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NEWS RELEASE

For Release: January 9, 2014
Contact: Michelle Ong (202) 728-8464

Stifel, Nicolaus & Company, Incorporated and Century Securities Associates, Inc. Action

FINRA Orders Stifel, Nicolaus and Century Securities to Pay Fines and Restitution Totaling More Than \$1 Million for Unsuitable Sales of Leveraged and Inverse ETFs, and Related Supervisory Deficiencies

WASHINGTON — The Financial Industry Regulatory Authority (FINRA) today announced that it has ordered two St. Louis-based broker-dealers – Stifel, Nicolaus & Company, Incorporated and Century Securities Associates, Inc. – to pay combined fines of \$550,000 and a total of nearly \$475,000 in restitution to 65 customers in connection with sales of leveraged and inverse exchange-traded funds (ETFs). Stifel and Century are affiliates and are both owned by Stifel Financial Corporation.

Brad Bennett, FINRA Executive Vice President and Chief of Enforcement, said, "The complexity of leveraged and inverse exchange-traded products makes it essential for securities firms and their representatives to understand these products before recommending them to their customers. Firms must also conduct reasonable due diligence on these and other complex products, sufficiently train their sales force and have adequate supervisory systems in place before offering them to retail investors."

Leveraged and inverse ETFs "reset" daily, meaning that they are designed to achieve their stated objectives on a daily basis so their performance can quickly diverge from the performance of the underlying index or benchmark. It is possible that investors could suffer significant losses even if the long-term performance of the index showed a gain. This effect can be magnified in volatile markets.

FINRA found that between January 2009 and June 2013, Stifel and Century made unsuitable recommendations of non-traditional ETFs to certain customers because some representatives did not fully understand the unique features and specific risks associated with leveraged and inverse ETFs; nonetheless, Stifel and Century allowed the representatives to recommend them to retail customers. Customers with conservative investment objectives who bought one or more non-traditional ETFs based on recommendations made by the firms' representatives, and who held those investments for longer periods of time, experienced net losses.

FINRA also found that Stifel and Century did not have reasonable supervisory systems in place, including written procedures, for sales of leveraged and inverse ETFs. Stifel and Century generally supervised transactions in leveraged and inverse ETFs in the same manner that they supervised traditional ETFs, and neither firm created a procedure to address the risk associated with longer-term holding periods in the products. Further, both firms failed to ensure that their registered representatives and supervisory personnel obtained adequate formal training on the products before recommending them to customers.

Stifel agreed to pay a fine of \$450,000 and to make restitution of nearly \$340,000 to 59 customers. Century agreed to pay a fine of \$100,000 and to make restitution of more than \$136,000 to six customers.

In settling this matter, Stifel and Century neither admitted nor denied the charges, but consented to the entry of FINRA's findings.



Investors can obtain more information about, and the disciplinary record of, any FINRA-registered broker or brokerage firm by using FINRA's BrokerCheck. FINRA makes BrokerCheck available at no charge. In 2013, members of the public used this service to conduct 16.5 million reviews of broker or firm records. Investors can access BrokerCheck at www.finra.org/brokercheck or by calling (800) 289-9999. Investors may find copies of this disciplinary action as well as other disciplinary documents in FINRA's Disciplinary Actions Online database.

FINRA, the Financial Industry Regulatory Authority, is the largest independent regulator for all securities firms doing business in the United States. FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. FINRA touches virtually every aspect of the securities business -- from registering and educating all industry participants to examining securities firms, writing rules, enforcing those rules and the federal securities laws, informing and educating the investing public, providing trade reporting and other industry utilities, and administering the largest dispute resolution forum for investors and firms. For more information, please visit www.finra.org.

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FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NOS. 2012034576901 & 2011025493401

RECEIVED

JAN 2 2014

To: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

Re: Stifel, Nicolaus & Company, Incorporated, Respondent
CRD No. 793

FINRA District 4

Century Securities Associates, Inc., Respondent
CRD No. 28218

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, the respondents, Stifel, Nicolaus & Company, Incorporated ("Stifel") and Century Securities Associates, Inc. ("Century"), submit 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 either respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. The respondents hereby accept and consent, 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

Stifel is a self-clearing broker-dealer that has been registered with FINRA – and, previously, the NASD – since 1936. Stifel has its main offices in St. Louis, Missouri. It has more than 3,900 registered representatives and approximately 380 branch offices.

Century is an introducing broker-dealer that has been registered with FINRA and the NASD since 1991. Its main offices are in St. Louis, Missouri, and it has approximately 190 registered individuals and approximately 125 branch offices.

Both Century and Stifel are wholly owned by Stifel Financial Corp., a publicly traded financial-services holding company. Stifel provides administrative and regulatory support to Century through a shared-services agreement.

RELEVANT DISCIPLINARY HISTORY

In September 2010, pursuant to AWC No. 2008015700901, Stifel paid a \$100,000 fine to settle charges by FINRA that the firm failed to establish an effective supervisory system and written supervisory procedures reasonably designed to ensure that customers received appropriate “breakpoints” and “rollover and exchange” discounts on eligible unit investment trust purchases.

Century does not have a relevant disciplinary history.

OVERVIEW

Between January 1, 2009 and June 1, 2013, certain Stifel and Century registered representatives recommended leveraged and inverse exchange-traded funds (collectively, “nontraditional ETFs”) to certain customers without fully understanding the features and risks associated with them. Thus, Stifel and Century allowed certain of their respective registered representatives to make unsuitable recommendations of nontraditional ETFs to certain of their customers by failing to conduct adequate due diligence on the products. Through this conduct, Stifel and Century each violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010.¹

During the same time period, Stifel and Century each failed to establish and maintain a supervisory system, including written procedures, reasonably designed to ensure that the firms’ sales of nontraditional ETFs complied with applicable securities laws and NASD and FINRA rules. Through this conduct, Stifel and Century each violated NASD Conduct Rule 3010 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

A. Nontraditional ETFs

Exchange-traded funds, or ETFs, are typically registered unit investment trusts or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. Shares of ETFs are typically listed on national securities exchanges and trade throughout the day at prices established by the market.

Nontraditional ETFs differ from other ETFs in that they seek to return a multiple of the performance of the underlying index or benchmark, the inverse of that performance, or both. To accomplish their objectives, nontraditional ETFs use swaps, futures contracts, and other derivative instruments. In addition, nontraditional ETFs are designed to achieve their stated objectives only over the course of one trading session. Between one trading session and the next, the fund manager must generally rebalance the fund’s holdings in order to meet its

¹ On July 9, 2012, FINRA Rule 2111 superseded NASD Conduct Rule 2310.

objective. For most nontraditional ETFs, this happens on a daily basis, and is known as the “daily reset.”

For each day’s trading session, a nontraditional ETF may come close to achieving its intended return. But the correlation between a nontraditional ETF and its linked index or benchmark is inexact, and there is typically at least a small difference, or “tracking error,” between a fund and its benchmark, which may compound over longer periods of time. This effect becomes more pronounced during periods of volatility in the underlying index or benchmark. FINRA advised its membership in June 2009 in FINRA Regulatory Notice 09-31 concerning nontraditional ETFs that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”² Because of these risks and the inherent complexity of the products, FINRA Regulatory Notice 09-31 further advised broker-dealers that nontraditional ETFs “are typically not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets.”

B. Stifel and Century, through certain of their registered representatives, violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010 by recommending nontraditional ETFs to certain customers without certain of their representatives fully understanding the features and risks associated with the products.

NASD Conduct Rule 2310 required that, before recommending a security to any customer, a broker-dealer and its registered representatives must have an “adequate and reasonable basis” for any recommendation that they make.³ This is a prerequisite to any recommendation, because “a broker cannot determine whether a recommendation is suitable for a particular customer unless he has a ‘reasonable basis’ to believe that the recommendation could be suitable for at least some customers.”⁴

FINRA Rule 2111, which superseded NASD Rule 2310 on July 9, 2012, reiterates the longstanding “reasonable basis” suitability obligation. FINRA Rule 2111.05(a) “requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least *some* investors.”

A broker-dealer lacks a reasonable basis to recommend a security to its customers if it or its representatives fail to investigate the security’s characteristics sufficiently to understand the potential risks and rewards of the transaction. Thus, to satisfy NASD Rule 2310 and FINRA Rule 2111, a broker-dealer and its registered representatives must exercise due diligence to understand the nature of

² FINRA Reg. Notice 09-31.

³ *FJ Kaufman and Co.*, 50 S.E.C. 164, 168 (1989).

⁴ *Id.*

the recommended security. With respect to nontraditional ETFs, "this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETFs' use of leverage, and the customer's intended holding period will have on their performance."⁵

As detailed below, Stifel and Century allowed certain of their registered representatives to recommend nontraditional ETFs to certain of their customers without their representatives conducting adequate due diligence on the products. Stifel and Century also did not provide adequate formal training to their representatives regarding nontraditional ETFs before permitting them to recommend the products to customers. As a result, certain registered representatives of both Stifel and Century were insufficiently informed regarding the unique features and specific risks associated with nontraditional ETFs.

Nonetheless, Stifel and Century, through their registered representatives, recommended nontraditional ETFs to their retail customers. From 2009 through the second quarter of 2013, these recommendations resulted in Stifel's retail customers buying approximately \$641 million worth of nontraditional ETFs. During the same time period, these recommendations resulted in Century's retail customers buying approximately \$31 million worth of nontraditional ETFs. Certain customers with conservative investment objectives who bought one or more nontraditional ETFs based on recommendations made by Stifel and Century registered representatives and who held those investments for longer periods of time experienced net losses.

For example, a Stifel registered representative recommended to a customer whose primary investment objective was income that he invest in a nontraditional ETF; the customer purchased the security and held it for at least 18 months, before selling the security for a loss of approximately \$41,000. A Century registered representative recommended to a customer whose primary investment objective was income that he invest in a nontraditional ETF; the customer bought the security and held it for at least two and a half years, before selling it for a loss of approximately \$13,600.

Through this conduct, Stifel and Century violated NASD Conduct Rule 2310 and FINRA Rules 2111 and 2010.

C. Stifel and Century each violated NASD Conduct Rule 3010 and FINRA Rule 2010 by failing to establish and maintain a reasonable supervisory system, including written procedures, concerning sales of nontraditional ETFs.

NASD Conduct Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each of its registered

⁵ FINRA Reg. Notice 09-31.

representatives, registered principals, and other associated persons, and that this system must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD and FINRA rules. Final responsibility for proper supervision rests with the member.

NASD Conduct Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its registered representatives, registered principals, and other associated persons, and that these procedures must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD and FINRA rules.

Stifel and Century conducted due diligence regarding nontraditional ETFs and emailed two compliance bulletins to their registered personnel in 2009 regarding the features and risks of the products. The firms, however, failed to ensure that their registered representatives obtained adequate formal training on the unique features and risks of nontraditional ETFs before permitting them to recommend those products to customers. Between January 2009 and June 2013, Stifel and Century did not require that their representatives complete any product-specific training on nontraditional ETFs before recommending them. Likewise, Stifel and Century did not provide adequate formal training to the supervisory personnel who they assigned to review and approve nontraditional ETF transactions in the unique aspects of those products.

From January 2009 until June 1, 2013, Stifel and Century generally supervised sales of nontraditional ETFs in the same manner in which they supervised sales of traditional ETFs, with the exception of a policy enacted in June 2009 that limited leveraged ETF holdings to 10% of the value on an account. For example, during that time period, neither firm created a procedure to address the risk associated with longer-term holding periods in nontraditional ETFs. Therefore, each firm failed to establish a supervisory system, including written procedures, reasonably tailored to address the unique features and risks associated with nontraditional ETFs.

Despite its supervisory deficiencies, Stifel recommended approximately \$641 million worth of nontraditional ETF transactions to retail customers between January 1, 2009 and June 1, 2013. Despite its supervisory deficiencies, Century recommended approximately \$31 million worth of nontraditional ETF transactions to retail customers during the same time period.

Thus, from January 1, 2009 through June 1, 2013, Stifel and Century each failed to establish and maintain a supervisory system, including written procedures, that was reasonably designed to ensure that their sales of nontraditional ETFs complied with applicable securities laws and NASD and FINRA rules. Through this conduct, Stifel and Century violated NASD Conduct Rule 3010 and FINRA Rule 2010.

- B. The respondents also consent to the imposition of the following sanctions:
1. A censure of both Stifel and Century;
 2. A fine to be paid by Stifel of \$450,000.00;
 3. Restitution to be paid by Stifel to certain of its customers in the amount of \$338,128.00;
 4. A fine to be paid by Century of \$100,000.00; and
 5. Restitution to be paid by Century to certain of its customers in the amount of \$136,485.00.

Stifel and Century each agree to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Both Stifel and Century have submitted Election of Payment forms showing the method by which they propose to pay the fines imposed.

Stifel and Century both specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid by Stifel to the Stifel customers listed on Attachment A hereto in the total amount of \$338,128.00. Restitution is ordered to be paid by Century to the Century customers listed on Attachment B hereto in the total amount of \$136,485.00.

A registered principal on behalf of each respondent firm shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Adam Walker, Principal Regional Counsel, FINRA – District 4, 120 W. 12th Street, Kansas City, Missouri 64105, either by letter that identifies either Stifel and AWC No. 2012034576901 or Century and AWC No. 2011025493401, as applicable, or by e-mail from a work-related account of the registered principal of Stifel or Century to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason Stifel cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Stifel shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Stifel shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

Likewise, if for any reason Century cannot locate any customer identified in Attachment B after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Century shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Century shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Stifel and Century each specifically and voluntarily waive 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, the respondents specifically and voluntarily waive any right to claim bias or prejudgment of the General Counsel, 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.

The respondents further specifically and voluntarily waive 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

The respondents understand 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 them; and
- C. If accepted:
 - 1. This AWC will become part of each respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against either respondent;
 - 2. This AWC will be made available through FINRA's public disclosure program in response to public inquiries about each respondent's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. The respondents 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. The respondents 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 the respondents' (i) testimonial obligations or (ii) rights to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Either respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The respondents understand that they 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 Stifel, 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 Stifel has agreed to its 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 Stifel to submit it.

The undersigned, on behalf of Century, 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 Century has agreed to its 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 Century to submit it.

Stifel, Nicolaus & Company, Incorporated

December 17, 2013
Date (mm/dd/yyyy)

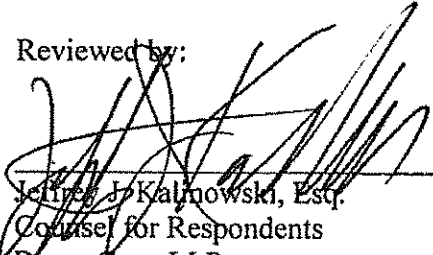
By: Bernard N. Burkemper
(name of signor), (title) Sr. V.P./CFO
Bernard N. Burkemper

Century Securities Associates, Inc.

December 17, 2013
Date (mm/dd/yyyy)

By: Bernard N. Burkemper
(name of signor), (title) Sr. V.P./CFO
Bernard N. Burkemper CFO

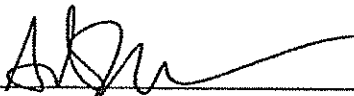
Reviewed by:


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Telephone: (314) 259-2949

Accepted by FINRA:

1/9/14
Date

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


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ATTACHMENT A

STIFEL CUSTOMER	RESTITUTION AMOUNT
1	\$18
2	\$19
3	\$27
4	\$45
5	\$55
6	\$96
7	\$125
8	\$280
9	\$388
10	\$507
11	\$600
12	\$661
13	\$681
14	\$786
15	\$867
16	\$907
17	\$980
18	\$1,309
19	\$1,617
20	\$1,641
21	\$1,846
22	\$2,051
23	\$2,268
24	\$2,274

ATTACHMENT A

25	\$2,329
26	\$2,335
27	\$2,539
28	\$2,557
29	\$2,864
30	\$2,899
31	\$3,213
32	\$3,300
33	\$3,655
34	\$4,028
35	\$4,407
36	\$5,215
37	\$5,254
38	\$5,716
39	\$6,056
40	\$6,184
41	\$6,225
42	\$6,231
43	\$6,441
44	\$6,705
45	\$6,782
46	\$6,887
47	\$6,915
48	\$8,812
49	\$9,011

ATTACHMENT A

50	\$9,288
51	\$9,294
52	\$9,516
53	\$9,938
54	\$11,020
55	\$11,079
56	\$16,828
57	\$35,370
58	\$38,178
59	\$41,009
TOTAL	\$338,128

ATTACHMENT B

CENTURY CUSTOMER	RESTITUTION AMOUNT
1	\$104,203
2	\$2,869
3	\$13,570
4	\$6,807
5	\$5,856
6	\$3,180
TOTAL	\$136,485

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090182292**

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

RE: UBS Financial Services Inc. ("UBS FS," "Respondent" or "the Firm"),
CRD No. 8174

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, UBS FS 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 UBS FS alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. UBS FS 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

UBS FS, with its predecessor, PaineWebber & Co., has been a FINRA-registered broker-dealer since October 1936. UBS FS is a full service brokerage firm headquartered in Weehawken, New Jersey. UBS FS has approximately 385 active branch offices with about 7,000 registered financial advisors.

RELEVANT DISCIPLINARY HISTORY

UBS FS has the following relevant disciplinary history:

In April 2011, UBS FS consented to a \$2.5 million fine and restitution of \$8.25 million for, among other things, violating NASD Rules 3010 and 2310 between March 17, 2008 and June 30, 2008, in that UBS FS: (1) failed to establish an adequate supervisory system, including adequate training and written supervisory policies and procedures, in connection with the marketing and sale of Lehman Brothers Principal Protection Notes ("PPNs"); and (2) failed to adequately

analyze the suitability of sales of Lehman PPNs to certain UBS FS customers through some of its registered representatives. (Letter of Acceptance, Waiver and Consent No. 2008015443301).

In June 2009, UBS FS consented to a \$100,000 fine for supervisory violations relating to unsuitable short-term sales of closed-end funds purchased at the funds' initial public offering, which resulted in customer losses of more than \$2 million. (Letter of Acceptance, Waiver and Consent No. 20070095202).

OVERVIEW

During the period from January 2008 through June 2009 (the "Relevant Period"), UBS FS failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Non-Traditional ETFs have certain risks that are not found in traditional ETFs, such as the risks associated with a daily reset, leverage and compounding. The performance of Non-Traditional ETFs over longer periods of time can differ significantly from the performance of their underlying index or benchmark, especially in volatile markets. Nonetheless, UBS FS supervised Non-Traditional ETFs the same way it supervised traditional ETFs. Thus, UBS FS failed to establish a reasonable supervisory system and written procedures to monitor the sale of Non-Traditional ETFs. UBS FS also failed to establish adequate formal training regarding Non-Traditional ETFs during the Relevant Period.

In addition, certain UBS FS registered representatives did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers. Certain UBS FS registered representatives also made unsuitable recommendations of Non-Traditional ETFs to certain customers with a primary conservative risk tolerance profile.

As such, UBS FS violated NASD Rules 3010, 2310, and 2110 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Non-Traditional ETFs

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.¹ Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market.

¹ See FINRA Regulatory Notice ("Notice") 09-31, *Non-Traditional ETFs* (June 2009).

Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are “inverse” or “short” funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts and other derivative instruments. UBS FS was not involved in the creation or initial structuring of these products.

Most Non-Traditional ETFs “reset” daily, meaning that they are designed to achieve their stated objectives only on a daily basis. FINRA noted in its June 2009 Regulatory Notice that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”² This effect can be magnified in volatile markets. For example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the index's daily return fell six percent, and the related ETF seeking to deliver twice the inverse of the index's daily return fell 26 percent.

Accordingly, investors were subjected to the risk that the performance of their investments in Non-Traditional ETFs could differ significantly from the performance of the underlying index or benchmark when held for longer periods of time, particularly in the volatile markets that existed during the Relevant Period.

Non-Traditional ETFs Have Dramatically Increased in Popularity Since 2006

In June 2006, a handful of Non-Traditional ETFs were listed and began trading on national securities exchanges after being registered with the U.S. Securities and Exchange Commission. Within nine months, over 40 additional Non-Traditional ETFs began trading on national securities exchanges. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately \$22 billion.

As the number of Non-Traditional ETFs grew, so did the number of transactions by customers at UBS FS. During the Relevant Period, UBS FS customers bought and sold a total of over \$4.5 billion of Non-Traditional ETFs.

² Id. at 2.

Certain UBS FS Customers Held Non-Traditional ETFs For Longer Periods of Time

Despite the risks associated with holding Non-Traditional ETFs for longer periods, certain UBS FS customers held Non-Traditional ETFs for extended time periods during the Relevant Period. In fact, certain UBS FS customers with a primary conservative risk tolerance profile held Non-Traditional ETFs for periods of several months. For example:

- A 64-year old customer with a primary conservative risk tolerance profile and net worth of \$290,000 held a Non-Traditional ETF for 139 days in his IRA account and sustained losses of over \$5,700 (43% of his initial investment); and
- A 54-year old customer with a primary conservative risk tolerance profile and net worth of \$400,000 held a Non-Traditional ETF for 21 days and sustained losses of over \$5,000.

UBS FS Failed to Establish and Maintain a Reasonable Supervisory System, including Written Procedures, in Violation of NASD Rules 3010 and 2110 and FINRA Rule 2010

NASD Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision shall rest with the member.

NASD Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules.

As described below, UBS FS violated NASD Rules 3010 and 2110 and FINRA Rule 2010³ in that during the Relevant Period: (1) the Firm failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with NASD and FINRA Rules in connection with the sale of Non-Traditional ETFs in accounts where the Firm provided brokerage services

³ For the period January 2008 to December 14, 2008, this conduct constitutes a violation of NASD Rule 2110, and for the period December 15, 2008 through June 30, 2009, this conduct constitutes a violation of FINRA Rule 2010, both of which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

to certain retail customers; and (2) the Firm failed to provide adequate formal training and guidance to its registered representatives and supervisors regarding Non-Traditional ETFs.

**UBS FS Failed to Establish a Reasonable Supervisory System
In Connection with the Sale of Non-Traditional ETFs**

The Firm supervised Non-Traditional ETFs the same way it supervised traditional ETFs until FINRA issued the Regulatory Notice in June 2009. The Firm relied on its general supervisory procedures to supervise transactions in Non-Traditional ETFs during the Relevant Period. However, the general supervisory system the Firm had in place during the Relevant Period was not sufficiently tailored to address the unique features and risks involved with these products. For example, during the Relevant Period, the Firm did not create a procedure to address the risks associated with longer-term holding periods in Non-Traditional ETFs. Thus, during the Relevant Period, the Firm failed to establish a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of Non-Traditional ETFs.

UBS FS Failed to Provide Adequate Training Regarding Non-Traditional ETFs

Prior to June 2009, UBS FS failed to provide adequate formal training to registered representatives and supervisors regarding the features, risks, and characteristics of Non-Traditional ETFs. For example, prior to June 2009, the Firm failed to establish adequate guidance or tools to educate registered representatives and supervisors about Non-Traditional ETFs.

**UBS FS Made Unsuitable Recommendations,
In Violation of NASD Rules 2310 and 2110 and FINRA Rule 2010**

The reasonable-basis suitability obligation under NASD Rule 2310 requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA recently stated, “[w]ith respect to leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETF’s use of leverage, and the customer’s intended holding period will have on their performance.”⁴ In this case, UBS FS violated NASD Rules 2310 and 2110 and FINRA Rule 2010 by allowing its registered representatives to recommend to customers a Non-Traditional ETF without performing reasonable diligence to understand the risks and features associated with it.

⁴ See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products – Heightened Supervision of Complex Product* (January 2012), at 5-6.

Certain UBS FS registered representatives made unsuitable recommendations of Non-Traditional ETFs to certain customers with a primary conservative risk tolerance profile, in further violation of NASD Rules 2310 and 2110 and FINRA Rule 2010.

B. UBS FS also consents to the imposition of the following sanctions:

1. Censure;
2. Fine in the amount of \$1.5 million; and
3. Restitution in the amount of \$431,488.

UBS FS agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. UBS FS has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

UBS FS specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid in the total amount of \$431,488. A registered principal on behalf of UBS FS shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Scott Andersen, Enforcement Director, Department of Enforcement, One World Financial Center, 200 Liberty Street, New York, NY 10281 either by letter that identifies UBS FS and the case number or by e-mail from a work-related account of the registered principal of UBS FS to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason UBS FS cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, UBS FS shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. UBS FS shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

UBS FS specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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, UBS FS specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

UBS FS 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

UBS FS 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 the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. the Firm 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. UBS FS 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 the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. UBS FS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. UBS FS 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 UBS FS, 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 the Firm has agreed to its 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 the Firm to submit it.

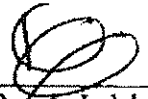
Date (mm/dd/yyyy)

Respondent
UBS Financial Services Inc.

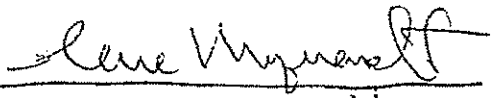
By: _____

Title: _____

Reviewed by:



Ben A. Indek, Esq.
Counsel for Respondent UBS Financial Services Inc.
Morgan, Lewis & Bockius LLP
101 Park Avenue
New York, NY 10178-0600
(212) 309-6109

By: 

Ilene Margueritt
Managing Director
4/20/12

Accepted by FINRA:

Date

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

Susan Light
Senior Vice President and Chief Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street
New York, NY 10281
(646) 315-7333

April 20, 2012

Date (mm/dd/yyyy)

Jonathan Eisenberg

Respondent

UBS Financial Services Inc.

By: Jonathan Eisenberg

Title: General Counsel

Reviewed by:

Ben A. Indek

Ben A. Indek, Esq.

Counsel for Respondent UBS Financial Services Inc.

Morgan, Lewis & Bockius LLP

101 Park Avenue

New York, NY 10178-0600

(212) 309-6109

Accepted by FINRA:

May 1, 2012

Date

Signed on behalf of the

Director of ODA, by delegated authority

Susan Light

Susan Light

Senior Vice President and Chief Counsel

FINRA Department of Enforcement

One World Financial Center

200 Liberty Street

New York, NY 10281

(646) 315-7333

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090191134**

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

RE: Citigroup Global Markets Inc. ("CGMI," "Respondent" or "the Firm"),
CRD No. 7059

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, CGMI 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 CGMI alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. CGMI 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

CGMI is a wholly-owned subsidiary of Citigroup Financial Products, Inc. and is indirectly a wholly-owned subsidiary of Citigroup, Inc. CGMI's principal place of business is in New York, New York. The Firm is a FINRA-regulated broker-dealer and provides a full range of financial services.

RELEVANT DISCIPLINARY HISTORY

CGMI has the following relevant disciplinary history:

In July 2011, CGMI entered into an AWC wherein it consented to a fine of \$500,000 and to findings that from 2001 to 2008, it violated NASD Rules 3010(a) and (b) and 2110 in that, among other things, CGMI failed to detect or respond adequately to a series of red flags that upon further inquiry would have alerted the Firm to a scheme of misappropriations by the Firm's former registered sales assistant. (STAR No. 2008013231502).

In February 2010, CGMI entered into an AWC wherein it consented to a fine of \$650,000 and a supervisory undertaking related to findings that, among other things, from 2005 to 2008, it violated NASD Rules 3010(a) and (b) in that it failed to establish and maintain a reasonable system, including written procedures, to supervise its Direct Borrow Program. (STAR No. 20080149558-01).

OVERVIEW

During the period from January 2008 through June 2009 (the "Relevant Period"), CGMI failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Non-Traditional ETFs have certain risks that are not found in traditional ETFs, such as the risks associated with a daily reset, leverage and compounding. The performance of Non-Traditional ETFs over longer periods of time can differ significantly from the performance of their underlying index or benchmark, especially in volatile markets. Nonetheless, CGMI supervised Non-Traditional ETFs the same way it supervised traditional ETFs. Thus, CGMI failed to establish a reasonable supervisory system and written procedures to monitor the sale of Non-Traditional ETFs. CGMI also failed to establish adequate formal training regarding Non-Traditional ETFs during the Relevant Period.

In addition, certain CGMI registered representatives did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers. Certain CGMI registered representatives also made unsuitable recommendations of Non-Traditional ETFs to certain customers with a conservative investment objective and/or risk profile.

As such, CGMI violated NASD Rules 3010, 2310, and 2110 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Non-Traditional ETFs

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.¹ Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market.

Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are "inverse" or "short"

¹ See FINRA Regulatory Notice ("Notice") 09-31, *Non-Traditional ETFs* (June 2009).

funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts and other derivative instruments. The Firm was not involved in the creation or initial structuring of these products.

Most Non-Traditional ETFs "reset" daily, meaning that they are designed to achieve their stated objectives only on a daily basis. FINRA noted in its June 2009 Regulatory Notice that "[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time."² This effect can be magnified in volatile markets. For example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the index's daily return fell six percent, and the related ETF seeking to deliver twice the inverse of the index's daily return fell 26 percent.

Accordingly, investors were subjected to the risk that the performance of their investments in Non-Traditional ETFs could differ significantly from the performance of the underlying index or benchmark when held for longer periods of time, particularly in the volatile markets that existed during the Relevant Period.

Non-Traditional ETFs Have Dramatically Increased in Popularity Since 2006

In June 2006, a handful of Non-Traditional ETFs were listed and began trading on national securities exchanges after being registered with the U.S. Securities and Exchange Commission. Within nine months, over 40 additional Non-Traditional ETFs began trading on national securities exchanges. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately \$22 billion.

As the number of Non-Traditional ETFs grew, so did the number of transactions by customers at CGMI. During the Relevant Period, CGMI customers bought and sold a total of over \$7.9 billion of Non-Traditional ETFs.

Certain CGMI Customers Held Non-Traditional ETFs For Longer Periods of Time

Despite the risks associated with holding Non-Traditional ETFs for longer periods, certain CGMI customers held Non-Traditional ETFs for extended time periods during the Relevant Period. In fact, certain CGMI customers with

² Id. at 2.

conservative investment objectives and/or risk tolerance profiles held Non-Traditional ETFs for periods of several months: For example:

- A 59-year old customer with a conservative investment objective and/or risk profile held a Non-Traditional ETF for 283 days and sustained losses of over \$3,500; and
- A 59-year old customer with a with a conservative investment objective and/or risk profile and net worth less than \$600,000 held a Non-Traditional ETF for 122 days in an IRA account and sustained losses of over \$4,500.

CGMI Failed to Establish and Maintain a Reasonable Supervisory System, including Written Procedures, in Violation of NASD Rules 3010 and 2110 and FINRA Rule 2010

NASD Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision shall rest with the member.

NASD Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules.

As described below, CGMI violated NASD Rules 3010 and 2110 and FINRA Rule 2010³ in that during the Relevant Period: (1) the Firm failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with NASD and FINRA Rules in connection with the sale of Non-Traditional ETFs in accounts where the Firm provided brokerage services to certain retail customers; and (2) the Firm failed to provide adequate formal training and guidance to its registered representatives and supervisors regarding Non-Traditional ETFs.

³ For the period January 2008 to December 14, 2008, this conduct constitutes a violation of NASD Rule 2110, and for the period December 15, 2008 through June 30, 2009, this conduct constitutes a violation of FINRA Rule 2010, both of which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

**CGMI Failed to Establish a Reasonable Supervisory System
In Connection with the Sale of Non-Traditional ETFs**

The Firm supervised Non-Traditional ETFs the same way it supervised traditional ETFs until FINRA issued the Regulatory Notice in June 2009. The Firm relied on its general supervisory procedures to supervise transactions in Non-Traditional ETFs during the Relevant Period. However, the general supervisory system the Firm had in place during the Relevant Period was not sufficiently tailored to address the unique features and risks involved with these products. For example, during the Relevant Period, the Firm did not create a procedure to address the risks associated with longer-term holding periods in Non-Traditional ETFs. Thus, during the Relevant Period, the Firm failed to establish a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of Non-Traditional ETFs.

CGMI Failed to Provide Adequate Training Regarding Non-Traditional ETFs

Prior to June 2009, CGMI failed to provide adequate formal training to registered representatives and supervisors regarding the features, risks, and characteristics of Non-Traditional ETFs. For example, prior to June 2009, the Firm failed to establish adequate guidance or tools to educate registered representatives and supervisors about Non-Traditional ETFs.

**CGMI Made Unsuitable Recommendations,
In Violation of NASD Rules 2310 and 2110 and FINRA Rule 2010**

The reasonable-basis suitability obligation under NASD Rule 2310 requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA recently stated, “[w]ith respect to leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETF’s use of leverage, and the customer’s intended holding period will have on their performance.”⁴ In this case, CGMI violated NASD Rules 2310 and 2110 and FINRA Rule 2010 by allowing its registered representatives to recommend to customers a Non-Traditional ETF without performing reasonable diligence to understand the risks and features associated with it.

Certain CGMI registered representatives made unsuitable recommendations of Non-Traditional ETFs to certain customers with a conservative investment objective and/or risk profile, in further violation of NASD Rules 2310 and 2110 and FINRA Rule 2010.

⁴ See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products – Heightened Supervision of Complex Product* (January 2012), at 5-6.

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

1. Censure;
2. Fine in the amount of \$2 million; and
3. Restitution in the amount of \$146,431.

CGMI agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. CGMI has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

CGMI specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid in the total amount of \$146,431. A registered principal on behalf of CGMI shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Scott Andersen, Enforcement Director, Department of Enforcement, One World Financial Center, 200 Liberty Street, New York, NY 10281 either by letter that identifies CGMI and the case number or by e-mail from a work-related account of the registered principal of CGMI to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason CGMI cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, CGMI shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. CGMI shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

CGMI specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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, CGMI specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

CGMI 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

CGMI 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 the Firm; and

C. If accepted:

1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
4. the Firm 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. CGMI 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 the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. CGMI may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. CGMI 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 CGMI, 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 the Firm has agreed to its 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 the Firm to submit it.

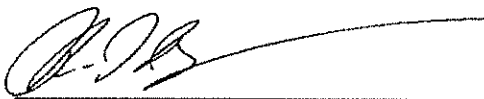
4/20/2012
Date (mm/dd/yyyy)

Citigroup Global Markets, Inc.
Respondent
Citigroup Global Markets Inc.

By: Elaine H. Mandelbaum

Title: Managing Director

Reviewed by:



Michael D. Wolk, Esq.
Counsel for Respondent Citigroup Global Markets Inc.
Bingham McCutchen LLP
2020 K Street, NW
Washington, DC 20006-1806
(202) 373-6249

Accepted by FINRA:

May 1, 2012
Date

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

Susan Light
Susan Light
Senior Vice President and Chief Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street
New York, NY 10281
(646) 315-7333

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090191139**

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

RE: Wells Fargo Advisors, LLC, Wells Fargo Advisors Financial Network, LLC and Wells Fargo Investments, LLC (collectively "Wells Fargo," "Respondent" or "the Firm"),
CRD Nos. 19616, 11025, 10582

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Wells Fargo 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 Wells Fargo alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Wells Fargo 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

Wells Fargo is the retail brokerage and wealth management affiliate of Wells Fargo & Company, headquartered in St. Louis, Missouri. On December 31, 2008, Wells Fargo & Company acquired Wachovia Corporation and its affiliated brokerage businesses, including Wachovia Securities. Wachovia Securities changed its name to Wells Fargo Advisors on May 1, 2009 and Wells Fargo Investments ceased doing business and merged into Wells Fargo Advisors on January 1, 2011. Wells Fargo, a FINRA-regulated broker-dealer, currently has over 15,000 Financial Advisors, approximately six million active client accounts, 5,000 branch offices and over \$1 trillion in client assets under management.

RELEVANT DISCIPLINARY HISTORY

Wells Fargo has the following relevant disciplinary history:

In August 2009, Wachovia Securities (now Wells Fargo) consented to a fine of \$350,000 and an undertaking for violations of NASD Rules 2110 and 3010(a) and (b) in that from August 2001 through October 2004, the Firm's supervisory systems and written supervisory procedures were inadequate to detect abusive sales practices regarding variable annuities, and the Firm lacked exception reports appropriate for monitoring variable annuity sales practices. (Letter of Acceptance, Waiver and Consent No. 2005002169202).

In May 2009, Wachovia Securities (now Wells Fargo) consented to a fine of \$1.4 million and an undertaking for violations of NASD Rules 2110 and 3010 in that the Firm, among other things, failed to deliver prospectuses and product descriptions to certain customers who had purchased certain investment products, and failed to have adequate supervisory systems and procedures to ensure that offering documents were being sent in connection with securities transactions. (Letter of Acceptance, Waiver and Consent No. 2007010181101).

In February 2009, Wachovia Securities (now Wells Fargo) consented to a fine of \$4.41 million and agreed to an undertaking that included remediation for violation of NASD Rules 2110, 2310, and 3010 in that the Firm, among other things, did not adequately consider breakpoints, fees and expenses when making recommendations to customers to purchase Class B or Class C shares in mutual funds instead of Class A shares and failed to establish, maintain, and enforce adequate supervisory and compliance policies and procedures. (Letter of Acceptance, Waiver and Consent No. E9A2005013001).

OVERVIEW

During the period from January 2008 through June 2009 (the "Relevant Period"), Wells Fargo failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Non-Traditional ETFs have certain risks that are not found in traditional ETFs, such as the risks associated with a daily reset, leverage and compounding. The performance of Non-Traditional ETFs over longer periods of time can differ significantly from the performance of their underlying index or benchmark, especially in volatile markets. Nonetheless, Wells Fargo supervised Non-Traditional ETFs the same way it supervised traditional ETFs. Thus, Wells Fargo failed to establish a reasonable supervisory system and written procedures to monitor the sale of Non-Traditional ETFs. Wells Fargo also failed to establish adequate formal training regarding Non-Traditional ETFs during the Relevant Period.

In addition, certain Wells Fargo registered representatives did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers. Certain Wells Fargo registered representatives also made unsuitable recommendations of Non-Traditional ETFs to certain customers with conservative income or conservative growth & income investment objectives and/or risk tolerances.

As such, Wells Fargo violated NASD Rules 3010, 2310, and 2110 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Non-Traditional ETFs

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.¹ Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market.

Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are “inverse” or “short” funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts and other derivative instruments. The Firm was not involved in the creation or initial structuring of these products.

Most Non-Traditional ETFs “reset” daily, meaning that they are designed to achieve their stated objectives only on a daily basis. FINRA noted in its June 2009 Regulatory Notice that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”² This effect can be magnified in volatile markets. For example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the index's daily return fell six percent, and the related ETF seeking to deliver twice the inverse of the index's daily return fell 26 percent.

Accordingly, investors were subjected to the risk that the performance of their investments in Non-Traditional ETFs could differ significantly from the

¹ See FINRA Regulatory Notice (“Notice”) 09-31, *Non-Traditional ETFs* (June 2009).

² *Id.* at 2.

performance of the underlying index or benchmark when held for longer periods of time, particularly in the volatile markets that existed during the Relevant Period.

Non-Traditional ETFs Have Dramatically Increased in Popularity Since 2006

In June 2006, a handful of Non-Traditional ETFs were listed and began trading on national securities exchanges after being registered with the U.S. Securities and Exchange Commission. Within nine months, over 40 additional Non-Traditional ETFs began trading on national securities exchanges. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately \$22 billion.

As the number of Non-Traditional ETFs grew, so did the number of transactions by customers at Wells Fargo. During the Relevant Period, Wells Fargo customers bought and sold a total of over \$9.9 billion of Non-Traditional ETFs.

Certain Wells Fargo Customers Held Non-Traditional ETFs For Longer Periods of Time

Despite the risks associated with holding Non-Traditional ETFs for longer periods, certain Wells Fargo customers held Non-Traditional ETFs for extended time periods during the Relevant Period. In fact, certain Wells Fargo customers with conservative investment objectives and/or risk tolerance profiles held Non-Traditional ETFs for periods of several months: For example:

- A 65-year old conservative customer with a stated net worth under \$50,000 held a Non-Traditional ETF for 43 days and sustained losses of over \$25,000.
- A 92-year old conservative customer with a stated net worth under \$500,000 held a Non-Traditional ETF for 135 days and sustained losses of over \$2,000.

Wells Fargo Failed to Establish and Maintain a Reasonable Supervisory System, including Written Procedures, in Violation of NASD Rules 3010 and 2110 and FINRA Rule 2010

NASD Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision shall rest with the member.

NASD Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered

principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules.

As described below, Wells Fargo violated NASD Rules 3010 and 2110 and FINRA Rule 2010³ in that during the Relevant Period: (1) the Firm failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with NASD and FINRA Rules in connection with the sale of Non-Traditional ETFs in accounts where the Firm provided brokerage services to certain retail customers; and (2) the Firm failed to provide adequate formal training and guidance to its registered representatives and supervisors regarding Non-Traditional ETFs.

**Wells Fargo Failed to Establish a Reasonable Supervisory System
In Connection with the Sale of Non-Traditional ETFs**

The Firm supervised Non-Traditional ETFs the same way it supervised traditional ETFs until FINRA issued the Regulatory Notice in June 2009. The Firm relied on its general supervisory procedures to supervise transactions in Non-Traditional ETFs during the Relevant Period. However, the general supervisory system the Firm had in place during the Relevant Period was not sufficiently tailored to address the unique features and risks involved with these products. For example, during the Relevant Period, the Firm did not create a procedure to address the risks associated with longer-term holding periods in Non-Traditional ETFs. Thus, during the Relevant Period, the Firm failed to establish a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of Non-Traditional ETFs.

**Wells Fargo Failed to Provide Adequate Training
Regarding Non-Traditional ETFs**

Prior to June 2009, Wells Fargo failed to provide adequate formal training to registered representatives and supervisors regarding the features, risks, and characteristics of Non-Traditional ETFs. For example, prior to June 2009, the Firm failed to establish adequate guidance or tools to educate registered representatives and supervisors about Non-Traditional ETFs.

³ For the period January 2008 to December 14, 2008, this conduct constitutes a violation of NASD Rule 2110, and for the period December 15, 2008 through June 30, 2009, this conduct constitutes a violation of FINRA Rule 2010, both of which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

**Wells Fargo Made Unsuitable Recommendations,
In Violation of NASD Rules 2310 and 2110 and FINRA Rule 2010**

The reasonable-basis suitability obligation under NASD Rule 2310 requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA recently stated, “[w]ith respect to leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETF’s use of leverage, and the customer’s intended holding period will have on their performance.”⁴ In this case, Wells Fargo violated NASD Rules 2310 and 2110 and FINRA Rule 2010 by allowing its registered representatives to recommend to customers a Non-Traditional ETF without performing reasonable diligence to understand the risks and features associated with it.

Certain Wells Fargo registered representatives made unsuitable recommendations of Non-Traditional ETFs to certain customers with conservative income or conservative growth & income investment objectives and/or risk tolerances, in further violation of NASD Rules 2310 and 2110 and FINRA Rule 2010.

B. Wells Fargo also consents to the imposition of the following sanctions:

1. Censure;
2. Fine in the amount of \$2.1 million; and
3. Restitution in the amount of \$641,489.

Wells Fargo agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Wells Fargo has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

Wells Fargo specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid in the total amount of \$641,489. A registered principal on behalf of Wells Fargo shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Scott Andersen, Enforcement Director, Department of Enforcement, One World Financial Center, 200 Liberty Street, New York, NY 10281 either by letter that identifies Wells Fargo and the

⁴ See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products – Heightened Supervision of Complex Product* (January 2012), at 5-6.

case number or by e-mail from a work-related account of the registered principal of Wells Fargo to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason Wells Fargo cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Wells Fargo shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Wells Fargo shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Wells Fargo specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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, Wells Fargo specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

Wells Fargo 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

Wells Fargo understands that:

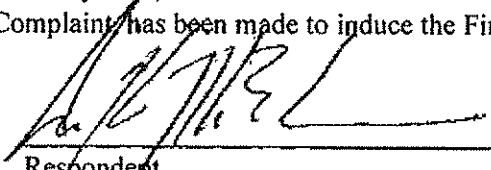
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. the Firm 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. Wells Fargo 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 the Firm's right to take legal or factual positions in

litigation or other legal proceedings in which FINRA is not a party.

- D. Wells Fargo may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Wells Fargo 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 Wells Fargo, 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 the Firm has agreed to its 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 the Firm to submit it.

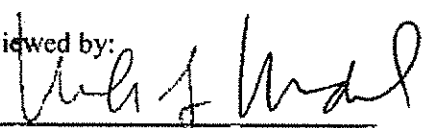
Date 04/19/12


Respondent
Wells Fargo

By: Ian K. MacEachern

Title: Managing Director

Reviewed by:


Mark S. Mandel, Esq.
Counsel for Respondent Wells Fargo
Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022
(212) 756 -2319

Accepted by FINRA:

May 1, 2012
Date

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

Susan Light

Susan Light
Senior Vice President and Chief Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street
New York, NY 10281
(646) 315-7333

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090181611**

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

RE: Morgan Stanley & Co. LLC ("Morgan Stanley," "Respondent" or "the Firm"),
CRD No. 8209

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Stanley 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 Morgan Stanley alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Morgan Stanley 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

Morgan Stanley & Co. Incorporated was a FINRA-regulated broker-dealer since 1936. Effective June 1, 2009, Morgan Stanley's Global Wealth Management Group combined with the Smith Barney Division of Citigroup Global Markets, Inc. to become Morgan Stanley Smith Barney Holdings LLC, a new joint venture that directly owns Morgan Stanley Smith Barney LLC. As of June 2011, Morgan Stanley & Co. Incorporated converted to a limited liability company and changed its name to Morgan Stanley & Co. LLC. The conduct described herein occurred almost entirely at Morgan Stanley.

RELEVANT DISCIPLINARY HISTORY

Morgan Stanley has the following relevant disciplinary history:

In April 2011, Morgan Stanley & Co. Inc. consented to a \$100,000 fine based on findings that it failed to establish adequate procedures and an effective

supervisory system to ensure that the Firm applied appropriate sales charge discounts for unit investment trust purchases in certain instances. (Letter of Acceptance, Waiver and Consent No. 2008015963801).

In March 2009, Morgan Stanley & Co. Inc. consented to a \$3 million fine, and agreed to pay restitution of over \$2 million to retiree or potential retiree clients based on the findings that the firm failed to adequately supervise the activities of certain brokers, who had failed to provide appropriate risk disclosures and suitable recommendations with respect to their handling of IRA rollover/retirement accounts. (Letter of Acceptance, Waiver and Consent 2006005132302).

In New York Stock Exchange Hearing Board Decision 07-66 (June 2007), Morgan Stanley & Co. Inc. consented to findings that it violated the NYSE supervisory rule in that the firm, among other things, failed to provide for appropriate supervisory controls regarding the monitoring of client accounts for suitability of investments, including guardian accounts established for minors pursuant to court orders implementing medical malpractice settlements. Morgan Stanley & Co. Inc. also lacked written supervisory procedures for reviewing and approving block trades. Morgan Stanley & Co. Inc. consented to a censure, a \$500,000 fine, and an undertaking.

OVERVIEW

During the period from January 2008 through June 2009 (the "Relevant Period"), Morgan Stanley failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Non-Traditional ETFs have certain risks that are not found in traditional ETFs, such as the risks associated with a daily reset, leverage and compounding. The performance of Non-Traditional ETFs over longer periods of time can differ significantly from the performance of their underlying index or benchmark, especially in volatile markets. Nonetheless, Morgan Stanley supervised Non-Traditional ETFs the same way it supervised traditional ETFs. Thus, Morgan Stanley failed to establish a reasonable supervisory system and written procedures to monitor the sale of Non-Traditional ETFs. Morgan Stanley also failed to establish adequate formal training regarding Non-Traditional ETFs during the Relevant Period.

In addition, certain Morgan Stanley registered representatives did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers. Certain Morgan Stanley registered representatives also made unsuitable recommendations of Non-Traditional ETFs to certain customers with a primary investment objective of income.

As such, Morgan Stanley violated NASD Rules 3010, 2310, and 2110 and

FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Non-Traditional ETFs

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.¹ Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market.

Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are “inverse” or “short” funds, meaning that they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts and other derivative instruments. The Firm was not involved in the creation or initial structuring of these products.

Most Non-Traditional ETFs “reset” daily, meaning that they are designed to achieve their stated objectives only on a daily basis. FINRA noted in its June 2009 Regulatory Notice that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”² This effect can be magnified in volatile markets. For example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the index's daily return fell six percent, and the related ETF seeking to deliver twice the inverse of the index's daily return fell 26 percent.

Accordingly, investors were subjected to the risk that the performance of their investments in Non-Traditional ETFs could differ significantly from the performance of the underlying index or benchmark when held for longer periods of time, particularly in the volatile markets that existed during the Relevant Period.

Non-Traditional ETFs Have Dramatically Increased in Popularity Since 2006

In June 2006, a handful of Non-Traditional ETFs were listed and began trading on national securities exchanges after being registered with the U.S. Securities and

¹ See FINRA Regulatory Notice (“Notice”) 09-31, *Non-Traditional ETFs* (June 2009).

² *Id.* at 2.

Exchange Commission. Within nine months, over 40 additional Non-Traditional ETFs began trading on national securities exchanges. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately \$22 billion.

As the number of Non-Traditional ETFs grew, so did the number of transactions by customers at Morgan Stanley. During the Relevant Period, Morgan Stanley customers bought and sold a total of over \$4.78 billion of Non-Traditional ETFs.

**Certain Morgan Stanley Customers Held Non-Traditional ETFs
For Longer Periods of Time**

Despite the risks associated with holding Non-Traditional ETFs for longer periods, certain Morgan Stanley customers held Non-Traditional ETFs for extended time periods during the Relevant Period. In fact, certain Morgan Stanley customers with a primary investment objective of income held Non-Traditional ETFs for periods of several months. For example:

- A 74-year old customer with a primary investment objective of income and a net worth under \$300,000 allocated over 25% of the account to a single Non-Traditional ETF that was purchased on a solicited basis and held for 128 trading days, sustaining losses of over \$13,000;
- An 89-year old customer with a primary investment objective of income and a net worth under \$200,000 allocated over 59% of the account to a single Non-Traditional ETF that was purchased on a solicited basis and held for 39 trading days, sustaining losses of over \$10,000.

**Morgan Stanley Failed to Establish and Maintain a Reasonable
Supervisory System, including Written Procedures,
in Violation of NASD Rules 3010 and 2110 and FINRA Rule 2010**

NASD Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision shall rest with the member.

NASD Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules.

As described below, Morgan Stanley violated NASD Rules 3010 and 2110 and FINRA Rule 2010³ in that during the Relevant Period: (1) the Firm failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with NASD and FINRA Rules in connection with the sale of Non-Traditional ETFs in accounts where the Firm provided brokerage services to certain retail customers; and (2) the Firm failed to provide adequate formal training and guidance to its registered representatives and supervisors regarding Non-Traditional ETFs.

**Morgan Stanley Failed to Establish a Reasonable Supervisory System
In Connection with the Sale of Non-Traditional ETFs**

The Firm supervised Non-Traditional ETFs the same way it supervised traditional ETFs until FINRA issued the Regulatory Notice in June 2009. The Firm relied on its general supervisory procedures to supervise transactions in Non-Traditional ETFs during the Relevant Period. However, the general supervisory system the Firm had in place during the Relevant Period was not sufficiently tailored to address the unique features and risks involved with these products. For example, during the Relevant Period, the Firm did not create a procedure to address the risks associated with longer-term holding periods in Non-Traditional ETFs. Thus, during the Relevant Period, the Firm failed to establish a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of Non-Traditional ETFs.

**Morgan Stanley Failed to Provide Adequate Training
Regarding Non-Traditional ETFs**

Prior to June 2009, Morgan Stanley failed to provide adequate formal training to registered representatives and supervisors regarding the features, risks, and characteristics of Non-Traditional ETFs. For example, prior to June 2009, the Firm failed to establish adequate guidance or tools to educate registered representatives and supervisors about Non-Traditional ETFs.

**Morgan Stanley Made Unsuitable Recommendations,
In Violation of NASD Rules 2310 and 2110 and FINRA Rule 2010**

The reasonable-basis suitability obligation under NASD Rule 2310 requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA recently stated, “[w]ith respect to

³ For the period January 2008 to December 14, 2008, this conduct constitutes a violation of NASD Rule 2110, and for the period December 15, 2008 through June 30, 2009, this conduct constitutes a violation of FINRA Rule 2010, both of which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETF's use of leverage, and the customer's intended holding period will have on their performance."⁴ In this case, Morgan Stanley violated NASD Rules 2310 and 2110 and FINRA Rule 2010 by allowing its registered representatives to recommend to customers a Non-Traditional ETF without performing reasonable diligence to understand the risks and features associated with it.

Certain Morgan Stanley registered representatives made unsuitable recommendations of Non-Traditional ETFs to certain customers with a primary investment objective of income, in further violation of NASD Rules 2310 and 2110 and FINRA Rule 2010.

B. Morgan Stanley also consents to the imposition of the following sanctions:

1. Censure;
2. Fine in the amount of \$1.75 million; and
3. Restitution in the amount of \$604,584.

Morgan Stanley agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Morgan Stanley has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

Morgan Stanley specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

Restitution is ordered to be paid in the total amount of \$604,584. A registered principal on behalf of Morgan Stanley shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Scott Andersen, Enforcement Director, Department of Enforcement, One World Financial Center, 200 Liberty Street, New York, NY 10281 either by letter that identifies Morgan Stanley and the case number or by e-mail from a work-related account of the registered principal of Morgan Stanley to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

⁴ See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products – Heightened Supervision of Complex Product* (January 2012), at 5-6.

If for any reason Morgan Stanley cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Morgan Stanley shall forward any undistributed restitution to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Morgan Stanley shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Morgan Stanley specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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, Morgan Stanley specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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. Morgan Stanley 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

Morgan Stanley 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 the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. the Firm 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. Morgan Stanley 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 the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Morgan Stanley may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Morgan Stanley 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 Morgan Stanley, 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 the Firm has agreed to its 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 the Firm to submit it.

4/19/2012
Date (mm/dd/yyyy)

[Signature]
Respondent
Morgan Stanley & Co. LLC

By: Scott Tucker
Title: Managing Director + Global
Head of Litigation

Reviewed by:
[Signature]
Michael G. Bongiorno, Esq.
Counsel for Respondent Morgan Stanley & Co. LLC
Wilmer Hale
399 Park Avenue
New York, NY 10022
(212) 937-7220

Accepted by FINRA:

4/26/12
Date

May 1, 2012

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

[Signature]
Susan Light
Senior Vice President and Chief Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street
New York, NY 10281
(646) 315-7333

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 20090191135**

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

RE: Morgan Keegan & Company, Inc. ("Morgan Keegan," "Respondent" or "the Firm"),
CRD No. 4161

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Morgan Keegan 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 Morgan Keegan alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Morgan Keegan 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

Morgan Keegan has been a FINRA-registered broker-dealer since 1969.

RELEVANT DISCIPLINARY HISTORY

Morgan Keegan has no relevant disciplinary history.

OVERVIEW

During the period from January 2008 through June 2009 (the "Relevant Period"), Morgan Keegan failed to establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of leveraged, inverse, and inverse-leveraged Exchange-Traded Funds ("Non-Traditional ETFs"). Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Some Non-Traditional ETFs are "inverse" or "short" funds, meaning that

they seek to deliver the opposite of the performance of the index or benchmark they track. Some funds are both inverse and leveraged, meaning that they seek to achieve a return that is a multiple of the inverse performance of the underlying index or benchmark.

Non-Traditional ETFs have certain risks that are not found in traditional ETFs, such as the risks associated with a daily reset, leverage and compounding. The performance of Non-Traditional ETFs over longer periods of time can differ significantly from the performance of their underlying index or benchmark, especially in volatile markets. Nonetheless, Morgan Keegan supervised Non-Traditional ETFs the same way it supervised traditional ETFs. Thus, Morgan Keegan failed to establish a reasonable supervisory system and written procedures to monitor the sale of Non-Traditional ETFs. Morgan Keegan also failed to establish adequate formal training regarding Non-Traditional ETFs during the Relevant Period.

In addition, certain Morgan Keegan registered representatives did not have an adequate understanding of Non-Traditional ETFs before recommending these products to retail brokerage customers. As such, Morgan Keegan violated NASD Rules 3010, 2310(a), and 2110 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

Non-Traditional ETFs

As described in a FINRA Regulatory Notice issued in June 2009, ETFs are typically registered unit investment trusts (UITs) or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index.¹ Shares of ETFs typically are listed on national securities exchanges and trade throughout the day at prices established by the market. To accomplish their objectives, Non-Traditional ETFs use swaps, futures contracts and other derivative instruments. Morgan Keegan was not involved in the creation or initial structuring of these products.

Most Non-Traditional ETFs “reset” daily, meaning that they are designed to achieve their stated objectives only on a daily basis. FINRA noted in its June 2009 Regulatory Notice that “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”² This effect can be magnified in volatile markets. For example, between December 1, 2008 and April 30, 2009, the Dow Jones U.S. Oil & Gas Index gained two percent, while an ETF seeking to deliver twice the index’s daily return fell six percent, and the related ETF seeking to deliver twice the inverse of the index’s daily return fell 26 percent.

¹ See FINRA Regulatory Notice (“Notice”) 09-31, *Non-Traditional ETFs* (June 2009).

² *Id.* at 2.

Accordingly, investors were subjected to the risk that the performance of their investments in Non-Traditional ETFs could differ significantly from the performance of the underlying index or benchmark when held for longer periods of time, particularly in the volatile markets that existed during the Relevant Period.

Non-Traditional ETFs Have Dramatically Increased in Popularity Since 2006

In June 2006, a handful of Non-Traditional ETFs were listed and began trading on national securities exchanges after being registered with the U.S. Securities and Exchange Commission. Within nine months, over 40 additional Non-Traditional ETFs began trading on national securities exchanges. By April 2009, over 100 Non-Traditional ETFs were available in the marketplace, with total assets under management of approximately \$22 billion.

As the number of Non-Traditional ETFs grew, so did the number of transactions by customers at Morgan Keegan. During the Relevant Period Morgan Keegan customers bought and sold a total of approximately \$631 million of Non-Traditional ETFs.

Morgan Keegan Failed to Establish and Maintain a Reasonable Supervisory System, including Written Procedures, in Violation of NASD Rules 3010 and 2110 and FINRA Rule 2010

NASD Rule 3010(a) states in part that each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules. Final responsibility for proper supervision shall rest with the member.

NASD Rule 3010(b)(1) states in part that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules.

As described below, Morgan Keegan violated NASD Rules 3010 and 2110 and FINRA Rule 2010³ in that during the Relevant Period: (1) the Firm failed to

³ For the period January 2008 to December 14, 2008, this conduct constitutes a violation of NASD Rule 2110, and for the period December 15, 2008 through June 30, 2009, this conduct constitutes a violation of FINRA Rule 2010, both of which require that a firm, in the conduct of its business, observe high standards of commercial honor and just and equitable principles of trade.

establish and maintain a supervisory system, including written procedures, reasonably designed to achieve compliance with NASD and FINRA Rules in connection with the sale of Non-Traditional ETFs in accounts where the Firm provided brokerage services to certain retail customers; and (2) the Firm failed to provide adequate formal training to its registered representatives and supervisors regarding Non-Traditional ETFs.

**Morgan Keegan Failed to Establish a Reasonable Supervisory System
In Connection with the Sale of Non-Traditional ETFs**

The Firm supervised Non-Traditional ETFs the same way it supervised traditional ETFs until FINRA issued the Regulatory Notice in June 2009. The Firm relied on its general supervisory procedures to supervise transactions in Non-Traditional ETFs during the Relevant Period. However, the general supervisory system the Firm had in place during the Relevant Period was not sufficiently tailored to address the unique features and risks involved with these products. For example, during the Relevant Period, the Firm did not create a procedure to address the risks associated with longer-term holding periods in Non-Traditional ETFs. Thus, during the Relevant Period, the Firm failed to establish a supervisory system, including written supervisory procedures, reasonably designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of Non-Traditional ETFs.

**Morgan Keegan Failed to Provide Adequate Formal Training Regarding
Non-Traditional ETFs**

Prior to June 2009, Morgan Keegan failed to provide adequate formal training to registered representatives and supervisors regarding the features, risks, and characteristics of Non-Traditional ETFs.

**Morgan Keegan Made Unsuitable Recommendations,
In Violation of NASD Rules 2310 and 2110 and FINRA Rule 2010**

The reasonable-basis suitability obligation under NASD Rule 2310(a) requires a broker-dealer and its registered representatives to, *inter alia*, perform reasonable diligence to understand the nature of a recommended security, as well as the potential risks and rewards. As FINRA recently stated, "[w]ith respect to leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective and the impact that market volatility, the ETF's use of leverage, and the customer's intended holding period will have on their performance."⁴ In this case, Morgan Keegan violated NASD Rules 2310(a) and 2110 and FINRA Rule 2010 by allowing certain of its registered representatives

⁴ See Notice 09-31, at 3; see also FINRA Regulatory Notice 12-03, *Complex Products Heightened Supervision of Complex Product* (January 2012), at 5-6.

to recommend to customers a Non-Traditional ETF without performing reasonable diligence to understand the risks and features associated with it.

- B. Morgan Keegan also consents to the imposition of the following sanctions:
1. Censure; and
 2. Fine in the amount of \$365,000.

Morgan Keegan agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. Morgan Keegan has submitted an Election of Payment form showing the method by which the Firm proposes to pay the fine imposed.

Morgan Keegan specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, the monetary sanctions imposed in this matter.

The sanctions imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Morgan Keegan specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against the Firm;
- 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, Morgan Keegan specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

Morgan Keegan 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

Morgan Keegan 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 the Firm; and
- C. If accepted:
 - 1. this AWC will become part of the Firm's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the Firm;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the Firm's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. the Firm 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. Morgan Keegan 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 the Firm's right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.

- D. Morgan Keegan may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Morgan Keegan 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 Morgan Keegan, 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 the Firm has agreed to its 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 the Firm to submit it.

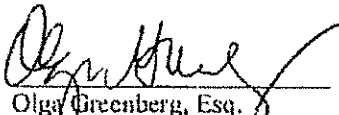
10/18/2017
Date (mm/dd/yyyy)


Respondent
Morgan Keegan & Company, Inc.

By: Paul L. Matert, Esq.

Title: General Counsel

Reviewed by:


Olga Greenberg, Esq.
Counsel for Respondent Morgan Keegan & Company, Inc.
Sutherland Asbill & Brennan LLP
999 Peachtree Street, NE
Atlanta, GA 30309-3996
(404) 853-8274

Accepted by FINRA:

10/24/12
Date

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

A handwritten signature in cursive script, appearing to read "Susan Schroeder", written over a horizontal line.

Susan Schroeder, Sr. VP & Counsel
FINRA Department of Enforcement
One World Financial Center
200 Liberty Street, 11th Floor
New York, NY 10281-1003
(646) 315-7466

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2012030789001**

**To: Department of Enforcement
Financial Industry Regulatory Authority (FINRA)**

**Re: Sunset Financial Services, Inc.
CRD No. 3538**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, the respondent, Sunset Financial Services, Inc., 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 the respondent alleging violations based on the same factual findings described herein.

I. ACCEPTANCE AND CONSENT

- A. The 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

Sunset Financial Services, Inc. ("Sunset") is an introducing broker-dealer that has been registered with FINRA – and, previously, the NASD – since 1968. Sunset has its main offices in Kansas City, Missouri. It has 371 registered representatives and 200 branch offices.

Relevant Disciplinary History

None.

Overview

Between March 16, 2009 and September 21, 2012, Sunset failed to establish and maintain a supervisory system, including written procedures, regarding the sale of leveraged or inverse exchange-traded funds (collectively "nontraditional ETFs") that was reasonably designed to achieve compliance with applicable NASD and FINRA rules.

Through this conduct, Sunset violated NASD Conduct Rule 3010 and FINRA Rule 2010.

Facts and violative conduct

Between March 2009 and September 2012, Sunset permitted its registered representatives to recommend and sell nontraditional ETFs to the firm's customers. During that time, however, Sunset's written supervisory procedures did not address nontraditional ETFs in any fashion. The firm also did not conduct due diligence of nontraditional ETF products before allowing their representatives to recommend them to customers.

Nontraditional ETFs are designed to return a multiple of an underlying index or benchmark, the inverse of that benchmark, or both only over the course of one trading session – usually a single day. As a result, the performance of nontraditional ETFs over periods of time longer than a single trading session “can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time.”¹ Because of these risks and the inherent complexity of the products, FINRA has advised broker-dealers and their representatives that nontraditional ETFs “are typically not suitable for retail investors.”²

Despite the unique features and characteristics of nontraditional ETFs, including notable risk factors, Sunset did not provide its representatives or supervisors with any training or other guidance regarding whether and when nontraditional ETFs might be appropriate for their customers. In addition, Sunset did not place any restrictions on its customers' ability to trade nontraditional ETFs into or out of their accounts. The firm did not create or obtain any exception reports or other tools to monitor either the length of time that customers held open positions in nontraditional ETFs or the losses occurring in those positions.

Through this conduct, Sunset failed to establish and maintain a supervisory system, including written procedures, regarding the sale of nontraditional ETFs that was reasonably designed to achieve compliance with applicable NASD and FINRA rules, in violation of NASD Conduct Rule 3010 and FINRA Rule 2010.

B. The respondent also consents to the imposition of the following sanctions:

1. A censure and
2. A \$20,000.00 fine.

¹ FINRA Regulatory Notice 09-31.

² *Id.*

The fine shall be due and payable immediately.

The respondent specifically and voluntarily waives any right to claim that it is unable 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

The 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, the respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, 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.

The 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

The 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 the respondent; and
- C. If accepted:
 - 1. this AWC will become part of the respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against the respondent;
 - 2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about the respondent's disciplinary record;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. The 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. The 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 the 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. The respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The 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 certifies, on behalf of the respondent, that he or she has read and understood all of the provisions of this AWC, and has been given a full opportunity to ask questions about it; that the respondent agrees to its 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 the respondent to submit it.

July 12, 2013
Date


Name and title Kelly T. Wilson, Executive Director
For SUNSET FINANCIAL SERVICES, INC.

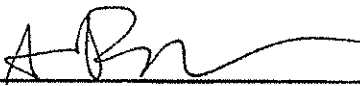
Reviewed by:


Counsel for Sunset Financial Services, Inc.

Accepted by FINRA:

7/17/2013
Date

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


Adam B. Walker, Principal Regional Counsel
Department of Enforcement, Kansas City
120 West 12th Street, Suite 800
Kansas City, MO 64105
Telephone: (816) 802-4751
Facsimile: (816) 421-4519
Email: adam.b.walker@finra.org