selling in the IFT Account.

45. On January 7, 2015, RI and JAI also sent a letter to Maughan instructing him to liquidate all positions in the IFT Account. This letter also instructed Maughan to transfer the

remaining account balance, together with any remaining dividends, to RI and JAI's checking account.

46. By April 2015, after the IFT Account was credited with a small amount of interest, the realized and unrealized losses caused by Maughan's trading in the IFT Account totaled approximately \$812,000. The total commissions and costs associated with Maughan's trading in the IFT Account during the Relevant Period amounted to approximately \$841,000—this amount included commission costs of approximately \$632,000 and margin interest costs of approximately \$193,000.

FIRST CAUSE OF ACTION Churning

(Willful violation of Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder, and violation of FINRA Rules 2020 and 2010)

47. The Department of Enforcement re-alleges and incorporates by reference all preceding paragraphs.

48. Section 10(b) of the Exchange Act prohibits the use of “any manipulative or deceptive device or contrivance” in connection with the purchase or sale of a security. Exchange Act Rule 10b-5 further prohibits: (a) employing “any device, scheme, or artifice to defraud,” (b) making “any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made . . . not misleading,” and (c) engaging “in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.”

49. FINRA Rule 2020 is similar to Rule 10b-5 and provides that a member may not “effect any transaction in, or induce the purchase or sale of, any security by any manipulative, deceptive or other fraudulent device or contrivance.”

50. FINRA Rule 2010 requires an associated person to “observe high standards of commercial honor and just and equitable principles of trade.”

51. Churning is a manipulative and deceptive device that violates Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. It is fraudulent conduct that occurs when: (i) a registered representative controls trading activity in an account, (ii) the level of activity in the account is inconsistent with the customer’s objectives and financial situation, and (iii) the registered representative acts with intent to defraud or a reckless disregard for the customer’s interests.

52. During the Relevant Period, Maughan exercised *de facto* control over the IFT Account at Financial West. Maughan made all investment decisions in the IFT Account, including what securities to buy and sell, the quantities of the securities to buy and sell, and when each transaction would occur.

53. The level of activity in the IFT Account was inconsistent with RI and JAI’s objectives and financial situation. Moreover, the trading was excessive and quantitatively unsuitable for RI and JAI—as evidenced by the annualized turnover rate (8.36) and the annualized cost-to-equity ratio (21.06 percent).

54. Through his churning of the IFT Account and by seeking to maximize his own financial benefit at the expense of his customers, RI and JAI, Maughan acted either with the intent to defraud (*scienter*) or with reckless disregard for RI and JAI’s interests.

55. Maughan’s fraudulent acts and transactions were accomplished by the use or means of the instrumentalities of interstate commerce and through the mail and involved securities transactions on a national securities exchange.

56. By reason of the foregoing, Respondent Maughan willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and also violated of FINRA Rules 2020 and 2010.

SECOND CAUSE OF ACTION
Excessive and Unsuitable Trading (Quantitative Unsuitability)

(Violation of NASD Rule 2310 and FINRA Rule 2111, and FINRA Rule 2010)

57. The Department of Enforcement re-alleges and incorporates by reference all preceding paragraphs.

58. FINRA Rule 2111 and its predecessor, NASD Rule 2310,¹ provide that a member and associated person must have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for the customer, based on the customer's financial circumstances and investment objectives. Under FINRA Rule 2111 and NASD Rule 2310, a broker must have reasonable grounds to believe that the number of recommended transactions within a particular period is not excessive and unsuitable for the customer. Excessive trading occurs, and is unsuitable, when a registered representative has actual or *de facto* control over trading in an account and the level of activity in that account is inconsistent with the customer's investment objectives and financial situation. Violations of FINRA Rule 2111 and NASD Rule 2310 also constitute a violation of FINRA Rule 2010.

59. During the Relevant Period, Maughan exercised *de facto* control over the IFT Account at Financial West. Maughan made all investment decisions in the IFT Account, including what securities to buy and sell, the quantities of the securities to buy and sell, and when each transaction would occur.

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

60. Maughan's trading in the IFT Account was excessive and quantitatively unsuitable for RI and JAI—as evidenced by the high turnover rate and cost-to-equity ratio, as well as the size and frequency of the transactions.

61. Maughan did not have reasonable grounds or a reasonable basis to believe that the number of recommended transactions and the level of activity in the account were suitable for his customers, RI and JAI, in light of their investment objectives and financial situation.

62. By reason of the foregoing, Respondent Maughan violated NASD Rule 2310 (for transactions before July 9, 2012), and FINRA Rule 2111 (for transactions on or after July 9, 2012), and FINRA Rule 2010.

THIRD CAUSE OF ACTION
Unsuitable Trading (Qualitative Unsuitability)

(Violation of NASD Rule 2310 and FINRA Rule 2111, FINRA Rule 2360(b)(19)(A) and (B), and FINRA Rule 2010)

63. The Department of Enforcement re-alleges and incorporates by reference all preceding paragraphs.

64. FINRA Rule 2111 and its predecessor, NASD Rule 2310, both require that a registered representative have a “reasonable basis” to believe that a recommended transaction or investment strategy is suitable for the customer based upon the customer's disclosed securities holdings, financial situation and needs. The rule also requires a broker to educate customers about the risks associated with any recommendation. Before a representative recommends a risky or speculative investment, the representative must be satisfied that it is appropriate for the particular customer and that the customer fully understands the risks and is not only able, but also willing, to take those risks. Violations of FINRA Rule 2111 and NASD Rule 2310 also constitute a violation of FINRA Rule 2010.

65. FINRA Rule 2860(b)(19)(A) provides that a representative shall only recommend the purchase or sale of an option contract when the representative has reasonable grounds to believe that the recommendation is suitable based on the customer's investment objectives, financial situation and needs, and any other pertinent information. A representative who trades options in a customer's account must ensure that the customer fully understands the risks involved and is not only able, but willing, to take those risks. FINRA Rule 2860 has been described as a heightened suitability standard for options trading.

66. FINRA Rule 2860(b)(19)(B) prohibits a representative from recommending an opening transaction in any option contract when the representative has a reasonable basis for believing that the customer does not have "such knowledge and experience in financial matters that he may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the option contract."

67. Violations of FINRA Rule 2860(b)(19)(A) and (B) also constitute a violation of FINRA Rule 2010.

68. All of the options trading strategies that Maughan recommended in the IFT Account during the Relevant Period were unsuitable for the account holders, RI and JAI. In making those recommendations, Maughan lacked a reasonable basis to believe that: (a) the options trading strategies he executed in the IFT Account were suitable for RI and JAI, since the trading was inconsistent with RI and JAI's investment objectives of income and capital appreciation; and (b) RI and JAI were aware of and understood the risks associated with the options trading strategies Maughan executed in the IFT Account.

69. Additionally, all of the transactions involving ETPs that Maughan recommended in the IFT Account during the Relevant Period were unsuitable. Maughan lacked a reasonable basis to believe that: (a) the transactions in inverse leveraged and leveraged ETFs and in VXX executed in the IFT Account were suitable for RI and JAI since these securities are speculative, volatile and intended for use by only sophisticated investors; (b) holding the inverse leveraged and leveraged ETFs in the IFT Account for more than one trading session was suitable for RI and JAI; and (c) RI and JAI were aware of and understood the risks particular to these speculative and volatile ETPs.

70. By reason of the foregoing, Respondent Maughan violated NASD Rule 2310 (for transactions before July 9, 2012), and FINRA Rule 2111 (for transactions on or after July 9, 2012), FINRA Rule 2360(b)(19)(A) and (B), and FINRA Rule 2010.

RELIEF REQUESTED

WHEREFORE, the Department of Enforcement respectfully requests that the Panel:

- A. make findings of fact and conclusions of law that Respondent Maughan committed the violations charged and alleged herein;
- B. order that one or more of the sanctions provided under FINRA Rule 8310(a) be imposed, including that Respondent Maughan be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;
- C. order that Respondent Maughan bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330; and

- D. make specific findings that Respondent Maughan willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

FINRA DEPARTMENT OF ENFORCEMENT

Date: August 14, 2019



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