

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2019063960201**

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

RE: Herbert G. Frey (Respondent)
Former General Securities Representative
CRD No. 214237

Pursuant to FINRA Rule 9216, Respondent Herbert G. Frey 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 in this AWC.

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

Frey first registered with FINRA in July 1966 through a FINRA member firm as a General Securities Principal (GP). Between 1966 and 2017, Frey was registered with FINRA through numerous member firms in various capacities including as a GP, General Securities Representative (GS), Registered Options Principal (OP), Compliance Registered Options Principal (CP), Senior Registered Options Principal (SR), Financial and Operations Principal (FN), Municipal Securities Principal (MP) and Government Securities Principal (PG).

In November 2017, Frey registered with FINRA as a GS, GP, OP and PG through Union Capital Company (CRD No. 110301). On September 7, 2018, Union Capital filed a Uniform Termination Notice for Securities Industry Registration (Form U5) disclosing that Frey was permitted to resign for "Failure to Disclose an Outside Business Activity." In August 2018, Frey registered with FINRA as a FN, GP, GS, OP, and PG through his association with Lincoln Douglas Investments, LLC (CRD No. 155578). In October 2018, he registered with FINRA through Lincoln Douglas as an Operations Professional (OS). In June 2019, Lincoln Douglas filed a Form U5 terminating Frey's OP, GP, FN and PG registrations. In December 2020, Lincoln Douglas filed a Form U5 terminating Frey's remaining registrations through the firm. The Form U5 stated that Frey was "[d]ischarged" for "Breach of Contract for non payment of funds owed to the firm."

Although Frey is no longer associated with a member firm, he remains subject to FINRA's jurisdiction pursuant to Article V, Section 4 of FINRA's By-Laws.

RELEVANT DISCIPLINARY HISTORY

In August 1977, Frey submitted an AWC to settle charges that he inadequately supervised back office practices. Frey was censured and fined \$2,000. (Case No. AWC-18).

In January 1978, Frey settled charges brought by the NYSE relating to his supervisory failures and for filing inaccurate and misleading reports and net capital violations. Frey consented to a censure, a \$7,500 fine and bar from membership, allied membership or employment in any supervisory capacity with a member for a period of three years.

In May 1983, Frey submitted an Offer of Settlement to the NASD for violations related to, among other things, his failure to reconcile the firm's checking account and general ledger, to properly post all purchases and sales, to make determinations relative to the possession and control of customer securities and to maintain required net capital. Frey was censured, fined \$5,000, suspended for five days as a principal and was required to pass the FN examination within six months. (No. CLE-243).

Frey submitted Offers of Settlement to the NASD in April 1990 to resolve charges in two matters that his firm conducted a securities business while failing to accurately compute and maintain the minimum net capital and for failing to maintain accurate books and records. Frey was censured and fined \$5,000 (jointly and severally with his firm). (Nos. CLE-352 and CLE-373).

In January 1991, Frey submitted an AWC to settle charges that, acting on behalf of a former member firm, he conducted a securities business while failing to maintain required minimum net capital and failed to accurately compute net capital. Frey was censured, fined \$10,000 and suspended from association with any NASD member as an FN for two years and one day. (Case No. CLE-390-AWC).

In September 1997, the SEC affirmed the NASD's findings that Frey failed to comply with and satisfy an arbitration award. Frey was censured and suspended from associating with any NASD member in any capacity until 180 days after he submitted proof that he paid the arbitration award or was released from further obligation to pay it. (Case No. C8B930020).

In June 2016, Frey submitted an AWC for violating FINRA Rules 4110(c)(1) and 2010 by causing his firm to violate provisions of the Securities Exchange Act of 1934 relating to net capital and books and records requirements. Frey consented to a \$5,000 fine, a 45-day suspension as an FN and a requirement to requalify as an FN. (AWC No. 2014039129301).

OVERVIEW

During the period March 1, 2018 through February 28, 2019, while associated with Union Capital and Lincoln Douglas, Frey excessively traded a customer's account (Customer 1) and placed unauthorized trades in Customer 1's account, in violation of FINRA Rules 2111 and 2010. Additionally, Frey caused Lincoln Douglas's books and records to be inaccurate when he completed Customer 1's new account forms with inaccurate information and sent Customer 1 misleading and inaccurate consolidated account summaries. Frey therefore violated FINRA Rules 4511 and 2010.

FACTS AND VIOLATIVE CONDUCT

Excessive Trading

FINRA Rule 2111(a) provides in pertinent part that "[a] member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." As explained in the Supplementary Material found at 2111.05(c):

Quantitative suitability requires a member or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.¹

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

A violation of FINRA Rule 2111 also constitutes a violation of FINRA Rule 2010, which requires registered representatives to "observe high standards of commercial honor and just and equitable principles of trade."

During the relevant period, Frey engaged in quantitatively unsuitable trading in Customer 1's account. Customer 1 is a 54-year old disabled homemaker who was gifted the

¹ FINRA Rule 2111 was amended effective June 30, 2020. The quoted text is from the pre-June 30, 2020 version of Rule 2111, which was in effect during the time period relevant to this AWC.

securities account that Customer 1 maintained with Frey. Customer 1's investment objectives were capital preservation and growth. As noted below, Frey executed 679 unauthorized trades in Customer 1's account during the relevant period and therefore exercised actual control over the account. This trading caused Customer 1 to pay \$135,210 in fees and commissions, and Frey retained \$76,137 of these commissions. Frey's trading in Customer 1's account resulted in an annualized cost-to-equity ratio of 63.88%. The trading in Customer 1's account resulted in Customer 1 incurring a realized loss of \$142,805.² Frey's trading in Customer 1's account was excessive and unsuitable given Customer 1's investment profile.

Therefore, Frey violated FINRA Rules 2111 and 2010.

Unauthorized Trades

FINRA Rule 2010 requires registered representatives to "observe high standards of commercial honor and just and equitable principles of trade." Unauthorized trading, or executing transactions in a customer's account without the customer's prior knowledge or consent, violates FINRA Rule 2010.

During the relevant period, Frey executed 679 transactions in Customer 1's account without Customer 1's prior authorization, knowledge, or consent. Frey did not contact Customer 1 regarding any of these transactions prior to placing the trades, and Frey did not have discretionary trading authority in Customer 1's account.

Therefore, Frey violated FINRA Rule 2010.

Books and Records

FINRA Rule 4511(a) states that "[m]embers shall make and preserve books and records as required under the FINRA rules, the Exchange Act and the applicable Exchange Act rules." An individual may violate FINRA Rule 4511 by causing his or her member firm to fail to maintain accurate books and records. A violation of FINRA Rule 4511 is also a violation of FINRA Rule 2010.

In January and February of 2019, Frey provided inaccurate and misleading consolidated account summaries to Customer 1, which made it appear that Customer 1's account value was much higher than its true value. Frey also directed Customer 1 to sign blank new account forms at Lincoln Douglas, which he then completed with inaccurate information regarding Customer 1's investment experience and risk tolerance. In both instances, Frey caused Lincoln Douglas to maintain inaccurate books and records.

Therefore, Frey violated FINRA Rules 4511 and 2010.

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

² Customer 1 brought and settled a customer arbitration relating to the account at issue here.

- a 16 month suspension from associating with any FINRA member in all capacities;
- a \$15,000 fine; and
- disgorgement of \$76,137 in commissions, plus interest, as described below.

The fine shall be due and payable either immediately upon reassociation with a member firm or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier.

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

Disgorgement of commissions received is ordered to be paid to FINRA in the amount of \$76,137, 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 March 1, 2019 until the date this AWC is accepted by the National Adjudicatory Council (NAC). Disgorgement shall be due and payable either immediately upon reassociation with a member firm or prior to any application or request for relief from any statutory disqualification resulting from this or any other event or proceeding, whichever is earlier.

Respondent 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.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

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 him;
- B. To be notified of the complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made, and to have a written decision issued; and

- D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

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 its subject matter 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

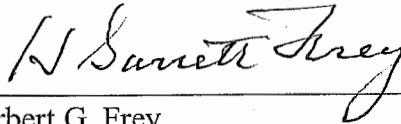
FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrative corrective steps taken to prevent future misconduct. Respondent understands that he 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.

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 understands and acknowledges that FINRA does not represent or advise him and Respondent cannot rely on FINRA for legal advice. 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 in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce him to submit this AWC.

3/4/2021

Date



Herbert G. Frey
Respondent

Accepted by FINRA:

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



3/29/21

Date

Ellen Sheridan-Cona
Senior Counsel
FINRA
Department of Enforcement
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