BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC

In the Matter of the Application of

The Dratel Group, Inc. and William M. Dratel

For Review of

FINRA Disciplinary Action

File No. 3-15869

FINRA'S BRIEF IN OPPOSITION TO APPLICATION FOR REVIEW

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FINRA'S BRIEF IN OPPOSITION TO APPPLICATION FOR REVIEW

I. INTRODUCTION

William M. Dratel ("Dratel") and his firm, The Dratel Group, Inc. ("DGI"), intentionally victimized 25 customers by engaging in a fraudulent "cherry-picking" scheme whereby Dratel day traded in an omnibus account at DGI, waited until the end of the trading day to assess the profitability of his trades, and then allocated profitable trades to his personal account while burdening his unknowing customers with his unprofitable or less profitable trades. Dratel was able to perpetuate his scheme completely unsupervised and undetected through his one-man firm and by using as his mark discretionary customers. Dratel and DGI engaged in their fraudulent scheme over a one-year period, during which time Dratel's personal account earned more than $489,000 as a result of his fraudulent trading, while Dratel's discretionary customers' accounts lost $228,000 as a result of that same trading.

FINRA's National Adjudicatory Counsel ("NAC") concluded that Dratel and DGI willfully engaged in a fraudulent cherry-picking scheme, failed to disclose their fraudulent trading to customers, and falsified and manipulated order tickets to further their scheme. The

NAC based this conclusion on abundant evidence, much of which was undisputed. For example, the record shows that Dratel had discretionary authority over the customer accounts at issue and was completely unsupervised (and thus he could carry out his scheme without detection or intervention), traded exclusively through an omnibus account, and increased dramatically his level of trading during the period in question. It is also undisputed that Dratel sometimes traded the same stocks for himself and his customers, generated unexplained and exorbitant profits for himself during the period in question (while his customers suffered large losses as a result of his fraudulent day trading), and that Dratel had low equity in his personal account.

The record also shows that Dratel was experiencing a strained financial situation during the time period immediately preceding the fraudulent scheme, and thus had a motive to engage in fraud. Finally, ample evidence—including the credible testimony of two witnesses (including a DGI employee) and numerous time-stamped allocation instructions—unequivocally demonstrates that Dratel and DGI executed trades without identifying customers until the end of the trading day, after Dratel could assess the performance of the trades and allocate more profitable trades to his own account.[1]

For Dratel's and DGI's egregious, fraudulent, and intentional misconduct, the NAC barred Dratel, expelled DGI, and ordered that Dratel disgorge $489,000 in ill-gotten gains. The

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[1] In addition to the NAC's findings that Dratel and DGI willfully engaged in a fraudulent cherry-picking scheme, the NAC also found that: (1) Dratel and DGI failed to establish, maintain, and enforce adequate supervisory procedures; (2) Dratel and DGI willfully failed to update periodically customer account information; and (3) DGI opened new customer accounts without requiring photographic identification and failed to independently test its Anti-Money Laundering ("AML") program. On appeal, applicants do not challenge these findings or the sanctions imposed, but not assessed, in light of the bar and expulsion imposed for applicants' willfully fraudulent misconduct. The Commission should affirm the NAC's findings as well supported by the record. A summary of the evidence in support of these violations begins on page 33.

NAC appropriately considered the presence of numerous aggravating factors, including applicants' prior disciplinary histories, the one-year period in which Dratel and DGI intentionally engaged in their scheme, the huge profits earned by Dratel's day trading in his personal account compared to his customers' significant losses as a result of that trading, and Dratel's efforts to conceal his actions. The NAC also appropriately ordered that Dratel disgorge his ill-gotten gains, the amount of which Dratel conceded.

Notwithstanding a record replete with evidence showing most of the elements common to fraudulent cherry-picking schemes, Dratel and DGI raise a number of arguments in which they attempt to justify their fraudulent trading and explain away the NAC's findings.[2] These arguments can be distilled into several overarching and unsupported complaints involving FINRA's allegedly unfair "cherry picking" of its own with regard to the time period and customer pool at issue, alleged erroneous calculations of profits and trading, the lack of direct testimonial evidence showing fraud, the relatively few incidents of certain aspects of applicants' fraudulent misconduct, and the alleged satisfaction of applicants' customers despite their egregious and fraudulent misconduct.

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[2] Applicants' "brief" filed with the Commission is identical to their Motion for Stay Pending Appeal and Interim Stay Pending Decision on Motion and for Expedited Consideration ("Stay Motion") filed with the Commission on or about May 12, 2014, which the Commission denied on June 2, 2014. Applicants blame the Commission for their duplicate submission, stating that because it "only" granted them a one-week extension of time to file their brief (instead of the 30-day extension they requested), they were "compelled to rely" on their previously submitted Stay Motion. The Commission should reject any efforts by applicants to suggest that they had insufficient time to submit a brief. They were served with the NAC's decision on May 2, 2014, and thus had more than two months to draft an appellate brief. Applicants, however, chose not to do so and instead rely entirely on their prior, unsuccessful submission. Moreover, in its order denying the Stay Motion and setting the briefing schedule, the Commission warned that "[r]equests for extensions of time to file briefs will be disfavored." Applicants were thus on notice that their brief would likely be due when the Commission originally said it would be due.

The NAC soundly rejected each of applicants' arguments as having no factual or legal basis, as did the Commission in the context of applicants' unsuccessful Stay Motion. Dratel and DGI have not raised a single new argument or justification that warrants modification of the NAC's findings. Dratel and DGI simply cannot overcome the preponderance of evidence, which shows that they willfully engaged in a fraudulent scheme. Nor do the applicants succeed in arguing that the sanctions are excessive for their abhorrent misconduct. The Commission should affirm the NAC's findings and sanctions, and dismiss applicants' appeal.

II. FACTUAL AND PROCEDURAL HISTORY

A. Dratel and DGI Willfully Engaged in a Fraudulent Cherry-Picking Scheme

1. Applicants' Background

Dratel was registered through DGI as, among other things, a general securities representative and principal, and a financial and operations principal ("FINOP").[3] RP 63, 7426. Since August 1999, Dratel has been the sole owner of DGI, and since 2002 he operated the firm under a waiver of the two-principal requirement. RP 66, 7426. During the period in question, Dratel was the only registered person at DGI and was designated as DGI's chief compliance officer, AML officer, and FINOP. RP 4473, 4547. DGI also employed two to three unregistered individuals to assist Dratel and perform administrative tasks. RP 2094-97.

DGI operated out of two offices. Its main office, where Dratel worked primarily, was located in East Hampton, New York. DGI's only branch office was located in New York City, where it maintained its customer files and trading records. RP 2091-93, 4134-39. Two unregistered staff members—Onolee Duncan ("Duncan"), the firm's receptionist who

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[3] FINRA's Central Registration Depository ("CRD"®) indicates that Dratel is not currently associated with any firm.

maintained all of DGI's trading records, and Veronica Perez ("Perez"), Dratel's sales assistant from October 2005 through September 2006—worked at the New York City office.[4] RP 2094-95, 2950-51, 4127-28, 4136. Perez was primarily responsible for manually entering trades. RP 2951.

2. The Discretionary Customers

From October 1, 2005 through December 31, 2006 (the "Relevant Period"), DGI had approximately 70 customer accounts in which Dratel exercised discretionary trading authority. RP 3517, 4268-70. In approximately 40 of those accounts, Dratel engaged in some day and overnight trading in addition to long-term investing.[5] RP 2544, 3018, 3517-18. Dratel did not engage exclusively in day and overnight trading in any of the discretionary customers' accounts, and all of those accounts also held long-term investments. RP 2544, 3017-19.

FINRA's Department of Enforcement ("Enforcement") confined its allegations of fraudulent cherry picking to 25 discretionary customers' accounts (the "Discretionary Customers").[6] RP 7, 2736-37, 5613. Most of the Discretionary Customers were friends and family of Dratel and long-term clients of DGI. RP 2088-89, 3165-84, 3554-58. During the Relevant Period, Dratel executed more than 1,200 day and overnight trades in the accounts of the Discretionary Customers. RP 5612-14.

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[4] Perez replaced Angela Lopez ("Lopez"). RP 4061-63. Lopez left DGI in September 2005 and returned in March 2007. *Id.*

[5] The Hearing Panel explained that in its decision, "day trades" referred to the purchase and sale (or short sale and purchase to cover) of a security within a single trading day or within two consecutive trading days, and the NAC referred to Dratel's and DGI's trades at issue as "day and overnight trades." *See* RP 8040.

[6] Enforcement's expert did not include discretionary customer accounts that had two or fewer day and overnight trades during the Relevant Period. He indicated, however, that the impact of these accounts would have been immaterial to his overall conclusions. *See* RP 5613.

3. Dratel's Trading Account

Dratel also actively traded for his personal account at DGI, in which he executed almost exclusively day and overnight trades. RP 2544, 3018-19. During the Relevant Period, Dratel executed 501 day and overnight trades in his personal account. RP 5612-14.

4. The Firm Account

Dratel initiated all positions, for Discretionary Customers' accounts and his personal account, in one of two firm accounts (the Average Price Listed Account or the OTC Principal Account) (together, the "Firm Account"). RP 2099-2102, 2129, 2226. DGI's staff, at Dratel's direction, allocated the positions or portions of the positions to one or more Discretionary Customers' accounts or Dratel's personal account. RP 2112-13, 2136-37. In 2005 and 2006, DGI did not conduct any proprietary trading in the Firm Account, and it was flat at the end of every day. RP 2100.

5. The Firm's Order Entry and Allocation Systems

DGI cleared on a fully-disclosed basis through Oppenheimer & Co. RP 63. Duncan and Perez had direct access to Oppenheimer's order entry and allocation systems, which enabled them to enter and allocate trades independently. RP 2097, 2130-33, 2951-55, 3378-79. DGI entered all of its orders through Oppenheimer's Order Management System ("OMS"). RP 2097-99. OMS documented the time that a trade was routed and executed in hours, minutes, and seconds, and OMS closed when the market closed at 4:00 p.m. RP 2104, 3662-63. DGI used Oppenheimer's back-office system, FiNet, to allocate trades from the Firm Account to customer accounts or Dratel's personal account. RP 2097-99, 3662. FiNet recorded only the trade and date and did not record time of entry or execution of an order. RP 4108-09. FiNet remained open and accessible until 7:00 or 8:00 p.m., and DGI employees sometimes entered allocations

into FiNet well after the market closed at 4:00 p.m. RP 2198-99, 2557-58. When Dratel purchased stock by placing an order through the Firm Account, it was not possible to determine via the OMS ticket for which customer account the trade was designated. RP 3150-52, 3826-27. Only FiNet tickets identified customer accounts.

6. The Mechanics of Applicants' Fraudulent Allocation Scheme

Applicants' fraudulent cherry-picking scheme followed a regular pattern. Dratel would open a position (with a purchase or short sale) in the Firm Account through OMS on one day and close the position (by selling or covering the short) on the same day or the next day. RP 2100-07, 3915-16, 3921-29. DGI executed all orders to open positions through OMS in the Firm Account. *Id.* DGI staff, at Dratel's direction, thereafter allocated the purchases or short sales executed in the Firm Account into a customer account or Dratel's personal account through the FiNet system. *Id.* As described below, Dratel usually allocated trades at, near, or after the close of the market so that he could assess each trade's profitability before taking profitable trades (or less unprofitable trades) for himself.

a. The Credible Testimony of DGI Staff and a FINRA Examiner that Dratel Provided Allocation Instructions Near or After the Market Close

Perez, the DGI sales assistant responsible for manually entering trades on OMS and allocations on FiNet, testified before the Hearing Panel that Dratel would contact her (or Duncan in Perez's absence) by telephone and direct her to place orders, generally early in the day. *See* RP 2951-55; *see also* RP 2130-32. Perez entered the orders into OMS and, as orders were executed, gave Dratel the execution price and order identification number from OMS over the phone so that Dratel could record them on each OMS order ticket. *See* RP 2950-51, 2954-55; *see also* RP 2227-29. When Dratel called Perez with an order, Dratel generally did not identify

the customer or customers (including Dratel's personal account) for whom he was purchasing the stock. RP 2952-55, 2971-73.

Perez further testified that she did not need to know customer names because all the trades were executed in the Firm Account. RP 2953-59, 2971-73. She testified that, for day and overnight trades, she did not receive allocation instructions until after Dratel closed out the positions, generally at approximately 4:00 p.m. and after Dratel could reliably assess the profitability of individual trades. *Id.* Perez testified that she received the majority of Dratel's allocation instructions between 3:30 p.m. and 4:00 p.m. or later, particularly on heavy trading days. RP 2954, 2971-73, 2980-81. The Hearing Panel found that Perez's testimony was credible.[7] RP 7526, 7528.

Additional evidence in the record, including manipulated time stamps, time stamps from the middle of the night (such as 3:20 a.m.), and facsimiles of allocation instructions, support Perez's testimony that Dratel usually provided allocation instructions at, near, or after the close of the market. *See* RP 7528, 8045-46; *see also* RP 3267-68, 3694-96, 4503-05, 5169, 5213, 5223, 5241, 5246-49, 5251, 5275, 5281, 5303, 5393 (examples of altered or incorrect time stamps); RP 4333-34, 4342-46, 4348-61, 5001-5108, 5170-82, 5207-08, 5239, 5260, 5301-02, 5351, 5394-96 (faxed allocation sheets sent at or near the close of the market or later); RP 5119-25, 5209-12, 5263-65, 5268, 5275-79, 5281-82, 5318, 5349-50, 5353-64, 5389-92, 5415-23,

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[7] The Commission has stated that credibility determinations of the initial fact finder are entitled to considerable weight and "can be overcome only when there is substantial evidence for doing so." *Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 SEC LEXIS 819, at *38 (Apr. 11, 2008).

5907-08, 6089 (tickets faxed from Dratel to DGI's New York City offices at, near, or after the close of the market).[8]

Moreover, a FINRA examiner further corroborated Perez's testimony. In April 2007, Patricia Hatzfeld ("Hatzfeld") visited DGI's New York City office to review trading records and facilitate DGI's production of documents to FINRA.[9] RP 2831-33. Hatzfeld found numerous faxed instruction sheets for allocations of securities positions established in the Firm Account and allocated to customer accounts and Dratel's personal account. RP 2833-34, 2873-79, 2881-86. Hatzfeld testified that in "most instances," Dratel appeared to have sent the facsimiles from the East Hampton office to the New York City office at or near the close of business on the trading day or the following day. RP 2833-34, 2873-79, 2881-86, 3289-92. Hatzfeld further testified that she could not locate all trade tickets, and she also found order tickets that appeared to be altered or for which the time stamps were missing, inaccurate, or contradicted by other documentation in DGI's files. RP 2835-36, 4289-4328. Not surprisingly, and based upon the foregoing, Hatzfeld questioned the reliability of DGI's trade tickets. RP 2840-43, 2844-49,

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[8] Lopez corroborated Perez's testimony that Dratel provided allocation instructions generally after he closed out positions in the Firm Account. Lopez testified that she would receive an order from Dratel to open a position and would enter the order in OMS (in the Firm Account). RP 4065-67, 4078-79, 4107-08. Lopez stated that, sometime during the day, Dratel would send her the other side of the order to make the Firm Account flat. *Id.* Then he would fax to her a FiNet ticket, if the allocation involved only one customer (or Dratel's personal account), or an allocation instruction sheet, if it involved more than one customer, and she would input the allocations into FiNet. *Id.* Lopez stated that this process occurred at various times throughout the day and Dratel's allocation instructions sometimes arrived after the market closed. *Id.*

[9] Enforcement began investigating DGI when FINRA detected an increase in the number of "as of" trades that DGI executed during late 2005 and early 2006. RP 2820-21. The NAC expressly rejected the argument that DGI's "as of" trades were unrelated to Dratel's fraudulent cherry-picking scheme, and found that some of the "as of" trades were in fact part of the scheme. *See* RP 8052.

2851-55. Similar to the Hearing Panel's findings regarding Perez's testimony, the Hearing Panel expressly found Hatzfeld's testimony to be credible. RP 7519.

b. Dratel's Testimony Regarding Allocations of Trades Was Not Credible

Dratel testified that both he and the New York City office staff shared the responsibility for completing DGI's order tickets. RP 2130-33. Dratel testified that, for both OMS and FiNet tickets, he sometimes time stamped and prepared tickets himself in the East Hampton office and, on other occasions, time stamped tickets and mailed them blank to the New York City office. RP 2225-30, 3953-58, 4022-23. At still other times, Dratel directed the New York City office staff to time stamp blank tickets and complete them later in the day when he supplied allocation information. RP 3953-58, 4022-23.

Dratel's testimony about calling Perez or Duncan to enter an OMS trade was generally consistent with Perez's and Duncan's testimony. Specifically, Dratel testified that he would call Perez to enter an OMS trade to open a position in the Firm Account. *See* RP 3915-16; *see also* RP 2149-51, 2191-94, 2225-26, 2952-55, 3369, 3375-79, 3921-29, 4006-19. Later in the day, he would fax completed FiNet tickets as "allocation instructions" to Perez or Duncan, or would relay allocation information to them via telephone. RP 2968, 3369, 3916, 4146.

For multiple customer (or bunched) trades, Dratel testified that he would call the opening position into the New York City office and would sometimes build the position throughout the day, then would fax allocation instructions on a sheet later in the day or at the end of the day. RP 2137, 2228-30, 2952-55, 3369, 3375-79, 3915-16, 3921-29, 4006-19. When Dratel called the opening position into the New York City office, he directed the staff to time stamp several blank FiNet tickets at that time to match the OMS time stamps. RP 2224-30, 2974, 3953-54. After receiving allocation instructions from Dratel, the New York City office would complete the

previously time-stamped FiNet tickets and input the allocations into FiNet. RP 3915-16, 3921-29.

Dratel testified that, notwithstanding the timing of the New York City office's receipt of allocation instructions or input of allocations into FiNet, he made all allocation decisions before he purchased any stock and maintained a running allocation list on his desk. RP 2169, 2176, 3408. The Hearing Panel, however, did not credit Dratel's assertion, and the NAC did not disturb this credibility determination for myriad reasons. RP 7529-30, 7547, 8048. For example, the NAC found that Perez and Lopez testified that Dratel generally did *not* communicate allocation instructions until after closing out positions. Further, Dratel time stamped blank FiNet order tickets and did not identify customer names when he placed orders in the Firm Account. Dratel also admitted to sometimes discarding tickets and creating new tickets, and the evidence included several examples of FiNet order tickets with altered or incorrect time stamps, suggesting that the tickets that did identify customer names were completed after the fact. Finally, for most trades, Dratel was unable to produce a copy of a running list that he allegedly maintained for any trading day. RP 8048; *see also* RP 7529-30.

7. Applicants' Fraudulent Scheme Generates Outrageously Large Profits for Dratel's Personal Account and Significant Losses for Discretionary Customers' Accounts

Dratel's and DGI's fraudulent scheme was highly successful, at the expense of the Discretionary Customers. Indeed, Dratel's day and overnight trading in 2006 resulted in cumulative profits in Dratel's personal account of $489,701 and cumulative losses in the Discretionary Customers' accounts of $228,163. RP 5617, 5637, 5651 5678-79. During the nine months preceding the Relevant Period, 46% of the Discretionary Customers' day and overnight trades were profitable, and 54% lost an average of $756 per trade. RP 5613-15, 5650. In stark

contrast, during the Relevant Period, only 28% of the Discretionary Customers' day and overnight trades were profitable, and 72% lost an average of $744 per trade. *Id.* Conversely, during the nine months preceding the Relevant Period, 40% of Dratel's day and overnight trades in his personal account were profitable and 60% were unprofitable. RP 5611-12, 5636. During the Relevant Period—from October 1, 2005 to December 31, 2006—however, an overwhelming 83% of Dratel's day and overnight trades were profitable with an average per trade profit of $1,374 per trade. *Id.* At the same time, only 17% of Dratel's day and overnight trades were unprofitable and generated an average per trade loss of $413. *Id.* Significantly, Dratel's personal account went from earning an average of $402 per profitable trade during the nine months preceding the Relevant Period to earning an average of $1,300 per profitable trade by the end of the Relevant Period. *Id.*; *see also* RP 5616 (showing dramatic differences in win/loss ratios and success rates for Dratel's day and overnight trading in his personal account versus the Discretionary Customers' accounts during the Relevant Period).

B. Enforcement's Complaint

In 2010, Enforcement filed against Dratel and DGI a seven-cause complaint. RP 1. Cause one alleged that during the Relevant Period, DGI and Dratel willfully executed a fraudulent trade allocation scheme by cherry picking profitable day and overnight trades for Dratel's personal account while steering unprofitable or less profitable trades to the Discretionary Customers' accounts, and failed to disclose material information to the Discretionary Customers. Cause two alleged that during the Relevant Period, Dratel and DGI willfully falsified and backdated order tickets and time-stamped blank order tickets to further the cherry-picking scheme. Cause three alleged that, between February 2005 and December 2006, Dratel and DGI failed to identify customer names on order tickets until after execution to further

the cherry-picking scheme. Enforcement withdrew cause four. Cause five alleged that, between January 2005 and December 2007, DGI and Dratel failed to establish, maintain, and enforce supervisory procedures adequate to prevent post-execution allocations of trades and ensure timely and accurate completion of customer order tickets, including the identification of customer names before execution. Cause six alleged that, between November 2004 and January 2008, DGI and Dratel willfully failed to update periodically customer account information. Cause seven alleged that, between August 2006 and January 2008, DGI opened new customer accounts without requiring the customers to show photographic identification and failed independently to test DGI's AML program in 2006 and 2007.

C. The Hearing Panel and NAC Find that Dratel and DGI Engaged in a Fraudulent Scheme and Engaged in Other Misconduct

1. The Hearing Panel Finds that Dratel and DGI Engaged in a Fraudulent Scheme

In a September 28, 2012 decision, after a multi-day hearing, a Hearing Panel majority found violations as alleged in the complaint, including that Dratel and DGI willfully engaged in a fraudulent cherry-picking scheme. RP 7509. The Hearing Panel majority barred Dratel, ordered that he disgorge $489,000 in ill-gotten gains, barred DGI from engaging in day trading, and fined DGI $185,000. RP 7564-70.

One member of the Hearing Panel dissented with respect to the Hearing Panel majority's finding that Dratel and DGI willfully engaged in a fraudulent cherry-picking scheme as alleged under cause one, although he agreed that they engaged in the other misconduct alleged in the

complaint.[10] *See* RP 7574-79. With respect to applicants' cherry-picking, and contrary to the majority of the Hearing Panel and well-established Commission precedent, the dissenting panelist was troubled that Enforcement's entire case was circumstantial. The dissenting panelist asserted that Dratel did not change the way he conducted his business during the Relevant Period, that Enforcement arbitrarily selected the Relevant Period and the Discretionary Customers, improperly counted trades, and Enforcement's expert witness report contained at least one error. The dissenting panelist further asserted that the Discretionary Customers made money overall, and he asserted that Enforcement did not present any evidence that Dratel intended to harm his customers. RP 7574-79.

Dratel and DGI appealed the Hearing Panel's decision to the NAC. RP 7581.

2. The NAC Finds that Dratel and DGI Engaged in a Fraudulent Scheme

The NAC found that Dratel and DGI willfully engaged in a fraudulent trade allocation scheme, as alleged in the complaint. RP 8048-68. The NAC found that Dratel effectuated the scheme by delaying the allocation of his stock purchases (to his personal account or the Discretionary Customers' accounts) until he knew whether the security appreciated in value, fraudulently failed to disclose to customers that he was engaging in these activities (and at times traded in his personal account side-by-side with the Discretionary Customers' accounts in the

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[10] It is the NAC's decision, not the Hearing Panel's decision (or the dissenting panelist's opinion) that is the subject of this appeal. *See Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 SEC LEXIS 2631, at *21 n.17 (Nov. 8, 2006). The dissenting Hearing Panelist's opinion is relevant only because on appeal, Dratel and DGI adopt, nearly verbatim, the dissenter's arguments concerning why Enforcement failed to prove fraud. These arguments have already been squarely rejected by the Hearing Panel, the NAC, and the Commission in connection with applicants' unsuccessful Stay Motion. As described in detail below, Dratel and DGI have not provided any new or additional reason why these arguments should now warrant a modification of the NAC's well-supported decision.

same stocks on the same days), and willfully maintained order tickets inaccurately and delayed identifying customers on order tickets to further their scheme.[11]

In support of its findings that applicants engaged in a fraudulent scheme, the NAC found the evidence showed that: (1) Dratel exercised discretionary authority in the Discretionary Customers' accounts and was unsupervised at all relevant times, which enabled him to orchestrate the scheme without detection or intervention; (2) Dratel traded exclusively through the Firm Account, which enabled him to hold each stock position, assess its performance, and execute the other side of the trade before allocating the trade to himself or his customers; (3) Dratel executed trades without identifying customers, which allowed him to allocate more profitable trades to his personal account towards, at, or after the end of the trading day; (4) Dratel's level of day trading activity increased dramatically beginning in October 2005 (i.e., the start of the Relevant Period); (5) in 27 instances, Dratel traded the same stocks for himself and his customers, with better results for himself; (6) Dratel generated approximately $489,000 in cumulative profits in his personal account as a result of his day and overnight trading, while his Discretionary Customers' accounts suffered cumulative losses of $228,163;[12] and (7) Dratel's account equity was low. The NAC also found that evidence of falsified order tickets, as well as

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[11] Similar to the Hearing Panel, the NAC confined its findings of violation regarding cause one to 2006. RP 8050. For causes two and three, the NAC found violations during the Relevant Period. RP 8041.

[12] The NAC found that Dratel "generated outrageously large profits for his personal account while the Discretionary Customers lost significant amounts of money in day and overnight trading, often in the same securities." RP 8050. The NAC further found that the numerous calculations showing that Dratel's day and overnight trading in 2006 was far more successful in his personal account than in the Discretionary Customers' accounts, as well as the calculations showing that Dratel's day and overnight trading increased substantially during the Relevant Period, were "compelling." *See* RP 8051, 8057.

Dratel's strained financial situation in the time preceding the Relevant Period, compelled it to find that applicants engaged in a fraudulent cherry-picking scheme.

The NAC considered, but rejected, a number of arguments raised by applicants. The NAC rejected applicants' argument that the differences in profitability between Dratel's account and the Discretionary Customers' accounts were attributable to market forces and different trading strategies Dratel employed, finding that he "failed to establish a meaningful difference in his trading strategies for his personal account and the Discretionary Customers' accounts to explain the vast differences in performance." RP 8060. The NAC also rejected applicants' arguments that FINRA unfairly focused on the Relevant Period and the Discretionary Customers, ignored the customers' long-term profits in their accounts, and utilized the wrong methodology for counting trades. RP 8055-56. Further, the NAC rejected applicants' argument that Dratel executed all trades through the Firm Account, and allocated trades after building positions in the Firm Account, because it was simpler, more convenient, how he always traded, and saved on ticket charges.[13] RP 8051.

The NAC also rejected applicants' argument that Dratel traded the same stock in both his personal account and the Discretionary Customers' accounts on only 27 occasions, which Dratel did not believe presented any conflict of interest. RP 8054. Moreover, the NAC rejected applicants' argument that the fact that the Discretionary Customers were friends and family

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[13] The NAC also explicitly addressed, and rejected, the dissenting Hearing Panelist's arguments regarding why he believed Enforcement did not demonstrate that Dratel and DGI engaged in fraudulent cherry picking. *See, e.g.*, RP 8050 (rejecting argument that circumstantial evidence is not sufficient to prove applicants engaged in a fraudulent cherry-picking scheme); RP 8055-58 (finding that Enforcement did not arbitrarily select the Relevant Period, customer pool, and properly counted trades); RP 8055 (rejecting argument that because the Discretionary Customers made money overall, applicants did not engage in fraud).

members undercuts a finding of scienter, stating that friends and family have previously been the targets of cherry-picking schemes. RP 8064. Finally, the NAC refused to excuse applicants' misconduct with respect to order tickets because they allegedly involved a small number of tickets (as compared to the thousands of order tickets that the firm purportedly prepared each year) and that Dratel was "a busy one-man firm and should not be held responsible" for his staff's errors. RP 8067.

The NAC affirmed the bar imposed upon Dratel, as well as the requirement that he disgorge $489,000 in ill-gotten gains. The NAC increased the day-trading bar imposed upon DGI to an expulsion. The NAC explained that it found Dratel's and DGI's "misconduct to be highly egregious, pervasive, [and] premeditated." RP 8077. Indeed, the NAC cited to numerous aggravating factors to support its sanctions. The NAC found that DGI and Dratel falsified order tickets, time stamped blank tickets, back-dated tickets, and failed to identify customers before execution, all of which materially aided their fraudulent scheme. RP 8078. The NAC also considered aggravating applicants' disciplinary histories, that their scheme involved a "high degree of scienter," that Dratel and DGI exploited their positions of trust over the Discretionary Customers' accounts, and that their misconduct occurred over a one-year period. RP 8078-79. The NAC also considered that applicants earned huge profits from Dratel's day and overnight trading, while the Discretionary Customers experienced significant losses as a result of that trading. RP 8079. Further, the NAC considered Dratel's efforts to conceal his actions, and found Dratel's "willingness to victimize friends and family aggravating." RP 8080.

3. The NAC Affirms Findings of Additional Misconduct by Dratel and DGI and Rejects Their Procedural Arguments

Although applicants do not challenge the remaining findings by the NAC, the NAC also affirmed the Hearing Panel's findings that applicants failed to establish, maintain, and enforce

adequate supervisory procedures. RP 8068-69. Further, the NAC affirmed the Hearing Panel's findings that DGI and Dratel willfully failed to update customer account information, in violation of securities rules and regulations. RP 8069-70. The NAC also affirmed the Hearing Panel's findings that DGI failed to comply with AML requirements.[14] RP 8070-71.

Finally, the NAC considered, and thoroughly rejected, applicants' arguments that they were denied a fair proceeding. RP 8071-76. The NAC rejected applicants' arguments that the Hearing Panel improperly designated Enforcement's proposed expert witness as an expert and improperly relied upon his report. RP 8072-74. The NAC also rejected the Hearing Officer's purported prejudicial exclusion of applicants' exhibits, as well as applicants' unsubstantiated assertion that they were unfairly denied the opportunity to respond to Enforcement's post-hearing arguments. RP 8074-75. Further, the NAC rejected applicants' argument that they were unfairly and materially prejudiced by Enforcement's delay in bringing this matter. RP 8075-76.

4. Applicants' Appeal

On May 12, 2014, Dratel and DGI filed a notice of appeal and the Stay Motion, which requested that the Commission stay FINRA's sanctions pending their appeal. RP 8139, 8151. Pursuant to an order dated June 2, 2014, the Commission denied the Stay Motion and rejected all arguments raised by applicants. The Commission noted that Dratel and DGI largely repeated the arguments of the Hearing Panel dissent, which the NAC thoroughly analyzed and "squarely rejected" (notwithstanding applicants' assertion to the contrary). *See* Order denying Stay Motion at 5. Nonetheless, going forward with this appeal, Dratel and DGI have chosen to simply repeat, verbatim, the arguments presented in their unsuccessful Stay Motion.

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[14] The NAC assessed, but did not impose in light of the bar and expulsion, various sanctions for this additional misconduct. *See* RP 8082-84.

III. ARGUMENT

The NAC's conclusion that Dratel and DGI willfully engaged in a fraudulent cherry-picking scheme is supported by abundant and persuasive evidence, including the credible testimony of two witnesses and numerous faxed allocation instructions showing that Dratel did not allocate trades to either his personal account or the Discretionary Customers' accounts until he could reliably assess the profitability of each trade. Moreover, it is undisputed that Dratel's trading activity increased dramatically during the Relevant Period, that he used the Firm Account to perpetuate his scheme, that he engaged in his scheme unfettered and by victimizing the Discretionary Customers, and that he had a motive for doing so to improve his own financial situation. And, compellingly, the record unequivocally shows that while Dratel earned oversized profits from his fraudulent cherry-picking scheme, the Discretionary Customers suffered losses from Dratel's fraudulent day and overnight trading. This is no coincidence.

On appeal, Dratel and DGI have not presented any new or legitimate reason for disturbing the NAC's findings. Barring Dratel, expelling DGI, and ordering that Dratel disgorge his ill-gotten gains are appropriately remedial sanctions under the circumstances and are the only appropriate sanctions to prevent Dratel and DGI from further harming customers. Consequently, the Commission should dismiss applicants' appeal.

A. Dratel and DGI Willfully Engaged in a Fraudulent Cherry-Picking Scheme

Section 10(b) of the Securities and Exchange Act of 1934 ("Exchange Act") and Exchange Act Rule 10b-5 prohibit fraudulent and deceptive acts and practices in connection with

the purchase or sale of a security.[15] NASD Rule 2120 (now FINRA Rule 2020) is FINRA's anti-fraud rule. It is similar to Rule 10b-5 and provides that no member shall effect any transactions, or induce the purchase or sale of any security, by means of any manipulative, deceptive or fraudulent device.[16] The Commission's and FINRA's anti-fraud rules are designed to ensure that members of the securities industry fulfill their obligations to the public to be complete and accurate when making statements about securities and to refrain from engaging in manipulative or deceptive conduct.

A cherry-picking scheme operates as a "device, scheme, or artifice to defraud" and "as a fraud or deceit upon" investors. *SEC v. K.W. Brown and Co.*, 555 F. Supp. 2d 1275, 1303 (S.D. Fla. 2007). "[B]y its very nature, [a] cherry-picking scheme operate[s] as a fraud on . . . clients, which is prohibited under [Exchange Act Rule] 10b-5(a) and (c)." *Id.* at 1304. Furthermore, a registered person and member firm who engage in an undisclosed fraudulent cherry-picking

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[15] Exchange Act Section 10(b) makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance. 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 makes it unlawful for any person, directly or indirectly, to: (a) employ any device, scheme, or artifice to defraud; (b) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engage in any act, 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 any security. 17 C.F.R. § 240.10b-5.

[16] Conduct that violates Commission rules or FINRA rules is inconsistent with high standards of commercial honor and just and equitable principles of trade and therefore also violates NASD Rule 2110 (now FINRA Rule 2010). *Joseph Abbondante*, 58 S.E.C. 1082, 1103 (2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006). "Misrepresentations also are inconsistent with just and equitable principles of trade and violate NASD . . . Rule 2110." *Dane S. Faber*, 57 S.E.C. 297, 306 (2004); *see also Keith Springer*, 55 S.E.C. 632, 646 (2002) (finding that representative who effected post-execution trade allocations and allocated trades with better executions to his personal account violated just and equitable principles of trade).

scheme also violate Exchange Act Rule 10b-5(b) and FINRA's anti-fraud rule by making omissions of material facts in connection with the purchase or sale of securities. *Id.*; *see also Basic Inc. v. Levinson*, 485 U.S. 224, 235, n.13 (1988) (finding that the Commission may prove fraud by demonstrating that the respondent made a material misrepresentation or omission and acted with scienter, in connection with the purchase or sale of a security, and while using the facilities of interstate commerce).[17]

1. The Evidence Strongly Supports the NAC's Finding that Dratel and DGI Willfully Engaged in a Fraudulent Cherry-Picking Scheme

a. Numerous Indicia of Fraud Are Present

The NAC properly concluded that a preponderance of the evidence demonstrated that Dratel and DGI willfully engaged in a fraudulent cherry-picking scheme, and that all elements necessary to prove a fraudulent scheme had been satisfied. *See* RP 8050-65. First, the NAC found that almost all of the indicia of a fraudulent cherry-picking scheme were present in this case. The evidence unequivocally demonstrated that Dratel operated a single-person firm where he was the only registered person and sole principal. *See* RP 2084-89; *see also K.W. Brown*, 55 F. Supp. 2d at 1283-84 (finding fraudulent cherry-picking scheme where, among other things, two individual respondents were the only principals reviewing account activity). The undisputed evidence further showed that Dratel had discretionary authority over the Discretionary Customers' accounts (which further enabled him to act, unimpeded) and he traded exclusively

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[17] As stated by the NAC, it is well established that circumstantial evidence can be sufficient to prove a violation of the securities laws and to demonstrate scienter in fraud cases. *See* RP 8050; *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983) (holding that proof of scienter may be "a matter of inference from circumstantial evidence"); *Terrance Yoshikawa*, Exchange Act Release No. 53731, 2006 SEC LEXIS 948, at *17 (Apr. 26, 2006) ("Proof of scienter may be inferred from circumstantial evidence.").

through the Firm Account without identifying the intended customer for each transaction. *See* RP 2100-07, 2199-2102, 2129, 2226, 3915-16, 3921-29, 4006-19; *see also MiddleCove Capital, LLC*, Exchange Act Release No. 68669, 2013 SEC LEXIS 162, at *6 (Jan. 16, 2013) (finding cherry-picking scheme where respondent used a master account for block purchases of securities that he allocated to personal and client accounts); *Gerson Asset Mgmt., Inc.*, Exchange Act Release No. 52880, 2005 SEC LEXIS 3120, at *6 (Dec. 2, 2005) (finding that perpetrator of cherry-picking scheme used an omnibus account to place orders for his own and clients' transactions and he exercised discretionary authority over customers' accounts).

Moreover, the credible testimony of both Perez and Hatzfeld, as well as the vast majority of faxed allocation instructions, demonstrated that Dratel did not allocate day and overnight trades until well after DGI staff had executed the trades in the Firm Account and near or after the market's close. Dratel thus would determine how a stock performed before he decided whether to allocate trades to his personal account or to Discretionary Customers' accounts. *See Melhado, Flynn & Assocs., Inc.*, Exchange Act Release No. 64467, 2011 SEC LEXIS 1662, at *6 (May 11, 2011) (finding that respondent effectuated fraudulent cherry-picking scheme by submitting equity buy orders to the trading desk in the morning without indicating the accounts to which the purchases would be allocated and providing allocation instructions much later in the day, "often shortly before the close of the market"); *Ark Asset Mgmt. Co.*, Investment Advisers Act Release No. 3091, 2010 SEC LEXIS 3233, at *5 (Sept. 29, 2010) (finding that respondent "accomplished this cherry-picking by placing orders for securities, but delaying allocation of the purchases and sales until after the orders had been filled and the price of the security had been obtained"); *Gerson Asset Mgmt., Inc.*, 2005 SEC LEXIS 3120, at *6 (finding that respondent in cherry-picking case purchased securities early in the day and waited until the end of the day to allocate

stock to individual accounts). Dratel and DGI do not present any evidence (and certainly do not present "substantial" evidence) to disturb the findings that Perez and Hatzfeld were credible (and that Dratel's testimony to the contrary was not credible). *See Lloyd Gordon*, 2008 SEC LEXIS 819, at *38.

Further, the evidence demonstrated that Dratel's level of day and overnight trading increased dramatically during the Relevant Period (from an average of approximately 19 day and overnight trades per month in his Discretionary Customers' accounts, and approximately 3 day and overnight trades per month in Dratel's personal account, prior to October 2005, to an average of approximately 83 trades per month in the Discretionary Customers' accounts, and approximately 33 day trades per month in his personal account, during the Relevant Period). *See* RP 5611-14; *see also MiddleCove Capital*, 2013 SEC LEXIS 162, at *6-7 (finding that respondent's cherry picking corresponded with a surge in his day trading). The record also showed that in 27 instances in 2006, Dratel day and overnight traded the same stock on the same day in his personal account and in the accounts of Discretionary Customers and Dratel's personal account usually received more favorable prices than the Discretionary Customers' accounts for the same stocks. *See* RP 3803, 3812-14, 3873-75, 5441-5486; *see also Ark Asset Mgmt. Co.*, 2010 SEC LEXIS 3233, at *5 (finding cherry picking where, among other things, respondent's proprietary account and customers' accounts often traded the same securities).

Finally, and perhaps most incriminating, Dratel earned $489,000 in profits during the Relevant Period from his day and overnight trading, while the Discretionary Customers lost

$228,000.[18] Dratel provided no legitimate explanation for this vast discrepancy, and he generated these sizable profits in his personal account while the equity in his account remained relatively low. *See* RP 2731-34, 5489, 5611-15, 5637, 5651; *see also Melhado, Flynn*, 2011 SEC LEXIS 1662, at *7 (finding cherry picking where nearly every trade allocated to the firm's proprietary account appreciated in value, resulting in 98% profitability); *Ark Asset Mgmt. Co.*, 2010 SEC LEXIS 3233, at *6-7 (finding that cherry-picked accounts were 68% profitable on the day of allocation while customer accounts were 37% profitable, and that favored accounts' long day trades were 75% profitable while long day trades in customer accounts were only 37% profitable); *James C. Dawson*, Investment Advisers Act Release No. 3057, 2010 SEC LEXIS 2561, at *4 (July 23, 2010) (finding cherry picking where, of 400 trades that respondent allocated to his personal account, 98.3% were profitable and, of the 2,880 trades that he allocated to customers, 51.7% were profitable); *Gerson Asset Mgmt., Inc.*, 2005 SEC LEXIS 3120, at *7 (finding that respondent's day trades were disproportionately more profitable than customers' day trades and that this supported finding of cherry picking).

When these numerous indicia of cherry picking are considered together—discretionary trading, using an omnibus account, allocating the trades near the market close, zero supervision, a dramatically increased level of day and overnight trading, trading the same stocks on the same day in both Dratel's personal account and the Discretionary Customers' accounts, and the huge disparity in profitability—the evidence of fraud is overwhelming.

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[18] Indeed, the NAC found that "an overwhelming 83% of Dratel's day and overnight trades were profitable [during the Relevant Period] with an average per trade profit of $1,374 per trade," while only 28% of the Discretionary Customers' day and overnight trades were profitable (and 72% were unprofitable) during the Relevant Period. *See* RP 8056.

b. Dratel and DGI Falsified Order Tickets to Perpetuate Their Fraudulent Scheme

Second, the NAC properly found that Dratel and DGI willfully maintained order tickets inaccurately, falsified order tickets, time stamped blank order tickets, back-dated time stamps on order tickets, and delayed identifying customer names on order tickets, all in furtherance of the fraudulent trading scheme. *See Melhado, Flynn*, 2011 SEC LEXIS 1662, at *3 (finding that respondent altered trade tickets in an effort to cover up fraudulent allocation scheme); *Ark Asset Mgmt. Co.*, 2010 SEC LEXIS 3233, at *8-9 (finding that respondent's failure to ensure that order tickets timely reflected allocation determinations supports a finding of cherry picking). Dratel testified that he directed DGI staff to time stamp blank FiNet tickets, and that staff would sometimes "get rid of" stamped tickets before they input them into the system. *See* RP 2224-30, 2974, 3151-52, 3938-41, 3954-59, 3963-64, 4022-23. Further, DGI staff rolled back DGI's time stamp to ensure that FiNet order tickets matched OMS order tickets. *See* RP 2959, 2974-76. The record contains numerous examples of applicants' misconduct with respect to order tickets.[19] *See, e.g.*, RP 3267-68, 3694-96, 5213, 5223-25, 5241, 5246-49, 5251, 5275, 5281, 5303, 5393.

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[19] The NAC also properly found that, in connection with applicants' fraudulent scheme, Dratel and DGI failed to disclose their cherry picking to the Discretionary Customers and the conflict of Dratel's contemporaneous trading for his personal account while trading his customers' accounts with discretion, in further violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5. *See* RP 8060-63; *see also U.S. v. Laurienti*, 611 F.3d 530, 540-41 (9th Cir. 2010) (holding that "when a relationship of trust and confidence exist between a broker and a client, a broker must disclose all facts material to that relationship" and even in the absence of a trust relationship a broker cannot affirmatively tell a misleading half-truth about a material fact).

c. Dratel and DGI Intentionally Perpetrated Their Cherry-Picking Scheme

Third, the NAC properly concluded that Dratel and DGI intentionally perpetrated their fraudulent cherry-picking scheme.[20] Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter is established if a respondent acted intentionally or recklessly. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007); *Irfan Mohammed Amanat*, Exchange Act Release No. 54708, 2007 SEC LEXIS 2558, at *35 (Nov. 3, 2007), *aff'd*, 269 F. App'x 217 (3d Cir. 2008). Reckless conduct includes

> a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and 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.

Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation omitted).

The NAC, based upon all of the evidence in the record (including that Dratel had sole and exclusive authority over the Discretionary Customers' accounts, allocated trades after he could assess their profitability, and that Dratel's financial situation was strained during the years leading up to 2006), found that Dratel and DGI had the requisite degree of scienter to find that they violated Exchange Act Section 10(b) and Exchange Act Rule 10b-5. *See* RP 7536-38 (Hearing Panel citing to numerous indications of Dratel's financial difficulties), 8063-65; *see*

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[20] The NAC concluded that, based upon Dratel's misconduct, sole ownership of DGI, control over the firm, and position as the only registered person conducting a securities business at DGI, Dratel's mental state could be attributed to DGI. *See* RP 8063; *see also Kirk A. Knapp*, 50 S.E.C. 858, 860 n.7 (1992) (noting that NASD properly attributed scienter of firm's owner to firm); *Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 SEC LEXIS 4168, at *59 (Dec. 10, 2009) (holding that a firm may be held accountable for the misconduct of its owner).

also K.W. Brown, 555 F. Supp. 2d at 1307 (finding scienter where respondent prepared allocation sheets that did not identify customer accounts until well after trade execution).[21]

The numerous indicia that Dratel and DGI perpetrated a fraudulent cherry-picking scheme and falsified trade tickets, combined with their fraudulent intent to take advantage of the Discretionary Customers for their own financial gain, demonstrate that Dratel and DGI willfully engaged in fraud, in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110. The Commission should affirm the NAC's findings and dismiss this appeal.

2. Applicants' Repetitive Arguments Lack Merit

Dratel and DGI have trotted out the same arguments that they argued before the Hearing Panel, and then repeated to the NAC and the Commission in their unsuccessful Stay Motion. The Commission should once again reject applicants' arguments and dismiss their appeal.

For example, Dratel and DGI continue to argue that FINRA arbitrarily "cherry picked" data and the pool of relevant customers to support its case against them. There was nothing arbitrary, however, about FINRA's focus on the abundant evidence showing that applicants engaged in fraud during the Relevant Period. The NAC fully explained the time period focused

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[21] Further, the NAC properly concluded that Dratel's and DGI's violations of the Exchange Act were willful. *See* RP 8067, 8084. The term "willful" need not connote that respondents intended to violate FINRA and Commission rules and federal statutes. *See Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976) (holding that the term "willfully" does not require proof of evil intent). "A willful violation under the federal securities laws simply means 'that the person charged with the duty knows what he is doing.'" *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *41 (Nov. 9, 2012) (*citing Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000)). That standard is easily satisfied here, and applicants to not present any arguments to the contrary. Moreover, because Dratel and DGI willfully violated the Exchange Act in connection with their fraudulent scheme (as well as their failure to update periodically customer information, as discussed below), they are statutorily disqualified under Exchange Act Section 3(a)(39).

on by FINRA, as well as the calculations showing that during the Relevant Period Dratel earned huge profits from his fraudulent trading activities while his customers lost more than $228,000 from those very same activities. Dratel's profits stand in stark contrast to the period prior to the Relevant Period. *See* RP 5611-16, 5636, 5650. In addition to the testimony and documentation showing that Dratel did not allocate trades until the end of the day during the Relevant Period, Dratel's level of day and overnight trading increased dramatically beginning in October 2005 (i.e., the beginning of the Relevant Period). *See* RP 5611-14. Moreover, the NAC found that Dratel's "financial situation was strained during the years leading up to 2006," which provides an additional reason to scrutinize Dratel's and DGI's trading allocations during the Relevant Period. RP 8064.

Further, applicants argue that FINRA improperly selected the composition of the Discretionary Customers by excluding those customers with two or fewer day or overnight trades. Enforcement's expert witness, however, concluded that even if he had included discretionary customer accounts with two or fewer day or overnight trades during the Relevant Period in the pool of Discretionary Customers, the impact of those trades would have been immaterial. RP 5613.

Applicants' arguments that FINRA arbitrarily used a nine-month review period for comparison to the Relevant Period (instead of reviewing profits and losses during the entire lives of the accounts) and that FINRA should have counted trades on a per stock (rather than a per trade) basis are likewise without merit. The NAC properly found that the fact that the Discretionary Customers may have made money during periods other than the Relevant Period "does not counteract the extreme nature of the reversal that occurred in 2006" and the differences in performance in 2006. RP 8056. Nor does the fact that the Discretionary Customers may have

enjoyed profits in their accounts during other periods excuse Dratel's and DGI's fraudulent misconduct during the Relevant Period. A broker's fraud is a securities law violation whether it is committed for one year or for a longer duration.

With respect to counting trades, the NAC properly rejected applicants' assertion that FINRA's calculations were erroneous and found that even their "proposed methodology for counting trades per security rather than per customer demonstrates that Dratel's trading in his personal account out-performed his trading in the Discretionary Customers' accounts." RP 8058; *see also* RP 2270, 5815, 6331, 6342, 5715, 5718-19, 5722-25, 5727-28, 5736, 5742, 5744-46, 5748, 5758-59, 5761. Similarly, applicants' argument that FINRA arbitrarily included one-day trades with overnight trades is without merit. It is not relevant whether Dratel allocated profitable trades to himself at the end of the trading day or the next day. The point is that Dratel made allocations to his personal account or the Discretionary Customers' accounts *after* he knew how the trades had performed, and allocated more profitable trades to himself as demonstrated by the compelling statistics in the record. *Cf. MiddleCove Capital, LLC*, 2013 SEC LEXIS 162, at *7 (finding cherry-picking scheme where respondent used a master account for block purchases of securities that he allocated to personal and client accounts, sometimes the day after the trade).

The NAC also properly rejected applicants' argument that because DGI staff never saw Dratel do anything improper, and did not testify that Dratel directed them to act improperly, they did not engage in fraud. Applicants create an absurdly high level for proving a fraudulent scheme that is not supported in any legal precedent or logic, and simply ignore that the NAC found present in this case the existence of numerous characteristics common to cherry-picking schemes generally, regardless of the absence of explicit testimony from DGI staff that Dratel

directed them to act fraudulently. *See* RP 8050-60. Moreover, it is well established that circumstantial evidence can be sufficient to prove a violation of the securities laws and to demonstrate scienter in fraud cases. *See Yoshikawa*, 2006 SEC LEXIS 948, at *17 ("Proof of scienter may be inferred from circumstantial evidence."); *K.W. Brown*, 555 F. Supp. 2d at 1302 (circumstantial evidence may be used to prove a case under Exchange Act Section 10(b)).

Next, Dratel and DGI reiterate that only a small number of order tickets were inaccurate and mismarked and that Dratel traded the same stocks on the same day in both his account and the discretionary customers' account on only 27 occasions, which they argue pales in comparison to the total number of order tickets that applicants purportedly properly completed and the total number of days that applicants did not trade the same stocks on the same day. Applicants' assertions that they were compliant in these two areas most of the time, even if supported somewhere in the record, do not exonerate their misconduct for the times that they were not (or all the other areas in which they acted fraudulently). *See Donner Corp. Int'l*, Exchange Act Release No. 55313, 2007 WL 516282, at *11 (Feb. 20, 2007) (finding that respondent's "compliance with the law in some instances does not excuse" violative conduct in other instances). Likewise, Dratel's argument that he has for years traded in the Firm Account in the manner that the NAC determined constituted cherry picking can offer applicants no relief from the NAC's conclusion that he fraudulently cherry picked in 2006. *Id.*

DGI and Dratel also point to their customers' purported continued support notwithstanding the NAC's decision. Applicants attached to the Stay Motion a number of short letters from some of the customers at issue (which were not presented below), argue that the customers' accounts were highly profitable overall, and argue that Dratel did not intend to harm his customers and has treated them fairly in the past. None of these facts, even if true, can

excuse Dratel's and DGI's fraudulent cherry-picking scheme over the course of a one year period.[22] *See, e.g.*, *Maximo Justo Guevara*, 54 S.E.C. 655, 664 (2000) (holding that FINRA's "power to enforce its rules is independent of a customer's decision not to complain"), *aff'd*, 47 F. App'x 198 (3d Cir. 2000); *cf. Dawson*, 2010 SEC LEXIS 2561, at *14 (holding that when assessing sanctions the interests of individual investors are outweighed by the interest in protecting investors generally).[23]

Finally, although the NAC decision cites to numerous cases involving fraudulent cherry-picking schemes, Dratel and DGI continue to take issue with the NAC's citation to two of those cases (*K.W. Brown* and *Dawson*). *See* Stay Motion at 11-13. They also continue to argue that a case not cited by the NAC (*SEC v. Slocum, Gordon & Co.*, 334 F. Supp. 2d 144 (D. R.I. 2004)) supports their argument that they did not engage in a fraudulent cherry-picking scheme. Stay Motion at 12-13.

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[22] Even if the Commission finds that these customer letters are somehow relevant to applicants' fraudulent scheme, it should exclude them from the record. Applicants did not submit these letters before the finder of fact or at any time during FINRA's proceedings (when they were represented by counsel). They have not demonstrated with particularity that these letters are material and that there were reasonable grounds for failing to introduce them previously pursuant to Commission Rule of Practice 452. Indeed, if they are, as applicants represent, customers who have known Dratel "in some cases for over forty years," the letters could have easily been introduced during the hearing. They were not, and applicants should not be permitted to skirt evidentiary rules.

[23] The Commission should also reject applicants' contention that the NAC unfairly failed to consider Dratel's good relationships with his customers and placed undo weight on Dratel's above-market cross trades prior to the Relevant Period. *See, e.g.*, Stay Motion at 11. Dratel's overall relationship with his customers is irrelevant to whether he willfully engaged in a fraudulent cherry-picking scheme. Further, the NAC considered Dratel's prior cross trades at above-market prices only for the purposes of showing that but for such cross trades, the Discretionary Customers may have suffered larger losses prior to the Relevant Period and as a contributing factor to Dratel's strained financial situation. *See* RP 8056, 8064, 8074.

As found by the Commission in its order denying the Stay Motion, *Brown* and *Dawson* do not undercut the NAC's findings. Dratel and DGI argue that because the customers in *Brown* experienced losses and the defendant often got better prices than his customers, the case is inapposite to the facts of this case. Here, however, the Discretionary Customers experienced significant losses as a result of Dratel's fraudulent trading, and Dratel did in fact get better prices for the majority of trades in which he traded the same stock on the same day. Applicants also incorrectly state that unlike *Brown*, there is no evidence that Dratel and DGI failed to identify customer allocations until after execution. To the contrary, the Hearing Panel expressly credited Perez's testimony and Hatzfeld's testimony, as corroborated by substantial additional evidence in the record, that Dratel usually did not allocate trades until the end of the trading day.

Likewise, Dratel and DGI point to *Dawson* in an attempt to differentiate their case based upon the fact that Dratel and DGI presented the favorable testimony of two customers at the hearing and that for years Dratel has been using the Firm Account for trading. These minor differences are immaterial. In *Dawson*, the Commission stated that "we look beyond the interests of particular investors in assessing the need for sanctions, to the protection of investors generally." *Dawson*, 2010 SEC LEXIS 2561, at *14. And applicants in fact utilized the Firm Account to perpetuate their scheme—the fact that they did not establish it contemporaneous with the start of their scheme has no bearing on their misconduct.

Finally, applicants' citation to *Slocum, Gordon & Co.* serves to highlight their fraud, not exonerate it. In that case, the court credited the defendants' explanations for the different trading strategies employed in the firm's account versus client accounts, and the defendants testified that they would allocate trades before executing them. Here, in contrast, the NAC considered and rejected Dratel's explanations regarding the purported differences in trading strategies for his

account and the Discretionary Customers' accounts, and the evidence overwhelmingly shows that applicants did not allocate trades until after Dratel knew the profitability of each trade. Moreover, the court in *Slocum* did not dismiss the case against defendants simply because the customers' accounts had performed extremely well overall, as implied by applicants. 334 F. Supp. 2d at 171-76. Rather, the court found that the customer accounts at issue were successful during the alleged fraudulent period and held that plaintiff failed to prove by a preponderance of the evidence that defendants engaged in a fraudulent cherry-picking scheme. *Id.*

* * *

For all of these reasons, the Commission should reject applicants' arguments, which are undercut by ample record evidence and legal precedent. The record thoroughly supports the NAC's findings that Dratel and DGI engaged in a fraudulent cherry-picking scheme. The Commission should dismiss this appeal.

B. Applicants Engaged in Other Misconduct

On appeal, applicants do not contest the NAC's findings with respect to Dratel's and DGI's other misconduct. *See Laborers' Int'l Union v. Foster Wheeler Corp.*, 26 F.3d 375, 398 (3d Cir. 1994) (holding that "[a]n issue is waived unless [raised by a party] in its opening brief"), *cert. denied*, 513 U.S. 946 (1994). Regardless, the preponderance of evidence in the record demonstrates that they engaged in the other misconduct alleged in the complaint. For example, the record shows that Dratel and DGI failed to establish, maintain, and enforce adequate supervisory procedures. DGI's WSPs did not address trade aggregation and allocation with respect to discretionary accounts and the manner in which trades must be executed. *See* RP 2369-72, 4473, 4547, 8068-69; *see also* NASD Rule 3010(a) (requiring each member to establish and maintain a system to supervise the activities of each registered representative that is reasonably designed to comply with applicable securities laws); *Kemper Fin. Servs., Inc.*, 51

S.E.C. 715, 718 (1993) (finding inadequate supervisory procedures where they failed to address time stamping order tickets and allocating orders among accounts). Dratel, as the sole registered person, supervisor, and principal at DGI was responsible for DGI's deficient WSPs. *See* RP 72.

Further, the record shows that DGI willfully failed to update customer account information, in violation of Exchange Act Section 17(a) and Exchange Act Rule 17a-3(a)(17)(i), and Dratel and DGI violated NASD Rules 3110(a) and 2110. These rules require member firms to supply certain information to customers and to provide them with an opportunity to update that information every 3 years.[24] Dratel did not do so, and he did not ensure that Oppenheimer, upon whom he purportedly relied for DGI's compliance with these requirements, provided customers with this information. *See* RP 2499-2505. The NAC properly concluded that Dratel and DGI willfully engaged in this misconduct. *See* RP 8069-70.

Finally, the preponderance of evidence shows that DGI opened 11 new customer accounts without requiring photo identification from August 2006 through January 2008, and

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[24] NASD Rule 3110(a) provides that FINRA members must make and preserve books, accounts, records, memoranda, and correspondence in conformity with all rules and regulations, as prescribed by Exchange Act Rule 17a-3. Exchange Act Rule 17a-3(a)(17)(i) provides that, for each customer account, a member firm shall make and keep a record including the customer's name, tax identification number, address, telephone number, date of birth, employment status, annual income, net worth, and account's objectives. The rule further provides that firms must supply such information to the customer and provide the customer with an opportunity to update the information, as necessary, every three years.

that DGI failed to independently test its AML program in 2006 and 2007, in violation of NASD Rules 3011(b) and (c).[25] *See* RP 2493-99.

C. The NAC's Sanctions Are Consistent with the FINRA Sanction Guidelines and Are Neither Excessive Nor Oppressive

On appeal, Dratel and DGI do not argue that the sanctions imposed upon them are excessive or oppressive, or impose an undue burden on competition. Regardless, the record demonstrates that the NAC carefully considered numerous factors, including the highly serious nature of Dratel's and DGI's intentionally fraudulent misconduct, in determining that barring Dratel, ordering that he disgorge $489,000 in ill-gotten gains, and expelling DGI were appropriate sanctions for applicants' willfully fraudulent misconduct under causes one through three.

For misrepresentations or omissions of facts, the FINRA Sanction Guidelines ("Guidelines") recommend, for intentional or reckless misconduct, a fine of $10,000 to $100,000 and a suspension of an individual and a firm for 10 business days to two years.[26] For egregious cases, the Guidelines recommend consideration of a bar of an individual and expulsion of a firm.[27] The Guidelines for recordkeeping violations recommend, in egregious cases, a fine of

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[25] NASD Rule 3011(b) requires member firms to establish and implement an AML program reasonably designed to achieve and monitor compliance with the Bank Secrecy Act and its implementing regulations (including 31 C.F.R. § 103.22, which requires broker-dealers to establish a written customer identification process as part of the broker-dealer's AML program, including procedures for verifying the identity of each customer). NASD Rule 3011(c) requires member firms to independently test, on an annual, calendar-year basis, compliance of a firm's AML program. *See also NASD Notice to Members 06-07*, 2006 NASD LEXIS 10, at *3 (Feb. 2006) (explaining the requirements for independent AML testing).

[26] *FINRA Sanction Guidelines*, at 88 (2013), http://www/finra.org/web/groups/industry /@ip/@enf/@sg/documents/industry/p011038.pdf (hereafter "*Guidelines*") [all relevant Guidelines are attached hereto as Appendix A.]

[27] *Guidelines*, at 88.

$10,000 to $100,000, a suspension of up to two years for an individual and a firm or a bar of an individual respondent and expulsion of a firm.[28] The Guidelines also provide that, where a respondent has obtained a financial benefit from his misconduct, an adjudicator may order that the respondent's ill-gotten gains be disgorged.[29]

The NAC consulted the appropriate Guidelines, looked to the Principal Considerations in Determining Sanctions, and carefully weighed a number of factors to conclude that Dratel should be barred, DGI expelled, and Dratel ordered to disgorge $489,000 in ill-gotten gains. The NAC found that numerous factors aggravated applicants' misconduct. These factors included:

(1) Dratel's and DGI's disciplinary histories;[30]

(2) their "high degree of scienter" and execution of a fraudulent scheme that "required specific preparation and the deliberate allocation of a disproportionate number of profitable trades to [Dratel's] own account;"

(3) their exploitation of their positions of trust over the Discretionary Customers, who granted Dratel control and authority over their accounts;

(4) the lengthy time period that applicants engaged in the fraudulent scheme and the large number of customers victimized;

(5) the significant profits earned by Dratel, versus the substantial losses suffered by the Discretionary Customers, from Dratel's day and overnight trading;

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28 *Id.* at 29.

29 *Id.* at 5 (General Principles Applicable to All Sanction Determinations, No. 6); *see also id.* at 10 (providing that adjudicators should order disgorgement in sales practice abuse cases, even where an individual is barred, if he has retained substantial ill-gotten gains).

30 As observed by the Commission in its order denying the Stay Motion, and in addition to Dratel's and DGI's disciplinary history cited by the NAC, another FINRA Hearing Panel recently found that applicants engaged in numerous rule violations. *See* Order Denying Stay, at 9 n.22. That Hearing Panel decision is currently on appeal to the NAC.

(6) Dratel's efforts to conceal his misconduct by failing to disclose his fraudulent trading (including that he sometimes traded the same stocks in his personal account and the Discretionary Customers' accounts) to the Discretionary Customers and "letting them instead believe that he and DGI complied with their obligations to abide by high standards of commercial honor;" and

(7) Dratel's willingness to victimize his friends, family, and long-time customers.

See RP 8077-80.

The NAC appropriately concluded that neither Dratel nor DGI could continue in the securities industry in a compliant manner, and that a bar and expulsion were the only appropriate remedies under the circumstances. RP 8081-82.

The NAC also appropriately ordered that Dratel disgorge $489,000 in ill-gotten gains. It is undisputed that Dratel's day and overnight trading resulted in profits to Dratel of approximately $489,000. *See* RP 5611-15; *see also* RP 2269-70 (Dratel's testimony). Disgorgement is appropriate where, as here, Dratel benefited from his misconduct at the expense of his customers. *See Michael David Sweeney*, 50 S.E.C. 761, 768 (1991) ("disgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched"). An order of disgorgement "need only be a reasonable approximation of profits casually connected to the violation." *Laurie Jones Canady*, 54 S.E.C. 65, 84 (1999).

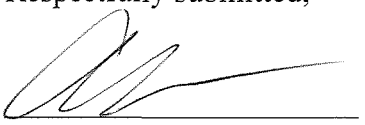
Applicants have not presented, and cannot present based upon the facts and circumstances of this case, any arguments that the NAC's sanctions are excessive or oppressive. Dratel and DGI, by engaging in a fraudulent cherry-picking scheme for an extended period, have demonstrated a flagrant disregard for complying with basic and fundamental rules integral to a broker's relationship with his customers. As the Commission has stated, "[c]onduct that violate[s] the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions . . ." *Alvin W. Gebhart, Jr.*, 58 S.E.C. 1133, 1177 (2006), *aff'd in*

relevant part, 255 F. App'x 254 (9th Cir. 2007); *see also Springer*, 55 S.E.C. 632 at 648-49 ("Springer's failure to allocate securities transactions fairly to his customers goes to the heart of the duties owed by a securities professional to his investor clients."). Given the presence of numerous aggravating factors, and applicants' "highly egregious, pervasive, [and] premeditated" fraudulent misconduct, the NAC appropriately concluded that Dratel and DGI could not comply with securities rules and regulations, and thus should no longer be in the securities industry. *See* RP 8077. The Commission should affirm the bar, expulsion, and disgorgement order.

IV. CONCLUSION

Dratel and DGI victimized customers who granted Dratel full and complete authority over their accounts by allocating to himself profitable or less unprofitable trades while sloughing off losing trades on his customers. Applicants displayed an utter disregard for securities rules and regulations, not to mention their customers' well-being. By engaging in a year-long fraudulent cherry-picking scheme, Dratel and DGI have demonstrated that they are not fit to continue in the securities industry. The Commission should sustain the NAC's findings of violations, and sustain the NAC's bar of Dratel, expulsion of DGI, and order that Dratel disgorge $489,000 in ill-gotten gains.

Respectfully submitted,



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CERTIFICATE OF COMPLIANCE

I, Andrew J. Love, certify that this Brief in Opposition to Application for Review (File No. 3-15869) complies with the length limitation set forth in SEC Rule of Practice 450(c). I have relied on the word count feature of Microsoft Word in verifying that this brief contains 12,116 words.

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APPENDIX A

General Principles Applicable to All Sanction Determinations

1. **Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.** The overall purposes of FINRA's disciplinary process and FINRA's responsibility in imposing sanctions are to remediate misconduct by preventing the recurrence of misconduct, improving overall standards in the industry, and protecting the investing public. Toward this end, Adjudicators should design sanctions that are significant enough to prevent and discourage future misconduct by a respondent, to deter others from engaging in similar misconduct, and to modify and improve business practices. Depending on the seriousness of the violations, Adjudicators should impose sanctions that are significant enough to ensure effective deterrence. When necessary to achieve this goal, Adjudicators should impose sanctions that exceed the range recommended in the applicable guideline.

   When applying these principles and crafting appropriate remedial sanctions, Adjudicators also should consider firm size[1] with a view toward ensuring that the sanctions imposed are not punitive but are sufficiently remedial to achieve deterrence.[2] (Also see General Principle No. 8 regarding ability to pay.)

2. **Disciplinary sanctions should be more severe for recidivists.** An important objective of the disciplinary process is to deter and prevent future misconduct by imposing progressively escalating sanctions on recidivists beyond those outlined in these guidelines, up to and including barring registered persons and expelling firms. Adjudicators should always consider a respondent's disciplinary history in determining sanctions. Adjudicators should consider imposing more severe sanctions when a respondent's disciplinary history includes (a) past misconduct similar to that at issue; or (b) past misconduct that evidences disregard for regulatory requirements, investor protection or commercial integrity. Even if a respondent has no history of relevant misconduct, however, the misconduct at issue may be so serious as to justify sanctions beyond the range contemplated in the guidelines; *i.e.*, an isolated act of egregious misconduct could justify sanctions significantly above or different from those recommended in the guidelines.

   Certain regulatory incidents are not relevant to the determination of sanctions. Arbitration proceedings, whether pending, settled or litigated to conclusion, are not "disciplinary" actions. Similarly, pending investigations or the existence of ongoing regulatory proceedings prior to a final decision are not relevant.

   In certain cases, particularly those involving quality-of-markets issues, these guidelines recommend increasingly severe monetary sanctions for second and subsequent disciplinary actions. This escalation is consistent with the concept that repeated acts of misconduct call for increasingly severe sanctions.

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1 Factors to consider in connection with assessing firm size are: the firm's financial resources; the nature of the firm's business; the number of individuals associated with the firm; the level of trading activity at the firm; other entities that the firm controls, is controlled by, or is under common control with; and the firm's contractual relationships (such as introducing broker/clearing firm relationships). **This list is included for illustrative purposes and is not exhaustive. Other factors also may be considered in connection with assessing firm size.**

2 Adjudicators may consider firm size in connection with the imposition of sanctions with respect to rule violations involving negligence. With respect to violations involving fraudulent, willful and/or reckless misconduct, Adjudicators should consider whether, given the totality of the circumstances involved, it is appropriate to consider firm size and may determine that, given the egregious nature of the fraudulent activity, firm size will not be considered in connection with sanctions.

3. **Adjudicators should tailor sanctions to respond to the misconduct at issue.** Sanctions in disciplinary proceedings are intended to be remedial and to prevent the recurrence of misconduct. Adjudicators therefore should impose sanctions tailored to address the misconduct involved in each particular case. Section 15A of the Securities Exchange Act of 1934 and FINRA Rule 8310 provide that FINRA may enforce compliance with its rules by: limitation or modification of a respondent's business activities, functions and operations; fine; censure; suspension (of an individual from functioning in any or all capacities, or of a firm from engaging in any or all activities or functions, for a defined period or contingent on the performance of a particular act); bar (permanent expulsion of an individual from associating with a firm in any or all capacities); expulsion (of a firm from FINRA membership and, consequently, from the securities industry); or any other fitting sanction.

   To address the misconduct effectively in any given case, Adjudicators may design sanctions other than those specified in these guidelines. For example, to achieve deterrence and remediate misconduct, Adjudicators may impose sanctions that: (a) require a respondent firm to retain a qualified independent consultant to design and/or implement procedures for improved future compliance with regulatory requirements; (b) suspend or bar a respondent firm from engaging in a particular line of business; (c) require an individual or member firm respondent, prior to conducting future business, to disclose certain information to new and/or existing clients, including disclosure of disciplinary history; (d) require a respondent firm to implement heightened supervision of certain individuals or departments in the firm; (e) require an individual or member firm respondent to obtain a FINRA staff letter stating that a proposed communication with the public is consistent with FINRA standards prior to disseminating that communication to the public; (f) limit the number of securities in which a respondent firm may make a market; (g) limit the activities of a respondent firm; or (h) require a respondent firm to institute tape recording procedures. **This list is illustrative, not exhaustive, and is included to provide examples of the types of sanctions that Adjudicators may design to address specific misconduct and to achieve deterrence. Adjudicators may craft other sanctions specifically designed to prevent the recurrence of misconduct.**

   The recommended ranges in these guidelines are not absolute. The guidelines suggest, but do not mandate, the range and types of sanctions to be applied. Depending on the facts and circumstances of a case, Adjudicators may determine that no remedial purpose is served by imposing a sanction within the range recommended in the applicable guideline; *i.e.*, that a sanction below the recommended range, or no sanction at all, is appropriate. Conversely, Adjudicators may determine that egregious misconduct requires the imposition of sanctions above or otherwise outside of a recommended range. For instance, in an egregious case, Adjudicators may consider barring an individual respondent and/or expelling a respondent member firm, regardless of whether the individual guidelines applicable to the case recommend a bar and/or expulsion or other less severe sanctions. Adjudicators must always exercise judgment and discretion and consider appropriate aggravating and mitigating factors in determining remedial sanctions in each case. In addition, whether the sanctions are within or outside of the recommended range, Adjudicators must identify the basis for the sanctions imposed.

4. **Aggregation or "batching" of violations may be appropriate for purposes of determining sanctions in disciplinary proceedings.** The range of monetary sanctions in each case may be applied in the aggregate for similar types of violations rather than per individual violation. For example, it may be appropriate to aggregate similar violations if: (a) the violative conduct was unintentional or negligent (*i.e.*, did not involve manipulative, fraudulent or deceptive intent); (b) the conduct did not result in injury to public investors or, in cases involving injury to the public, if restitution was made; or (c) the violations resulted from a single systemic problem or cause that has been corrected.

   Depending on the facts and circumstances of a case, however, multiple violations may be treated individually such that a sanction is imposed for each violation. In addition, numerous, similar violations may warrant higher sanctions, since the existence of multiple violations may be treated as an aggravating factor.

5. **Where appropriate to remediate misconduct, Adjudicators should order restitution and/or rescission.** Restitution is a traditional remedy used to restore the status quo ante where a victim otherwise would unjustly suffer loss. Adjudicators may determine that restitution is an appropriate sanction where necessary to remediate misconduct. Adjudicators may order restitution when an identifiable person, member firm or other party has suffered a quantifiable loss proximately caused by a respondent's misconduct.[3]

   Adjudicators should calculate orders of restitution based on the actual amount of the loss sustained by a person, member firm or other party, as demonstrated by the evidence. Orders of restitution may exceed the amount of the respondent's ill-gotten gain. Restitution orders must include a description of the Adjudicator's method of calculation.

   When a member firm has compensated a customer or other party for losses caused by an individual respondent's misconduct, Adjudicators may order that the individual respondent pay restitution to the firm.

   Where appropriate, Adjudicators may order that a respondent offer rescission to an injured party.

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3 Other avenues, such as arbitration, are available to injured customers as a means to redress grievances.

6. **To remediate misconduct, Adjudicators should consider a respondent's ill-gotten gain when determining an appropriate remedy.** In cases in which the record demonstrates that the respondent obtained a financial benefit[4] from his or her misconduct, where appropriate to remediate misconduct, Adjudicators may require the disgorgement of such ill-gotten gain by ordering disgorgement of some or all of the financial benefit derived, directly or indirectly.[5] In appropriate cases, Adjudicators may order that the respondent's ill-gotten gain be disgorged and that the financial benefit, directly and indirectly, derived by the respondent be used to redress harms suffered by customers. In cases in which the respondent's ill-gotten gain is ordered to be disgorged to FINRA, and FINRA collects the full amount of the disgorgement order, FINRA's routine practice is to contribute the amount collected to the FINRA Investor Education Foundation.

7. **Where appropriate, Adjudicators should require a respondent to requalify in any or all capacities.** The remedial purpose of disciplinary sanctions may be served by requiring an individual respondent to requalify by examination as a condition of continued employment in the securities industry. Such a sanction may be imposed when Adjudicators find that a respondent's actions have demonstrated a lack of knowledge or familiarity with the rules and laws governing the securities industry.

8. **When raised by a respondent, Adjudicators are required to consider ability to pay in connection with the imposition, reduction or waiver of a fine or restitution.** Adjudicators are required to consider a respondent's *bona fide* inability to pay when imposing a fine or ordering restitution. The burden is on the respondent to raise the issue of inability to pay and to provide evidence thereof.[6] If a respondent does not raise the issue of inability to pay during the initial consideration of a matter before "trial-level" Adjudicators, Adjudicators considering the matter on appeal generally will presume the issue of inability to pay to have been waived (unless the inability to pay is alleged to have resulted from a subsequent change in circumstances). Adjudicators should require respondents who raise the issue of inability to pay to document their financial status through the use of standard documents that FINRA staff can provided. Proof of inability to pay need not result in a reduction or waiver of a fine, restitution or disgorgement order, but could instead result in the imposition of an installment payment plan or another alternate payment option. In cases in which Adjudicators modify a monetary sanction based on a *bona fide* inability to pay, the written decision should so indicate. Although Adjudicators must consider a respondent's *bona fide* inability to pay when the issue is raised by a respondent, monetary sanctions imposed on member firms need not be related to or limited by the firm's required minimum net capital.

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4 "Financial benefit" includes any commissions, concessions, revenues, profits, gains, compensation, income, fees, other remuneration, or other benefits the respondent received, directly or indirectly, as a result of the misconduct.

5 Certain guidelines specifically recommend that Adjudicators consider ordering disgorgement in addition to a fine. These guidelines are singled out because they involve violations in which financial benefit occurs most frequently. These specific references should not be read to imply that it is less important or desirable to order disgorgement of ill-gotten gain in other instances. The concept of ordering disgorgement of ill-gotten gain is important and, if appropriate to remediate misconduct, may be considered in all cases whether or not the concept is specifically referenced in the applicable guideline.

6 *See In re Toney L. Reed*, Exchange Act Rel. No. 37572 (August 14, 1996), wherein the Securities and Exchange Commission directed FINRA to consider financial ability to pay when ordering restitution. In these guidelines, the NAC has explained its understanding of the Commission's directives to FINRA based on the *Reed* decision and other Commission decisions.

Monetary sanctions–Imposition and collection of monetary sanctions. FINRA has identified the circumstances under which Adjudicators generally will impose and FINRA generally will collect monetary sanctions. In that the overriding purpose of all disciplinary sanctions is to remedy misconduct, deter future misconduct and protect the investing public, Adjudicators may exercise their discretion in applying FINRA's policy on the imposition and collection of monetary sanctions as necessary to achieve FINRA's regulatory purposes. **The following lists of violations may not be exhaustive and these recommendations also may be appropriate for other types of cases.**[7]

- Adjudicators generally should not impose a fine if an individual is barred and there is no customer loss in cases involving the following types of misconduct:
  - failure to respond under FINRA Rule 8210;
  - exam cheating; and
  - private securities transactions (if the Adjudicator does not order disgorgement or restitution).
- Adjudicators generally should not impose a fine if an individual is barred and the Adjudicator has ordered restitution or disgorgement of ill-gotten gains as appropriate to remediate the misconduct in cases involving the following types of misconduct:
  - conversion or improper use of funds or securities;
  - forgery; and
  - sales practice and private securities transaction cases (if only one or a small number of customers are harmed).
- Adjudicators generally should impose a fine and require payment of restitution and disgorgement even if an individual is barred in all sales practice cases if:
  - the case involves widespread, significant and identifiable customer harm; or
  - the respondent has retained substantial ill-gotten gains.
- In all cases, Adjudicators may exercise their discretion and, if a bar is imposed, refrain from imposing a fine, but require proof of payment of an order of restitution when a respondent files an application for re-entry into the securities industry.[8] Adjudicators also may, in their discretion, impose a suspension and a fine, but require proof of payment of the fine when the respondent re-enters the securities industry. In this regard, Adjudicators should consider the following factors:
  - whether the respondent is suspended or otherwise not in the securities industry when the sanction is imposed; and
  - the number of customers harmed.

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7 Interested parties are directed to NASD *Notice to Members 99-86* (October 1999) for additional information on FINRA's Monetary Sanctions Policy.

8 Adjudicators have the discretion to impose post-judgment interest on restitution orders.

Recordkeeping Violations

FINRA Rule 2010, NASD Rule 3110 and SEC Rules 17a-3 and 17a-4[1]

Principal Considerations in Determining Sanctions	Monetary Sanction	Suspension, Bar or Other Sanctions
See Principal Considerations in Introductory Section	Fine of $1,000 to $10,000.	***Firm***
1. Nature and materiality of inaccurate or missing information.	In egregious cases, fine of $10,000 to $100,000.	Consider suspending the firm with respect to any or all activities or functions for up to 30 business days. In egregious cases, consider a lengthier suspension (of up to two years) or expulsion of the firm. ***Individual*** Consider suspending the Financial Principal or responsible party in any or all capacities for up to 30 business days. In egregious cases, consider a lengthier suspension (of up to two years) or a bar.

1 This guideline also is appropriate for violations of MSRB Rules G-8 and G-15.

Misrepresentations or Material Omissions of Fact

FINRA Rules 2010 and 2020[1]

Principal Considerations in Determining Sanctions	Monetary Sanction[2]	Suspension, Bar or Other Sanctions
See Principal Considerations in Introductory Section	***Negligent Misconduct*** Fine of $2,500 to $50,000. ***Intentional or Reckless Misconduct*** Fine of $10,000 to $100,000.	***Negligent Misconduct*** Suspend individual in any or all capacities and/or suspend firm with respect to any or all activities or functions for up to 30 business days. ***Intentional or Reckless Misconduct*** Suspend individual in any or all capacities and/or suspend firm with respect to any or all activities or functions for a period of 10 business days to two years. In egregious cases, consider barring the individual and/or expelling the firm.

1 This guideline also is appropriate for violations of MSRB Rule G-17.

2 In cases involving misrepresentations and/or omissions as to two or more customers, the Adjudicator may impose a set fine amount per investor rather than in the aggregate. As set forth in General Principle No. 6, Adjudicators may also order disgorgement.