

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2017056561102**

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

RE: Network 1 Financial Securities Inc., Respondent
Member Firm
CRD No. 13577

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Network 1 Financial Securities Inc. ("Network 1" 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

Network 1 has been a member of FINRA since December 1983. The Firm is headquartered in Red Bank, New Jersey, maintains approximately 21 branch offices, and has approximately 103 registered personnel.

RELEVANT DISCIPLINARY HISTORY

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

From January 2016 through October 2017 (the "AML Relevant Period"), Network 1 failed to develop and implement a written anti-money laundering ("AML") program, and failed to establish and implement policies and procedures that were reasonably expected

to detect and cause the reporting of potentially suspicious transactions. As a result, Network 1 violated FINRA Rules 3310 and 2010.

Between July 2018 and July 2019 (the "Arbitration Relevant Period"), Network 1 failed to provide several categories of discovery in an arbitration proceeding that a former customer brought in FINRA's Dispute Resolution forum. As a result, Network 1 violated IM-12000 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

A. Network 1's Failure to Develop and Implement a Reasonably Designed Anti-Money Laundering Program Regarding Customer Insider Trading and Trading in Microcap Securities

I. FINRA Rule 3310

FINRA Rule 3310 requires that each member firm develop and implement a written AML program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act (31 U.S.C. § 5311, *et seq.*) ("BSA") and the implementing regulations promulgated thereunder. Rule 3310(a) further provides that members must "[c]establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of" potentially suspicious transactions. BSA regulations, in turn, contain suspicious activity reporting requirements for broker-dealers (31 C.F.R. 1023.320). A violation of FINRA Rule 3310 also constitutes a violation of FINRA Rule 2010, which requires member firms and their associated persons to "observe high standards of commercial honor and just and equitable principles of trade."

Notice to Members ("NTM") 02-21 provided detailed guidance regarding the obligation of a broker-dealer to monitor for and report potentially suspicious transactions. NTM 02-21 advised each broker-dealer that when developing an AML program, it should tailor the program to fit its business, taking into consideration, among other factors, "the types of transactions in which its customers engage." NTM 02-21 further reminded broker-dealers of their duty to look for "red flags," *i.e.*, signs of suspicious activity that suggest money laundering or other violative activity, and provided broker-dealers with a non-exhaustive list of such red flags. That list of red flags included when a "customer, for no apparent reason or in conjunction with other 'red flags,' engages in transactions involving certain types of securities, such as penny stocks...which although legitimate, have been used in connection with fraudulent schemes and money laundering activity."

Where such red flags are detected, NTM 02-21 cautioned broker-dealers to "perform additional due diligence before proceeding with the transaction."¹

¹ More recently, in FINRA Regulatory Notice 19-18 ("RN 19-18"), issued in May 2019, FINRA reminded broker-dealers of their obligations to develop and implement a written AML program reasonably designed to achieve and monitor the firm's compliance with the requirements of the BSA and its implementing regulations, and to establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of

2. Network 1's Failure To Establish and Implement Policies And Procedures To Detect And Report Potentially Suspicious Insider Trading

During the AML Relevant Period, Network 1 failed to establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of potentially suspicious insider trading by Firm customers.

The Firm's written AML procedures did not address potential insider trading by Firm customers. Moreover, Network 1 had no system for detecting potential customer insider trading during the AML Relevant Period. The Firm knew that certain of its customers were insiders of the securities in which they were trading based on information disclosed to the Firm in those customers' new account forms. But, the Firm's systems did not identify those customers' transactions for AML review. Therefore, when Firm personnel reviewed trade blotters, they had no way to identify which customers were insiders of the securities in which they were trading without manually referencing customer new account forms, which they did not do.

As a result, the Firm failed to identify that Customer A, a self-identified corporate insider of a microcap issuer, was actively trading the stock of his own company during the AML Relevant Period. The Firm consequently failed to conduct any investigation or cause the reporting of that potentially suspicious activity, as described in more detail below.

3. Network 1's Failure To Implement Policies And Procedures To Detect And Report Potentially Suspicious Trading In Microcap Securities

During the AML Relevant Period, Network 1 failed to implement policies and procedures that can be reasonably expected to detect and cause the reporting of potentially suspicious transactions in microcap securities.

Network 1's written AML procedures provided that the Firm would monitor account activity for "unusual size, volume, pattern or type of transactions" and other AML red flags through (a) the daily review of exception reports provided by the Firm's clearing firm and (b) the daily review of deposit and withdrawal activity in customer accounts. Network 1's AML procedures provided "examples of risk indicators (red flags) that may suggest potential money laundering." These red flags included:

- Customers depositing shares of microcap securities, liquidating those shares, and then wiring out the proceeds;
- Customers who, for no apparent business purpose, have multiple accounts under a single name or multiple names (including corporate entities);

transactions required under the BSA and its implementing regulations. RN 19-18 provided broker-dealers with a non-exhaustive list of money laundering "red flags" potentially indicative of suspicious activity. RN 19-18 further explained that "[u]pon detection of red flags through monitoring, firms should consider whether additional investigation, customer due diligence measures or a SAR [Suspicious Activity Report] filing may be warranted."

- Customers who transact in securities during atypical trading patterns, including trading during sudden spikes in price and volume;
- Notifications received from a clearing firm that the clearing firm has identified potentially suspicious activity concerning certain securities or certain customer accounts; and
- Sales through by individuals known throughout the industry to be stock promoters.

The Firm's AML procedures further required that Firm personnel review activity detected through the daily monitoring, conduct appropriate investigations, and document such reviews and investigations.

Network 1, however, failed to implement these procedures during the AML Relevant Period. As a result, the Firm failed to detect that Customer A engaged in microcap securities trading that raised most of the red flags set forth above. Indeed, Customer A's microcap securities trading appeared on many of the exception reports and deposit and withdrawal activity reports that the Firm utilized for AML purposes. Nevertheless, the Firm failed to detect Customer A's trading as potentially suspicious or performed any investigation of this trading, as described in more detail below.

4. Network 1's Failure To Identify Red Flags of Potentially Suspicious Trading In Customer A's Accounts

During the AML Relevant Period, Customer A purchased and sold approximately 2.6 billion shares of microcap securities, in a gross total amount of approximately \$730,688, through Network 1. This activity included: (a) trading in a security for which Customer A had disclosed to the Firm that he was an insider; (b) trading in another security for which the Firm could have determined he was a stock promoter; and (c) trading patterns displaying red flags as identified in the Firm's AML procedures.

Because of the deficiencies in its AML program, the Firm failed to identify red flags of potentially suspicious trading by Customer A. For example:

Suspicious Activity Involving Company No. 1

- In 2014, Customer A opened a personal account in his name at Network 1. Thereafter, in February 2016, Customer A opened a corporate account at the Firm for Company No. 1; he was the primary account holder. In the opening documentation for both accounts, Customer A identified himself as an officer of Company No. 1. In the following months, Customer A transferred approximately 850 million shares of Company No. 1 into his personal account at Network 1.
- From March 2016 through November 2016, as a corporate insider of Company No. 1, Customer A placed 31 unsolicited buy transactions of Company No. 1's stock totaling approximately \$123,500. The initial purchases started at \$.0004 per share. Concurrent with Customer A's purchase activity, which was a significant

percentage of the stock's overall daily trading activity, Company No. 1's stock price rose to \$.0009 per share – a 125% increase in price.

Suspicious Activity Involving Company No. 2

- In November 2016, Customer A purchased a total of 111,811,340 shares of Company No. 2 for approximately \$201,000. Customer A's initial purchases of Company No. 2's stock started at \$.0001 per share and, concurrent with his trading, the price rose to \$.0004 per share – a 300% increase in price.
- In late November 2016, Customer A purchased 35% of the total daily market volume of Company No. 2's shares. Approximately one week later, Customer A sold 25% of the total daily market volume of Company No. 2's shares. Customer A soon thereafter wired out all of the proceeds from his sales of Company No. 2's shares from his Network 1 account.
- In addition, contemporaneous internet searches would have revealed that Customer A was a stock promoter for the purchase of Company No. 2's stock.

Suspicious Activity Involving Company No. 3

- In August and September 2016, Customer A purchased 362,000,000 shares of Company No. 3 in the Network 1 account of Company No. 1 at an average price of \$.0002 per share. In February 2017, Customer A became the CEO of Company No. 3, and on the same day he sold 340 million shares of Company No. 3 at \$.0002 per share.
- Later in February 2017, Customer A purchased 30% of the total daily market volume of Company No. 3's stock just prior to a positive press release by the Company. Specifically, in February 2017 and March 2017, Customer A purchased 28 million shares of Company No. 3 in his Network 1 personal account at a price range of \$.0004 to \$.0009 per share – a 300% price increase.
- Contemporaneous internet searches would have revealed that Customer A was engaged in the promotion of Company No. 3's stock during the time of his trading of Company No. 3's stock.

Customer A's trading in microcap securities exhibited many of the red flags of money laundering or other illegal activities that were identified in the Firm's procedures, including: the deposit and liquidation of shares of microcap securities, followed by the wiring out of proceeds; trading during price and volume spikes; and trading by a known stock promoter. The accounts also appeared on exception reports provided to the Firm by its clearing firm to detect potentially suspicious microcap securities trading. However, contrary to the Firm's AML procedures, the Firm failed to timely review those exception reports and its daily deposit and withdrawal activity reports, and, as a result, failed to detect or investigate those red flags.

Customer A's trading activity as an insider in microcap securities through Network 1 only ceased when the Firm's clearing firm identified his suspicious activity and restricted his account.

By virtue of the foregoing, Network 1 violated FINRA Rules 3310 and 2010.

B. Network 1's Failure to Produce Discovery in an Arbitration Brought in FINRA's Dispute Resolution Forum

On or about July 31, 2018, a former customer of Network 1 ("Customer B") commenced an arbitration against the Firm and two of its registered representatives (RR 1 and RR 2) in FINRA's Dispute Resolution forum. Customer B generally alleged that RR 1 and RR 2 made unsuitable recommendations that were aimed at generating large commissions for themselves and resulted in significant losses for Customer B. The Statement of Claim included claims for, among other things, fraud, suitability, unauthorized trading, churning and failure to supervise.

FINRA's Code of Arbitration Procedure for Customer Disputes requires that the parties to an arbitration exchange certain documents and information in discovery. IM-12000 states that "[I]t may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2010 for a member or a person associated with a member to . . . (c) fail to appear or to produce any document in his possession or control as directed pursuant to provisions of the Code."

Pursuant to FINRA Rule 12506(a), "Document Production Lists 1 and 2 describe the documents that are presumed to be discoverable in all arbitrations between a customer and a member or associated person." FINRA Rule 12506(b)(1) generally requires parties to produce the materials described in the Document Production Lists within 60 days of the date that the answer to the statement of claim is due, explain why specific documents identified in the Document Production Lists cannot be produced within the required timeframe and state when they will be produced, or make objections as provided for in FINRA Rule 12508. FINRA Rule 12506(b)(2) requires parties to act in "good faith," which means that "a party must use its best efforts to produce all documents required or agreed to be produced. If a document cannot be produced in the required time, a party must establish a reasonable timeframe to produce the document."

Document Production List 1 identifies 22 categories of documents that a firm or associated person must produce in all customer cases. The categories that are relevant to this matter are set forth below.

- 5(a). All materials the firm and/or associated persons prepared or used and/or provided to the customer parties relating to the transactions or products at issue, including research reports, sales materials, performance or risk data, prospectuses, other offering documents, and copies of news articles or outside research, including documents intended or identified as being "for internal use only."

- 7(a). All notes or memoranda evidencing supervisory, compliance, or managerial review of the customers' parties accounts or transactions therein or of the associated persons assigned to the customer parties' accounts for the period at issue.
- 13(a). All exception reports, supervisory activity reviews, concentration reports, active account runs and similar documents produced to review for activity in the customer parties' accounts related to the allegations in the Statement of Claim or in which the claims, transactions, products or types of products at issue are referenced or listed.
- 13(b). For claims alleging failure to supervise, all exception reports, supervisory activity reviews, concentration reports, active account runs, and similar documents produced to review for activity in customer accounts handled by associated persons and related to the allegations in the Statement of Claim that were generated not earlier than one year before or not later than one year after the transactions at issue.

Network 1 failed to produce required discovery to Customer B in the arbitration, and this interfered with Customer B's ability to prove his allegations in the arbitration.

Network 1 claimed that it had no documents responsive to Item 5(a) in Document Production List 1. This claim was false. In fact, Network 1 was in possession of due diligence files related to two private placements that the Firm's representatives had recommended and sold to Customer B, but the Firm did not produce these files in discovery. These files contained, among other things, presentations, overviews, checklists, financial statements, officer questionnaires and news articles about the two issuers and/or their private placements. Network 1 knew it had these files because it had produced a number of the documents to FINRA previously in a separate matter, yet still claimed in the arbitration that it did not have any responsive documents.

Although the Firm asserted that it would produce responsive documents to the extent they existed with respect to item 7(a) in Document Production List 1, the Firm failed to provide the relevant RR's heightened supervisory plan. RR 1 was on a plan of heightened supervision commencing April 2015, which lasted for two years. The period the plan of heightened supervision was in place coincided, in part, with the trading in Customer B's account. RR 1's heightened supervision plan was memorialized in a memorandum that set forth, among other things, the reasons why the plan was implemented and the steps RR 1's supervisor would follow in performing the supervisory review. The memorandum, for example, stated that RR 1 was experiencing a "higher than normal rescission rate on initial orders entered for new accounts" and also referenced RR 1's disciplinary history with FINRA and customer complaints and arbitrations. The plan required, among other things, a random review of initial orders, review of correspondence, monitoring and review of telemarketing activities, regular meetings and mentoring, and active account reviews.

Similarly, Network 1 asserted that it would produce responsive documents to the extent that they existed with respect to items 13(a) and 13(b) in Document Production List 1, but again failed to produce responsive documents to Customer B in the arbitration. For example, Customer B appeared on six exception reports, including reports the Firm utilized to flag actively traded accounts. One of these reports dated October 2016 showed that in the seven months since Customer B opened their account, Customer B paid a total of \$35,152 in commissions. In addition, there were other documents evidencing the Firm's supervisory review of Customer B's account such as account statements with handwritten notations made by RR 1's supervisor and "Compliance/Broker Meeting" forms reflecting that Customer B's account was reviewed by RR 2 and RR 2's supervisor. Network 1 failed to produce the six exception reports and these supervisory review documents during discovery.

By virtue of the foregoing, Network 1 violated IM-12000 and FINRA Rule 2010.

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

- A censure;
- A fine of \$60,000; and
- An undertaking, within 30 days of the issuance of the Notice of Acceptance of this AWC, to review and revise, as necessary, the Firm's written AML program. Within 90 days of the Notice of Acceptance of this AWC, a registered principal on behalf of the Firm shall certify in writing to Noel C. Downey, FINRA Department of Enforcement, 581 Main St., Suite 710, Woodbridge, NJ 07095, either by letter that identifies Network 1 and Matter No. 2017056561102 or by email from a work-related account of a registered principal of the Firm to EnforcementNotice@FINRA.org, with a copy to noel.downey@finra.org, that: (i) the Firm has completed its review; and (ii) as of the date of the certification, the Firm has developed and implemented a written AML program reasonably designed to achieve and monitor the member's compliance with the requirements of the BSA and its implementing regulations, including that the Firm has established and implemented policies and procedures that are reasonably expected to detect and cause the reporting of potentially suspicious transactions.

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.

6/25/2020
Date

Network 1 Financial Securities Inc.
Respondent

By: William R. Hunt Jr.

Print Name: William R. Hunt Jr.

Title: PRESIDENT

Reviewed by:

Joseph C. Cascarelli, Esq.
Counsel for Respondent
Network 1 Financial Securities Inc.
The Galleria
2 Bridge Ave., Suite 241
Red Bank, NJ 07701

Accepted by FINRA:

8-14-20
Date

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

Noel Downey
Noel C. Downey
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FINRA
Department of Enforcement
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