FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. HANK M. WERNER (CRD No. 1615495), and LEGEND SECURITIES, INC. (BD No. 44952), Respondents.	Disciplinary Proceeding No. 2015048048801 Hearing Officer–MJD **DEFAULT DECISION** November 6, 2017

Respondent Legend Securities, Inc. failed to supervise Respondent Hank M. Werner, who fraudulently churned the accounts of an elderly, blind customer. The Firm also failed to establish, maintain, and enforce an adequate supervisory system to ensure that Werner was subject to heightened supervision. The Firm is censured and fined $200,000.

For the Complainant: Samuel Barkin, Esq., and Michael Perkins, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondent: No appearance.

DECISION

I. Introduction

Respondent Legend Securities, Inc. ("Legend" or the "Firm") failed to supervise Hank M. Werner ("Werner"), who fraudulently churned the accounts of an elderly and blind customer. Legend also failed to establish and enforce written supervisory procedures (WSPs) to ensure that Werner was subject to heightened supervision. By engaging in this misconduct, Legend violated NASD Rules 3010(a) and (b) and FINRA Rules 3110(a) and (b) and 2010. It is censured and fined $200,000.

Enforcement served the Amended Complaint in conformity with FINRA's Rules of Procedure. Legend failed to Answer the Amended Complaint. Accordingly, Enforcement filed a motion for entry of default decision ("Default Motion"), together with counsel Samuel Barkin's Declaration ("Decl.") in support of the motion, and 15 supporting exhibits (identified as "CX-1" through "CX-15"). Legend did not respond to the Default Motion.

For the reasons set forth below, I grant the Default Motion, and find that find Legend committed the violations alleged in the Amended Complaint, and fine the Firm $200,000.

II. Findings of Fact and Conclusions of Law

A. Respondent's Background

Legend became a FINRA member firm in 1998. It maintained its principal place of business in New York, New York. In November 2015, it employed 51 registered representatives and operated nine branch offices. On December 8, 2016, a week after Enforcement filed the Amended Complaint in this proceeding, the Firm filed a Uniform Request for Broker-Dealer Withdrawal ("Form BDW") seeking to withdraw its registration with the U.S. Securities Exchange Commission and terminate its FINRA membership.[1] On January 19, 2017, FINRA cancelled Legend's registration pursuant to FINRA Rule 9553. On April 17, 2017, Legend was expelled from FINRA for failure to pay fines and costs.[2]

B. FINRA's Jurisdiction

Although Legend is no longer a FINRA member firm, it remains subject to FINRA's jurisdiction for purposes of this proceeding under Article IV, Section 6 of FINRA's By-Laws, because (i) the Amended Complaint charges the Firm with violations committed while it was a FINRA member, and (ii) Enforcement filed the Amended Complaint before the effective date that FINRA expelled the Firm.

C. Origin of the Investigation

This proceeding resulted from a cause examination conducted by FINRA's Member Regulation staff. The staff investigated allegations of fraudulent churning and unsuitable recommendations by Werner, who was a registered representative at Legend.[3]

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[1] Decl. at ¶¶ 5-6; CX-1, at 1-3; Amended Complaint ("Am. Compl.") ¶ 17.

[2] Decl. at ¶ 8; CX-1, at 4-5.

[3] Am. Compl. ¶ 13; Decl. at ¶ 4. Werner was registered with Legend as a General Securities Representative and General Securities Principal from December 11, 2012, to March 9, 2016, when the Firm filed a Uniform Termination Notice for Securities Industry Registration terminating his registration. Am. Compl. ¶¶ 11-12.

D. Procedural History

On August 1, 2016, Enforcement filed a three-cause Complaint against Werner, alleging that for over three years he engaged in quantitatively unsuitable trading and fraudulently churned accounts belonging to customer DC. The Complaint charges that for the first two months, from October to November 2012, Werner churned DC's accounts while he was registered with Liberty Partners Financial Services, LLC. Werner then registered with Legend in December 2012 and began churning DC's accounts in February 2013. The Complaint also charged Werner with making an unsuitable recommendation to DC to switch from an existing variable annuity to another. DC was 77 years old and recently widowed when Werner's misconduct commenced. She also has been blind most of her life and is physically disabled. The Complaint alleged that Werner willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 and violated FINRA Rules 2010, 2020, 2111, and 2330(b).

On November 30, 2016, Enforcement filed an Amended Complaint. It alleged the same three causes of action against Werner but added two causes alleging that Legend failed to supervise Werner and failed to implement a plan of heightened supervision for Werner.[4] Legend did not file an Answer and was held in default.[5]

E. Respondent's Default

On November 30, 2016, Enforcement served the Notice of Amended Complaint and Amended Complaint on Legend at the address recorded in FINRA's Central Registration Depository (CRD), the only address known to Enforcement, by certified mail and first-class mail. Enforcement received a return receipt for the certified mailing signed by a representative of the Firm.[6]

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[4] Cause five alleges that, in addition to the Legend, a Firm principal, MS, failed to reasonably supervise Werner. In May 2017, Enforcement accepted MS's Offer of Settlement which resolved all the charges against him.

[5] On June 5 and 6, 2017, a hearing was held in New York, New York, involving only the allegations against Werner. The charges against Werner have been resolved in an Extended Hearing Panel Decision which is being issued simultaneously with this Default Decision. The Panel found that Werner committed each of the violations alleged in the Complaint, barred him from associating with any member firm in any capacity, imposed an $80,000 fine, and ordered him to pay restitution in the amount of $155,393.61 to customer DC and disgorge a commission in the amount of $10,030. The restitution amount the Panel ordered Werner to pay took into account $20,000 that the Firm paid as voluntary partial restitution to DC before it went out of business. The $10,030 disgorgement represents Werner's share of the issuer's commission for the variable annuity DC purchased.

[6] Decl. ¶¶ 10-11, 18; CX-2; CX-3; CX-4. On December 8, 2016, counsel for Legend called Enforcement to acknowledge that the Firm received the Notice of Amended Complaint and Amended Complaint. He told Enforcement that Legend had filed a Form BDW and would not respond to the Amended Complaint. Decl. ¶ 14; CX-5.

On December 29, 2016, Enforcement served a Second Notice of Amended Complaint and the Amended Complaint on Legend at its CRD address, again by certified mail and first-class mail.[7]

Legend's Answer was due no later than January 17, 2017. Legend did not file an Answer or respond to the Amended Complaint in any manner.[8]

Legend's failure to file an Answer to the Amended Complaint constitutes a default. On January 25, 2017, the Hearing Officer originally assigned to this matter found Legend in default.[9] On June 9, 2017, after the hearing on the allegations against Werner, I ordered Enforcement to file a Default Motion. On July 14, 2017, Enforcement filed the Default Motion. I grant the motion and, pursuant to FINRA Rules 9215(f) and 9269(a)(2), I deem the allegations in the Amended Complaint admitted.

F. Legend Failed to Prepare a Plan of Heightened Supervision for Werner

The fourth cause of action alleges that Legend had identified Werner when it hired him as a broker who should be subject to heightened supervision. Legend failed to prepare such a plan or place Werner on heightened supervision at any time during the more than three years that he was registered with the Firm.

NASD Rule 3010(a) and FINRA Rule 3110(a)[10] require member firms to establish and maintain a system to supervise associated persons reasonably designed to achieve compliance with applicable securities laws and FINRA Rules. NASD Rule 3010(b) and FINRA Rule 3110(b) require each member firm to establish, maintain, and enforce written supervisory procedures appropriate to its specific business and that are reasonably designed to achieve compliance with the applicable securities laws and FINRA's rules. A violation of FINRA's supervision rules constitutes a violation of FINRA Rule 2010.[11]

FINRA has provided member firms with guidance about when to place registered representatives under heightened supervision. Notice to Members 97-19 states, in relevant part:

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[7] Decl. ¶¶ 15, 18; CX-6; CX-7.

[8] Decl. ¶ 19.

[9] Respondent is notified that it may move to set aside the default pursuant to FINRA Rule 9269(c) upon a showing of good cause.

[10] FINRA Rule 3110 became effective on December 1, 2014, superseding NASD Rule 3010 without substantive change, although with some modifications not at issue here. FINRA Regulatory Notice 14-10, 2014 FINRA LEXIS 17 (Mar. 2014). Thus, NASD Rule 3010 applies to Legend's conduct before December 1, 2014, and FINRA Rule 3110 applies to the Firm's conduct beginning that date.

[11] *Dep't of Enforcement v. Thaddeus James North*, No. 2012030527503, 2017 FINRA Discip. LEXIS 28, *20 n.17 (NAC Aug. 3, 2017) (citing *Robert J. Prager*, 58 S.E.C. 634, 635 n.3 (2005)).

A firm that employs persons in the following categories and does not have a standard supervisory policy that addresses such persons should determine whether existing procedures are adequate to provide reasonable supervision or whether heightened supervision is warranted:

- registered representatives with a history of customer complaints, disciplinary actions, or arbitrations;

  * * *

- registered representatives terminated from prior employment for what appears to be a significant sales practice or regulatory violation; or

- registered representatives who have had a frequent change of employers within the industry.

Notice to Members 97-19 also states that after a person has been identified as someone requiring special supervision because of such a history a firm "should consider developing and implementing special supervisory procedures structured to address sales practice concerns that are raised by that history."[12]

Legend had WSPs that addressed heightened supervision requirements. They required the Firm to conduct a review to determine whether a representative should be placed on heightened supervision if the person had a history of being terminated for cause, or was allowed to resign, in cases when the termination involved sales practice or other regulatory violations or when a broker was registered with three or more broker-dealers in the past five years. The WSPs required either the preparation of a written plan of heightened supervision or, in instances when the firm decided not to place the person on heightened supervision, a memorandum addressing why existing supervision of the person was adequate.[13]

When Werner joined Legend in December 2012, he had been (i) discharged by a firm in 1994 for taking client orders while not registered; (ii) discharged by another firm in 2009 for failing to timely disclose three tax liens; and (iii) employed by four different firms between December 2007 and December 2012. When Legend hired Werner, he had five outstanding tax liens against him totaling over $600,000.[14]

Even though Legend identified Werner as a broker who should be subject to heightened supervision, the Firm failed to prepare a plan of heightened supervision. Legend failed to place Werner on heighted supervision at any time during his association with the Firm. The Firm did

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[12] NASD Notice to Members 97-19, 1997 NASD LEXIS 23, *15-16 (Apr. 1997).

[13] Am. Compl. ¶ 85.

[14] Am. Compl. ¶ 86.

not prepare any memorandum explaining why the current supervisory system was adequate to supervise someone like Werner.[15]

Based on the allegations of the Amended Complaint and the supporting Default Motion, I find that Legend failed to enforce the provisions in its WSPs concerning heightened supervision of Werner and thus violated NASD Rule 3010 and FINRA Rules 3110 and 2010.

G. Legend Failed to Supervise Werner

Cause five alleges that from February 2013[16] to December 2015 Legend failed to reasonably supervise Werner, which allowed him to churn and excessively trade DC's accounts.[17] The Firm is charged with violating NASD Rule 3010(a) and (b) and FINRA Rules 3110(a) and (b) and 2010.

1. Werner's Churning and Excessive Trading in DC's Accounts

In February 2013, DC opened two IRA Accounts with Werner at Legend ("IRA Account No. 1" and "IRA Account No. 2").[18] The account applications for both IRA accounts listed her investment objective as "Growth" and her risk tolerance as "Moderate."[19] In July 2015, on Werner's recommendation, DC opened a non-qualified investment account (the "Investment Account").[20] As soon as DC's accounts were opened at Legend, Werner began aggressively trading them without making a reasonable assessment of the suitability of his recommended active and excessive trading strategy.[21] Werner also charged DC commissions that averaged more than 3.00 percent of the principal amount of every purchase and sale transaction in the three accounts.[22] Based on the level of Werner's trading and the high commissions that Werner and the Firm charged, there was virtually no chance that DC could break even—let alone profit—from Werner's trading.

The Amended Complaint alleges that Legend failed to supervise Werner and that he engaged in quantitatively unsuitable trading and churning in DC's accounts. Excessive trading,

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[15] Am. Compl. ¶ 87.

[16] Even though Werner registered with Legend in early December 2012, DC's accounts were not transferred to the Firm until February 2013. Am. Compl. ¶ 90; Default Motion at 12.

[17] The Firm's supervision relating to Werner's allegedly unsuitable recommendation involving a variable annuity exchange in August 2015 (cause three) is not at issue in cause five. Default Motion at 12 n.30.

[18] Am. Compl. ¶¶ 43, 90.

[19] Am. Compl. ¶ 91.

[20] Am. Compl. ¶ 50.

[21] Am. Compl. ¶¶ 44, 51.

[22] Am. Compl. ¶ 44; CX-11, at 24-25.

or quantitatively unsuitable recommendations, violates FINRA Rule 2111.[23] The Rule provides that 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 a customer" based on the customer's investment profile. A customer's investment profile includes the customer's age, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the associated person.[24]

Excessive trading occurs when a broker controls the trading in a customer's account and the level of trading is inconsistent with the customer's objectives and financial condition.[25] When a broker acts with scienter in excessive trading cases, the misconduct constitutes churning.[26] Scienter "is established either by evidence of intent to defraud or by evidence of willful and reckless disregard of the customer's interests."[27]

Werner exercised control over each of DC's accounts. He recommended all of the stocks that were purchased by DC. He also recommended when DC's stocks should be sold. Because of her physical condition and health, DC completely relied on Werner to handle her accounts and trusted him to act in her best interests and in accordance with her investment objectives and risk tolerance.[28]

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[23] Supplementary Material 2111.05(c) defines "quantitative suitability:" Quantitative suitability requires an 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 FINRA Rule 2111(a). No single test defines excessive activity but factors such as the turnover rate, the cost-equity rate, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or an associated person has violated the quantitative suitability obligation.

[24] FINRA Rule 2111(a). *See also* Supplementary Material 2111.04 (Customer's Investment Profile). Supplementary material to Rule 2111 describes the suitability rule as "fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct." "Implicit in all member and associated person relationships with customers and others is the fundamental responsibility of fair dealing." Supplementary Material 2111.01 (General Principles). Rule 2111 identifies three suitability obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability. Supplementary Material 2111.05 (Components of Suitability Obligations).

[25] *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *40-41 (2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012). *See also Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at *27 n.28 (NAC Apr. 26, 2013) (citing *Dep't of Enforcement v. Medeck*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *35 n.14 (NAC July 30, 2009)).

[26] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *31 (citing *Dep't of Enforcement v. Murphy*, No. 2005003610701, 2011 FINRA Discip. LEXIS 42, at *54-58 (NAC Oct. 20, 2011)), *aff'd*, *William J. Murphy*, Exchange Act Release No. 69923, 2013 SEC LEXIS 1933 (July 2, 2013). *See also O'Conner v. R.F. Lafferty & Co., Inc.*, 965 F.2d 893, 898 (10th Cir. 1992) (noting that "churning deals with the quantity of securities purchased for an account, while [the typical] unsuitability concerns the quality of the purchased securities").

[27] *Murphy*, 2013 SEC LEXIS 1933, at *64 (quoting *Al Rizek*, 54 S.E.C. 261, 268 (1999)).

[28] Am. Compl. ¶¶ 52-57.

Werner churned and excessively traded DC's accounts by making over 600 trades at Legend from February 2013 to December 2015. Most of the securities Werner bought for the accounts were held for less than a month before Werner would sell the securities and use the proceeds to buy other securities. Werner's trading was excessive, as evidenced by the high turnover rates and cost-to-equity ratios. The annualized turnover rates were 9.55, 12.73 and 18.05 and the cost-to-equity ratios were 79.53, 105.07, and 141.09 percent, respectively, for the three accounts.[29] Werner and Legend charged DC a total of $232,626.36 in commissions, ticket charges, and other fees. DC suffered net losses exceeding $170,000 as a result of Werner's trading in her three accounts.[30]

Werner's trading constituted fraudulent churning. Werner's intent to engage in fraudulent activity is established by the amount of commissions he charged DC and the excessive trading he engaged in. Werner did not have a reasonable basis to believe that the recommended transactions were consistent with DC's investment objectives and her precarious financial situation.[31] Werner controlled DC's accounts because DC followed his advice and relied on him to such an extent that he was able to direct the volume and frequency of trading in her accounts.[32] The high turnover rates and cost-to-equity ratios for DC's accounts evidence Werner's intent to churn the accounts.[33] By churning and excessively trading DC's accounts, Werner violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5,[34] and FINRA Rules 2010, 2020, and 2111.

2. Legend Ignored Red Flags Indicating Churning and Excessive Trading

In February 2013, Legend designated MS to supervise Werner. The WSPs contained required that a broker's activities be supervised to ensure that account activity was suitable for customers, including elderly customers such as DC.[35] Legend, acting through MS, failed to implement these procedures in connection with its supervision of Werner's trading in DC's

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[29] CX-12; CX-13; CX-14.

[30] CX-12; CX-13; CX-14.

[31] *See Michael T. Studer*, Exchange Act Release No. 50543, 2004 SEC LEXIS 2347, at *16-17 (Oct. 14, 2004) (churning exists when a broker "manages a client's account for the purposes of generating commissions"), *aff'd*, 148 F.App'x 58 (2d. Cir. 2005).

[32] *Dep't of Enforcement v. Sisson*, No. C01960020, 1998 NASD Discip. LEXIS 41, at *11 (NAC Nov. 18, 1998) (finding that *de facto* control of an account may be established where the client habitually followed the advice of the broker) (citing *Mihara v. Dean Witter & Co.*, 619 F.2d 814, 821 (9th Cir. 1980).

[33] *Jack H. Stein*, 56 S.E.C. 108, 118 (2003) ("Turnover rates between three and five have triggered liability for excessive trading, and it has been generally recognized than an annual turnover rate of greater than six evidences excessive trading."); *Rafael Pinchas*, 54 S.E.C. 331, 340 (1999) (finding that a cost-to-equity ratio of 20 percent constitutes excessive trading).

[34] Werner's fraud was accomplished by the use of the instrumentalities of interstate commerce, including telephone calls and the mails, and it involved effecting securities transactions on a national securities exchange. Am. Compl. ¶¶ 58-59.

[35] Am. Compl. ¶¶ 93-94.

accounts. Legend's new account form for DC's two IRA accounts stated that her investment objective was "Growth" and her risk tolerance was "Moderate," and disclosed that she was 77 years old and blind.[36]

By May 2013, just three months after DC opened accounts at Legend, the Firm's compliance department and MS were aware that Werner's trading in DC's accounts was excessive. Specifically, on May 2, 2013, Legend's compliance department sent MS a memo concerning DC's IRA Account No. 1 showing that since February 2013, Werner had generated $22,050 in commissions from trading in the account while DC had suffered $11,331 in losses. No one from the compliance department, including MS, investigated whether Werner's trading in DC's IRA Account No. 1 was suitable for DC.[37]

In addition, on October 4, 2013, compliance sent MS a report showing that for September 2013, DC's two IRA accounts each had a *monthly* turnover rate of 1.78, and *monthly* commission-to-equity ratios of 6.5 and 7.0 percent.[38] On October 18, 2013, compliance sent MS a memo showing that over the seven-month history of DC's IRA Account No. 1, Werner had generated $54,762.60 in commissions while DC had suffered $30,622.26 in losses. The same memo also showed that for the same seven-month period, the account's turnover rate was 10.62 and commission-to-equity ratio was 47 percent. Legend, through MS, again failed to investigate whether Werner's trading in DC's accounts was suitable for DC or even to speak with Werner about the activity in DC's account.[39]

On March 4, 2014, MS received another report about Werner's trading. It showed that in February 2014 Werner placed 29 trades in DC's two IRA accounts and charged between four and five percent on each purchase and sale. Furthermore, on April 21, 2014, another report showed that in March 2014, DC's two IRA accounts had *monthly* turnover rates of 2.19 and 2.59, and *monthly* commission-to-equity ratios of 7.5 and 7.7 percent, respectively. Once again, Legend failed to investigate whether Werner's trading in DC's accounts was unsuitable given her age, financial circumstances, and investment objectives.[40]

Legend, acting through MS, failed to consider the information set forth in the WSP section entitled "Accounts for Senior Investors," including DC's income needs to meet future expenses and her health insurance and future requirements to fund her health costs. Legend failed to review DC's new account forms and review the transactions in those account for consistency with investment objectives, as required by the WSP section that addressed IRAs. Similarly, Legend failed to review reports to identifying active accounts for further review, which would have identified DC's accounts, failed to confront Werner about the activity in DC's

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[36] Am. Compl. ¶ 91.

[37] Am. Compl. ¶ 103.

[38] Am. Compl. ¶ 104.

[39] Am. Compl. ¶¶ 105-06.

[40] Am. Compl. ¶¶ 107-10.

accounts, and failed to contact DC, as required by a section in the WSPs on addressing active accounts.

Finally, Legend failed to supervise Werner's trading to ensure it was suitable for DC by reviewing monthly transaction records, to confer with Werner about suitability issues, confer with compliance, or contact DC to confirm her understanding of, and agreement with, transactions in her account. These supervisory steps were required by sections in the WSPs that addressed reviews of the suitability of recommendations made to customers and account activity.[41]

Legend, through MS, also failed to adequately investigate multiple red flags indicating that Werner was churning DC's IRA Accounts and Investment Account. Legend failed to adequately investigate—or simply ignored—that Werner was engaged in aggressive, "in-and-out" trading, repeatedly purchasing securities and then selling them after a short holding period to then purchase other securities. This trading had no purpose other than generating commissions for Werner. It is evidence of excessive trading and churning. Werner's in-and-out trading ignored DC's investment objective of "Growth" and "Moderate" risk tolerance. Furthermore, Legend ignored that Werner charged commissions that averaged 3.57 percent, on both purchases and sales. Commission of this size, together with a high volume of trading, resulted in huge commissions for Werner. They made it impossible for DC to earn a profit on her investments. No one from Legend ever spoke to Werner concerning the proper amount of commissions he could charge. In fact, no one even spoke to him about commissions at all.[42]

From February 2013 to December 2015, Legend, acting through MS and its compliance department, failed to establish and maintain a reasonable system to supervise Werner's activities regarding DC's accounts or to adequately enforce Legend's WSPs. When reviewing trading in DC's accounts, Legend failed to adequately enforce its WSPs concerning: (i) senior investors; (ii) IRA accounts; (iii) active accounts; and (iv) quantitative suitability. Moreover, Legend and MS failed to adequately investigate, or simply ignored, significant red flags that Werner was churning DC's accounts.

By failing to implement Legend's WSPs, ignoring red flags, and failing to reasonably investigate whether Werner was churning DC's accounts or engaging in unsuitable trading. The NAC has held that the "duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation."[43] Accordingly, Legend failed to supervise, in violation of NASD Rule 3010 and FINRA Rules 3110 and 2010.[44]

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[41] Am. Compl. ¶¶ 95-99; Decl. ¶ 32; CX-10.

[42] Am. Compl. ¶¶ 100-02.

[43] *Dep't of Enforcement v. Rooney*, No. 2009019042402, 2015 FINRA Discip. LEXIS 19, at *60-61 (NAC July 23, 2015), (quoting *Ronald Pellegrino*, Exchange Act Release No. 59125, 2008 SEC LEXIS 2843, at *33 (Dec. 19, 2008)). *See also Murphy*, 2011 FINRA Discip. LEXIS 42, at *105-06 (supervisor who overlooked warnings that

III. Sanctions

In determining the appropriate sanctions for Legend's misconduct, I considered FINRA's Sanction Guidelines ("Guidelines"),[45] including the General Principles Applicable to All Sanction Determinations and the Principal Considerations in Determining Sanctions. Given the circumstances present in this case, I find that it is appropriate to assess a unitary sanction for the misconduct alleged against the Firm, all of which relates to its failure to exercise adequate supervision over Werner and his trading activity in DC's accounts.[46]

The Guideline for a firm's failure to supervise instructs adjudicators to consider a fine of $5,000 to $73,000 and limit the activities of the appropriate branch office or department for up to 30 business days. In egregious case, adjudicators should consider limiting the activity of the branch office or department for a longer period or suspending the firm with respect to any or all activities or functions for up to 30 business days.[47]

The principal considerations for failing to reasonably supervise include: (i) whether the respondent ignored red flag warnings that should have resulted in additional supervisory scrutiny, (ii) the nature, extent, size, and character of the underlying misconduct, and (iii) the quality and degree of the implementation of the firm's supervisory procedures and controls.[48] Each of these is relevant in this case. The Firm repeatedly ignored red flags indicative of excessive trading in DC's accounts. Werner's excessive trading and churning caused DC to lose over $170,000, an amount that she could not afford to lose given her age and ill health.[49] The

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broker was churning and engaging in unsuitable trading in customer accounts failed to exercise reasonable supervision) (citing *Bradford John Titus*, 52 S.E.C. 1154, 1159-60 (1996) (respondents failed to supervise by overlooking red flags of unsuitable options trading); *Paul C. Kettler*, 51 S.E.C. 30, 33 (1992) (respondent failed to supervise where he failed to respond to the dramatic increase in transactions, which constituted a clear red flag)).

[44] Because Legend failed to supervise Werner with the objective of preventing his willful violations of Section 10(b) of the Exchange Act, Legend is subject to statutory disqualification by operation of law, in accordance with Section 4, Article III, of FINRA's By-Laws, and Sections 3(a)(39)(F) and 15(b)(4)(E) of the Exchange Act. *See Dep't of Market Regulation v. Lane*, No. 20070082049, 2013 FINRA Discip. LEXIS 34, at *57 n.33 (NAC Dec. 26, 2013) (supervisor statutorily disqualified for failing to reasonably supervise to prevent broker's violations of Sec. 10(b) of the Exchange Act), *aff'd, Robert Marcus Lane*, Exchange Act Release No. 74269, 2015 SEC LEXIS 558, at *5 n.5 (Feb. 12, 2015).

[45] *See* FINRA Sanction Guidelines (2017), http://www.finra.org/industry/sanction_guidelines.

[46] Guidelines at 4 (General Principles Applicable to All Sanction Determinations, No. 4.) (providing that sanctions may be applied in the aggregate for similar types of violations rather than per individual violation and the where the violations result from a single underlying problem); *Dep't of Enforcement v. Escarcega*, No. 2012034936005, 2017 FINRA Discip. LEXIS 32, at *67 (NAC July 20, 2017) (citing *Blair C. Mielke*, Exchange Act Release No. 75981, 2015 SEC LEXIS 3927, at *59 (Sept. 24, 2015) (affirming FINRA's imposition of a single sanction for violations that are based on the same facts)).

[47] Guidelines at 104.

[48] Guidelines at 104.

[49] *See also* Guidelines at 7 (Principal Consideration in Determining Sanctions No. 11) (whether the respondent's misconduct resulted directly or indirectly in injury to another party and the nature and extent of the injury).

Firm failed altogether to implement its supervisory procedures and controls with respect to DC, which includes its failure to place him under heightened supervision. A reasonable supervisory program likely would have prevented harm to DC.

The principal considerations applicable to all rule violations militate in favor of a substantial sanction against Legend. Legend's failure to implement a plan of heightened supervision of Werner and to supervise his trading in DC's account extended for three years, from December 2012 to December 2015.[50] Legend's supervisory deficiencies also involved a pattern of misconduct which led to Werner's being subject to virtually no supervision.[51] Legend ignored a November 2013 FINRA staff examination report telling the Firm it had failed to place Werner under heightened supervision.[52] The Firm's failure persisted for two years after the warning, which is an additional aggravating factor. The Firm also has significant relevant disciplinary history.[53]

Based on the allegations contained in the Amended Complaint, the Default Motion, and Barkin's Declaration, Legend's misconduct was also intentional or, at the very least, reckless.[54] The Firm was on notice that Werner was having serious financial problems, including that he had multiple tax liens. Nonetheless, it undertook no steps to ensure that he was not overcharging and overtrading the accounts of an elderly and vulnerable customer.[55] The supervisory failures also resulted in the Firm's benefiting from the high commissions that Werner's excessive trading and churning generated.[56]

I find that there are no factors mitigating Legend's misconduct. The appropriate remedial sanction is a censure and a fine of $200,000 for Legend's egregious supervisory failures.

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[50] Guidelines at 7 (Principal Consideration in Determining Sanctions No. 9) (whether the respondent engaged in the misconduct over an extended period of time).

[51] Guidelines at 7 (Principal Consideration in Determining Sanctions No. 8) (whether the respondent engaged in numerous acts and/or a pattern of misconduct).

[52] Decl. ¶ 31; Guidelines at 8 (Principal Consideration in Determining Sanctions No. 14) (whether the respondent engaged in the misconduct notwithstanding prior warnings from a regulator that the conduct violated FINRA rules or applicable securities laws and regulations).

[53] Guidelines at 2 (General Principle No. 2) (sanctions should be more severe for recidivists); Guidelines at 7 (Principal Consideration in Determining Sanctions No. 1) (respondent's relevant disciplinary history). In 2016, the Firm entered into consent orders with two states for failing to reasonably supervise and for fraudulent and unsuitable recommendations concerning the sales of an over-the-counter security. Legend also entered in to a Letter of Acceptance, Waiver and Consent with FINRA in 2016 for anti-money laundering violations relating to its stock liquidation business. FINRA found that Legend failed to conduct due diligence that would have uncovered suspicious activity by customers selling large volumes of penny stock sales. Decl. ¶¶ 24-26; CX-9, at 28-33.

[54] Guidelines at 8 (Principal Consideration in Determining Sanctions No. 13) (whether the respondent's misconduct was the result of an intentional act, recklessness, or negligence).

[55] CX-15, at 4-5.

[56] Guidelines at 8 (Principal Consideration in Determining Sanctions No. 16) (whether the respondent's misconduct resulted in the potential for the respondent's monetary or other gain).

IV. Order

Respondent Legend Securities, Inc. violated NASD Rules 3010(a) and (b) and FINRA Rules 3110(a) and (b) and 2010, as alleged in causes four and five of the Amended Complaint. The Firm is censured and fined $200,000.

The fine shall be due on a date set by FINRA, but not sooner than 30 days after this Default Decision becomes FINRA's final disciplinary action in this proceeding.

Michael J. Dixon
Hearing Officer

Copies to: Hank M. Werner (via electronic and first-class mail)
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