INITIAL DECISION RELEASE NO. 766
ADMINISTRATIVE PROCEEDING
FILE NO. 3-15918

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of DENNIS J. MALOUF	INITIAL DECISON April 7, 2015

APPEARANCES: Stephen C. McKenna, Dugan Bliss, and John H. Mulhern for the Division of Enforcement, Securities and Exchange Commission

Burton W. Wiand, Robert K. Jamieson, and Peter B. King of Wiand, Guerra King P.L. for Respondent Dennis J. Malouf

SUMMARY

This Initial Decision finds that Respondent Dennis J. Malouf (Malouf) violated Sections 206(1) and 206(2), and aided and abetted and caused violations of Sections 206(4) and 207 and Rule 206(4)-1(a)(5), of the Investment Advisers Act of 1940 (Advisers Act); violated Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933 (Securities Act); and violated Section 10(b) and Rules 10b-5(a) and 10b-5(c) of the Securities Exchange Act of 1934 (Exchange Act). This Initial Decision orders Malouf to cease and desist from causing further violations of these securities laws, bars Malouf from participating in the securities industry for a period of seven-and-one-half years, and orders Malouf to pay a civil money penalty of $75,000.

I. INTRODUCTION

The Securities and Exchange Commission (Commission or SEC) issued an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) on June 9, 2014, pursuant to Section 8A of the Securities Act, Sections 15(b), 15C(c), and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). Malouf filed his Answer on July 21, 2014. A hearing was held in Albuquerque, New Mexico, from November 17 through November 25, 2014. The admitted exhibits are listed in the Record Index issued by the Secretary of the Commission on March 20, 2015. The Division of Enforcement (Division) and Malouf filed post-hearing briefs and post-

hearing reply briefs, proposed findings of fact and conclusions of law and responses, and briefs regarding Malouf's inability to pay disgorgement or penalties.[1]

The OIP alleges the existence of a secret agreement between Malouf and a branch manager of a broker-dealer between 2008 and 2011, where Malouf directed UASNM, Inc.'s (UASNM) investment advisory client trades to the branch office of the broker-dealer, which he had previously owned, and the branch manager forwarded to Malouf substantially all of the resulting commissions. OIP at 2. According to the OIP, Malouf earned approximately $1.1 million from the scheme and did not disclose this arrangement to his clients. *Id.* Additionally, as a result of this secret agreement, the OIP alleges that (1) Malouf caused UASNM's website to make false or misleading statements, (2) Malouf failed to seek best execution on client bond trades, and (3) Malouf acted as an unregistered broker-dealer. *Id.*

Malouf denies these allegations, claiming that this action was orchestrated by Joseph Kopczynski (Kopczynski), UASNM's former owner, Chairman, and Chief Compliance Officer (CCO) and Malouf's former father-in-law, as a result of Malouf's decision to divorce Kopczynski's daughter. Answer at 1-6. Malouf also asserts a statute of limitations defense for any activity that forms the basis of the Division's allegations that occurred more than five years before the issuance of the OIP. *Id.* at 16.

II. FINDINGS OF FACT

I base the following findings of fact and conclusions on the entire record and the demeanor of the witnesses who testified at the hearing, applying preponderance of the evidence as the standard of proof. *See Steadman v. SEC*, 450 U.S. 91, 100-04 (1981). All arguments and proposed findings and conclusions that are inconsistent with this decision are rejected. I find the following facts to be true.

A. Relevant People and Entities

1. Dennis J. Malouf

Malouf, age fifty-five, was the chief executive officer, president, and majority owner of UASNM from September 2004 until May 13, 2011, when he was terminated. Stipulated FOF Nos. 1, 14, 286; JS No. 6. During 2008 to May 2011, Malouf was UASNM's advisory representative. Stipulated FOF No. 286; JS No. 6. When Malouf was CEO of UASNM, he was "top dog" and Kopczynski and Hudson worked for him. Stipulated FOF No. 197.

[1] Citations to the hearing transcript are noted as "Tr. __." Citations to the Division's exhibits and Malouf's exhibits are noted as "Div. Ex. ___" and Resp. Ex. ___," respectively. I will use similar designations in citations to the post-hearing filings. Citations to the parties' prehearing joint stipulations are noted as "JS No. ___." Citations to the parties' post-hearing stipulated findings of fact are noted as "Stipulated FOF No. ___" and conclusions of law are noted as "Stipulated COL No. ___." *See Dennis J. Malouf*, Admin. Proc. Rulings Release No. 2189, 2015 SEC LEXIS 73 (Jan. 8, 2015).

He is currently the sole owner and president of NM Wealth Management, LLC, an investment adviser registered with the State of New Mexico with approximately $26 million in assets under management.[2] Stipulated FOF Nos. 1, 14, 194. Malouf was a registered representative associated with Raymond James Financial Services (RJFS) from February 1999 through December 2007 and the owner of RJFS Branch 4GE (Branch 4GE). Stipulated FOF No. 14; Tr. 912, 914. From 2008 to May 2011, Malouf was not registered with the Commission as a broker or dealer and he was not associated with a broker or dealer. Stipulated FOF Nos. 46, 292; JS No. 12. In thirty-one years in the financial industry Malouf has never had a securities license suspended, has never had any discipline taken against his securities license, has never been fined for any securities related conduct, and has never been sued by a customer. Tr. 1009-10.

2. UASNM, Inc.

UASNM is a New Mexico corporation located in Albuquerque, New Mexico, that registered as an investment adviser with the Commission on September 4, 2004. Stipulated FOF Nos. 2, 15. UASNM, formerly known as "Universal Advisory Services" (UAS), provides discretionary advisory services primarily to individuals, charitable organizations, and employee benefit plans. Stipulated FOF Nos. 2, 15. UASNM's most recent Form ADV reported approximately $275 million in assets under management. Stipulated FOF Nos. 2, 15. UASNM is named as a respondent in a separate administrative proceeding. Stipulated FOF No. 2; *UASNM, Inc.*, Advisers Act Release No. 3846, 2014 WL 2568398 (June 9, 2014). Under a settlement in that proceeding, UASNM agreed to pay $506,083.74 to customers for purportedly excessive commissions and a $100,000 civil money penalty. Tr. 1274, 1371; *UASNM, Inc.*, 2014 WL 2568398, at *6, 8. Pursuant to a state court settlement between UASNM and Malouf, UASNM used Malouf's money to pay that $606,083.74. Stipulated FOF No. 371.

a. Joseph Kopczynski

Kopczynski, age sixty-five, is currently the chairman of UASNM's board of directors and its CCO. Stipulated FOF No. 16. He started the UASNM business and sold the firm to Malouf, his then son-in-law, and Kirk Hudson (Hudson), in September of 2004, but maintained a one-percent ownership interest. *Id.* Kopczynski was UASNM's CCO from 2004 to 2010, relinquished that position to Malouf in January of 2011, and resumed the position in June 2011, after Malouf was terminated. *Id.*; Stipulated FOF No. 302. During the time that Kopczynski was CCO, Malouf relied upon him to carry out all responsibilities of the compliance program at UASNM. Tr. 1062. Prior to 2011, Malouf relied on Kopczynski as CCO to ensure the firm was complying with its best execution obligation. Stipulated FOF 98. From 2008 to 2010 it was Kopczynski's responsibility as CCO to review the arrangements between UASNM and third party providers such as RJFS. Tr. 787-788; Div. Ex. 15 at 99. Kopczynski claims he reviewed and approved the content posted on UASNM's website and other marketing materials and that it

[2] Since the parties stipulated to these facts, it became clear that the amount of assets under management is less than $20 million.

was his responsibility to ensure the accuracy of the firm's Forms ADV. Tr. 1323, 1325, 1354; Stipulated FOF Nos. 57-58; *see* Div. Ex. 15 at 53; Stipulated FOF Nos. 55-56.

b. Kirk Hudson

Hudson, age fifty-two, held a minority ownership interest in UASNM from August 2004 to 2011, and is currently UASNM's chief financial officer and chief investment officer. Stipulated FOF No. 17. Hudson did bond trading for a significant number of his clients at UASNM, and was the secondary trader that would step in if Malouf was unavailable. Tr. 731-32. Hudson placed a significant number of bond trades for UASNM customers through Branch 4GE prior to 2008. Tr. 772.

c. Other Relevant UASNM Personnel

Matthew Keller (Keller) is a minority shareholder of UASNM. Stipulated FOF No. 90. During 2008 through 2011, Keller was an investment adviser with UASNM. Stipulated FOF No. 296. Keller placed 50-60% of the bond trades he directed through RJFS. Tr. 1165-66.

Paula Calhoun (Calhoun), UASNM's bookkeeper, is an employee at will. Stipulated FOF Nos. 91, 254, 299. Beginning in late 2007 or early 2008, through 2011, Calhoun performed bookkeeping services for Malouf personally. Stipulated FOF Nos. 195, 254, 299. Calhoun performed personal bookkeeping services for Malouf because those were his instructions in his capacity as UASNM's President. Stipulated FOF No. 256. Calhoun is a workplace friend of Aubrey Kopczynski, daughter of Kopczynski and Malouf's ex-wife. Stipulated FOF No. 92.

3. Raymond James Financial Services, Inc.

RJFS is a Florida corporation formed in 1999. Stipulated FOF No. 15. RJFS, through a predecessor, has been registered with the Commission as a broker-dealer since 1974, and is a member of FINRA. *Id.*

a. Maurice Lamonde

Maurice Lamonde (Lamonde) was a registered representative associated with RJFS from March 2000 until August 2011, and, from January 2008 through August 2011, he owned an Albuquerque office of RJFS, Branch 4GE. Stipulated FOF No. 15. He died unexpectedly on April 4, 2014, at age sixty-five.[3] *Id.*; Stipulated FOF No. 308.

b. Kirk Bell

[3] I admitted the prior sworn statement of Lamonde on September 23, 2014, after briefing by the parties. *Dennis J. Malouf*, Admin. Proc. Rulings Release No. 1831, 2014 SEC LEXIS 3533. During the hearing, the Division and Respondent read relevant sections of Lamonde's investigative testimony into the record. Tr. 854-85, 1593-1616.

From 2007-2011, Kirk Bell (Bell) was Assistant Regional Director at RJFS. Stipulated FOF No. 219. Bell supervised the 4GE Branch owned by Lamonde from 2008-2011, with which Malouf was previously affiliated. Stipulated FOF No. 220.

4. Adviser Compliance Associates, LLC

UASNM engaged Adviser Compliance Associates, LLC (ACA), a compliance consulting firm that provides advice and guidance to registered investment advisers, at various times beginning in 2002 through 2011. Stipulated FOF Nos. 139, 303. ACA contracted with UASNM to provide mock SEC compliance audits annually and used that process to recommend potential updates or changes to UASNM's Form ADV. Stipulated FOF Nos. 35, 93, 304, 346. In 2010 ACA would have normally charged $50,000 per year for the type of service provided to UASNM, but ACA only charged UASNM $15,000. Tr. 790. ACA does not undertake a duty to root out fraud on behalf of its clients. Stipulated FOF No. 155.

Michael Ciambor (Ciambor) started at ACA in the spring of 2003. Stipulated FOF No. 144. Ciambor was a consultant at ACA from 2006 to 2009 and a principal consultant from 2009 to 2012. Stipulated FOF No. 392. Ciambor took over the lead role with respect to ACA's annual examinations of UASNM in or around 2006. Stipulated FOF Nos. 144, 393. Ciambor worked primarily with Hudson and Kopczynski on matters relating to UASNM's engagement of ACA. Stipulated FOF No. 274. Ciambor primarily interacted with them rather than Malouf. Tr. 790. Malouf reasonably believed that Kopczynski, Hudson, and Ciambor were all sufficiently experienced and qualified for their positions and the attendant duties. Tr. 1018, 1062-63, 1127.

Ciambor was not a former securities regulator, although many of ACA's founding employees were. Tr. 718, 757, 761. Ciambor did not undergo any formal training for his position at ACA with respect to best execution or identifying conflicts of interest or continuing commission payments. Tr. 757-58; Stipulated FOF No. 143.

ACA conducted mock SEC inspections of UASNM by using the current document request list utilized in inspections by the SEC at that time as a baseline, and then submitting supplemental document requests as warranted. Stipulated FOF No. 382. ACA also prepared UASNM's compliance manual, which was intended to keep UASNM in compliance with SEC regulations. Stipulated FOF No. 350. ACA's annual review of UASNM included testing to ensure that UASNM's practices were consistent with the procedures set forth in its written compliance manual. Tr. 780.

B. Background

In 2004, Malouf purchased a majority interest in UASNM, and Hudson purchased a minority interest in UASNM, and registered the firm as an investment adviser with the Commission. Stipulated FOF Nos. 3, 18, 114. At that time, Malouf was also associated as a registered representative and owned a branch of a broker-dealer, RJFS. Stipulated FOF Nos. 3, 18. The RJFS branch owned by Malouf subleased and occupied a portion of UASNM's office space. Stipulated FOF Nos. 3, 18.

In 2007, RJFS became concerned about potential conflicts of interest and supervision risks, among other issues, arising from Malouf's work at UASNM, and asked him to choose between associating with UASNM or RJFS. Stipulated FOF Nos. 4, 19. Malouf decided to continue his advisory work at UASNM and to terminate his association as a registered representative and owner of a branch office of RJFS. Stipulated FOF Nos. 4, 19. Prior to RJFS approaching him, Malouf had not contemplated selling his profitable RJFS branch. Stipulated FOF No. 163. He considered Branch 4GE to be a substantial asset that he wanted to protect. Stipulated FOF No. 387.

As a result, at the end of 2007, Malouf terminated his registration with RJFS and he transferred his broker-dealer customers either to UASNM or to the new branch manager, Lamonde. Stipulated FOF Nos. 5, 19. Lamonde continued to operate Branch 4GE within UASNM's office space until June 2011. Stipulated FOF Nos. 5, 19.

As a broker, Lamonde had the power and authority to set the commission on trades placed through Branch 4GE, subject to a maximum commission rate designated by RJFS. Tr. 669-70, 709-10, 1614; *see* Div. Ex. 127.

Malouf was considered the person with the most experience with bonds within UASNM, based upon his prior experience in trading bonds. Stipulated FOF No. 6. As a result, he handled most of the bond trading on behalf of UASNM clients. *Id.* From 2008 to 2011, Malouf selected Lamonde and RJFS to execute the majority of bond transactions that he directed on behalf of UASNM clients. *Id.* Between January 2008 and May 2011, UASNM placed over 200 bond trades through RJFS, representing approximately ninety percent of its bond trading in this period. *Id.* During this period, Malouf, through UASNM, effected transactions in securities, including U.S. Treasuries, federal agency bonds, and municipal bonds. *Id.* From 2008 to May 2011, Malouf was one of several investment advisers at UASNM who provided advice regarding investments on behalf of UASNM customers, and transactions were carried out on behalf of UASNM customers pursuant to the advice of Malouf and other UASNM advisers. Stipulated FOF Nos. 37, 284; JS No. 4. In providing investment advice to UASNM customers, Malouf and other UASNM advisers utilized instruments of interstate commerce, such as telephones, email, and regular mail. Stipulated FOF No. 285; JS No. 5. During 2008 to May 2011, Malouf solicited clients on behalf of UASNM. Stipulated FOF Nos. 43-2, 287; JS No. 7. Malouf was primarily the person at UASNM who identified which bonds should be purchased for UASNM customers. Stipulated FOF No. 288; JS No. 8.

On May 13, 2011, Kopczynski and Hudson voted to terminate Malouf as CEO of UASNM and locked him out of the office. Stipulated FOF No. 309. On May 27, 2011, Kopczynski, Hudson, and UASNM filed a lawsuit against Malouf in the Second Judicial District Court, Bernalillo County, New Mexico, seeking injunctive relief and a declaratory judgment. Stipulated FOF No. 310. Malouf was paid $1.1 million for his interest in UASNM as part of a settlement agreement; $350,000 was paid directly to Malouf and $850,000 was held back in an account. Stipulated FOF No. 371. $506,000 of the $850,000 that was held back was paid to UASNM customers, and another $100,000 from that account was used to pay UASNM's civil penalty. *Id.*

C. Malouf's Sale of RJFS Branch 4GE to Lamonde

1. Timing

On approximately January 1, 2008, Malouf sold the RJFS broker-dealer branch that he founded in 1999 to his then branch manager Lamonde. Stipulated FOF No. 293; JS No. 13. Kopczynski, Hudson, and Keller knew Branch 4GE had been sold to Lamonde at the beginning of 2008. Stipulated FOF No. 50.

Although the sale was supposedly effective on January 2, 2008, the first time that Lamonde or Malouf disclosed a written agreement was almost two-and-a-half years later, in response to requests by Bell to Lamonde. In May 2009, RJFS intercepted an email between Lamonde and his wife, referencing financial problems and the lack of the written agreement with Malouf. Stipulated FOF No. 223; Tr. 639-40. As a result, Bell requested a copy of the written buy/sell agreement between Malouf and Lamonde. *Id.* Lamonde indicated that he and Malouf were still working on it, and did not provide a signed copy. Div. Exs. 60, 94; Stipulated FOF No. 27. Lamonde told Bell that Lamonde and Malouf were working on a buy/sell agreement, but that no sale had yet taken place; Lamonde did not tell Bell that Lamonde was already making payments to Malouf. Stipulated FOF No. 224.

During 2009, Bell requested a copy of the buy/sell agreement on multiple occasions but the agreement was not provided. Stipulated FOF No. 225. Lamonde responded to email requests for the agreement as follows: "I'M WORKING ON THE PURCHASE AGREEMENT" (on May 15, 2009) and "I AM STILL WORKING ON THE AGREEMENT AND WILL SEND IT AS SOON AS WE FINISH IT" (on June 4, 2009). *Id.*; Stipulated FOF No. 27. Bell understood there was no sale or agreement at that time. Stipulated FOF No. 225.

Bell ultimately received a copy of the purported Purchase of Practice Agreement (PPA) on June 10, 2010. Div. Ex. 97; Stipulated FOF No. 227. The front page of the agreement was dated January 2, 2008, but the signature page and notary were dated June 11, 2010. Div. Ex. 97; Stipulated FOF No. 227. Bell was concerned about the date discrepancy and thought it did not make sense and was inappropriate. Stipulated FOF No. 227.

No witness other than Malouf or Lamonde claimed to have seen a written PPA prior to June 10, 2010. Prior to that date, Hudson, Kopczynski, and Keller had not seen a written PPA, and Hudson and Kopczynski had not asked to see a written PPA, regarding Malouf's sale of his RJFS branch to Lamonde. Stipulated FOF Nos. 52, 62, 126. Although Malouf told Ciambor that he had sold the branch during ACA's 2008 on-site review, Ciambor was not provided with the agreement in 2008. Tr. 736; Stipulated FOF No. 149. However, at that time Ciambor did not ask Malouf for a copy of the PPA and did not ask what the terms of the sale of Branch 4GE were. Tr. 736, 774; Stipulated FOF No. 49.

Neither Hudson nor Kopczynski ever disclosed to Ciambor that they knew Malouf was receiving payments from Lamonde. Stipulated FOF No. 385. Ciambor discovered that Malouf had been receiving payments from Lamonde for the sale of his RJFS branch no later than the

June 2010 on site review. Stipulated FOF No. 150. In 2010, Ciambor's understanding of the payments made by Lamonde to Malouf is that they were payments for the sale of Branch 4GE and not commission-based compensation. Tr. 799. Don Miller (Miller), Malouf's accountant, first saw a copy of the written PPA in May of 2011. Stipulated FOF No. 325.

Malouf has been unable to produce any copy of Exhibit A to the PPA, which purportedly set forth the clients Malouf was transferring to Lamonde. Tr. 921-22; Stipulated FOF No. 128; *see* Div. Ex. 97. While Malouf has been unable to locate a copy, clients were indisputably transferred from Malouf to Lamonde via a list that was in RJFS's possession on or around December 31, 2007. Stipulated FOF No. 69. This list of customers was attached to email communications between RJFS and Malouf on January 2, 2008. Stipulated FOF No. 70. Steven McGinnis (McGinnis) never asked Malouf or RJFS for a copy of Exhibit A.[4] Tr. 460-61. Bell testified that the account transfer could have occurred without Lamonde or Malouf providing a list of accounts; RJFS could have transferred the accounts using the individual representative numbers associate with Lamonde and Malouf. Tr. 635. Bell did not testify that the transfer in fact occurred without Lamonde or Malouf providing a list of accounts. In fact, the evidence showed that a list was provided. *See* Div. Exs. 82, 83; Resp. Exs. 514, 515 (indicating Malouf sent a list to RJFS); Tr. 681-82.

Lamonde changed his testimony about entering into a written agreement with Malouf in late 2007 or early 2008 after being confronted with e-mails indicating that there was no written agreement until 2010, and acknowledged that he and Malouf did not create a written, signed agreement until June of 2010. Resp. Ex. 308 at 70-71; Div. Ex. 239 at 285-86.

2. Terms

The PPA between Malouf and Lamonde stated that Lamonde would pay Malouf continuing commissions pursuant to IM-2420-2, the FINRA (formerly NASD) rule on "Continuing Commissions Policy" (NASD 2420-2). Div. Ex. 97 at RJFS-SEC-UASNM-000163; *see* Div. Ex. 234. Malouf learned about or was directed to NASD 2420-2 by RJFS. Tr. 1043. Malouf read information regarding NASD 2420-2 on the RJFS intranet, and he reviewed the plain language of the rule on FINRA's website. Tr. 1041.

The process for the sale of an RJFS branch typically involves RJFS providing the registered representatives with a sample agreement, getting a list of client accounts that would be part of the buy-sell agreement, and then moving the accounts according to that list. Tr. 633.

Malouf testified that he and Lamonde agreed that the price for the branch would be two times trailing revenue of approximately $500,000 to $550,000, or approximately $1.1 million. Tr. 924-25. This is same formula that Malouf had employed for his purchase of UASNM. Tr. 924, 1056. Lamonde made installment payments for his purchase of Branch 4GE. *See* Stipulated FOF Nos. 293, 294.

[4] McGinnis is a consultant to Capital Forensics, which was hired by UASNM in its lawsuit against Malouf to evaluate the evidence related to UASNM's bond trading and opine as to what would be UASNM's compliance response. Stipulated FOF Nos. 40, 209-10, 355.

The sale agreement between Malouf and Lamonde required Lamonde to make periodic payments to Malouf for the purchase of the branch. Tr. 924. Malouf testified that payment for the branch was to be 40% of branch revenue over a four-year production period. Stipulated FOF No. 166. The PPA stated that the production period was to be five years, from January 2, 2008, to December 31, 2012. Stipulated FOF No. 167. Malouf is not sure why if everything is based on four years, the contract contemplates five. Stipulated FOF No. 168.

3. Payments

From 2008-2011, Malouf did the majority of his bond trades on behalf of UASNM clients through RJFS. Stipulated FOF No. 173. RJFS's trade blotter (Div. Ex. 29) shows that from January 2008 to May 2011 UASNM traded $140,819,708.15 in bonds through RJFS. Stipulated FOF No. 23. A summary of UASNM's bond trades prepared by Hudson shows that between January 2008 and May 2011, UASNM traded only $16,789,390.30 in bonds through other brokers. Div. Exs. 30, 207; Tr.101-03.[5] Thus, 89% of UASNM's bond trades were made through RJFS during the relevant period. Div. Ex. 207; Tr. 108, 357.

Malouf testified that when he used RJFS's bond desk to purchase bonds Lamonde was paid a commission and then had money to pay Malouf under their agreement. Stipulated FOF No. 175. Malouf used RJFS to trade bonds, among other reasons, because he was paid for those bond transactions, and he was not ashamed of receiving the approximately $1.1 million of payments for the sale of his branch because he thought he had done a good job. Tr. 941-42; Stipulated FOF Nos. 176, 177; Div. Ex. 231 at 259-60. Malouf said that if he could get the same bond at the same price from either RJFS or another broker, he was not obligated to direct a trade to the other broker simply because he might benefit in some way if the trade went through RJFS. Div. Ex. 231 at 259-60.

From 2008 into 2011, Lamonde made a series of ongoing payments to Malouf for the RJFS branch. Stipulated FOF No. 294; JS No. 14. During that time period, Lamonde earned $1,074,454 in commissions from RJFS on UASNM bond trades and paid $1,068,084 to Malouf. Stipulated FOF Nos. 7, 20.

Beginning with his purchase of Branch 4GE in January 2008, Lamonde did not make payments to Malouf on a monthly basis as provided for in the PPA. Div. Ex. 97 at RJFS-SEC-UASNM-000162; *see* Stipulated FOF Nos. 258, 323; Div. Ex. 201.[6] The payments were not made on a set schedule and oftentimes more than one payment would be made each month. Div. Ex. 201. According to Malouf, Lamonde was simply prepaying what he owed for the branch. Stipulated FOF No. 28.

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[5] Division Exhibit 207 is a chart prepared by summary witness John Schmalzer (Schmalzer), a financial analyst who works for the Commission on a contract basis and who testified for the Division. Tr. 345-46, 355-56.

[6] Division Exhibit 201 is a chart prepared by Schmalzer. Tr. 347.

Lamonde admitted in investigative testimony that he and Malouf did not follow the terms of the PPA and that he paid Malouf more than the terms of the PPA required. Div. Ex. 239 at 178-79. Lamonde also testified that Malouf repeatedly demanded immediate cash payments for the entire commission that had been earned from particular UASNM bond trades (which was contrary to the terms of the PPA that provided for monthly payments). *Id.* at 274-75; Stipulated FOF No. 21. Malouf sometimes asked Lamonde, "where is my check" in the presence of at least Hudson or Calhoun. Stipulated FOF Nos. 21, 60. Lamonde espoused the opinion that that Malouf acted as if the commissions Lamonde made on bond trades referred by Malouf were Malouf's money, though Lamonde did not testify that Malouf told him that he felt that way. Div. Ex. 239. at 195.

Lamonde sought at least twelve cash advances from RJFS in pertinent part to pay Malouf. Stipulated FOF No. 214; Div. Exs. 101, 102. Two of these cash advances indicate "FBO" Peter Lehrman, indicating that they were to pay Peter Lehrman and not Malouf. Div. Ex. 101.

For Lamonde to pre-pay what he owed Malouf for the branch, he borrowed against a life insurance policy, took money from his father-in-law's bank account, and took on new credit card debt without telling his wife. Div. Ex. 89; Div. Ex. 239 at 127-28; *see* Stipulated FOF No. 223.

Often, Lamonde's payments to Malouf appeared to be related to commissions earned on the UASNM bond trades Malouf made through Branch 4GE. Tr. 142; Div. Ex. 203; *see* Stipulated FOF No. 196.[7] According to Lamonde, under the agreement, Lamonde passed along almost all of the commissions he made from RJFS bond trading on behalf of UASNM clients back to Malouf. Div. Ex. 239 at 205. Lamonde's payments to Malouf totaled $1,068,084.13, which equaled 99.4% of Lamonde's commissions. Div. Ex. 203; *see* Stipulated FOF No. 71. On a quarterly basis in 2008 and 2009, the amounts of the payments by Lamonde to Malouf at times exceeded the amount of commissions received by Lamonde, and on a quarterly basis in 2010, the amount of payments by Lamonde to Malouf are at times less than the amount of commissions received by Lamonde. Stipulated FOF Nos. 72, 72-2. Jerry DeNigris (DeNigris), an expert witness for Malouf, calculated that Lamonde paid Malouf 57.35% of the net branch revenues and 44.59% of the gross commission earned by the branch. Resp. Ex. 583 at Exhibit 4.

Lamonde gave inexplicably contradictory testimony regarding whether payments to Malouf were based, on the one hand, on bond-trade commissions from the accounts that Malouf sold to Lamonde (44Y5), or, on the other hand, that the payments were based on gross commissions for the whole branch, not just accounts transferred to 44Y5. Div. Ex. 239 at 184; Stipulated FOF No. 221; Tr. 1595-96.

Lamonde referred to the payments he made to Malouf as "commissions" on his 2008, 2009, and 2010 tax returns. Stipulated FOF No. 44; Div. Exs. 76, 77, 78. Lamonde provided Malouf with IRS Forms 1099 for the payments. Stipulated FOF No. 44. At Malouf's instruction, from 2008 through the first quarter of 2011, Calhoun performed bookkeeping

[7] Division Exhibit 203 is a chart prepared by Schmalzer. Tr. 351-53.

services for Lamonde's Ltd. Stipulated FOF Nos. 259, 301. Calhoun prepared Forms 1099 for Lamonde's Ltd., including a 1099 to Malouf for 2010 that listed amounts he was paid as non-employee compensation, but not as proceeds from the sale of a business.[8] Stipulated FOF No. 260. Miller, an experienced CPA, testified that Lamonde did not report the payments correctly and issued the 1099s in error. Tr. 1577-78.

Kopczynski believed the sale of Branch 4GE could have involved payments over time from Lamonde to Malouf, similar to the terms of his sale of UAS to Malouf and Hudson in 2004. Tr. 1331-1332; Stipulated FOF No. 51. Additionally, the payments to Lamonde were broadcast openly throughout the office on those occasions when Malouf would ask Lamonde about the status of payments, resulting in at least one or two open arguments about the payments. Div. Ex. 229 at 104-05. The fact that Lamonde was making payments to Malouf, according to Hudson, "wasn't a hidden thing," and Hudson assumed the payments were for the purchase of Branch 4GE. *Id.* at 106-07; Stipulated FOF Nos. 34, 347. Hudson did not object to Malouf receiving money from RJFS because it meant him borrowing less from UASNM. *Id.* at 106. Hudson did not ask about or investigate the agreement between Malouf and Lamonde because he did not think it was part of his role or any of his business. Tr. 140-41.

According to UASNM's independent compliance consultant, Ciambor, Malouf told him that with the sale of his RJFS branch to Lamonde, his relationship with RJFS was effectively severed, though Ciambor could not recall whether Malouf actually used the phrase "severed ties" in discussing the matter with him. Tr. 736-37, 773-76. Prior to June 2010, Malouf did not tell Ciambor that he was receiving ongoing payments from Lamonde from the RJFS branch. Tr. 737; Stipulated FOF No. 36. When asked if Malouf told him when he interviewed Malouf in June of 2009 that he had received in the last year and a half over forty payments from Lamonde totaling over half a million dollars based upon trades that had been run through Malouf's former RJFS branch, Ciambor testified "absolutely not," but if that were the case Malouf should have told Ciambor about it. Stipulated FOF No. 156. Ciambor testified that based upon what he knows now, he thinks Malouf lied to him. Tr. 852.

[8] I do not find credible Calhoun's hearing testimony that Lamonde told her that the checks from Lamonde to Malouf were commissions from RJFS. Tr. 1243-45. During her investigative testimony, Calhoun testified that when she started working at UASNM in 2004 – Malouf still owned Branch 4GE at that time and was registered with RJFS – Malouf received commission checks. Div. Ex. 227 at 19-20. At the hearing she testified there was no reason for her to think any different later on when Malouf had sold Branch 4GE. Tr. 1256. She did not testify that Lamonde told her they were commissions during her investigative testimony, but that she would ask about the memo that Lamonde would allegedly put on the checks – "commission." Div. Ex. 227 at 20. When confronted with the checks at the hearing, Calhoun admitted that contrary to her statement about the memo line, none of them actually contained the memo "commission." Tr. 1257-58; *see* Stipulated FOF No. 61. She never testified during the investigation that Lamonde told her they were commissions.

D. UASNM Forms ADV

Malouf, Kopczynski, Hudson, and outside compliance consultant ACA each were involved to varying degrees in preparing or reviewing UASNM's Forms ADV from 2008 through May 2011. Stipulated FOF No. 32. ACA reviewed Parts I and II of UASNM's Forms ADV annually and made recommendations to UASNM regarding updates it thought were necessary. Stipulated FOF No. 384. Ciambor primarily worked with Kopczynski and Hudson to update UASNM's Forms ADV. Tr. 751. Ciambor personally reviewed Part II of UASNM's Forms ADV on at least an annual basis. Tr. 820.

Hudson signed or authorized ACA to sign his name to every Form ADV filed by UASNM. Tr. 291-92; Stipulated FOF No. 54. By doing so, he and the investment adviser both certified, under penalty of perjury under the laws of the United States of America, that the information and statements made therein, including exhibits and any other information submitted, were true and correct. Tr. 291-92.

Malouf performed at least a cursory review of some Forms ADV focusing on disclosures relating to himself and RJFS. Stipulated FOF No. 33. Malouf had a responsibility to make full and accurate disclosure in the Forms ADV regarding his ongoing relationship with RJFS. Tr. 995. Malouf, as CEO, president, and majority shareholder of UASNM, had final and ultimate responsibility for UASNM's Forms ADV between 2006 and the end of 2010. Tr. 993-95.

At least some of UASNM's ADVs between 2008 and 2011 did not disclose that Malouf sold his RJFS branch to Lamonde and was receiving ongoing payments from Lamonde in connection with that sale. Stipulated FOF No. 8.[9, 10]

Items 8 and 9 of UASNM's Forms ADV Part II, dated February 4, 2008, August 20, 2008, and December 1, 2008, disclosed that employees of UASNM were or may be registered representatives of RJFS and could receive commissions. Stipulated FOF No. 29.

Items 8 and 9 of UASNM's Forms ADV Part II, dated October 1, 2009, January 1, 2010, and April 12, 2010, removed the prior disclosure regarding the UASNM employees' status as registered representatives of RJFS but were otherwise the same as the prior versions. Stipulated FOF No. 30.

[9] The Division does not dispute that the conflict with Branch 4GE was disclosed from 2004 through August 2008, and again in March 2011 in UASNM's Forms ADV.

[10] At times between 2008 and May 2011, UASNM's Forms ADV and website stated that Malouf had a Bachelor of Science in Finance degree from the University of Northern Colorado at Greeley. Stipulated FOF No. 335. Malouf did not receive a Bachelor of Science in Finance degree from the University of Northern Colorado. Stipulated FOF No. 336. Malouf was not initially aware that the disclosure was incorrect. He became aware that he had not successfully received his degree and immediately took steps to ensure that the disclosure on the Form ADV was corrected. Stipulated FOF No. 83.

Item 12 of UASNM's Form ADV Part II, dated April 12, 2010, affirmatively represented that "employees of UASNM are not registered representatives of Schwab, [RJFS] or Fidelity, and do not receive any commissions or fees from recommending these services." Stipulated FOF No. 10.

Item 12 of UASNM's Form ADV Part II, dated April 12, 2010, disclosed that the broker recommended by UASNM was not "based upon any arrangement between the recommended broker and UASNM," and, instead, was

> dependent upon a number of factors including the following: Trade execution, custodial services, trust services, recordkeeping and research, and/or ability to access a wide variety of securities. UASNM reviews, on a periodic and systematic basis, its third-party relationships to ensure it is fulfilling its fiduciary duty to seek best execution on client transactions.

Stipulated FOF No. 9.

Items 10 and 12 of UASNM's Form ADV Part 2A, dated March 2011, disclosed that Malouf had sold his interest in an RJFS branch in exchange for a series of payments, and that an incentive may exist for UASNM to utilize RJFS to generate revenue that may be utilized to make payments to Malouf. Stipulated Finding of Fact Nos. 11, 31.

All or most of UASNM's Forms ADV created between October 1, 2009, and April 12, 2010, portions of which are reflected in Exhibit 193, were provided to UASNM clients.[11] Tr. 1377-78, 906. Malouf's conflict of interest related to Lamonde's payments to Malouf from UASNM bond trades placed through RJFS was not specifically disclosed to the testifying UASNM investors. Stipulated FOF Nos. 328, 330. The testifying UASNM investors would have wanted to know that Malouf would receive payments related to bond trades placed through RJFS. Stipulated FOF Nos. 329, 331.

Malouf testified that "without a doubt," disclosure regarding the ongoing payments he was receiving from Lamonde should have been in all the relevant ADV disclosures. Stipulated FOF No. 193; Tr. 1001. Hudson viewed Malouf's arrangement with Lamonde as a potential conflict of interest. Stipulated FOF No. 127. When Ciambor learned in June of 2010 that Malouf had been receiving payments from Lamonde as a result of UASNM bond trades through the RJFS branch he believed that was a clear conflict of interest. Stipulated FOF No. 151. Ciambor believes that disclosure of the financial incentive for UASNM to route trades through RJFS, which was ultimately made in March 2011, should have been disclosed in all Forms ADV ever since Malouf's arrangement with Lamonde in 2008. Stipulated FOF No. 154. Malouf agrees that the ongoing payment arrangement with Lamonde created a clear conflict of interest ever since he entered into the arrangement with Lamonde in early 2008. Stipulated FOF No.

[11] Division Exhibit 193 is a demonstrative exhibit containing a summary of UASNM's Forms ADV Part II Items 8.C and 9.B.E disclosures dated July 17, 2006-April 12, 2010. Tr. 187; Div. Ex. 193.

178. McGinnis testified that in his forty-four years in the securities industry, he has "never seen a million dollars conflict of interest like this before." Tr. 421-22; Stipulated FOF No. 213.

E. UASNM Website

According to Hudson, as CEO and head of UASNM's marketing efforts, Malouf had some responsibility for ensuring that the information on UASNM's website was accurate. Tr. 156-57. Malouf was the lead salesman for UASNM, and he was familiar with at least some of the contents of its website. Stipulated FOF No. 13. Malouf assisted in creating the website content. Tr. 157, 1137-38. Malouf's understanding was that what is on the UASNM website for the public to consume is what is important. Stipulated FOF No. 190. While Malouf testified that he may not have read every word of UASNM's website, he was familiar with its contents in the 2008, 2009, and 2010 time frame. Stipulated FOF No. 189. Malouf previously testified that he "probably read" statements on UASNM's website in 2008 about UASNM being independent and not charging commissions. Stipulated FOF No. 191.

The primary compliance responsibility for the website was assigned to Kopczynski as CCO by UASNM's compliance manual; he acknowledged he was responsible for representations on the website and he actually reviewed the website. Resp. Ex. 346 at 72; Tr. 1354-57. Malouf delegated all compliance functions to Kopczynski as CCO, including the website content, consistent with UASNM's written compliance procedures, and reasonably relied on Kopczynski to ensure the information was compliant; Kopczynski described his duties as follows: "My responsibility as chief compliance officer was to take procedures and protocols that were established in an effort to keep UASNM in compliance with the Commission's regulations, and effectively work with the consultant to make sure anything that was required along those lines would be taken care of." Tr. at 1287.

At times, between 2008 and 2011, UASNM's website, memorialized in Division Exhibits 66, 68, and 69, made the following statements:

> We do not accept commissions and we vigorously maintain our independence to ensure absolute objectivity drives our decisions in managing our clients' portfolios.
>
> * * *
>
> Uncompromised Objectivity Through Independence
>
> UAS[NM] is not owned by any "product" company nor compensated by any commissions. This allows us to provide investment advice void of conflicts of interest. UAS[NM] may place trades through multiple sources, ensuring that the best cost/service/execution mix is met for its clients.

Div. Exs. 66, 68-69; Stipulated FOF Nos. 12, 131. These statements were very common statements UASNM would use in marketing. Stipulated FOF No. 131.

ACA advised UASNM in its September 2007 and December 2009 annual reports that the language in its marketing materials "void of conflicts of interest" was potentially misleading, and recommended removing it. Stipulated FOF Nos. 85, 86. The "void of conflicts of interest" language continued to appear on the UASNM website and in marketing materials in 2008-2010. Stipulated FOF No. 87. Kopczynski claims to have reviewed the UASNM website and believed it to be accurate in 2008. Tr. 1356-57. Neither Hudson nor Kopczysnki took any action to remove language from the UASNM website regarding UASNM being "void of conflicts of interest" until 2012, despite being specifically advised by ACA in its 2007 and 2009 annual reports that such language was problematic. Tr. 1363, 1369.

Similar to the website, UASNM's other marketing materials informed clients that brokers would be recommended "based on the broker's cost, skill, reputation, dependability, and compatibility with Clients, and not upon any arrangement between the recommended broker and [UASNM]." Div. Ex. 24 at MaloufSEC000559. Kopczynski admitted it was also his obligation to review UASNM's marketing materials before they were disseminated. Tr. 1289, 1356.

F. <u>Best Execution</u>

From 2008 to 2011, RJFS had written policies and procedures pertaining to best execution duties of a broker-dealer, rather than of an investment adviser. Tr. 710-11; Stipulated FOF No. 267. RJFS maintained a policy requiring the price on all bond trades to be fair and reasonable. Tr. 669; Div. Ex. 127 at RJFS-SEC-UASNM-004167. If a bond trade is placed through RJFS with a commission or markup that exceeds the RJFS commission/markup grid, then that trade will be rejected by RJFS. Tr. 710; *see* Stipulated FOF Nos. 232, 265. Part of the reason RJFS reviews the markups/commissions charged on bond trades is to ensure that its customers are getting best execution. Tr. 710; Div. Ex. 126. From 2008-2011, Malouf was not governed by RJFS's markup/markdown policy. Stipulated FOF No. 252. Malouf admitted that there is a different best execution duty for a broker-dealer than there is for an investment adviser. Tr. 1147-48.

An investment adviser may not rely solely on a broker's trading platform, such as BondDesk, to fulfill his fiduciary duty of best execution. Tr. 1147; Div. Ex. 243 at 28-29. However, BondDesk is a tool that can assist in achieving best execution, and the Division's expert agreed it was a good place to find bond bids/asks. *See* Stipulated FOF No. 263. BondDesk allows users to see what the best asks and best bids are from approximately 160 broker-dealers at any given time for particular bonds. Tr. 541; Stipulated FOF No. 374.

To seek best execution, an investment adviser generally must obtain competing bid or ask prices from more than one broker-dealer. Div. Ex. 20; Div. Ex. 243 at 21; Tr. 935; *see* Stipulated FOF Nos. 133, 145. Obtaining multiple bids is not an absolute requirement and the Division's expert acknowledged that whether multiple bids were necessary depends upon the circumstances. *See* Stipulated FOF No. 381; Tr. 548-49, 552. Best execution is based upon a number of qualitative and quantitative factors that may not require multiple bids. Stipulated FOF No. 381; Tr. 548-49, 552.

Malouf told others that he sought multiple bids for his bond trades. Tr. 169, 726-27, 1203. However, Malouf generally did not shop around for bids from competing brokers when executing bond trades on behalf of UASNM clients. Div. Ex. 243 at 4; Stipulated FOF No. 174. Malouf's own expert witness acknowledges that Malouf's practice was not to obtain competitive quotes every time he placed bond trades through RJFS. Resp. Ex. 579 at 8; Tr. 1462-63.

The evidence shows that in at least some cases, shopping bond trades among brokers resulted in a broker offering a better price than RJFS. Div. Ex. 218; Stipulated FOF No. 204. By shopping bond trades with other brokers, Keller was at times able to get RJFS to come down to meet a lower price. Resp. Ex. 341. Malouf was one of the people who told Keller about the practice of obtaining multiple bids from broker-dealers when purchasing bonds. Tr. 1201. Even Malouf acknowledged that he should have gotten multiple bids and that had he shopped around among brokers for lower bids on bond sales it is possible that he could have gotten a lower bid for his clients. Stipulated FOF Nos. 174, 334.

McGinnis advised that UASNM had a best execution problem because there were excessive markups, and possibly an unregistered broker-dealer issue, and said that UASNM needed to self-report the issue, quickly. Stipulated FOF No. 137. McGinnis never independently verified whether any of the conduct at issue was actually attributable to Malouf, instead relying on what Hudson and Kopczynski told him. Tr. 446-47; *see* Stipulated FOF No. 111.

A commission of over one percent on a U.S. Treasury or agency bond trade of $1,000,000 or more is excessive. In the 2008-2011 time period, Malouf understood that Lamonde would charge at most a one percent commission on a bond trade, or less if RJFS's institutional grid suggested it. Stipulated FOF No. 184. Malouf and Lamonde also both testified that they would never charge more than a hundred basis points on a bond trade, yet some bond trades run through RJFS were subject to commissions in excess of one percent. Stipulated FOF No. 43.

For a U.S. Treasury bond trade of over $1 million, an appropriate commission would start at one-half of one percent and go down from there. Malouf did not dispute his prior testimony that for a $1 million U.S. Treasury bond an appropriate commission would be 1%, would drop to 0.5% above that then go down from there. Stipulated Finding of Fact No. 186. The evidence shows many UASNM bond trades of $1 million or more where the commissions charged were in excess of the 0.5% that Malouf testified was reasonable for trades of that size. A commission of approximately 1% was paid to the RJFS branch on the $3 million federal agency loan reflected in Respondent Exhibit 339. Stipulated FOF No. 321. As another example, a $5,500 commission was paid on the $522,825 bond trade (1.052%) reflected in Exhibit 553 and another trade was for $1,537,829 and involved a $15,212.90 commission (0.99%). Stipulated FOF No. 322; Resp. Ex. 582, Tab 1 at 1-2.

A September 17, 2010, email exchange between Bell and Eva Skibicki (Skibicki), a manager in Trading and Retail Sales at RJFS, reflects that a 1% commission on a $3.8 million bond trade was reduced to fifty basis points based on a discussion between Bell and Skibicki. Div. Ex. 65; Tr. 147-48. Hudson became concerned about Malouf's receipt of payments from Lamonde in the fall of 2010 when he learned that Malouf had questioned RJFS's decision to

write down the commission charged on a particular bond trade. Tr. 147-48. Hudson thought it was odd that Malouf would be concerned about a commission write down because that money was going to Lamonde. Tr. 148-49.

The payments from Lamonde and Malouf's incentive to execute bond trades through RJFS created a best execution issue in Ciambor's mind. Stipulated FOF No. 153. However, Kopczynski convinced Ciambor to remove the "high" risk level rating that ACA assigned to UASNM's best execution practices in its 2011 annual review a week before the Commission conducted its examination of UASNM. Stipulated FOF 386.

The Commission conducted examinations of UASNM in 2002 and 2006. *See* Resp. Exs. 391, 558. Neither examination resulted in UASNM being advised that any issues existed with respect to whether UASNM was satisfying its best execution obligations. Tr. 1125-26; Resp. Exs. 391, 558. UASNM's bond trading practices and procedures were generally unchanged from 2000 through May 2011. Tr. 1126. ACA never advised Malouf at any time from 2002 to 2010 that there was any issue with respect to UASNM's best execution. Tr. 1128.

The scope of ACA's engagement included best execution. Stipulated FOF No. 96. Each year ACA performed a periodic and systematic evaluation of the execution quality of UASNM's client trades with respect to equities and fixed income. Tr. 725-26. The written semi-annual reviews of best execution that ACA provided to UASNM did not state that they were limited to equities. Tr. 793. Kopczynski sent UASNM trade blotters to ACA quarterly. Tr. 1291. ACA reviewed UASNM's trade confirms during ACA's annual reviews. Tr. 1303. However, the confirmations that UASNM received for bond trades did not reflect the specific amount of any markups. Tr. 1308.

Ciambor was advised that UASNM would seek bids from multiple brokers to achieve best execution on bond trades, and he was provided documentation which evidenced that process. Tr. 728. Based upon interviews with various UASNM personnel and his review of documents, Ciambor's understanding was that a multi-bid process for bond transactions was used fairly consistently for the majority of trades, but that only a sample of the documentation evidencing that process was being maintained. Tr. 729, 763; Stipulated FOF No. 145. Ciambor told Kopczynski that Malouf had shown him evidence of bids regarding bond transactions. Tr. 837. Ciambor saw evidence during ACA's annual mock audits that UASNM was seeking best execution on fixed income investments. Tr. 726.

Prior to June 2010, ACA advised UASNM and Malouf each year that UASNM was complying with its best execution obligation and never advised UASNM of any deficiencies in best execution. Stipulated FOF No. 100. Hudson believed ACA was conducting a periodic and systematic review of UASNM's best execution, that ACA had the resources available to conduct a proper best execution review, and that they were looking at commission levels in connection with their best execution review. Stipulated FOF No. 359. When ACA did not advise UASNM of any issues with respect to its best execution, Hudson believed that the firm, in fact, did not have any issues. *Id.* Hudson relied upon ACA to conduct UASNM's periodic and systematic review of best execution. Stipulated FOF No. 360. Likewise, Kopczynski relied on ACA to assist UASNM with complying with its best execution obligation. Stipulated FOF No. 97. Prior

to 2011, Malouf relied on ACA to assist Kopczynski to ensure the firm was complying with its best execution obligation and prior to May 2011, Kopczynski never advised Malouf of any deficiencies in best execution. Stipulated FOF Nos. 99, 101; Tr. 947. Kopczynski was responsible for supervising Malouf's bond trading. Tr. 1311. However, supervision of Malouf's bond trading was limited to analysis and/or review performed by ACA. Stipulated FOF No. 342. ACA never advised UASNM or Malouf that it was not examining UASNM's fixed income trades for excessive markups or commissions. Stipulated FOF No. 383.

G. Expert Witness Testimony

The parties agreed that experts' reports would be incorporated, by reference, into their direct testimony for the sake of efficiency. *See Dennis J. Malouf*, Admin. Proc. Ruling Release No. 1971, 2014 SEC LEXIS 4123 (Nov. 3, 2014); Tr. 470-71.

1. Dr. Gary Gibbons

Dr. Gary Gibbons (Dr. Gibbons), the Division's expert, is a visiting professor of entrepreneurship at Thunderbird School of Global Management, focusing on securities investing and corporate finance.[12] Div. Ex. 243 at 1. He is also a Principal with The Coleridge Group, an investment advisory firm. *Id.* From 2007-2011, Dr. Gibbons was an active investment adviser and traded an average of $45 million of bonds per year on behalf of his clients. *Id*. at 2.

At the request of the Division, Dr. Gibbons offered opinions on the duties of investment advisers with respect to clients, bond trading, best execution, and whether Malouf fulfilled his duties to clients. Div. Exs. 243-44.

Dr. Gibbons concluded that investment advisers have a number of obligations with respect to their position as a fiduciary, including: not making any misrepresentations to clients; not engaging in any scheme that perpetrates a fraud; avoiding all avoidable conflicts of interest; disclosing all actual and potential conflicts of interest; providing independent advice free of pecuniary motives not related to the payment of the fee charged to the client; being knowledgeable and mindful of the law; being knowledgeable of industry practices and competent in applying industry practice to the construction of client portfolios and the selection of securities; and providing best execution and having procedures in place to determine if best execution is being provided. Div. Ex. 243 at 9-10.

Dr. Gibbons testified that bonds are different from equities because their theoretical value is determined in a very specific matter, their price is a function of a negotiated exchange between the buyer and seller, and most bonds do not trade on exchanges or in an auction outcry market. Div. Ex. 243 at 19. He believes that investment advisers should view broker-dealers as counterparties when buying and selling bonds for their clients. *Id.* Dr. Gibbons testified that the

[12] Dr. Gibbons earned a BS in Business Administration from the University of Arizona, Tucson; a master of science in Business Administration from California State University, Dominguez Hills; and a doctor of philosophy in Business Administration from The Claremont Graduate University. Div. Ex. 243 at 53.

factors that impact bond prices, such as liquidity, credit quality, issuer, trade size, and maturity, are unique and specific. *Id.* According to Dr. Gibbons, markets play a distinct role in setting the ultimate trading price of a bond and commissions have a very large impact on the final trade price of a bond and the ultimate return to the investor. *Id.*

With respect to best execution, Dr. Gibbons testified that the minimum standard for investment advisers to achieve best execution involves identifying qualified broker-dealers, getting alternative bids or asks for the security, and having a clear procedure in place to document the process. Div. Ex. 243 at 29. He noted that investment advisers should be particularly focused on price. *Id.*

Dr. Gibbons explained that an investment adviser's fiduciary duty of best execution is different from a broker-dealer's lesser duty. Div. Ex. 243 at 20-23. According to Dr. Gibbons, simply trading through a broker, such as RJFS, does not satisfy an investment adviser's fiduciary duty of best execution. *Id.* at 28-29. In a similar vein, Dr. Gibbons explained that an investment adviser may not rely solely on a broker's trading platform, such as BondDesk, to fulfill a fiduciary duty of best execution. *Id.* Instead, according to Dr. Gibbons, to seek best execution an investment adviser generally must obtain competing bid or ask prices from more than one broker-dealer. *Id.* at 21-22. Dr. Gibbons conceded that multiple bids may not need to be sought on every single trade to achieve best execution. Tr. 551-52.

Dr. Gibbons identified eighty-one UASNM trades in U.S. Treasury and federal agency bonds during the period in question that represented $95,954,806 in principal amount and generated $833,798 in commissions, which, on a dollar weighted average basis, is 87.28 basis points, or 0.8728%. Stipulated FOF No. 39. Dr. Gibbons relied on his experience and other sources to opine that U.S. Treasury and agency bond trades such as these should have been subject to commissions in the range of ten to seventy-five basis points. *Id.* Dr. Gibbons testified that his ranges of "acceptable" markups/markdowns are not absolute. Tr. 555; Stipulated FOF No. 112. He testified that there is no publication setting forth a fixed acceptable range of commissions on bond trades. Tr. 525-26; Stipulated FOF Nos. 80, 378.

Dr. Gibbons found that UASNM clients were charged excess commissions of between $442,106 and $693,804 on the eighty-one bond trades he analyzed. Div. Ex. 243 at 36. Dr. Gibbons also opined that Malouf engaged in several repetitive short-term bond trades that lost money for his clients. *Id.* at 4-5.

Dr. Gibbons rebutted the contention of one of Malouf's experts, Alan Wolper (Wolper), that neither "Mr. Malouf nor UASNM had an obligation on a real-time, trade-by-trade basis to ensure that the executions he was getting from RJFS constituted" best execution, as follows:

> 1. Mr. Malouf has a fiduciary duty to his clients which includes the duty of diligence, prudence, the duty to be knowledgeable and to act in the client's best interest. Without a doubt this means when trades are being done not at some later time. Points 2 and 3 below follow from this duty[,]

2. The duty to get alternative bids and asks on a contemporary basis (this duty is described in UASNM's brochure),

3. The duty Mr. Malouf has to trade at the lowest commissions or mark-ups or mark-downs when available within the constraints of the market and the broker-dealer.

Div. Ex. 244 at 3 (formatting altered); Stipulated FOF No. 81.

Dr. Gibbons's Report acknowledges that he refers to the eighty-one trades as "Malouf's trades" but was unable to confirm whether Malouf directed any specific bond trade at issue. Div. Ex. 243 at 3; Tr. 508. Malouf directed no more than forty-eight to seventy-seven of these eighty-one trades (60% and 95%). Stipulated FOF No. 77. [13]

Dr. Gibbons did not review or consider any of the trade tickets for the trades at issue in preparing his expert report or forming any of his opinions. Tr. 542. Dr. Gibbons was unable to find and did not consider any studies regarding markups or commissions on bond trades. Tr. 544. There is no data available to compare the actual markups and commissions charged on UASNM's bond trades against other markups or commissions that were being charged on the same bonds at the same time. Tr. 558. Dr. Gibbons did not consider any misconduct by ACA or Kopczynski as CCO in his expert report. Tr. 511.

2. Jerry DeNigris

DeNigris is a broker-dealer professional with substantial experience in fixed income trading, mark-up analysis, and reviews.[14] Resp. Amended Witness List and Good Faith Identification of Exhibits at Ex. C; Tr. 1518-22. At the request of Malouf, he offered opinions regarding the bond trading at issue and the payments received by Malouf from Lamonde. Resp. Ex. 581 at 1.

DeNigris found that UASNM customers' bond trades incurred an average commission of 81.8 basis points. Stipulated FOF No. 41. He identified multiple bond trades made through RJFS that exceeded 100 basis points, including three trades with commissions of approximately 150 basis points. Stipulated FOF No. 43.

DeNigris did not offer any opinion as to what a reasonable commission would be on the bond trades at issue or whether UASNM customers paid excessive commissions. Stipulated FOF Nos. 41, 248. DeNigris testified that that Malouf is not governed by RJFS's markup/markdown policy. Stipulated FOF No. 252.

[13] I have found, for reasons set forth below, that Malouf was responsible for at least sixty percent of these trades.

[14] DeNigris earned a BA in Economics from Rutgers University and has held Series 4, 7, 15, and 63 licenses at one time. Resp. Amended Witness List and Good Faith Identification of Exhibits, Ex. C at 2; Tr. 1518.

DeNigris compared the actual yield on bonds purchased by UASNM, as determined by the price and reported to the customer with the yield that would have been achieved if a hypothetical forty basis point commission was assumed on every transaction. Resp. Ex. 582 at 3. He found that the average effect of the commissions on bond yields in question was 0.14%. Resp. Ex. 582 at 3, Tab 3.

DeNigris found that when the payments from Lamonde to Malouf are extrapolated over four years they would have ultimately constituted approximately 46.97% of the revenues earned by Branch 4GE. Resp. Ex. 582 at 4, Tab 4a.

3. Alan Wolper

Wolper was previously Director of NASD's Atlanta District Office, where he oversaw hundreds of member firms and thousands of branch offices.[15] Resp. Ex. 579 at 2. He also served as a member of the NASD's Department of Enforcement, where he had responsibility for prosecuting hundreds of formal disciplinary actions. *See* Tr. 1394; Resp. Ex. 579 at 1-2. At Malouf's request, Wolper opined on the allegations that Malouf failed to seek best execution for UASNM clients and received commission payments from RJFS even after resigning from the broker-dealer. Resp. Ex. 579 at 1.

Wolper testified that there are important and clear differences between the manner in which equity and debt securities are sold, including the fact that debt securities are not offered for sale on national exchanges and in order for a buyer to compare among sellers the types and prices of bonds, it can be necessary to contact multiple sellers separately. Resp. Ex. 579 at 3-4. He noted that some vendors offer a service that compiles the available inventories of many broker-dealer sellers of bonds in a single location, allowing subscribers to see thousands of debt offerings at once and conduct a quick and efficient review of available bonds and prices. *Id.* at 4. BondDesk is one such service. *Id.*

Wolper testified that one of an investment adviser's fiduciary obligations is to obtain best execution on trades effected for customers. Resp. Ex. 579 at 4. He explained that determining best execution requires a review of a combination of a number of both quantitative and qualitative factors and involves more than just obtaining the lowest possible commission on a particular trade. *Id.* at 5. Factors that should be evaluated include the price of the security, the costs of the transaction, the speed of execution, the size of the transaction, and the liquidity of the security. *Id.* He added that best execution also involves an analysis of the executing broker-dealer's abilities. *Id.*

Wolper opined that a trade-by-trade, real-time comparison and analysis is not necessary to achieve best execution and that best execution should be determined based at least in part on a periodic and systematic evaluation. Resp. Ex. 579 at 5-6; Resp. Ex. 580 at 3; Tr. 1409; Stipulated FOF No. 82. Wolper does not believe there is a difference between the fiduciary duty

[15] Wolper earned a BA in English from Rutgers University and a JD from the University of North Carolina, Chapel Hill. Resp. Amended Witness List and Good Faith Identification of Exhibits, Ex. B; Resp. Ex. 579 at 1.

applied to broker-dealers versus investment advisers as to best execution, but admitted that RJFS satisfying its duty of best execution does not mean that Malouf satisfied his. Stipulated FOF Nos. 242-43. However, he testified that the record reflects that Malouf's decision to use RJFS was reasonable and could be accurately characterized as an effort to obtain best execution. Resp. Ex. 579 at 6. Wolper cited Malouf's justifications that: RJFS gave him access to BondDesk; based on his years in the business he was aware that all broker-dealers in that space charged basically the same commissions for the types of bonds he was trading; Malouf instructed Lamonde to limit commissions to no more than one point; Malouf spot checked the competitiveness of RJFS's prices; Malouf read research on a daily basis on the bonds he was trading for customers, allowing him to gauge the competitiveness of the prices he was getting from RJFS; and Malouf's experience trading bonds using Fidelity and Schwab taught him that those firms could not offer the same inventory he could see on BondDesk and they charged prices that were generally higher than those he could get from RJFS. *Id.* at 7-8. Wolper opined that Malouf was not required to obtain competitive quotes from three different broker-dealers each time he placed an order for execution with RJFS. *Id.* at 8. Wolper did not offer an opinion on appropriate commission range or whether particular commissions were reasonable. Stipulated FOF No. 241.

Wolper opined that Malouf appropriately delegated the compliance function to Kopczynski and relied upon him to properly carry out his duties. Resp. Ex. 579 at 9-11; Resp. Ex. 580 at 4-6. Wolper based that opinion on his understanding that a president/CEO of a broker-dealer may delegate responsibility for the functions of a firm to other qualified individuals, whereupon the delegate assumes ultimate responsibility, not the CEO. Resp. Ex. 580 at 5. Wolper agreed that this principle was decided in the broker-dealer context (as opposed to the investment adviser context), and that such delegation requires reasonable follow-up and review of delegation, which there was no evidence of in this case. *Id.*; Tr. 1488-89; Stipulated FOF No. 246.

Wolper never provided legal advice to investment advisers on best execution issues, provided expert opinions regarding investment adviser best execution, held any securities licenses, worked as a regulator of an investment adviser or as an investment adviser, traded bond funds for a client, or managed a bond fund. Stipulated FOF Nos. 233, 235-39.

According to Wolper, NASD 2420-2 requires only that the agreement be "bona fide," not that it be written. Tr. 1421-22; Resp. Ex. 579 at 8-9. Generally, Wolper agreed that Commission staff no-action letters provide persuasive authority and guidance that are relied upon in the securities industry. Tr. 1498. Wolper thinks that retiring from the securities industry does not mean one has to stop selling securities, but rather just leave the broker-dealer industry; one may still be an investment adviser. Stipulated FOF No. 245.

III. CONCLUSIONS OF LAW

Malouf contends that he finds himself in his current predicament because Kopczynski turned on him days after Malouf revealed his intent to divorce Kopczynski's daughter. Resp. Br. at 1-3. In the absence of that precipitating incident, it is possible that the ensuing events leading to UASNM's self-reporting to the Commission may not have taken place. While, from Malouf's

perspective, it seems palpably unfair that neither Kopczynski nor Hudson were charged in administrative proceedings, the Commission's decision not to pursue charges against them is an unreviewable exercise of prosecutorial discretion. *See Greer v. Chao*, 492 F.3d 962, 964 (8th Cir. 2007).[16] Many factors inform that exercise. *See Wayte v. United States*, 470 U.S. 598, 607 (1985) ("Such factors as the strength of the case, the prosecution's general deterrence value, the Government's enforcement priorities, and the case's relationship to the Government's overall enforcement plan are not readily susceptible to the kind of analysis the courts are competent to undertake."); *Dirks v. SEC*, 463 U.S. 646, 678 n.16 (1983) (Blackmun, J., dissenting) (noting that passing on "information to regulatory authorities . . . may be the reason . . . the SEC, in an exercise of prosecutorial discretion, did not charge [the tipper of insider information] under Rule 10b-5"). Thus, even if Kopczynski and Hudson committed misconduct similar to Malouf's – such as failure to disclose conflicts of interest – it would make no difference with respect to Malouf's liability. *See, e.g., United States v. Foster*, 754 F.3d 1186, 1193 (10th Cir. 2014) ("[A] prosecutor exercises prosecutorial discretion in determining whether to file charges against some individuals but not others, even when the individuals in question committed sufficiently similar conduct" but once charged, a defendant's guilt is determined by reference to statute, not others' conduct.).

A. Exchange Act Sections 15(a)(1) and 15C(a)(1)(A)

Exchange Act Section 15(a)(1) makes it "unlawful for any [unregistered or unaffiliated] broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security . . .) unless such broker or dealer is registered" with the Commission in accordance with Section 15(b) of the Exchange Act. 15 U.S.C. § 78*o*(a)(1). Scienter is not required for a violation of this provision. *SEC v. Martino*, 255 F. Supp. 2d 268, 283 (S.D.N.Y. 2003). Similarly, Section 15C(a)(1)(A) of the Exchange Act makes it unlawful for any unregistered broker to effect any transaction in any government security and does not require scienter. 15 U.S.C. § 78*o*-5(a)(1)(A).

Exchange Act Section 3(a)(4) defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others."[17] 15 U.S.C. §78c(a)(4). The phrase "engaged in the business" connotes "a certain regularity of participation in securities

[16] As that Court explained, *Heckler v. Chaney*, 470 U.S. 821 (1985), "held that when an agency declines to initiate enforcement proceedings, that decision is not presumptively reviewable. This is true because when an agency decides to seek enforcement actions (or declines to seek enforcement actions), it is entitled to the same type of discretion that a prosecutor is afforded in bringing (or not bringing) criminal charges." *Greer*, 492 F.3d at 964 (internal citations omitted) (citing 470 U.S. at 831 ("[A]n agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion.")); *see Drake v. FAA*, 291 F.3d 59, 71 (D.C. Cir. 2002) (citing *Block v. SEC*, 50 F.3d 1078, 1082 (D.C. Cir. 1995)).

[17] It is not disputed that the bond trades at issue were securities and that U.S. Treasury bonds are government securities. The use of interstate commerce is also not disputed.

transactions at key points in the chain of distribution." *Mass. Fin. Servs., Inc. v. Sec. Investor Protection Corp.*, 411 F. Supp. 411, 415 (D. Mass. 1976); *see also SEC v. Kramer*, 778 F. Supp. 2d 1320, 1334 (M.D. Fla. 2011). Broker activity can be evidenced by such things as regular participation in securities transactions, receiving transaction-based compensation or commissions (as opposed to salary), a history of selling the securities of other issuers, and involvement in advice to investors and active recruitment of investors. *See, e.g.*, *SEC v. George*, 426 F.3d 786, 797 (6th Cir. 2005); *SEC v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 12-13 (D.D.C. 1998).

Receipt of commissions is a "hallmark" of a being broker. *Kramer*, 778 F. Supp. 2d at 1334-35 (citing *Cornhusker Energy Lexington, LLC v. Prospect St. Ventures*, No. 8:04cv586, 2006 U.S. Dist. LEXIS 68959, at *20 (D. Neb. Sept. 12, 2006)). Yet, transaction-based compensation is not a prerequisite to finding liability for acting as an unregistered broker-dealer. *David F. Bandimere*, Initial Decision Release No. 507, 2013 WL 5553898, at *52, 82 (Oct. 8, 2013) (finding that "[e]ven assuming [Respondent] did not receive transaction-based compensation, the evidence that he acted as an unregistered broker is overwhelming").[18]

Malouf voluntarily gave up his broker-dealer registration on December 31, 2007. He elected to focus on UASNM, the investment adviser, instead of transferring his registration to another broker-dealer to continue doing business as a broker. *See* Stipulated FOF Nos. 5-6. Malouf had sold Branch 4GE to Lamonde when he gave up his registration. The broker-dealer for all the transactions at issue in this case was Lamonde, who was registered and associated with broker-dealer RJFS. By contrast, Malouf, and other officials at UASNM, such as Hudson and Keller, who directed business to Lamonde, were investment advisers. Malouf's actions, like that of Hudson and Keller, were consistent and typical with those of a registered investment adviser. An investment adviser is "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." 15 U.S.C. § 80b-2(a)(11).

As a preliminary matter, before addressing the issues of whether or not Malouf, as opposed to Lamonde, received commissions, or whether it was permissible for him to do so, I consider the Division's argument, relying on *David F. Bandimere*, that Malouf acted as an unregistered broker dealer. Div. Br. at 18-19.

Unlike Malouf, Bandimere directly sold unregistered investments related to Ponzi schemes. Bandimere enticed investors based on accounts of his own success with such investments. *David F. Bandimere*, 2013 WL 5553898, at *51. He handled the paperwork necessary for investors to make a direct investment, obtained their signatures, took their money and transferred it to the companies' accounts, and sent out returns. *Id.* By contrast, Malouf's conduct as an investment adviser, which involved managing client portfolios, recommending

[18] Although *David F. Bandimere* is an Initial Decision and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it, but does distinguish its application based on the facts. Div. Proposed Additional FOF and COL at 66; Resp. Response to Div. Proposed Additional FOF and COL at 102-03.

investments, and utilizing a broker (Lamonde) to effect transactions in customer accounts, does not present a sufficient parallel to Bandimere's misconduct.

I am also not persuaded that Malouf is an unregistered broker-dealer based on the Division's allegations that he received commissions. Malouf testified that he and Lamonde agreed that the price for the branch would be two times trailing revenue of approximately $500,000 to $550,000, or approximately $1.1 million. Tr. 924-25. This is same formula that Malouf had employed for his purchase of UASNM. Tr. 924, 1056. Lamonde made installment payments for his purchase of Branch 4GE. *See* Stipulated FOF Nos. 293, 294. If Lamonde did not have the money upfront to purchase the branch outright, logically those payments would come from Branch 4GE's revenue – particularly Lamonde's commissions – since that seemed to be Lamonde's principal source of income.[19] However, in addition to the Branch 4GE revenue, the Division acknowledges that Lamonde also used money from other sources to pay Malouf for the branch, such as borrowing against a life insurance policy, withdrawing money from a family member's bank account, and taking on credit card debt. Div. Ex. 89; *see* Div. Proposed Additional FOF and COL at 38. I find that Lamonde's payments to Malouf, based on the profitability of the branch, and other sources, do not meet the definition of transaction-based compensation.[20] Because of Lamonde's untimely, unexpected demise, and the malleable investigative testimony that he provided, I find that Malouf's testimony – notwithstanding his self-interest – is the best evidence regarding the agreement that he entered into with Lamonde at the time he sold the branch.

The Division's claim that Malouf received commissions is challenged by the fact that, among several dozen transactions at issue, the hearing evidence does not clearly tie particular payments made to Malouf, by Lamonde, to specific trades that Malouf was involved in – as opposed to other UASNM investment advisers.[21] There is a range of conflicting estimates as to the percentage of bond trades directed by Malouf, as opposed to Hudson and Keller.[22] Keller

[19] Another likely option for Lamonde to purchase Branch 4GE would have been a bank loan, which would have had its own set of transaction costs.

[20] The CPA for Malouf and UASNM opined that, for federal income tax purposes, Lamonde's payments to Malouf for the sale of the RJFS branch represented capital gains, not ordinary income, as commissions would be classified. Tr. 1578-79. While there is spirited discussion between the parties as to how payments are classified on draft tax returns and other tax-related documents, I am unpersuaded by the significance of those indications, because they appear to be a hold-over from the years that Malouf owned the RJFS branch and served as a broker-dealer, but were not updated. I found the testimony of the CPA much more reliable than non-final or inaccurate tax documents.

[21] The Division, to its credit, did attempt to tie Malouf to a few isolated trades, but, the evidence that they were his, as opposed to another UASNM investment adviser, is not clear. *See* Stipulated FOF No. 199; *compare, e.g.*, Resp. Ex. 553, *and* Tr. 122, *with* Tr. 1141-42, 1211-12.

[22] While the estimates of the individuals involved is evidence, I note that Hudson's understanding of the total amount of bond trading was inaccurate, which in turn may indicate

confirmed that there was no document that would identify trades entered by each adviser at UASNM. Tr. 1187.

Because the Division could not validate its commission theory based on specific trades, it instead attempted to prove that Malouf received commissions based upon the similarity between the total payments, on the one hand, and the total commissions, on the other, generated over three years. However, measured quarterly, the payments to Malouf vary significantly from the commissions generated and appear inconsistent with an agreement to pass all the commissions along. Div. Ex. 203. Although the Division accurately notes that "Malouf's own Exhibit A to his Brief shows that payments to Malouf were within 5% of Lamonde's commissions for the first six months of the agreement," they did not match up in that fashion afterwards. Div. Reply at 7. From 2008 through the second quarter of 2011 (fourteen quarters), there are only three quarters during which the payments made by Lamonde to Malouf are within 5% of the commissions earned. *See* Div. Ex. 203. The average variance between the payments and commissions over the entire time frame is about 26%. *See id.* Another challenge for the Division is that while the overall amounts of payments and commissions are quite similar, this is also similar to the amount that Malouf testified that Lamonde agreed to pay for Branch 4GE. Malouf's explanation for that purchase price seems sensible, as it was based on a similar sale Malouf was involved in a few years earlier. So, when Lamonde received commissions from his broker activity related to UASNM, and then used them to make payments for Branch 4GE, those would be commissions received by Lamonde, not Malouf; and in my mind, installment payments for the sale of a business as they were made to Malouf. Malouf was also paid from other sources than Branch 4GE, which were clearly not commissions. Yet, Lamonde is presumably permitted to spend his commissions as he sees fit, such as satisfying outstanding payments for his purchase of the broker-dealer branch.

Assuming, for the sake of argument, that the payments by Lamonde to Malouf represent Malouf's "commissions" and are therefore evidence of broker-dealer conduct by Malouf, I find that Lamonde's payments to Malouf were made pursuant to the plain language of NASD 2420-2, which contemplates the permissible payment of commissions to an individual after they cease being a broker, where: (1) a "bona fide contract" calls for such payment; (2) the selling broker does not undertake any "solicitation of new business or the opening of new accounts;" and (3) no payments are made to anyone ineligible for FINRA membership or anyone disqualified from being associated with a member. Div. Ex. 234 at 4.

It appears, from their conduct, that Malouf and Lamonde had a bona fide contract for the sale of the branch.[23] It appears highly implausible that, unless Malouf and Lamonde had a

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that his estimate ascribing almost all bond trades to Malouf as similarly inaccurate. Tr. 150.

[23] The Division argues that there was in fact no contract and that the signed PPA was a sham. Div. Br. at 6-9. I find this implausible because it would be illogical for two parties to create a sham contract with obvious issues on its face, such as the fact that the contract was dated as of January 2, 2008, but notarized in June 2010. I find it more likely that if this contract were a sham, the signature and notary page would likely be backdated to 2008.

meeting of the minds, that Malouf would give up something so valuable and Lamonde would pay so much money in exchange for nothing of value. The essential agreement was that Malouf would sell his branch, Lamonde would service all transferred accounts, Lamonde would make payments based on branch revenues for a period of time to satisfy the purchase price, and would then no longer be obligated to pay Malouf. The parties' conduct was consistent with such an agreement beginning in January 2008. Whether the agreement was reduced to writing is irrelevant because, as Malouf's expert and former NASD regulator Wolper testified, NASD 2420-2 requires only that the agreement be "bona fide," not that it be written. *See* Div. Ex. 234 at 4; Tr. 1421-22. Although it appears that RJFS had an internal requirement that its representatives provide a written contract, NASD 2420-2 contains no such requirement. Whether or not Lamonde met RJFS's internal supervisory rules for sale agreements does not disprove the bona fide nature of an agreement. It is also irrelevant if Lamonde did not precisely follow subsequently memorialized written terms by choosing to pre-pay additional amounts as "a written contract may be modified, rescinded or discharged by subsequent oral agreement." *Medina v. Sunstate Realty, Inc.*, 889 P.2d 171, 174 (N.M. 1995) (quoting 4 Samuel Williston & Walter H.E. Jaeger, *A Treatise on the Law of Contracts*, § 591, at 203 (3d ed. 1961) (parties to a written contract may modify that contract by express or implied agreement as shown by the words and conduct)). The written agreement, which may have been provided simply as a way to placate RJFS's requests for a writing, is not invalid because "Exhibit A" cannot be located. I note that a document with a virtually identical function to Exhibit A existed and was relied upon by RJFS to transfer accounts in connection with the sale of the branch. Tr. 680-82; *see* Resp. Ex. 515. RJFS transferred clients from Malouf to Lamonde pursuant to a list existing on December 31, 2007. Stipulated FOF Nos. 69, 70. That list was either Exhibit A, or contained information from Exhibit A. The transfer of accounts was consistent with usual methods by which branches were sold. Tr. 633; *see Medina*, 889 P.2d at 174.

Malouf otherwise complied with the terms of NASD 2420-2. No evidence was presented that Malouf solicited new business or opened accounts for Branch 4GE after 2007. NASD 2420-2's plain language does not require retirement from the securities industry, as indicated by a no-action letter issued in November 2008 by the Commission's Division of Trading and Markets. *See* Div. Ex. 235. This no-action letter relied upon by the Division (which is similar to a handful that preceded it) states that "[t]his staff position concerns enforcement action only and does not represent a legal conclusion regarding the applicability of the statutory or regulatory provisions of the federal securities laws." *Id.* at 1. The letter also only applies to a specific set of circumstances, and the Commission staff member states that ". . . any different facts or circumstances might require a different response." *Id.* Although the no-action letter suggests that Malouf would have to retire, completely, to receive "continuing commissions" – the rule on its face does not.[24] As no-action letters "constitute neither agency rule-making nor

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The Division did not raise the argument that the contract was invalid under New Mexico state law. Whether the statute of frauds would require this contract to be in writing to be enforced is not a matter for my consideration as both Malouf and Lamonde believed themselves to be, and their actions suggest that they were, subject to an enforceable contract.

[24] On December 30, 2014, the Commission approved a proposed rule change by FINRA to streamline provisions of several NASD and New York Stock Exchange Rules, including NASD

adjudication," they are "entitled to no deference beyond whatever persuasive value they might have." *Gryl ex rel. Shire Pharms. Group PLC v. Shire Pharms. Group PLC*, 298 F.3d 136, 145 (2d Cir. 2002). Malouf substantially complied with the rule, and thus, I find that even if one was to consider the payments "Malouf's commissions" (which I do not), his conduct would nonetheless be appropriate, and I would not find that he was acting as an unregistered broker-dealer in violation of Sections 15(a)(1) and 15C(a)(1)(A) of the Exchange Act.

B. Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2)

Malouf is charged with violating the antifraud provisions of Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2). OIP at 6. The conduct violating one of the antifraud provisions may also violate other provisions, as they proscribe similar misconduct. *See United States v. Naftalin*, 441 U.S. 768, 773 n.4, 778 (1979); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363 n.4 (9th Cir. 1993); *SEC v. Berger*, 244 F. Supp. 2d 180, 192 (S.D.N.Y. 2001); *SEC v. Blavin*, 557 F. Supp. 1304, 1315 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985).

Securities Act Sections 17(a)(1) and 17(a)(3) prohibit employing a fraudulent device, scheme, or artifice to defraud or engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit in the offer or sale of a security. 15 U.S.C. § 77q(a)(1), (3). Exchange Act Section 10(b) and Rule 10b-5 subsections (a) and (c) prohibit any person from employing any device, scheme, or artifice to defraud and engaging in any act,

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2420-2. Order Approving FINRA Proposed Rule Changes to FINRA Rules 0190 and 2040 and Amending FINRA Rule 8311, 80 Fed. Reg. 553 (Dec. 30, 2014). Among other things, new FINRA Rule 2040(b) will allow FINRA members to pay continuing commissions to retiring registered representatives as long as (1) a bona fide contract exists between the member and the retiring registered representative that prohibits the representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments, and (2) the arrangement complies with applicable federal securities laws and Exchange Act rules and regulations. *Id.* at 555. Under the Rule, "retiring registered representative" means "an individual who retires from a member (including as a result of total disability) and leaves the securities industry." *Id.* In its initial proposal, FINRA included the requirement that the arrangement must comply with "published guidance issued by the SEC or its staff in the form of releases, no-action letters or interpretations"; however, this language was deleted from the final version based on concerns raised by commenters. Notice of Filing of a Proposed Rule Change to Adopt FINRA Rules 0910 and 2040 and Amend FINRA Rule 8311, 79 Fed. Reg. 59322, 59328 (Oct. 1, 2014). Although it appears that under the new rule a retiring registered representative in a situation similar to Malouf would be prohibited from receiving continuing commissions, the new rule is not yet in effect and has no bearing on my interpretation of the old rule. *See* FINRA Manual, Recently Approved Rule Changes Pending Determination of Effective Date, SR-FINRA-2014-037, Rule 2040, *available at* http://finra.complinet.com/ (stating that the "effective date for this rule has not yet been determined") (website last accessed March 31, 2015).

practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of a security. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(a), (c). Primary liability under Securities Act Section 17(a)(1) and Exchange Act Rule 10b-5 subsections (a) and (c) proscribe even a single act of making or drafting a material misstatement to investors and constitutes the employment of a deceptive device or act. *John P. Flannery*, Securities Act Release No. 9689, 2014 SEC LEXIS 4981, at *42, *62 (Dec. 15, 2014). Repeatedly making or drafting such misstatements over a period of time could constitute engaging in any fraudulent transaction, practice, or course of business as prohibited under Securities Act Section 17(a)(3). *Id.* at *62-63.

Sections 206(1) and 206(2) of the Advisers Act prohibit an investment adviser from using instruments of interstate commerce to employ any device, scheme, or artifice to defraud, or to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client or prospective client. Stipulated COL No. 8. Advisers Act Section 206 establishes a federal fiduciary standard for investment advisers, including the obligations to exercise the utmost good faith in dealing with their clients, to disclose to their clients all material facts, and to employ reasonable care to avoid misleading their clients. Stipulated COL No. 9. Investment advisers have a duty "to eliminate, or at least to expose, all conflicts of interest which might incline [them] – consciously or unconsciously – to render advice which was not disinterested." Stipulated COL No. 10. Malouf had an obligation to disclose conflicts of interest that existed at UASNM that he was aware of. Stipulated COL No. 25.

Malouf was the CEO and President of UASNM, a registered investment adviser, and he was an advisory representative for UASNM. Stipulated FOF No. 286. As such, he is a primary violator under Advisers Act Section 206 because he received compensation in connection with giving investment advice and thus comes within the broad statutory definition of an investment adviser as defined by Section 202(a)(11) of the Advisers Act: a "person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ." *See* 15 U.S.C. § 80b-2(a)(11); *Abrahamson v. Fleschner*, 568 F.2d 862, 870 (2d Cir. 1977) (general partners of investment adviser considered investment advisers under Advisers Act Section 202(a)(11)); *Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *73-74 & n.196 (May 16, 2014) (investment adviser's principal and owner liable as a primary violator under Advisers Act Sections 206(1) and 206(2)).

Scienter is required to establish violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1); a showing of negligence is sufficient to establish violations of Securities Act Section 17(a)(3) and Advisers Act Section 206(2). Stipulated COL Nos. 8, 14; *Aaron v. SEC*, 446 U.S. 680, 695-97, 701-02 (1980); *SEC v. Steadman*, 967 F.2d 636, 641 & n.3, 643 & n.5, 647 (D.C. Cir. 1992). Scienter is defined as a mental state consisting of intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter may be proven by showing extreme recklessness. *SEC v. Steadman*, 967 F.2d at 641-42. Recklessness is an "extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Steadman*, 967 F.2d at

641-42 (ellipses in original) (quoting *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

Material misstatements and omissions violate the antifraud provisions; information is "material" if there is a substantial likelihood that a reasonable person would consider the information important. Stipulated COL No. 11; *see Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Specifically, the existence of a conflict of interest is a material fact that an investment adviser, as a fiduciary, must disclose to a client. Stipulated COL No. 12.

"To be liable for a scheme to defraud, a defendant must have 'committed a manipulative or deceptive act in furtherance of the scheme.'" *SEC v. Fraser*, No. CV-09-00443-PHX-GMS, 2010 U.S. Dist. LEXIS 7038, at *23 (D. Ariz. Jan. 28, 2010) (quoting *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997)). The defendant "must have engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), *vacated on other grounds, Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008).

Based on my analysis below, I find that Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3), Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2).

1. Misstatements and Scheme

Malouf's agreement with Lamonde created a conflict of interest for Malouf because Malouf was incentivized to send UASNM bond transactions through Branch 4GE so that Lamonde would be able to pay what he owed for the business. Malouf did not explicitly and completely disclose his conflict of interest in submitting bond trades through Branch 4GE, resulting in misleading disclosures in UASNM's Forms ADV and on its website.

Malouf did not tell anyone at UASNM or ACA the details of his agreement to receive payments from Lamonde. I have previously accepted that, based on Malouf's own description, key terms of the agreement were oral, rather than written. Just as it took effort for me to understand the nature of the agreement, so too, without exposition, it would have been difficult for anyone else to understand without the specifics. Malouf's receipt of payments from Lamonde created a conflict of interest. Stipulated FOF No. 178. Yet, the conflict created by Malouf's receipt of payments from Lamonde was not disclosed on UASNM's Forms ADV between 2008 and 2011 or on its website. Stipulated FOF No. 8; *see* Div. Exs. 66, 68-69. Given this crucial omission, the website's statements about independence and freedom from conflicts of interest, and the lack of disclosure of Malouf's continuing relationship with the RJFS branch on UASNM's Forms ADV were materially misleading to UASNM clients. All Forms ADV distributed between 2008 and 2011 were materially misleading by failing to disclose Malouf's arrangement with Lamonde.

Prior to 2008, the "void of conflicts of interest" language was at least countered by the disclosure that Malouf owned the Branch 4GE and that he and other registered representatives

might receive compensation for transactions executed through that branch; after that language was removed the "free of conflicts of interest" language and other statements disclaiming compensation from commissions and proclaiming "[u]ncompromised objectivity through independence" on UASNM's Forms ADV and website were misleading. *See* Stipulated FOF No. 12.

Malouf's argument that Kopczynski's tiny ownership interests in Secured Partners and National Advisors Trust Company (NATC) was inconsistent with the "devoid of conflicts of interest" language on UASNM's website (but was disclosed on the Form ADV) does not excuse Malouf's failure to disclose his receipt of over one million dollars in payments from Lamonde. Tr. 1383. Similarly, the collective failure to list RJFS as a broker through which UASNM did business in its October 2009 Form ADV does not excuse the failure to disclose Malouf's conflict of interest.

Malouf's principal response is that other UASNM officials knew or should have known that he was receiving payments from Lamonde and that he relied on them to make the disclosures. Resp. Br. at 22-23. However, even if all the relevant officials at UASNM, RJFS, and ACA knew all about Lamonde and Malouf's agreement, and the payments, it would not excuse Malouf's recklessness. The parties previously agreed, and I have found, investment advisers have a duty "to eliminate, or at least to expose, all conflicts of interest which might incline [them] – consciously or unconsciously – to render advice which was not disinterested." Stipulated COL No. 10. Thus, regardless of what Hudson, Kopczynski, Keller, Bell, or Ciambor knew, UASNM's customers were not told about Malouf's conflict of interest and thus, Malouf was reckless in allowing material omissions on the Forms ADV and misrepresentations on the website.

Malouf's reliance-on-others defense requires him to show that he made full disclosure to those upon whom he relied.[25] *See Provenz v. Miller*, 102 F.3d 1478, 1491 (9th Cir. 1996), *citing C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988) (finding that "[i]f it is true that defendants withheld material information from their accountants, defendants will not be able to rely on their accountant's advice as proof of good faith"). Malouf claims, without support, that "Kopczynski was aware or should have been aware of the nature of the sale of Branch 4GE." Resp. Br. at 22. However, Malouf stipulated that Kopczynski and Hudson understood that Malouf had sold Branch 4GE to Lamonde, but they were not aware of the specific terms of that sale. Stipulated FOF No. 34. Moreover, the claim that Kopczynski should have been aware is not a defense to Malouf's own failure to disclose. Likewise, his claimed reliance on UASNM's outside consultant is misplaced where he failed to disclose his payments from Lamonde for over two years and misrepresented that he had severed all ties with RJFS. Tr. 736-37, 773-76.

Ultimately, because Malouf was the only one who knew the details of his conflict of interest, regardless of whether others were reckless, or merely negligent, in investigating the

[25] Malouf's own reliance on *SEC v. Huff*, 758 F. Supp. 2d 1288, 1351-52 (S.D. Fla. 2010), fails to address the fact that Huff's reliance-on-others defense failed because Huff never disclosed critical facts to his accountant. *See* Resp. Prehearing Br. at 19-20.

nature and extent of Malouf's conflict, I conclude that Malouf's failure to disclose, for years, any details of the payments, to be extremely reckless. Indeed, even when the PPA was disclosed in 2010, because its terms were not the terms that Lamonde and Malouf had agreed to, his failure to disclose the details of the oral agreement at that time – which he and Lamonde abided by, as opposed to the PPA – evidence continuing reckless behavior.

Malouf had a direct role with regard to reviewing the Forms ADV, especially as they related to his own conflicts of interest, and had a greater role with regard to UASNM's marketing materials, particularly those present on the website. Malouf also had the best knowledge of his ongoing financial relationship with Lamonde. Malouf was the best-suited official to apprehend his conflict, and ensure that appropriate disclosures were made and inconsistent language was corrected. Though Malouf, to his credit, ultimately corrected language in the Forms ADV in 2011 (but not language on the website and in marketing materials), that does not excuse his highly reckless behavior with respect to his own conflicts of interest for years before then.

I disagree with Malouf's contention that the "Division has not offered sufficient evidence to establish whether the Forms ADV introduced at the hearing were final or were drafts that were never filed with the SEC or disseminated to clients." Resp. Br. at 30. The Division established at the hearing that: (1) UASNM did not update its Form ADV to specifically reflect the payments by Lamonde to Malouf for the sale of the RJFS branch until March 2011, Stipulated FOF No. 307; (2) at least some of UASNM's Forms ADV between 2008 and 2011 did not disclose that Malouf sold his RJFS branch to Lamonde and was receiving ongoing payments from Lamonde in connection with that sale, Stipulated FOF No. 8; (3) Judith Owens, a UASNM client, signed an investment management services agreement acknowledging that she had received and read Part II of the February 4, 2008, UASNM Form ADV, Stipulated FOF No. 63; and (4) all or most of the Forms ADV created between October 1, 2009, and April 12, 2010, portions of which are reflected in Division Exhibit 193, were provided to UASNM clients. Div. Ex. 193; Tr. 906, 1377-78. For the foregoing reasons, I find that a preponderance of evidence establishes that the Forms ADV were either filed with the Commission or disseminated to clients.

Based on the above, I find that Malouf violated Securities Act Sections 17(a)(1) and 17(a)(3), Securities Act Section 10(b) and Rules 10b-5(a) and 10b-5(c), and Advisers Act Sections 206(1) and 206(2).

2. Failure to Seek Best Execution

I find that Malouf violated his fiduciary duty by failing to seek best execution for UASNM's clients with regard to the majority of U.S. Treasury and federal agency bond trades routed through RJFS between 2008 and 2011. One of an investment adviser's "basic duties" under Advisers Act Section 206 is to ensure that its clients' transactions are executed "in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances." *Kidder, Peabody & Co.*, Advisers Act Release No. 232, 1968 SEC LEXIS 251,

at *10-11 (Oct. 16, 1968)[26]; *see Donald L. Koch*, Exchange Act Release No. 72179, 2014 SEC LEXIS 1684, at *70-72 & n.189 (May 16, 2014). Failure to seek best execution or to conduct best execution review constitutes a violation of Section 206(2) of the Advisers Act. *Jamison, Eaton & Wood, Inc.*, Advisers Act Release No. 2129, 2003 SEC LEXIS 1174, at *3 (May 15, 2003) ("By failing to disclose its potential conflict of interest and other brokerage options, and by failing to seek to obtain best execution, Jamison violated Section 206(2) of the Advisers Act.").[27, 28]

The Division argues that an adviser's failure to seek best execution for clients can be established by showing that clients paid higher commissions with no apparent corresponding benefit, citing a settled enforcement action. Div. Proposed Additional FOF and COL at 69; *see Jamison, Eaton & Wood, Inc.*, 2003 SEC LEXIS 1174, at *16 ("Taking into consideration the higher commissions paid by some of Jamison's clients, and the lack of any apparent corresponding benefit such as better trading prices, Jamison failed to seek to obtain best execution for these clients."). Malouf disputes this additional proposed conclusion of law, noting that while the "language from *Jamison* is accurately quoted," it "does not support the proposed conclusion of law," citing a Commission interpretive release. Resp. Response to Div. Proposed Additional FOF and COL at 107; *see* Resp. Ex. 578. The release states that a "money manager should consider the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager." Resp. Ex. 578 at 15. It also notes that "the determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account. *Id.* An investment adviser must consider a number of qualitative and quantitative factors when trying to achieve best execution, not just the amount of commission. Stipulated COL No. 23.

However, when the other factors are equal, cost may be of principal concern in determining best execution. As Dr. Gibbons explained, for U.S. Treasury and agency bond

[26] Although the *Kidder, Peabody & Co.* release is a settled enforcement action and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it. Div. Proposed Additional FOF and COL at 68; Resp. Response to Div. Proposed Additional FOF and COL at 106.

[27] Although the *Jamison, Eaton & Wood, Inc.*, release is a settled enforcement action and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it. Div. Proposed Additional FOF and COL at 68; Resp. Response to Div. Proposed Additional FOF and COL at 106.

[28] Malouf contends that the only specific requirement for ensuring compliance with best execution is "periodic and systematic review" of the procedures employed for best execution. Resp. Br. at 27. In support, Malouf cites to *Jamison, Eaton & Wood*, where the firm "did not periodically and systematically review its brokerage arrangements" and "thereby failed to seek to obtain best execution for these clients." 2003 LEXIS 1174, at *16; Resp. Response to Div. Additional FOF and COL at 107. However, as set forth below, an investment adviser can fail to satisfy a duty of best execution through other actions or omissions.

trades – the ones at issue here – the other factors are largely irrelevant due to the highly liquid and transparent nature of the bonds and other factors. Tr. 553-54; s*ee* Div. Ex. 243 at 16, 18, 30; Tr. 476-77, 532. Multiple witnesses, including Hudson, Keller, Ciambor, Dr. Gibbons, McGinnis, and even Malouf himself, testified that in seeking best execution an investment adviser should shop trades to multiple brokers. Div. Ex. 20; Div. Ex. 243 at 21-22; Tr. 935; Stipulated FOF Nos. 133, 145; Tr. 168-69, 172-73, 453; Resp. Ex. 559. Malouf has admitted that he often did not do that. Stipulated FOF No. 174; Div. Ex. 243 at 4; Resp. Ex. 579 at 8; Tr. 935-37. By contrast, another UASNM advisor, Keller, was able to get lower bond prices from other brokers or have RJFS lower its price to meet prices offered by other brokers. Stipulated FOF No. 204; Div. Ex. 218; Resp. Ex. 341.

Instead, between 2008 and 2011, Malouf generally selected Lamonde's branch of RJFS to execute bond trades on behalf of UASNM clients.[29] Stipulated FOF No. 38. Malouf's failure to obtain competing bids caused UASNM's clients to pay markups/markdowns that were significantly higher than industry norms on dozens of U.S. Treasury and federal agency bond trades. Div. Ex. 243 at 32-34. Dr. Gibbons concluded that UASNM failed to seek best execution for its U.S. Treasury and federal agency bond trades, and has estimated that this failure caused UASNM clients to pay between $442,106 and $693,804 in excess commissions. *Id.* at 36. Dr. Gibbons and McGinnis (who previously performed a similar calculation in the state court litigation involving UASNM and Malouf) both found that commissions charged on UASNM bond trades were excessive.[30] Dr. Gibbons's range – ten to seventy-five basis points (bps) – was slightly broader than McGinnis's range – twenty to fifty bps – but both have similar averages of thirty-five (McGinnis) and 42.5 bps (Dr. Gibbons). Stipulated FOF No. 39; Div. Ex. 44 at Ex. 5. Dr. Gibbons's range is thirty-five bps more favorable to Malouf than the range applied in the state court litigation in that it provides a wider range of acceptable commission rates. In addition, Dr. Gibbons's seventy-five bps upper limit is much closer to the 100 bps maximum commission than McGinnis's fifty bps upper limit that Lamonde and Malouf agreed should ever be charged on such trades.

[29] Malouf did open accounts at UBS, Smith Barney, and Morgan Stanley, and used existing accounts at Griffin Kubiak, Stevens and Thompson, and Crews & Associates to buy bonds and check prices. Stipulated FOF No. 353. However, evidence that Malouf actually sought competing bids is sparse, and it is clear that the substantial majority of UASNM's bond trades were done with RJFS.

[30] Malouf objected to the introduction of McGinnis's analysis done for the state court litigation because he believed it to be expert testimony (and the Division did not offer McGinnis as an expert witness). Tr. 403-04. I allowed in the testimony, noting that I would not base any part of the ruling on McGinnis's opinions to the detriment of Malouf and would not rely on his opinions to shore up the Division's expert testimony. Tr. 404, 408. My ruling during the hearing remains unchanged; I am not relying on McGinnis's opinions in any way, only noting that Dr. Gibbons's opinions are more favorable to Malouf than McGinnis's opinions, which were the subject of the state court litigation and considered when entering into the settlement agreement, including holding $850,000 in escrow to cover potential liability resulting from UASNM's plan to report possible best execution failures to the Commission. *See* Resp. Ex. 312 at 3; Resp. Ex. 479, Ex. 1 at 3, Ex. 2 at 3, 7.

In *Mark David Anderson*, an expert testifying regarding trades in U.S. Treasury securities noted, as Dr. Gibbons did here, that markups and markdowns on such securities are "driven by th[e] bid-ask spread." Exchange Act Release No. 48352, 2003 WL 21953883, at *4 (Aug. 15, 2003) (alteration in original). That expert further testified that after "doubling what was custom and practice in the industry," an appropriate commission on the U.S. Treasury notes at issue, which as here were extremely liquid and carried an implied rating of AAA, would be between twenty-five and fifty bps. *Id*. This range coincides with the ranges set forth by Dr. Gibbons and McGinnis. In *Mark David Anderson*, the Commission found that:

> The Division introduced expert testimony which supported its contention that Anderson's pricing was "well above what professionals in the business would generally charge for the transactions in question" and not warranted by any extraordinary circumstances.

Id. at *7 (internal footnote omitted). I find that Dr. Gibbons's testimony reliably serves the same function as the expert opinion in *Mark David Anderson*. *Id.* at *7 n.40 (noting that "expert testimony is generally very helpful when the question to be resolved is the proper pricing of debt securities"). Malouf offered no expert opinion to the contrary. Stipulated FOF No. 241.

Dr. Gibbons's testimony did not attempt to attribute any specific trade to Malouf. *See* Stipulated FOF No. 372. Malouf, Hudson, Keller, and Kopczynski have roughly estimated that Malouf directed somewhere between 60% to 95% of UASNM's bond trades. Stipulated FOF Nos. 6, 76. As noted, there has been no reliable evidence showing that Malouf directed any particular trade. The evidence shows only that from 2008 to 2011, Malouf directed certain bond trades for UASNM clients to RJFS but no evidence indicating *which* bond trades he directed there. Stipulated FOF No. 38.

I am unconvinced that the high point of the preceding range, which is based primarily on Hudson's testimony, is reliable. First, when Hudson initially attempted to determine the trades that Malouf directed, he was in the process of suing Malouf and had no small self-interest in avoiding regulatory liability. Tr. 100-01. One could reasonably expect that Hudson would give himself, and others, the benefit of the doubt in his calculation to Malouf's detriment. Second, although Hudson claimed he only occasionally directed bond trades, Ciambor testified that Hudson did a "significant" amount of bond trading. Tr. 731-32. Third, when Hudson testified about UASNM's bond trading, he was off by tens of millions of dollars with regard to the annual value of trades, suggesting his estimates regarding bond trading are not the most reliable. Tr. 149-50. Fourth, Keller admitted to directing 50% to 60% of his own trades through RJFS. Tr. 1165-66.

In the absence of the Division proving any particular trade was directed by Malouf, and the deficiencies with the highest estimates, I am confident that a preponderance of the evidence nonetheless established that Malouf directed sixty percent of trades to RJFS. While sixty percent of the trades does not necessarily equate to sixty percent of the value of the trades, because it is the lowest estimate of Malouf's trade in the range for which estimates were offered, and Malouf was often the principal investment adviser on large-scale institutional trades, more likely than not, the value of at least sixty percent of the bond trades can be attributed to Malouf. It is of

course possible that Malouf could have been responsible for more than sixty percent. To prove that, the Division could have inquired of witnesses as to each trade, using all the documentary evidence available. However, such evidence was not presented by the Division. In the absence of such evidence, given the uncertainties, I am unable to declare that by a preponderance of the evidence Malouf directed more of the trades, and, more particularly, that he directed more than sixty percent of the trades on which there were commissions in excess of what should reasonably have been paid.

Based on Dr. Gibbons's opinion that the failure to seek best execution resulted in an actual cost to UASNM customers of at least $442,106, and my preceding determination that Malouf is culpable for at least sixty percent of the underlying trades, I find that Malouf's failure to seek best execution on bond trades resulted in $265,263.60 of unnecessary cost and expense to UASNM customers.[31]

In addition to this tangible, adverse result, the fact that Malouf was not actually seeking and achieving best execution, recklessly, further demonstrates how the statements in the website and Forms ADV to the contrary were misleading, and hence violations of Advisers Act Section 206(1) and (2).

C. Aiding and Abetting Liability

To establish aiding and abetting liability, the Commission must show: "(1) that a principal committed a primary violation; (2) that the aider and abettor provided substantial assistance to the primary violator; and (3) that the aider and abettor had the necessary 'scienter' – i.e. that she rendered such assistance knowingly or recklessly." *Graham v. S.E.C.*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *see also First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891, 898 (10th Cir. 1992), *rev'd on other grounds*, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).[32] The Tenth Circuit applies a "recklessness" standard for

[31] While UASNM's settlement with the Commission involved the repayment of a greater amount of money to its customers, that settlement was targeted to satisfy all of UASNM's best execution failures – not just those of Malouf; and was based on McGinnis's analysis of customer losses, which, as noted previously, found a greater amount of loss than the Division's expert Dr. Gibbons.

[32] This test has also been formulated as: "(1) a primary or independent securities law violation by an independent violator; (2) the aider and abettor's knowing and substantial assistance to the primary securities law violator; and (3) awareness or knowledge by the aider and abettor that his role was part of an activity that was improper." *SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144, 184 (D.R.I. 2004); *see Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir. 1980). The requirement of "awareness or knowledge by the aider and abettor that his role was part of an activity that was improper" has been reformulated under the scienter requirement under more recent case law. *See Howard v. SEC*, 376 F.3d 1136, 1142-43 (D.C. Cir. 2004); *Graham*, 222 F.3d at 1000 (explaining that the aiding and abetting test has been "variously formulated" and citing *Investors Research*, among other circuit precedent, for the D.C. Circuit's more recent articulation of the test).

aiding and abetting liability and the D.C. Circuit requires a showing that the aider and abettor acted with "extreme recklessness." *First Interstate Bank*, 969 F.2d at 903 ("We hold that in an aiding-and-abetting case based on assistance by action, the scienter element is satisfied by recklessness."); *Howard*, 376 F.3d at 1143 (citing *Graham*, 222 F.3d at 1004; *SEC v. Steadman*, 967 F.2d at 641).

A respondent who aids and abets a violation is a cause of the violation. *See Zion Capital Mgmt. LLC*, Securities Act Release No. 8345, 2003 SEC LEXIS 2939, at *28 (Dec. 11, 2003).

1. Advisers Act Section 206(4) and Rule 206(4)-1(a)(5)

Malouf is charged with aiding and abetting and causing UASNM's violations of Advisers Act Section 206(4) and Rule 206(4)-1(a)(5). Advisers Act Section 206(4) prohibits a registered investment adviser from engaging "in any act, practice, or course of business which is fraudulent, deceptive, or manipulative[,]" including those defined by the Commission. 15 U.S.C. § 80b-6(4). Neither scienter nor proof of client harm is required. *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1105 (9th Cir. 1977) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

Rule 206(4)-1(a)(5) prohibits a registered investment adviser from publishing, circulating, or distributing advertisements containing untrue statements of material facts, or that are otherwise false or misleading. 17 C.F.R. § 275.206(4)-1(a)(5). A website can be considered an advertisement for purposes of the rule. *Anthony Fields, CPA*, Initial Decision Release No. 474, 2012 WL 6042354, at *12 (Dec. 5, 2012) ("Fields's misrepresentations on Platinum's website violated Securities Act Section 17(a), and his misrepresentations on the AFA website and in AFA's Form ADV and brochure violated Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1(a)(5).").[33]

Based on preceding findings, I have determined that UASNM violated Rule 206(4)-1(a)(5) by making statements about independence, freedom from conflicts of interest, and best execution that were materially misleading as a result of Malouf's agreement with Lamonde. *See supra* pp. 30-32, 36. Malouf provided substantial assistance by recklessly failing to disclose to others at UASNM his conflict of interest with respect to RJFS. Therefore, I find that Malouf aided and abetted and caused UASNM's false and misleading website statements by failing to disclose his receipt of payments from Lamonde, as detailed above.

2. Advisers Act Section 207

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[33] Although the *Anthony Fields, CPA* release is an initial decision and thus non-precedential, the Division proposed this conclusion of law and Malouf did not dispute it. Div. Proposed Additional FOF and COL at 72; Resp. Response to Div. Proposed Additional FOF and COL at 110.

Malouf is charged with violating, or in the alternative, aiding and abetting and causing UASNM's violations of, Advisers Act Section 207. I do not find that Malouf was a primary violator because he delegated responsibility for the Forms ADV to Kopczynski and Hudson and Hudson ultimately was the person who signed them. Advisers Act Section 207 makes it unlawful for any person willfully to make any untrue statement of a material fact or omit to state any material fact required to be stated in a report filed with the Commission, including Form ADV.[34] 15 U.S.C. § 80b-7; *Vernazza v. SEC*, 327 F.3d 851, 858 (9th Cir. 2003). The materiality standard for Advisers Act Section 207 claims is essentially the same as for violations of Advisers Act Section 206. *Id*. Advisers Act Section 207 does not require a showing of scienter. *Montford and Co.*, Advisers Act Release No. 3829, 2014 SEC LEXIS 1529, at *68 (May 2, 2014).

Item 12.B of Form ADV Part II (and Item 12.A of the new Part 2A) requires an investment adviser to describe the factors considered in selecting broker-dealers and determining the reasonableness of their commissions. *See, e.g.*, Div. Ex. 24 at UASNM0442. Thus, an investment adviser violates Advisers Act Section 207 by failing to disclose those factors. The disclosures in UASNM's Forms ADV between 2008 and 2011, willfully omitted required information.

UASNM violated Advisers Act Section 207. Malouf substantially assisted this violation. The UASNM Compliance Manual provided that its "employees" (including Malouf, as CEO) should bring to the CCO's attention disclosures that may require amendment to the Form ADV: "Employees are encouraged to review UASNM's disclosure documents and bring to the CCO's attention any disclosures that may require amendment/updating." Stipulated FOF No. 55. Instead of following this guidance, Malouf failed to disclose to others at UASNM the full extent of his conflict of interest and did not tell Kopczynski that the Form ADV needed to be revised. Malouf acted knowingly as he testified that "[w]ithout a doubt," disclosures regarding the ongoing payments Malouf was receiving from Lamonde should have been in all the relevant ADV disclosures. Stipulated FOF No. 193; Tr. 1001.

For the foregoing reasons, I find that Malouf aided and abetted and caused UASNM's violation of Advisers Act Section 207.

IV. SANCTIONS

A. Willfulness

Some of the requested sanctions are only appropriate if Malouf's violations were willful. *See* 15 U.S.C. § 78*o*(b)(4)(A), (D), (E), (6)(A)(i), 78*o*-5(c), 78u-2(a), 80a-9(b)(2), (3), (d), 80b-3(e)(1), (5), (6), (f), (i). Malouf's actions were unquestionably willful because he did not adequately and fully disclose his conflict of interest to UASNM and its clients and he was

[34] A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976).

responsible for the false and misleading misstatements that appeared in UASNM's Forms ADV and on its website.

B. Statute of Limitations

Malouf asserts the five year statute of limitations set forth in 28 U.S.C. § 2462 as an affirmative defense. Resp. Br. at 39-40; Resp. Reply at 20-21. The Division's equitable and remedial claims are not barred by that or any other applicable statute of limitations. By its express wording, Section 2462 applies only where the Commission seeks relief that a court deems punitive – "any civil fine, penalty, or forfeiture, pecuniary or otherwise." 28 U.S.C. § 2462. Section 2462 does not limit the time for the Commission to file claims seeking equitable or remedial relief such as disgorgement or cease-and-desist orders. *Riordan v. SEC*, 627 F.3d 1230, 1234-35 (D.C. Cir. 2010) (disgorgement and cease-and-desist order not subject to five-year statute of limitations); *Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009) ("[A]n 'order to disgorge is not a punitive measure; it is intended primarily to prevent unjust enrichment.'") (citations omitted); *Johnson v. SEC*, 87 F.3d 484, 491 (D.C. Cir. 1996) (citing cases); *SEC v. Kelly*, 663 F. Supp. 2d 276, 286 (S.D.N.Y. 2009) (citing cases); *see Gabelli v. SEC*, 133 S. Ct. 1216, 1219, 1220 n.1 (2013).

I disagree with Respondent's contention that the five-year statute of limitations contained in 28 U.S.C. § 2462 applies to all forms of relief sought by the Division. Respondent cites the non-precedential opinion of *SEC v. Graham*, 21 F. Supp. 3d 1300, 1307-11 (S.D. Fla. 2014), for the proposition that injunctive relief and disgorgement claims are subject to the five-year statute of limitations. That non-binding opinion does provide "persuasive" authority for Respondent's contention. At present I am not persuaded by that opinion's reasoning that the longstanding precedents on the pertinent limitations period were swept aside, in effect, by the Supreme Court's decision in *Gabelli*, which specifically noted that its holding did not extend to injunctive relief and disgorgement claims. 133 S. Ct. at 1220 n.1; s*ee SEC. v. LeCroy*, Civil Action No. 2:09-cv-2238-AKK, 2014 U.S. Dist. LEXIS 126836, at *2-5 n.1 (N.D. Ala. Sept. 5, 2014) (collecting cases inconsistent with *Graham*).

As to the Division's request for a civil penalty, I disagree, in part, that the statute of limitations is tolled by the continuing violation doctrine. *See* Div. Br. at 28; Div. Reply at 25. Under that doctrine, if the alleged unlawful practice continues into the limitations period, the complaint is timely if filed within the required limitations period measured from the end of that practice. *See Havens Realty Corp. v. Coleman*, 455 U.S. 363, 380-81 (1982); *SEC v. Kovzan*, 807 F. Supp. 2d 1024, 1035-36 (D. Kan. 2011); *see also SEC v. Geswein*, Case No. 5:10CV1235, 2011 U.S. Dist. LEXIS 111893, *7 (N.D. Ohio Sept. 29, 2011) (equitable tolling includes the continuing violations doctrine); *Huff*, 758 F. Supp. 2d at 1340 ("[W]here the appropriate facts exist, the 'continuing violations' doctrine may apply to the statute of limitations in SEC enforcement actions."); *Kelly*, 663 F. Supp. 2d at 288 (rejecting motion to dismiss Commission's claim for penalties on statute of limitations grounds because continuing violation doctrine in combination with a tolling agreement made the claims timely filed); *but cf. SEC v. Caserta*, 75 F. Supp. 2d 79, 89 (E.D.N.Y. 1999) ("[I]t is not at all certain that the continuing violation doctrine applies in securities fraud litigation."); *SEC v. Jones*, No. 05 Civ. 7044 (RCC), 2006 WL 1084276, *4-5 (S.D.N.Y. Apr. 25, 2006).

Here, however, I find that the continuing violation doctrine generally does not apply to the false and misleading Forms ADV because the violations relate to separate and discrete acts of filing and providing Part II to clients. *See National R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 114-15 (2002) (finding a plaintiff could not recover for discrete violations occurring outside the applicable time period and rejecting application of the continuing violations doctrine); *CSC Holdings, Inc. v. Redisi*, 309 F.3d 988, 992 (7th Cir. 2002) (refusing to apply the continuing violation doctrine to violations arising from sales constituting separate and discrete statutory violations). Repeatedly violating a statute does not convert multiple individual violations into a continuing wrong. *Redisi*, 309 F.3d at 992. Elsewhere, the Division's position is clearly that this case involves separate violations, i.e. "[e]ach of the 74 commission payments Malouf received . . . was a separate violation, as was each misleading disclosure on UASNM's Forms ADV and website." *See* Div. Br. at 33. By contrast, the misleading statements and omissions on the website represent a continuing wrong. As a result, except with respect to the website, claims based on violations occurring prior to June 9, 2009, are barred by the statute of limitations. Thus, for the purpose of civil penalties, I limit my consideration to violations from then until May 2011, when Malouf was terminated from UASNM.

C. Cease and Desist Order

The Division requests findings of liability for the violations alleged and an order to cease and desist from violating Section 17(a) of the Securities Act, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), (2), and (4) and 207 of the Advisers Act. Div. Br. at 28. Securities Act Section 8A, Exchange Act Section 21C, and Advisers Act Section 203(k) provide that, if the Commission finds that any person has violated or caused a violation of the Securities Act, Exchange Act, or Advisers Act, respectively, or any rule or regulation thereunder, the Commission may enter an order requiring any person that was a cause of the violation to cease and desist from committing or causing any future violation of the same provision, rule, or regulation. 15 U.S.C. §§ 77h-1(a), 78u-3(a), 80b-3(k)(1).

In deciding whether to issue a cease-and-desist order, the Commission must consider whether there is a reasonable likelihood of future securities violations. *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 SEC LEXIS 98, at *101 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002). The Division asserts that "a past violation suffices to establish a risk of future violations." Division Proposed Additional FOF and COL at 76 (citing *KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *102). Malouf disputes this contention as incomplete. Resp. Response to Div. Proposed Additional FOF and COL at 115-16. The D.C. Circuit qualified this notion in *WHX Corp. v. SEC*, 362 F.3d 854 (D.C. Cir. 2004):

> Under this view, apparently, the "risk of future violation" element is satisfied if (1) a party has committed a violation of a rule, and (2) that party has not exited the market or in some other way disabled itself from recommission of the offense. Given that the first condition is satisfied in every case where the Commission seeks a cease-and-desist order on the basis of past conduct, and the second condition is satisfied in almost every such case, this can hardly be a significant factor in determining when a cease-and-desist order is warranted. The

> Commission itself has disclaimed any notion that a cease-and-desist order is "automatic" on the basis of such an almost inevitably inferred risk of future violation.

362 F.3d at 859 (citing *KPMG, LLP v. SEC*, 289 F.3d 109, 124-25 (D.C. Cir. 2002)). The court in *WHX Corp*. went on to find that "[t]he 'risk of future violation' cannot be the sole basis for its imposition of the [cease and desist] order, as the SEC's standard for finding such a risk is so weak that it would be met in (almost) every case." *Id.* at 861.

In deciding whether to issue a cease-and-desist order, the court may consider several factors including the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, the respondent's opportunity to commit future violations, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings. *KPMG Peat Marwick LLP*, 2001 SEC LEXIS 98, at *116. This inquiry is a flexible one and no one factor is dispositive. *Id.* It is undertaken not to determine whether there is a "reasonable likelihood" of future violations but to guide the court's discretion. *Id.*

I find that a cease-and-desist order associated with the violations is appropriate. The violations were relatively serious and lasted for more than three years. Malouf was extremely reckless, and has provided little meaningful assurance against future violations or recognition of wrongdoing; in fact he mostly places blame for his misconduct on others. To the extent Malouf is not barred from practice as an investment adviser, there is a decided opportunity to commit future violations. McGinnis testified that in his forty-four years in the securities industry, he had "never seen a million dollars conflict of interest like this before." While it is difficult to assess the impact to the investors, or the market, of such a conflict; in this case, where Malouf's failure to seek best execution was apparently borne out of the conflict of interest, my calculation establishes a loss of more than a quarter-million dollars to investors.

D. Collateral and Associational Bar

Exchange Act Section 15(b) provides that the Commission shall censure, limit, suspend, or bar any person acting as a broker from being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, or from participating in an offering of penny stock, if the Commission finds that such censure, limitation, suspension, or bar is in the public interest and that person has (1) willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated or willfully aided and abetted violations of, certain provisions of the securities laws.[35] 15 U.S.C. § 78*o*(b)(4)(A), (D), (E), (6)(A)(i).

[35] Exchange Act Section 15C(c) provides for a similar censure, limitation, suspension, or bar from acting as an associated person of a government securities broker or dealer. 15 U.S.C. § 78*o*-5(c).

Advisers Act Section 203(f) provides that the Commission shall censure, limit, suspend, or bar any associated person of a registered investment adviser from being associated with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, if the Commission finds that such censure, limitation, suspension, or bar is in the public interest and that person has (1) willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission; or (2) has willfully violated or willfully aided and abetted violations of, certain provisions of the securities laws. 15 U.S.C. § 80b-3(e)(1), (5), (6), (f).

Investment Company Act Section 9(b) authorizes the Commission to prohibit, conditionally or unconditionally and either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter if such person has willfully violated or willfully aided and abetted violations of certain provisions of the securities laws. 15 U.S.C. § 80a-9(b)(2), (3).

In determining the public interest the Commission has considered the following factors: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, the likelihood that the respondent's occupation will present opportunities for future violations, the age of the violation, the degree of harm to investors and the marketplace resulting from the violation, and, in conjunction with other factors, the extent to which the sanction will have a deterrent effect. *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at * 6 (Feb. 13, 2009) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)); *see also Ralph W. LeBlanc*, Exchange Act Release No. 48254, 2003 WL 21755845, at * 6 (July 30, 2003); *Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *11 n.72 (Dec. 12, 2013). The "inquiry into the appropriate sanction to protect the public interest is a flexible one, and no one factor is dispositive." *Gary M. Kornman*, 2009 WL 367635, at * 6 (quoting *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at * 15 (Dec. 21, 2007)).

For the aforementioned reasons, a collateral bar under the Advisers Act and an associational bar under the Investment Company Act are justified.[36] Malouf was associated with UASNM, a registered investment adviser, and I previously found that he violated Exchange Act Section 10(b) and Rules 10b-5(a) and 10b-5(c); Securities Act Sections 17(a)(1) and 17(a)(3); and Advisers Act Sections 206(1) and 206(2); and aided and abetted violations of Advisers Act Sections 206(4) and 207 and Rule 206(4)-1(a)(5). In making that determination, I note that in

[36] Malouf cannot be sanctioned under Exchange Act Sections 15(b) and 15C(c) because I did not find that Malouf was acting as a broker.

the Commission-approved settlement for UASNM, none of the other officials who were responsible for the materially misleading Forms ADV and website materials during the pertinent period, the CCO and CFO, were even suspended. *See UASNM, Inc.*, 2014 WL 2568398. However, the firm was subjected to heightened surveillance for two years, and credit must undeniably be given to UASNM's decision to report themselves and Malouf to the Commission. In addition, I do find that Malouf's conduct was more problematic because the most significant conflict of interest was his own, and he bore the ultimate responsibility to disclose it. On the other hand, I recognize that the circumstances that gave rise to the conflict and problems with best execution – the sale of Malouf's RJFS branch – have now passed, and are unlikely to recur. Given Malouf's age of fifty-five, a bar of seven-and-one-half years may mean that he will never return to the industry. Even if he does return to such work in his sixties, he would be near retirement. Because he works as an investment adviser, this bar will deprive him of his entire livelihood, and force him into another profession. As an individual who worked for over thirty years in the industry, first as a broker-dealer, and then as an investment adviser, this will be a substantial professional and personal blow given his age and career prospects. However, I find that the severity of such a bar is necessary to serve the public interest.

E. Disgorgement and Prejudgment Interest

Securities Act Section 8A(e), Exchange Act Section 21C(e), and Advisers Act Section 203(k)(5) authorize disgorgement, including reasonable interest, in cease-and-desist proceedings. 15 U.S.C. §§ 77h-1(e), 78u-3(e), 80b-3(k)(5). Exchange Act Section 21B(e), Investment Company Act Section 9(e), and Advisers Act Section 203(j) authorize disgorgement in proceedings in which a penalty may be imposed. 15 U.S.C. §§ 78u-2(e), 80a-9(e), 80b-3(j). "Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989).

Because of the difficultly in many cases to separate "legal from illegal profit . . . it is proper to assume that all profits gained while defendants were in violation of the law constituted ill-gotten gains." *SEC v Bilzerian*, 814 F. Supp. 116, 121 (D.D.C. 1993) (internal citations omitted); *see also SEC v. Drexel Burnham Lambert, Inc*., 837 F. Supp. 587, 611-12 (S.D.N.Y. 1993), *aff'd*, *SEC v. Posner*, 16 F.3d 520 (2d Cir. 1994). "[T]he well-established principle is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that uncertainty." *Zacharias*, 569 F.3d at 473. Here, however, the monies constituting fair value for the sale of Branch 4GE are clearly identifiable as legal profits, and should not be the subject of disgorgement.

By contrast, the monies received from excessive commissions, attributable to Malouf, should be disgorged. For the reasons set forth above, I find that this figure is roughly $265,000. However, as the Division agreed that any disgorgement awarded may be "offset by the $506,083.74 already reimbursed to investors from [Malouf's] settlement with UASNM[,]" my

order will not require Malouf to pay any additional money for disgorgement purposes.[37] Div. Br. at 31.

F. Civil Penalties

Based on the willful violations and conduct set forth above, Respondent should be ordered to pay a civil penalty pursuant to Section 8A of the Securities Act, Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act. Exchange Act Section 21B(a), Advisers Act Section 203(i), and Investment Company Act Section 9(d) authorize the Commission to impose civil monetary penalties in any cease-and-desist proceeding against any person after notice and opportunity for hearing where penalties are in the public interest and the person (1) has willfully violated, or aided and abetted violations of, certain provisions of the securities laws or rules or regulations; or (2) has willfully made or caused to be made a materially false or misleading statement, or omitted any material fact, in a report required to be filed with the Commission. 15 U.S.C. §§ 78u-2(a), 80a-9(d), 80b-3(i). Securities Act Section 8A(g) authorizes the Commission to impose civil monetary penalties in any cease-and-desist proceeding against any person after notice and opportunity for hearing where penalties are in the public interest and the person has violated or caused the violation of any provision of the Securities Act or its rules and regulations. 15 U.S.C. § 77h-1(g).

To determine whether a penalty is in the public interest, Exchange Act Section 21B, Advisers Act Section 203(i), and Investment Company Act Section 9(d) call for consideration of: (1) whether the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) harm caused to others; (3) unjust enrichment, taking into account restitution made; (4) prior violations; (5) deterrence; and (6) such other matters as just may require. 15 U.S.C. §§ 78u-2(c), 80a-9(d)(3), 80b-3(i)(3). The statutes also allow a respondent to present evidence of the ability of the respondent to pay such penalty. 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d), 80a-9(d)(4), 80b-3(i)(4); *see* 17 C.F.R. § 201.630; *see also SEC v. Tourre*, 4 F. Supp. 3d 579, 593 (S.D.N.Y. 2014) (citations omitted); *SEC v. Opulentica, LLC*, 479 F. Supp. 2d 319, 331 (S.D.N.Y. 2007); *SEC v. Haligiannis*, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007); *SEC v. Lybrand*, 281 F. Supp. 2d 726, 730 (S.D.N.Y. 2003), *aff'd*, *SEC v. Kern*, 425 F.3d 143 (2d Cir. 2005); *SEC v. Coates*, 137 F. Supp. 2d 413, 429 (S.D.N.Y. 2001).

Malouf argues that a "defendant's net worth and corresponding ability to pay has proven to be one of the most important factors that district courts consider when determining how much of a civil penalty to assess." Resp. Response to Div. Proposed Additional FOF and COL at 123 (citing *SEC v. Gunn*, Civ. Action No. 3:08-cv-1013-G, 2010 WL 3359465, at *10 (N.D. Tex. Aug. 25, 2010); *SEC v. Svoboda*, 409 F. Supp. 2d 331, 347-48 (S.D.N.Y. 2006) (rejecting request to impose maximum penalty where defendants "perpetrated a fraud involving repeated securities law violations, considerable profits, and a high degree of scienter" because the maximum penalty "would be inappropriate given each defendant's financial situation"); *SEC v. Mohn*, No. 02-74634, 2005 WL 2179340, at *9 (E.D. Mich. Sept. 9, 2005) (waiving civil penalties against defendant where the court found it unlikely the Commission could collect any

[37] Because no further disgorgement is required, I do not address the issue of prejudgment interest.

civil penalties given defendant's net worth and his speculative and uncertain future income potential); *SEC v. Rubin*, No. 91 CIV 6531 (MBM), 1993 WL 405428, at *7 (S.D.N.Y. Oct. 8, 1993) (imposing $1,000 penalty against impecunious defendant due to "the distinction between an ordinary debt that arises from a particular and definable liability, and a penalty that is designed to punish and is imposed based on an exercise of discretion")). The Commission has found that "ability to pay may be considered, but it is only one factor" and "[c]onsidering it is also discretionary." *Johnny Clifton*, Securities Act Release No. 9417, 2013 SEC LEXIS 2022, at *66 (July 12, 2013); *see Gregory O. Trautman*, Securities Act Release No. 9088, 2009 SEC LEXIS 4173, at *93 & n.115 (Dec. 15, 2009). When a respondent's conduct is egregious, ability to pay may be disregarded. *Johnny Clifton*, 2013 SEC LEXIS 2022, at *66; *Gregory O. Trautman*, 2009 SEC LEXIS 4173, at *93.

Securities Act Section 8A, Exchange Act Section 21B, Advisers Act Section 203(i), and Investment Company Act Section 9(d) set out a three-tiered system for determining the maximum civil penalty for each violation. A maximum third-tier penalty is permitted if (1) the violations involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and (2) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission. 15 U.S.C. §§ 77h-1(g)(2)(C), 78u-2(b)(3), 80a-9(d)(2)(C), 80b-3(i)(2)(C). The maximum third-tier penalty for conduct occurring after March 3, 2009, and on or before March 5, 2013, is $150,000 per violation. 17 C.F.R. § 201.1004, Subpt. E, Table IV.

I have considered "evidence concerning [Malouf's] ability to pay in determining whether disgorgement, interest or a penalty is in the public interest." 17 C.F.R. § 201.630(a); *see* 15 U.S.C. §§ 77h-1(g)(3), 78u-2(d), 80b-3(i)(4); *Gunn*, 2010 WL 3359465, at *10. Malouf affirmed his first Statement of Financial Condition on January 12, 2015. *See* Resp. Br. at Ex. B. On January 14, 2015, I set a briefing schedule to allow the parties to file briefs setting forth their respective positions on Malouf's inability to pay any potential disgorgement, interest, or penalties that might be ordered. *Dennis J. Malouf*, Admin. Proc. Rulings Release No. 2219, 2015 SEC LEXIS 149. On February 27, 2015, the parties submitted briefs and documentary evidence on this issue (Div. Position and Resp. Position), including Malouf's second, revised Statement of Financial Condition, affirmed by Malouf on February 25, 2015. *See* Resp. Position at Ex. A. The revised statement contains supplementary detail, including additional assets and income that were previously undisclosed. I do not draw an adverse inference from Malouf's inclusion of this additional information, because the initial statement was prepared with comparatively limited information under challenging time constraints.

According to Malouf, his liabilities exceed his assets by an estimated $634,000. *See* Resp. Position at 2-9, Exs. A-I. His "regularly monthly personal expenses are approximately $4,600," including "$1,500 for rent, $850 for health insurance for himself and his children, food, utilit[ies], medical and automobile expenses" and "$550 per month in child support to his ex-wife." *Id.* at 9. The Division claims that Malouf's withdrawals from a NM Wealth Management bank account demonstrate that he received more than $3,000 to $6,000 per month of draws from the company, but, many such withdrawals, including cash withdrawals, could be business expenses, as opposed to personal ones. Div. Position at 4-5, Ex. D.

I disagree with Malouf's estimated value of his home and mortgages. Malouf's statement of financial condition does not include the value of his home, though Malouf notes in his position that the value was inadvertently omitted and his estimated value, based on public records, is $274,000, and the statement lists mortgages of $360,749 and a second mortgage of $164,122. Resp. Position at 2 n.1, Ex. A. Malouf's credit report, dated January 21, 2015, lists a mortgage account balance with Seterus, Inc., of $360,749 as of January 2015 and a home equity loan with US Bank with a balance as of December 2014 of $164,122.[38] *Id.* at Ex. H. The Division notes that on January 14, 2015, Malouf's property was sold at auction to CITIMORTGAGE, Inc., for $355,009.71. Div. Position at 5, Ex. G at 2. Taking into account the sale, it is more likely that Malouf's net liability involving his home is $169,861.29, instead of $250,871.

I disagree with Malouf's estimate, that his investment advisory firm, with almost $20 million under management, has a value of only $100,000. Resp. Position at 3. At the hearing it was established that with respect to two similar circumstances, the sale of investment adviser firm UAS by Kopczynski to Malouf, and the sale of broker-dealer Branch 4GE by Malouf to Lamonde, that Malouf valued each business for sale at twice its annual trailing revenue. *See* Resp. Supplemented Proposed FOF No. 73. Employing that same rule of thumb, the value of Malouf's current investment advisory firm should be at least $292,500.[39] Thus taking into account my revised mortgage liability and investment advisory firm value estimates, while Malouf's liabilities exceed his assets, they do so by only $360,752.29.

For purposes of determining whether his ability to pay is in the public interest, I will not consider, in Malouf's favor, either the $286,000 of his estimated tax liability to the IRS for 2005 to 2011, nor his $68,103 state tax lien. Malouf's failure to file and pay taxes is his own fault; and allowing him to profit from his refusal to keep current with his taxes by offsetting any pecuniary remedy would negatively affect the public interest. Because I will not consider these elements to his benefit, I find that, for purposes of his ability to pay, his liabilities exceed his assets by $6,649.29. However, the mere fact that liabilities exceed assets does not establish an inability to pay, or that excusing him from paying anything would be in the public interest. Unlike someone who was destitute, and lacked the ability to work, Malouf has considerable assets (though he also has considerable obligations), and although he will not be able to work as an investment adviser going forward, he is nonetheless an individual of aptitude and shrewdness who will undoubtedly work in some other business profession. I acknowledge that for someone whose liabilities exceed their assets on Malouf's score, any civil penalty would be much more

[38] The Division notes that in an earlier statement of financial condition Malouf listed a mortgage liability of $458,250 and $159,250 for a second mortgage. Div. Position at 5, Ex. C at 2. Upon questioning Malouf's counsel, the Division was told that Malouf double-counted his second mortgage; Malouf then provided a corrected statement of financial condition. *Id.* at 5, Ex. F.

[39] Malouf charges his clients on a quarterly basis an annual fee of 1.20% on assets under management (AUM) of up to $1,000,000; 1.00% on AUM of between $1,000,000 and $2,000,000; and 0.75% on AUM over $2,000,000. Div. Position at 2, Ex. B at 3. Based on the firm's AUM, it could earn anywhere between $146,250 and $234,000. *See* Resp. Position at 8.

significant, in its punitive and deterrent effect on that individual, than it would be for someone in better financial circumstances. I will consider that duly in deciding any penalty in this case.

Third-tier penalties are appropriate because Malouf recklessly disregarded his fiduciary duties and disclosure requirements and thereby created a significant risk of substantial losses to his advisory clients. Dr. Gibbons calculated those losses, at a minimum, as $442,106, with Malouf's personal culpability exceeding a quarter-million dollars. It is undisputed that Malouf's money was used by UASNM to pay roughly twice the amount to its customers that I found Malouf was personally responsible for. I also note that Malouf already paid the $100,000 civil penalty on behalf of UASNM, and has made a convincing showing that, given his present financial status, he has dramatically less ability to pay any more substantial sums of money. The collateral bar I have ordered will deprive him of his ability to work in his chosen profession and his liabilities exceed his available assets. Balancing the aforementioned seriousness of his misconduct, with those mitigating factors of paying UASNM's penalty and his projected inability to pay, I find that a civil penalty consisting of one violation of $75,000 is appropriate to serve the public interest.[40]

V. RECORD CERTIFICATION

Pursuant to Rule of Practice 351(b), 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the Record Index issued by the Secretary of the Commission on March 20, 2015.

VI. ORDER

I ORDER that, pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Section 203(k) of the Investment Advisers Act of 1940:

> Dennis J. Malouf shall cease and desist from committing or causing violations, and any future violations, of Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933; Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rules 10b-5(a) and 10b-5(c); and Sections 206(1), 206(2), 206(4), and 207 of the Investment Advisers Act and Advisers Act Rule 206(4)-1(a)(5).

I FURTHER ORDER that, pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act:

> Dennis J. Malouf is barred for a period of seven-and-one-half years from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal

[40] Although one could parse Malouf's conduct, over time, into particular violations, the underlying violative conduct that supports a civil penalty is that he never adequately disclosed the essential terms of his agreement to sell Branch 4GE to Lamonde to anyone else.

underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

I FURTHER ORDER that, pursuant to Section 8A(g) of the Securities Act of 1933, Section 21B(a) of the Securities Exchange Act of 1934, Section 9(d) of the Investment Company Act of 1940, and Section 203(i) of the Investment Advisers Act of 1940:

Dennis J. Malouf shall pay a civil monetary penalty in the amount of $75,000.

Payment of civil penalties shall be made no later than twenty-one days following the day this Initial Decision becomes final, unless the Commission directs otherwise. Payment shall be made in one of the following ways: (1) transmitted electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) direct payments from a bank account via Pay.gov through the Commission website at http://www.sec.gov/about/offices/ofm.htm; or (3) by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order, payable to the Securities and Exchange Commission.

Any payment by certified check, United States postal money order, bank cashier's check, wire transfer, or bank money order shall include a cover letter identifying the Respondent and Administrative Proceeding No. 3-15918, and shall be delivered to: Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Blvd., Oklahoma City, Oklahoma 73169. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule of Practice 360, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule of Practice 111, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then a party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

_____

Jason S. Patil
Administrative Law Judge