SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 100762 / August 19, 2024

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY PROCEEDING

Applicant appeals from a FINRA disciplinary proceeding finding that he failed to register with FINRA as required and committed antifraud violations of the securities laws and FINRA rules. FINRA barred Smith from association with any member firm and ordered him to pay restitution. *Held*, FINRA's findings of violations and imposition of sanctions are sustained.

APPEARANCES:

Robert Knuts of Sher Tremonte LLP for Eric S. Smith

Alan Lawhead, *Gary Dernelle*, and *Jennifer Brooks* for FINRA

Appeal filed: October 19, 2020
Last brief received: March 11, 2021

Eric S. Smith appeals from FINRA disciplinary action. FINRA found that Smith (i) failed to register as a general securities representative and principal in violation of NASD Rules 1021 and 1031[1] and FINRA Rule 2010, and (ii) made fraudulent misrepresentations and omissions in securities offering documents in violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. FINRA barred Smith from associating with any FINRA member firm in any capacity and ordered him to pay $130,000 (plus prejudgment interest) in restitution. We sustain FINRA's findings of violations and imposition of sanctions.

I. Background

Smith is the chairman, chief executive officer, and majority owner of Consulting Services Support Corporation ("CSSC"), which Smith founded in 1998. The firm is a financial services firm that provides research, marketing, technology, and administrative services to professionals who provide investment advice to their clients. Among the services it provides is the use of a proprietary "decision-assistance technology" designed to help clients select the best investments for their particular circumstances. CSSC is also the parent company of several wholly owned subsidiaries, including a registered investment adviser and a broker-dealer, CSSC Brokerage Services, Inc. ("CSSC-BD"), formerly a FINRA member firm.[2]

A. Smith's control of CSSC and its subsidiaries

During the relevant time (approximately 2010 through 2015), CSSC and its subsidiaries all occupied the same office space in Troy, Michigan. Although formally separate entities, CSSC and its subsidiaries maintained a considerable amount of operational overlap. For example, CSSC had relationships with independent investment professionals around the country with their own client bases, who were called CSSC "affiliates." Affiliate agreements, which Smith signed, required the affiliates to be representatives of CSSC's investment adviser subsidiary and FINRA-registered representatives of CSSC-BD. The agreements also determined the compensation that affiliates would receive from the investment adviser subsidiary and the percentage of commissions they would receive as registered representatives of CSSC-BD.

Smith was responsible for recruiting and signing new CSSC affiliates, and thus also for hiring CSSC-BD's registered representatives, and he decided whether to end an affiliate's relationship with CSSC and its subsidiaries. But Smith himself never registered with FINRA as a representative. Instead, as part of CSSC-BD's application for FINRA membership, Smith submitted a letter to FINRA in July 2006 stating that he was personally exempt from registration. In that letter, he acknowledged that such an exemption would apply only "so long as [he was] not actively engaged in the management of [CSSC-BD's] securities business, including the

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[1] NASD Rules 1021 and 1031 were in effect at the time of Smith's alleged misconduct. They have been superseded by FINRA Rules 1210 and 1220.

[2] FINRA also brought a disciplinary proceeding against CSSC-BD, but the firm did not appeal. *See infra* Section I.C. CSSC-BD terminated its FINRA registration in 2018.

supervision, solicitation, conduct of business or the securities training of persons associated with the Firm."

Around 2010, after the initial president of CSSC-BD left the firm, Smith appointed Jennifer LaRose and Alex Martin as CSSC-BD's co-presidents. Smith also appointed LaRose as CSSC-BD's Chief Compliance Officer. As more than one witness who worked for CSSC testified, LaRose and Martin were seen as presidents "by title" or "in title only." Indeed, Martin himself testified that he had a "fairly small" role in the "hands-on work" of running the subsidiary.

Smith, by contrast, was extensively involved in running CSSC *and* its subsidiaries. As one CSSC affiliate testified, Smith "maintained absolute ironfisted control over everything that went on in the company [i.e., CSSC]," including "the entities" that were its subsidiaries. For example, when CSSC-BD was in danger of not meeting its minimum net capital requirement in 2014, CSSC's assistant controller spoke directly about the issue with Smith, not LaRose or Martin. Smith directed the assistant controller to prioritize certain payments and directed the investment adviser subsidiary to divert funds to enable CSSC-BD to maintain the required level of net capital. Similarly, when CSSC-BD's auditors had concerns about whether it could continue as a going concern, they contacted Smith.

B. CSSC's debt offerings and revenue initiatives

CSSC struggled financially after the 2008 financial crisis. Most of the firm's revenue came from investment advisory fees based on assets under management, which decreased significantly during this period. To raise money, CSSC pursued three different debt offerings (in 2010, 2014, and 2015), as well as several new business opportunities. FINRA found that Smith engaged in fraud in connection with the 2015 offering by both misrepresenting CSSC's new business opportunities and not mentioning CSSC's default on its earlier debt offerings.

1. CSSC's 2010 and 2014 offerings

In 2010, CSSC needed funds to retire over one million dollars of short-term debt and to pay deferred salaries and legal fees, so it sought to raise $5 million through a convertible debenture bond offering (the "2010 Offering"). Smith managed this offering, during which he directed CSSC-BD registered representatives to sell the bonds to their customers using offering documents that Smith provided. Smith also directed CSSC-BD representatives to introduce Smith to their customers and then offered and sold the bonds directly to those customers.

The offering raised $2.25 million, but CSSC nevertheless continued to struggle to meet its day-to-day obligations, including deferring paying employee salaries and the advisory fees and commissions it owed its affiliates. CSSC therefore conducted another debt offering in 2014 (the "2014 Offering"), in which it sold what it called "bridge loan notes." Smith again managed the offering and used CSSC-BD registered representatives to sell the notes. In doing so, Smith even provided Donald Southwick, a CSSC-BD representative, what Southwick referred to as a "script" to tell his customers when selling the notes. The 2014 Offering ultimately raised approximately $1.1 million.

2. CSSC's other revenue initiatives

In addition to issuing debt, CSSC pursued several other projects in an effort to improve its finances. These projects are relevant here because Smith would later misrepresent them when raising money from investors in a 2015 debt offering.

a. Project X

One of the projects—dubbed "Project X"—related to the formation of a special purpose bank. In late 2014, Smith asked Southwick—whom Smith had hired to work for the parent company on such projects—to spearhead Project X, but it faced significant hurdles from the start. Although CSSC hired experienced legal counsel to help form the bank, and Southwick had previous experience setting up a special purpose bank, regulatory approval was far from certain, as was the bank's structure. The initial plan was for a client of Ken Wheeler (a CSSC affiliate) to finance the bank, but questions lingered about obtaining additional financing from private equity firms, as well as the client's role in any newly formed bank.

Although an entity was formed in August 2015 that was intended eventually to provide consulting services to the planned bank, the entity had no employees, board of directors, capital, or operations. Smith fired Southwick in September 2015. At that time, no application to charter the bank had yet been submitted to regulatory authorities, no financing to fund the bank or the consulting entity had been secured, and CSSC had entered into no agreements about advising any such bank.

b. South Dakota Trust Company

In late 2014, around the time it was pursuing Project X, CSSC also sought a relationship with the South Dakota Trust Company ("SDTC"), a national trust administration company that catered to wealthy clients. Smith and Southwick believed that CSSC could help SDTC create a range of new investment funds for which CSSC could serve as an investment adviser and that SDTC could refer its clients to CSSC for services that SDTC did not offer. In November 2014 and March 2015, Smith and Southwick met with representatives of SDTC to discuss a potential relationship, but no agreement was reached. Southwick attempted to arrange a follow-up meeting with SDTC in 2015 but was unsuccessful. SDTC never entered into a formal relationship with CSSC.

c. City of Jacksonville

CSSC also sought to provide financial advisory services to the City of Jacksonville, Florida. In 2014, Southwick, at Smith's direction, approached the city's treasurer about having CSSC directly manage Jacksonville's investments. City representatives declined the direct management suggestion but were open to having CSSC use its decision-assistance technology to evaluate the investment advice the city was already receiving. In July 2015, Smith submitted a written proposal offering to have CSSC serve as an independent reviewing consultant to the city for a quarterly fee of $15,000. City representatives never accepted this proposal, however, and never paid CSSC any fees.

3. CSSC's 2015 offering

CSSC's financial troubles continued. In 2014, the company operated at a deficit, with a net loss of approximately one million dollars. It frequently deferred paying compensation to its employees and affiliates and had trouble making credit card payments. Around the end of the year, CSSC-BD was in danger of falling below net capital requirements, and Smith directed the transfer of funds from CSSC's investment adviser subsidiary to CSSC-BD. CSSC also lacked the funds to repay hundreds of thousands of dollars of principal from the 2010 and 2014 Offerings coming due in May and June 2015. CSSC therefore pursued a bridge loan note offering in 2015 (the "2015 Offering"). Smith drafted the offering documents for the 2015 Offering, including an offering document labeled the "Confidential Report."

Smith testified that he personally solicited 15 to 25 people to invest in the 2015 Offering and sent them versions of offering documents. These potential investors included both CSSC-BD registered representatives themselves and their customers. Smith also used CSSC-BD registered representatives to find investors. Ultimately, four investors invested $130,000 in the 2015 Offering between August and November 2015.[3]

But the 2015 Offering documents that Smith used to solicit investors included many false or misleading representations about the business initiatives described above. For example, although little progress had been made on Project X, and no agreements were ever made for CSSC to advise the future bank, the June 2015 Confidential Report falsely asserted that creation of a special purpose bank was "in the final stages"; that CSSC had already earned and would soon be paid half of a "$1m consulting fee"; and that the remainder would be paid when the new bank opened, before "the end of the 3rd quarter of 2015." The report added that CSSC expected to receive an additional $400,000 in 2015 for creating a second special purpose bank, something that was not even contemplated in this timeframe by those working on the project. Smith subsequently acknowledged in a September 2015 update to investors that the receipt of this expected revenue "did not take place as planned," and baselessly blamed this development on "a plan to deprive [CSSC] of the expected and earned benefit" of the project.

Similarly, although no agreement or formal relationship was ever reached with SDTC, Smith's June 2015 Confidential Report falsely stated that CSSC had been "active in the formation of an important new strategic alliance" with SDTC. The report touted that this relationship could provide "substantial" "revenue and profit potential" and that CSSC expected the relationship to be "up and running before the end of calendar year 2015." September and October 2015 updates to the Confidential Report acknowledged "a hiatus" in the SDTC discussions, but falsely stated that "discussions have recently recommenced." The updates further stated that the potential fees from the initiative "could be quite large and is expected to

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[3] Two of the four investors were CSSC-BD registered representatives, and the other two were not CSSC-BD customers.

provide a growing source of revenue."[4] Moreover, Smith continued to highlight a relationship with SDTC in offering documents throughout 2015.

Finally, although no agreement was ever reached with the City of Jacksonville, Smith's June 2015 Confidential Report highlighted what it described as "a pending engagement" with the city. The report falsely claimed that CSSC was "currently in the final stages of being engaged as Special Reviewing Consultant with regard to the investment management of Jacksonville's nearly $1 billion in short-term operating funds." The report asserted that this arrangement would increase CSSC's revenue as well as its "reportable assets under management by nearly $1 billion—a very significant credentialing plateau." Throughout 2015, Smith's updated disclosure documents continued to highlight a "pending engagement" with Jacksonville, calling the relationship "a real milestone," and claiming that the engagement with the city was "to commence on or about October 1st of this year," and after that date passed, "prior to the end of this calendar year."

The 2015 Offering documents also contained notable omissions, which rendered the statements Smith made in the offering documents misleading. Importantly, they did not disclose that CSSC owed investors hundreds of thousands of dollars in principal payments in connection with the 2010 and 2014 Offerings that was due or coming due. (The 2010 Offering documents, by comparison, had disclosed the company's then-debt.)

C. Procedural History

FINRA began investigating CSSC-BD and Smith after conducting a routine examination in 2015 and receiving complaints from CSSC-BD customers who had invested in CSSC debt offerings. On August 4, 2017, FINRA's Department of Enforcement filed a complaint against Smith and CSSC-BD. The complaint charged Smith and CSSC-BD with fraudulently misrepresenting or omitting material facts in connection with the 2015 Offering and with failing to register Smith as a general securities representative and principal of CSSC-BD as required by FINRA's rules.

After an eight-day hearing, a hearing panel found that Smith and CSSC-BD engaged in the alleged misconduct. For the fraud violations, the hearing panel barred Smith from associating with any FINRA member firm in any capacity, suspended CSSC-BD from participating in private securities offerings in all capacities for one year, and fined the firm $100,000. The hearing panel also ordered Smith and CSSC-BD to pay restitution of $130,000, jointly and severally, to the four investors in the 2015 Offering. For the registration violations, the hearing panel assessed—but in light of the bar for the fraud violations, did not impose—two suspensions in all capacities for one year and two $50,000 fines on Smith, one for each registration-related cause of action. The hearing panel also imposed a $20,000 fine on CSSC-BD for the registration violations.

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[4] Although the September and October 2015 updates to the Confidential Report stated that these discussions had "recently recommenced," the November 2015 update stated that these "discussions are expected to recommence."

Smith, but not CSSC-BD, appealed to FINRA's National Adjudicatory Council ("NAC"), which affirmed the hearing panel's findings of violations against Smith. The NAC affirmed the hearing panel's imposition of a bar and restitution order for the fraud violations. For acting as an unregistered principal, the NAC increased the hearing panel's sanctions against Smith to a $75,000 fine and a two-year suspension in all capacities and, for acting as an unregistered representative, increased the sanctions to a $50,000 fine and a one-year suspension in all capacities. But like the hearing panel, the NAC declined to impose the assessed sanctions for the registration violations because of the bar imposed for the fraud violations.

This appeal followed.

II. Analysis

In reviewing FINRA's action, we determine whether Smith engaged in the conduct FINRA found, whether that conduct violated the statutory provisions or rules specified in FINRA's determination, and whether those provisions and rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[5] We base our findings on an independent review of the record and apply a preponderance of the evidence standard.[6]

A. Smith is subject to FINRA's disciplinary authority and violated NASD and FINRA rules by not registering.

1. FINRA has authority to bring a disciplinary action against Smith.

As a threshold matter, we first address Smith's claim that FINRA lacked authority to discipline him. To register as a national securities association, the Exchange Act requires an association to, among other things, have rules providing that "its members and persons associated with its members"—which the Act defines as "any partner, officer, director, or branch manager of such member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member"[7]—"shall be appropriately disciplined for violation of any provision of" the Act, "the rules or regulations thereunder . . . or the rules of the association."[8] The Exchange Act also requires registered securities associations to "enforce compliance" with the Act, the rules and regulations thereunder, and the association's own rules by members and associated persons.[9] And the Exchange Act authorizes registered securities

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5 15 U.S.C. § 78s(e)(1).

6 *See Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *1, *9 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

7 15 U.S.C. § 78c(a)(21).

8 *Id.* § 78*o*-3(b)(7).

9 *Id.* § 78s(g)(1)(B); *see also id.* § 78o-3(b)(2) (requiring as a condition of registration with the Commission that a national securities association "be so organized and have the capacity" to "enforce compliance by its members and persons associated with its members" with the federal securities laws and the association's own rules).

associations to initiate disciplinary proceedings against members and associated persons.[10] FINRA is a registered securities association, and its bylaws, in turn, define an associated person as a "natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, *whether or not any such person is registered or exempt from registration*."[11]

Smith is an "associated person" of a FINRA member firm because he both controlled a member firm and was engaged in the securities business. Smith does not dispute that he controlled a member firm, CSSC-BD, because he was the chairman, chief executive officer, and majority owner of CSSC, which wholly owned CSSC-BD. As discussed below, Smith also was actively engaged in CSSC-BD's securities business by acting as both a general securities representative and as a principal. Acting in either capacity makes him an associated person of CSSC-BD under FINRA bylaws. Thus, Smith is properly subject to FINRA's disciplinary authority.[12]

a. Smith acted as a general securities representative of CSSC-BD.

Smith acted as a general securities representative by offering and selling securities to CSSC-BD's customers.[13] He offered and sold CSSC debt securities both personally and by

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[10] *Id.* § 78o-3(h); *see Louis Ottimo*, Exchange Act Release No. 83555, 2018 WL 3155025, at *14 (June 28, 2018) (noting that FINRA has authority "to discipline all associated persons of a member firm") (citing *Stephen Grivas*, Exchange Act Release No. 77470, 2016 WL 1238263, at *5 n.15 (Mar. 29, 2016)). FINRA has "the authority to exercise comprehensive oversight over 'all securities firms that do business with the public.'" *UBS Fin. Servs., Inc. v. W. Va. Univ. Hosps., Inc.*, 660 F.3d 643, 648 (2d Cir. 2011) (quoting 72 Fed. Reg. 42170 (Aug. 1, 2007)). Upon joining FINRA, a member organization agrees to comply with FINRA's rules. *See* FINRA By-Laws Art. IV, Section 1.

[11] FINRA By-Laws, Art. I (rr) (emphasis added); *see also Order Approving Proposed Rule Change Relating to the Definition of "Person Associated with a Member"*, Exchange Act Release No. 42036, 1999 WL 961340 (Oct. 19, 1999) (approving the definition of "person associated with a member" currently in FINRA By-Laws Art. I as consistent with the Exchange Act).

[12] *See Bruce Zipper*, Exchange Act Release No. 90737, 2020 WL 7496222, at *12 (Dec. 21, 2020) (agreeing with FINRA that "activities requiring registration are a subset of those that constitute 'associating' with a FINRA member firm"); *compare* FINRA By-Laws, Art. I (rr) (defining associated person as "natural person *engaged* in the investment banking or securities business . . . .") (emphasis added) *with* NASD Rule 1060 (exempting from registration "persons associated with a member who are not *actively engaged* in the investment banking or securities business") (emphasis added).

[13] *See* NASD Rule 1031(b) (defining "representatives" as "[p]ersons associated with a member . . . who are engaged in the investment banking or securities business for the member"); *cf. Michael F. Flannigan*, Exchange Act Release No. 47142, 2003 WL 60764, at *4-5 (Jan. 8, 2003) (holding that conducting securities business with a FINRA member's customers requires registration with that firm).

directing CSSC-BD's registered representatives to do so. As part of the 2010, 2014, and 2015 debt offerings, Smith disseminated offering documents that he had prepared to CSSC-BD registered representatives with the intent that they would, in turn, offer and sell the securities to their customers. Smith also had CSSC-BD registered representatives introduce him to their customers so that he could solicit them directly. Through Smith's efforts, CSSC ultimately sold CSSC-BD customers hundreds of thousands of dollars of CSSC's debt securities. Smith thus did not, as he suggests, simply act as a representative of an unrelated issuer (CSSC) reaching out to potential investors. Rather, he used the relationship that CSSC-BD and its representatives had with their customers to solicit those customers, both directly and indirectly, and thereby obtained their investments in CSSC. In doing so, he plainly used CSSC-BD to engage in securities business with the broker-dealer's customers.[14]

Smith was thus engaged in the activities of a securities representative with CSSC-BD customers, making him an associated person of the firm subject to FINRA's disciplinary authority.

b. Smith acted as a principal of CSSC-BD.

Smith also acted as a principal of CSSC-BD through his significant role running the broker-dealer's securities operations. NASD Rule 1021(b) defines "principal" as one who is "actively engaged in the management of the member's . . . securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions."[15] The functions that individuals perform, and not their title, determines whether they are acting in a principal capacity.[16] Smith engaged in such functions here.

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[14] *See, e.g.*, *Flannigan*, 2003 WL 60764, at *3-4 (holding that individuals who solicited and confirmed indications of interest, sent prospectuses, and accepted the orders of a FINRA member's customers were required to register with that firm as its representatives); *First Cap. Funding, Inc.*, Exchange Act Release No. 30819, 1992 WL 150797, at *2-3 (June 17, 1992) (holding that "send[ing] correspondence soliciting securities business," including offering documents, is engaging in the securities business and requires registration); *Bruce Zipper*, Exchange Act Release No. 84334, 2018 WL 4727001, at *5 (Oct. 1, 2018) (holding that emailing customers to recommend securities transactions and speaking with customers on the phone about their investments were functions that "were part of the conduct of a securities business" and thus of an associated person).

[15] NASD Rule 1021(b).

[16] *See Dennis Todd Lloyd Gordon*, Exchange Act Release No. 57655, 2008 WL 1697151, at *6 (Apr. 11, 2008) (holding that "a person who devotes significant time to firm affairs and participates in management decisions is a principal, whether or not the person holds an official firm title"); *Gordon Kerr*, Exchange Act Release No. 43418, 2000 WL 1476174, at *3 (Oct. 5, 2000) (holding that, in determining whether an individual functions as a principal, "we look at the responsibilities assigned to the associated person by the firm and the activities the individual actually performed"); NASD Notice to Members 99-49 (June 1, 1999) ("The registration

(continued…)

Smith effectively managed the registered broker-dealer's securities business. Although Martin and LaRose were co-presidents of CSSC-BD, inside CSSC they were seen as such "in title only." Smith was ultimately responsible for both the hiring and firing of CSSC-BD personnel, including its CCO and registered representatives, and he personally negotiated and determined the registered representatives' commissions.[17] He made decisions about how the firm met its net capital requirement. He was involved in selecting CSSC-BD's clearing firm. And when CSSC-BD auditors had concerns about whether the firm could continue as a going concern, they contacted Smith.

Smith disputes that he acted as a principal by virtue of his recruiting CSSC affiliates. He argues that hiring affiliates did not involve him in CSSC's securities business and there is no evidence that he "played any supervisory role with respect to [CSS-BD's] trade execution and collection activity." Although Smith may not have directly supervised CSSC-BD representatives' trading activity (beyond hiring and firing CSSC-BD representatives), his overall "authority over a broad range of Firm operations, including recruiting, hiring, and firing of Firm personnel," demonstrates that he acted as a principal of CSSC-BD and was thus an associated person of the firm.[18]

c. Smith's claim that his decision not to register as an associated person exempts him from FINRA's disciplinary authority has no merit.

Smith argues that FINRA should not have authority over any individuals who, like him, have not "voluntarily" registered with FINRA by filing a Form U4, [19] regardless of whether that decision not to do so was proper. For FINRA to exercise authority over him, Smith contends, would undermine the voluntary nature of the self-regulatory system that Congress established when it authorized the creation of organizations like FINRA. But the Exchange Act itself requires that self-regulatory organizations (like FINRA) enforce the federal securities laws and their own rules, including by disciplining the associated persons of its members, and neither the Exchange Act nor FINRA bylaws definitions of an associated person hinges on that person's registration status.[20] Moreover, the Commission has repeatedly held that self-regulatory organizations can discipline associated persons of members, regardless of whether those

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determination does not depend on the individual's title, but rather on the functions that he or she performs").

17 *See, e.g.*, *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 WL 1892137, at *13 (June 29, 2007) (finding that an individual who was "actively involved in hiring," among other things, was "actively engaged in the management of the Firm's securities business" and was required to register as a principal); *Kirk A. Knapp*, Exchange Act Release No. 30391, 1992 WL 40436, at *3 (Feb. 21, 1992) (finding that applicant actively engaged in the management of the firm's securities business based on, among other things, his hiring firm personnel).

18 *Gordon*, 2008 WL 1697151, at *2, *6.

19 The Form U4 (Uniform Application for Securities Industry Registration or Transfer) is used by firms to register and update the registration information of associated persons with self-regulatory organizations.

20 *See supra* notes 7 through 11 and accompanying text.

individuals are registered.[21] Allowing associated persons of member firms to avoid FINRA disciplinary action simply by choosing not to register would undermine FINRA's ability to carry out its regulatory function.[22]

Smith acknowledges that in *Vladislav Steven Zubkis*, the Commission held that NASD had authority to discipline an individual who was not registered with NASD at the time but was an associated person of a member firm.[23] Smith attempts to distinguish that holding by noting that, in that case, the respondent had previously registered with and obtained securities licenses from NASD. But the holding in *Zubkis* did not turn on that fact; rather, it was based on the respondent's status as an unregistered associated person at the time of his alleged misconduct.[24] In any event, Smith does not account for cases, like *Joseph Patrick Hannan* and *Stephen M. Carter*, that involved unregistered associated persons subject to NASD discipline.[25]

Finally, although Smith may not have registered himself (as he was required to), he agreed to register CSSC-BD, the broker-dealer he controlled. As noted above, the Exchange Act's definition of an associated person does not require registration and FINRA's bylaws explicitly authorize FINRA to discipline all associated persons of member firms "whether or not any such person is registered or exempt from registration."[26] At the time CSSC-BD applied for membership, Smith acknowledged to FINRA that he was exempt from registration only "so long as [he was] not actively engaged in the management of [CSSC-BD's] securities business" and that he would "not be permitted to become active in the Firm's securities business" until he

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21 *See, e.g.*, *Vladislav Steven Zubkis*, Exchange Act Release No. 40409, 1998 WL 564562, at *3-4 (Sept. 8 1998) (holding that the NASD had authority to discipline an individual who was unregistered at the time of his alleged misconduct because he was an "associated person" of a member firm based on the facts that he controlled the firm and was engaged in its securities business); *Joseph Patrick Hannan*, Exchange Act Release No. 40438, 1998 WL 611732, at *1 & n.1 (Sept. 14, 1998) (affirming finding of violation and modifying sanction of unregistered administrative assistant whose employment with a NASD member made him a "person associated with a member"); *Stephen M. Carter*, Exchange Act Release No. 26264, 1988 WL 902876, at *1 (Nov. 8, 1988) (holding that the NASD had authority to discipline an unregistered "cashier" of a NASD member firm because he was engaged in "the conduct of a securities business" and was thus an "associated person" of the firm).

22 *See supra* notes 8 through 10; *cf. First Cap. Funding*, 1992 WL 150797, at *3 (holding that NASD's regulation of associated persons and the requirement that they register "before engaging in any securities business provides an important safeguard in protecting public investors").

23 1998 WL 564562, at *3-4.

24 *Id.*

25 *See supra* note 21.

26 FINRA By-Laws, Art. I (rr); *see also id.* Articles V and XIII.

registered.[27] Even if, as Smith claims, this letter showed his then-intent not to register, his acknowledgement that his active engagement would require registration demonstrates an understanding that he was an associated person of the firm and thus subject to FINRA discipline. Moreover, despite his representations in the letter, Smith became actively engaged in CSSC-BD's securities business, triggering registration requirements and reinforcing his associational status.[28]

Smith also challenges the application of FINRA's bylaws, which define and authorize FINRA to discipline persons "associated with" FINRA member firms. He notes that FINRA is a Delaware corporation and suggests that, under the Delaware corporate code, FINRA's bylaws cannot govern a person "who is not a stockholder/member, director, officer, or employee" of FINRA. But Smith has not shown that FINRA bylaws conflict with the Delaware code, because the section that Smith cites states that corporation bylaws "may contain" provisions relating to not only "the rights or powers of its stockholders, directors, officers or employees," as Smith notes, but also "any provision . . . relating to the business of the corporation, the conduct of its affairs, and its rights or powers."[29] In any event, the Delaware code cannot limit or interfere with FINRA's ability to carry out its Exchange Act mandate, as a registered securities association, to discipline its member firms and their associated persons.[30] And FINRA's bylaws—in making explicit that its disciplinary authority extends to associated persons (whether or not registered)—give effect to and implement that statutory directive. We thus find no basis for concluding that FINRA lacks the authority to discipline Smith through this proceeding.

2. Smith violated NASD Rules 1021 and 1031 and FINRA Rule 2010 by failing to register.

Smith also violated the registration rules applicable to associated persons of FINRA member firms. NASD Rule 1021(a) requires that "[a]ll persons engaged or to be engaged in the investment banking or securities business of a member who are to function as principals shall be registered as such." NASD Rule 1031(a) requires that "[a]ll persons engaged or to be engaged in

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[27] Smith notes that he unsuccessfully sought to submit evidence during the hearing that NASD had drafted the letter and forwarded it to CSSC-BD staff for Smith's signature. Smith identifies no error, nor can we find any, in FINRA's exclusion of this evidence. Regardless of who drafted the letter, Smith signed it, and its plain terms acknowledge that his active involvement in CSSC-BD's securities business would require his registration.

[28] NASD Rule 1060, for example, exempts from registration "persons associated with a member who are not actively engaged in the investment banking or securities business," but Smith's active engagement in CSSC-BD securities business negated that exemption.

[29] 8 Del. C. § 109(b); *see Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 951 (Del. Ch. 2013) (Strine, C.) (noting that § 109(b) "has long been understood to allow the corporation to set 'self-imposed rules and regulations [that are] deemed expedient for its convenient functioning'" (citation omitted)).

[30] *See Arizona v. United States*, 567 U.S. 387, 399 (2012) ("[S]tate laws are preempted when they conflict with federal law," including where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.").

the investment banking or securities business of a member who are to function as representatives shall be registered as such." By functioning as both a general securities representative and principal, without ever registering with FINRA in any capacity, Smith violated NASD Rules 1021 and 1031 and, in doing so, also violated FINRA Rule 2010.[31] Accordingly, we affirm FINRA's finding that Smith violated these registration rules.

3. NASD's and FINRA's rules are, and were applied, consistent with the purposes of the Exchange Act.

The Exchange Act requires that FINRA's rules be designed "to protect investors and the public interest."[32] As we have stated, registration requirements "provide an important safeguard in protecting public investors and strict adherence to that requirement is essential, because it serves a significant purpose in the policing of the securities markets and in the protection of the public interest."[33] FINRA's application of the registration requirements was thus consistent with the Exchange Act's purposes because enforcing the registration requirements protects investors.

B. Smith violated antifraud provisions of the securities laws and FINRA's rules.

FINRA found, and we agree, that Smith violated Exchange Act Section 10(b), Rule 10b-5(b) thereunder, and FINRA Rules 2020 and 2010 in connection with the 2015 Offering. Exchange Act Section 10(b) makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules.[34] Rule 10b-5(b) makes it unlawful, "in connection with the purchase or sale of any security," to "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 light of the circumstances under which they were made, not misleading."[35] A violation of Section 10(b) and Rule 10b-5 constitutes a violation of FINRA Rule 2020, which prohibits FINRA members from "effect[ing] any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance."[36] And such conduct also violates FINRA Rule 2010, which requires members to observe high standards of commercial honor and just and equitable principles of trade.[37]

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31 FINRA Rule 2010 states that "[a] member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." A violation of another NASD or FINRA rule constitutes a violation of Rule 2010. *See Newport Coast Secs., Inc.*, Exchange Act Release No. 88548, 2020 WL 1659292, at *3 n.8 (Apr. 3, 2020).

32 15 U.S.C. § 78*o*-3(b)(6).

33 *Flannigan*, 2003 WL 60764, at *4 (internal quotation marks omitted).

34 15 U.S.C. § 78j(b).

35 17 C.F.R. § 240.10b-5(b).

36 *William Scholander*, Exchange Act Release No. 77492, 2016 WL 1255596, at *4 (Mar. 31, 2016), *pet. denied sub nom. Harris v. SEC*, 712 F. App'x 46 (2d Cir. Oct. 25, 2017).

37 *Id.*

As explained below, Smith violated these provisions by making misrepresentations and omissions of material fact, with scienter, in connection with the 2015 Offering.[38] Before the NAC, and now in his briefs to the Commission, Smith challenges only the finding that his misstatements and omissions were material.[39] Smith has thus forfeited any challenge to other elements of FINRA's fraud finding on appeal, but we nevertheless review FINRA's findings of violations on each element consistent with our standard of review.[40]

1. Smith made misrepresentations and omissions in connection with the 2015 Offering.

By writing and disseminating the 2015 Offering documents, Smith made numerous false and misleading representations about CSSC's revenue initiatives.[41] He also made several

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[38] *See Aaron v. SEC*, 446 U.S. 680, 691-95 (1980) (holding that a violation of Section 10(b) and Rule 10b-5 requires a finding of scienter). We also find, and Smith does not dispute, that because the 2015 offering involved notes with a one-year maturity, his material misrepresentations and omissions were made in connection with the purchase or sale of a security. *See* 15 U.S.C. § 78c(a)(10) (defining a "security" to include "any note," except notes with a maturity of less than nine months); *Reves v. Ernst & Young*, 494 U.S. 56, 65, 67 (1990) (adopting a rebuttable "presumption that every note is a security"). A violation of Section 10(b) and Rule 10b-5(b) also requires the use of means or instrumentalities of interstate commerce, and Smith's emailing offering documents and accepting payments by wire or check satisfy the interstate commerce requirement. *See, e.g.*, *Grubbs v. Sheakley Grp., Inc.*, 807 F.3d 785, 803 (6th Cir. 2015) ("[T]he very act of sending an e-mail creates the interstate commerce nexus necessary for federal jurisdiction."); *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 861, 865 (S.D.N.Y. 1997) (Sotomayor, J.) (finding that wire and mail transfers of funds satisfied interstate commerce requirement of Exchange Act Section 10(b) and Rule 10b-5), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

[39] Smith's application for review listed other "findings and conclusions" for which he sought Commission review, but we deem these other claims forfeited because he did not brief them. *See* Rule of Practice 420(c), 17 C.F.R. § 201.420(c) ("Any exception to a determination not supported in an opening brief . . . may, at the discretion of the Commission, be deemed to have been waived by the applicant."); *Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, at *19 & n.115 (Feb. 20, 2015) (explaining that "arguments for reversal not made in the opening brief" are subject to waiver).

[40] *See* 15 U.S.C. § 78s(e)(1); *Newport Coast Secs.*, 2020 WL 1659292, at *3 (recognizing waiver but reviewing FINRA liability findings consistent with standard of review).

[41] *See SEC v. GenAudio Inc.*, 32 F.4th 902, 924 (10th Cir. 2022) (finding that a CEO made multiple false and misleading statements about his company's potential relationship with a business partner and noting that "no matter how heartfelt their subjective beliefs, corporate executives . . . cannot make material representations to shareholders in disregard or contravention of obvious facts" (citing *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 188 (2015))).

statements about CSSC's solvency and profitability that were misleading by omission. The misrepresentations and omissions in the initial June 2015 Confidential Report included:

- *Project X.* The report stated that CSSC was "in the final stages" of creating a special purpose bank, which was expected to "open . . . for business" by October 2015. But as Southwick and Wheeler both testified, these statements were false; indeed, no request for regulatory approval for the bank had even been submitted to authorities. The report also asserted (among other things) that CSSC had already "earned" $500,000 for its work associated with the first bank and would receive another $500,000 when the first bank opened, plus an additional $400,000 in 2015 for helping to create a second. Yet Southwick testified that there was no revenue agreement in place that would have provided for such payments. Wheeler similarly testified that Project X was not "even remotely close to being able to generate any kind of revenue stream in 2015" and that the statements in the offering documents were "delusional."

- *SDTC.* The report falsely represented that CSSC had formed "a new strategic alliance with South Dakota Trust Company," in particular (i) that CSSC would be "the investment advisor of the common and collective trust funds it [was] helping [SDTC] to create"; and (ii) that CSSC had a "client referral relationship with SDTC." In fact, at the time that Smith distributed the report to potential investors, he and Southwick had had only a couple of in-person meetings with representatives from SDTC to discuss the ideas, and no agreement had been reached to form such an alliance. Thus, Smith could not have "expect[ed] to have both of these potentially important new revenue sources [from SDTC] up and running before the end of calendar year 2015," as the report claimed.

- *City of Jacksonville.* The report falsely claimed that CSSC was "currently in the final stages of being engaged as Special Reviewing Consultant" for Jacksonville and that CSSC's relationship with the city would increase its "reportable assets under management by nearly $1 billion." In truth, Southwick had had some initial discussions with Jacksonville, but city representatives had made clear that the city was not interested in CSSC directly managing its money, and CSSC had not yet even submitted an initial written proposal for the work. Moreover, when CSSC did submit a written proposal in July 2015, it was only for CSSC to serve as a reviewing consultant for a fee of $15,000 per quarter. Thus, even as proposed by CSSC, the relationship would not have increased CSSC's assets under management at all, let alone by "nearly $1 billion."

- *Omissions about CSSC's financial health.* Throughout 2015—including in the June 2015 Confidential Report—Smith repeatedly misrepresented CSSC's financial prospects, including his baseless assertion that 2015 "will likely be the most profitable year (so far) in the Company's history," with net earnings "more than double that of our best year to this point." Smith failed to disclose, however, that CSSC had defaulted on hundreds of thousands of dollars in debt and was

unable to timely pay its current debt holders, depriving potential investors of crucial information about the company's actual financial situation.[42]

Smith also wrote and disseminated updates to the Confidential Report throughout the fall of 2015. Those updates reiterated many of the same misstatements and continued to misrepresent important information about CSSC's various revenue initiatives. Those misrepresentations included:

- *Project X*. The September 2015 update acknowledged that the revenue from Project X "did not take place as planned" but maintained that CSSC could still "salvage" the project. Smith's October and November 2015 updates included the same message even though Smith fired Southwick in September 2015—and the project was unlikely to succeed without Southwick's expertise. And rather than acknowledge that there had never been an agreement for CSSC to receive payments for the project, Smith drafted updates to the Confidential Report that baselessly blamed the lack of revenue on "a plan to deprive [CSSC] of the expected and earned benefit" of the project.

- *SDTC*. In September and October 2015 updates to the Confidential Report, Smith continued to falsely tout a "pending strategic relationship" with SDTC and added that discussions with SDTC had "recently recommenced." But this statement was belied by the November 2015 update, which replaced "have recently recommenced" with "are expected to recommence (possibly in the first quarter of 2016)." Smith's updates also continued to misleadingly represent that the SDTC relationship "is expected to provide a growing source of revenue" for CSSC.

- *City of Jacksonville*. In the September 2015 update, Smith continued to falsely claim a "pending engagement with the City of Jacksonville" that was "to commence on or about October 1st of [2015]" and that the relationship would increase CSSC's assets under management by nearly $1 billion. When October 1 passed, the October and November 2015 updates falsely claimed that the engagement would commence "prior to the end of this calendar year."

- *Omissions about CSSC's financial health*. In updates to the Confidential Report, Smith claimed that the value of CSSC's assets "significantly exceed current amounts of Company debt." But Smith again failed to disclose that CSSC had defaulted on hundreds of thousands of dollars in debt and was unable to timely pay its current debt holders.

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[42] *See Macquarie Infrastructure Corp. v. Moab Partners, L. P.*, 601 U.S. 257, 263 (2024) ("Half-truths," or "representations that state the truth only so far as it goes, while omitting critical qualifying information," are actionable under Rule 10b-5(b).); *SEC v. Johnston*, 986 F.3d 63, 72 (1st Cir. 2021) ("Statements can be misleading if they are materially untrue. They can also be misleading if they are half-truths, painting a materially false picture in what they say because of what they omit." (citations omitted)).

2. Smith's false and misleading representations were material.

A misrepresentation or omission is material "if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to buy or sell securities."[43] Courts and the Commission alike have repeatedly recognized that information about an entity's financial health—and, in the context of a debt offering, information about the company's ability to repay that debt—is material.[44] Here, Smith's false and misleading statements about allegedly significant and imminent revenue streams from Project X, SDTC, and Jacksonville were all statements about CSSC's financial condition that a reasonable investor would find important in deciding whether to participate in the 2015 Offering.[45] And a reasonable investor in new CSSC debt would find it important that CSSC was at that time unable to make payments on prior debt that were due.[46]

Smith argues that FINRA improperly determined materiality "as a matter of law," without introducing "actual evidence" of materiality from, for example, affected investors, other fact witnesses, or experts. Smith thus contends that it was "pure speculation" whether the misrepresentations would have been material to investors. But the standard for determining materiality is objective, not subjective, so the testimony of individual investors is not determinative.[47] Likewise, the Commission has observed that "expert testimony is not

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[43] *SEC v. Talbot,* 530 F.3d 1085, 1097, (9th Cir. 2008); *see also Basic Inc. v. Levinson,* 485 U.S. 224, 231-32 (1988) (a misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would have viewed the misrepresentation or omission "as having significantly altered the 'total mix' of information" available in making an investment decision).

[44] *See, e.g., SEC v. Todd*, 642 F.3d 1207, 1221 (9th Cir. 2011) ("Information regarding a company's financial condition is material to investment."); *SEC v. Blavin,* 760 F.2d 706, 711 (6th Cir. 1985) (holding that the materiality of misstatements about "financial condition, solvency, and profitability" is "not subject to serious challenge"); *Fuad Ahmed,* Exchange Act Release No. 81759, 2017 WL 4335036, at *15 (Sept. 28, 2017) (information about financial condition is material to a company's "ability to repay" its debt).

[45] *See, e.g., Cooper v. Pickett*, 137 F.3d 616, 626 (9th Cir. 1997) (holding that "substantially overstat[ing]" revenue constitutes "false or misleading statements of material fact"); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1421 n.9 (3d Cir. 1997) ("[I]nformation about a company's past and current earnings is likely to be highly 'material.'").

[46] *See, e.g., Aubrey v. Barlin,* No. A-10-CA-076-SS, 2011 WL 675068, at *9 (W.D. Tex. Feb. 16, 2011) ("[A]ny reasonable investor would want to know if the entity to which they were loaning money was already defaulting on its prior obligations."); *SEC v. Bravata*, 763 F. Supp. 2d 891, 916 (E.D. Mich. 2011) (finding misrepresentations in offering documents material where "defendants failed to depict the true financial condition of the company, particularly the inevitability that the only way investors would see a return or recovery of principal was if new investors paid money into the company").

[47] *See TSC Indus. Inc. v. Northway Inc*., 426 U.S. 438, 445 (1976).; *Louis Ottimo,* Exchange Act Release No. 95141, 2022 WL 2239146, at *7 (June 22, 2022); *Richmark Capital Corp.,*

(continued…)

necessary" to establish materiality.[48] In some situations, misrepresentations and omissions can be "so obviously important to an investor" that they are indeed material as a matter of law.[49] Such representations may include those involving "financial condition, solvency, and profitability,"[50] and those that "affect the probable future of the company," [51] both of which are at issue here.

In any event, FINRA properly weighed the total mix of information available to potential investors in the 2015 Offering to conclude that there was ample evidence of materiality.[52] Smith himself repeatedly emphasized in the offering documents that the new revenue initiatives were "important" to CSSC's profitability, underscoring his appreciation of the materiality of this information to investors.[53] For example, the offering documents emphasized—in bold and underlined text—that the purported $1.4 million consulting fee for Project X "should ensure that 2015 is not only profitable, but also that it will be the most profitable year in CSSC's history."

Securities Act Release No. 8333, 2003 WL 22570712, *5 (Nov. 7, 2003), *aff'd*, 86 F. App'x 744 (5th Cir. 2004).

48 *Ottimo*, 2022 WL 2239146, at *7; *see also United States v Mazumder*, 800 F. App'x 392, 395-96 (6th Cir. 2020) (affirming exclusion of expert testimony regarding the materiality of misrepresentations).

49 *TSC Indus.*, 426 U.S. at 450.

50 *Blavin*, 760 F.2d at 711; *see also Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970) (finding a discrepancy in net revenue projections material as a matter of law).

51 *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968); *see also GenAudio*, 32 F.4th at 933 (finding a statement regarding the likelihood of a technology acquisition deal material as a matter of law).

52 *See, e.g.*, *TSC Indus.*, 426 U.S. at 450 (noting that determining materiality "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact").

53 *See SEC v. Mayhew*, 121 F.3d 44, 52 (2d Cir. 1997) ("[A] major factor in determining whether information was material is the importance attached to it by those who knew about it.")

The offering documents stated the following about the initiatives (with emphasis added): "The creation of this new Bank is *very important* to CSSC" (June 2105 Confidential Report); Project X is "a *very important* CSSC Project" (September 2015 Confidential Report) or "an *important* CSSC Project" (October and November 2015 Confidential Reports); Project X is an "*important* initiative" that CSSC is working to get "back on track" (September, October, November, December Important Memorandums); CSSC formed "an *important* new strategic alliance with South Dakota Trust Company" (June 2015 Confidential Report); CSSC "expects to have both of these potentially *important* new revenue sources [from the SDTC relationship] up and running before the end of calendar year 2015" (June Confidential Report); "The *importance* to us of both [CSSC's program focused on government entities and the special reviewing consultant program] is best illustrated by a pending engagement with the City of Jacksonville" (June, September, October, and November 2015 Confidential Reports).

At the same time, as discussed, the offering documents failed to disclose CSSC's then-current defaulted debt obligations. Such information plainly would have been information that investors would have wanted to know. Moreover, the fact that Smith knowingly included information about CSSC's debt obligations in the earlier 2010 bond offering suggests that he thought the information was important.[54]

Smith also claims that the offering documents provided adequate warnings about CSSC's financial condition. But as FINRA found, the offering documents contained only "boilerplate" disclosures, such as "[m]aking an unsecured loan to a company that is experiencing current cash flow shortfalls involves a significant amount of risk"; there is "no guarantee that the loan would be repaid with interest when due"; and "[l]oans of this type should be made only by those financially able and willing to accept the risk that all or part of the loan could be lost." These generic warnings failed to provide investors with meaningful information about CSSC's actual financial condition rather than mere boilerplate.[55] And "cautionary language does not protect material misrepresentations or omissions when," as here, they are "knowingly false" or misleading.[56]

3. Smith acted with scienter.

Scienter is "a mental state embracing intent to deceive, manipulate, or defraud"[57] and may be established by recklessness—conduct representing an "extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."[58] One can establish scienter, therefore, by showing an actual knowledge of falsity or a reckless disregard for the truth.[59]

Here, the record shows, and Smith does not dispute, that he knew or must have known that his statements about CSSC's financial condition and revenue initiatives in the offering

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54 *Cf. Mayhew*, 121 F.3d at 52 (noting that information is likely to be material if those who "knew about it" deemed it to be "importan[t]").

55 *See, e.g.*, *GenAudio*, 32 F.4th at 928-929 (holding that to negate the materiality of forward-looking statements, "the cautionary statements must be substantive and tailored to the specific future projections, estimates, or opinions" at issue); *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 767 (11th Cir. 2007) (holding that to render alleged omission or misrepresentations immaterial "cautionary language must be meaningful: boilerplate will not suffice").

56 *GenAudio*, 32 F.4th at 929 (citation omitted).

57 *Aaron*, 446 U.S. at 686 n.5 (1980) (internal quotation marks omitted).

58 *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (citation omitted); *accord Teamsters Loc. 237 Welfare Fund v. ServiceMaster Glob. Holdings, Inc.*, 83 F.4th 514, 526 (6th Cir. 2023).

59 *See, e.g.*, *SEC v. Lyttle*, 538 F.3d 601, 603 (7th Cir. 2008) (holding that scienter means "that the defendants either knew that the representations they made to investors were false or were reckless in disregarding a substantial risk that they were false").

documents were false or misleading. For example, as to Project X, Smith knew or must have known that, contrary to what he wrote in the offering documents, CSSC had no agreement in place to earn fees from Project X, and no special purpose bank was anywhere close to opening its doors, let alone a second bank. Although Smith testified that he had relied on Southwick for the information in the June 2015 Confidential Report about Project X, Smith also testified that he would have had to personally sign any agreement that CSSC entered into to earn the fees claimed in the offering documents, and he knew that he had never done so for any such agreement here.[60] Smith also knew, or must have known, that he was misleading a potential investor when he sent the June 2015 Confidential Report to that person in September 2015, after he had already written a less optimistic (but still false) update to the report.

Similarly, as to the SDTC and Jacksonville initiatives, Smith knew that CSSC had not entered into any "pending" relationships with these entities as claimed in the offering documents. For example, Smith knew in June 2015 that CSSC had not even submitted a written proposal to Jacksonville. When CSSC finally did submit a proposal, in July 2015, Smith knew, because he drafted the proposal, that it did not contemplate CSSC managing any of Jacksonville's assets. Smith also knew that Jacksonville never accepted CSSC's proposal. Yet beginning in June 2015 and through the November 2015 offering documents, Smith continued to include that the Jacksonville relationship would "increase [CSSC's] reportable assets under management by nearly $1 billion" and that the engagement would soon commence.

Smith also knew that CSSC was defaulting on debt from prior offerings at the same time he was seeking new debt investments in the 2015 Offering. Smith therefore knew or must have known that it created a substantial risk of misleading investors about CSSC's financial health not to disclose this information to potential investors in CSSC's 2015 debt offering.[61]

* * * *

Accordingly, we sustain FINRA's findings that Smith violated Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010. We also sustain FINRA's findings that Smith willfully violated Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA Rules 2020 and 2010.[62] And because we find that Smith willfully violated Section 10(b)

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60 For example, Smith tried to obtain a signed affiliation agreement between CSSC and the consulting entity established as part of Project X to show it to a potential investor in the 2015 Offering. But Smith was unable to secure that investment because CSSC never executed such an agreement.

61 *See Ottimo*, 2018 WL 3155025, at *12 (holding that "omitting materially adverse information" was "at least reckless" because applicant "must have known that [it] presented a substantial risk of misleading investors").

62 *See, e.g.*, *Bennett Grp. Fin. Servs., LLC*, Exchange Act Release No. 80347, 2017 WL 1176053, at *4 n.30 (Mar. 30, 2017) ("Our finding of scienter . . . demonstrates that Bennett's violations were willful."), *abrogated in part on other grounds by Lucia v. SEC*, 138 S. Ct. 2044 (2018).

and Rule 10b-5, we also sustain FINRA's finding that he is statutorily disqualified on that ground.[63]

In sustaining these findings, we find that FINRA's rules were, and were applied in a manner, consistent with the purposes of the Exchange Act. As we have repeatedly recognized, Rules 2020 and 2010, "which are designed to prevent fraud and promote just and equitable principles of trade," are "consistent with the Exchange Act's purposes."[64] In finding Smith liable for these violations under Exchange Act Section 10(b), Rule 10b-5 thereunder, and FINRA's own rules, FINRA also applied these provisions consistently with the purposes of the Exchange Act.

III. Sanctions

Under Exchange Act Section 19(e)(2), we sustain FINRA sanctions unless we find that, giving due regard to the public interest and the protection of investors, the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[65] We consider evidence of any aggravating or mitigating factors, as well as whether the sanctions serve remedial rather than punitive purposes.[66] Although they are not binding on us, FINRA's Sanction Guidelines serve as a benchmark in our review.[67]

Smith does not assert, nor do we find, that FINRA's sanctions—a bar and an order of restitution—are excessive or oppressive or serve a punitive rather than remedial purpose.[68] At all events, Smith forfeited any challenge to the sanctions by failing to challenge FINRA's imposition of them or to argue that mitigating factors warrant lesser sanctions.[69]

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63 *See* 15 U.S.C. §§ 78c(a)(39)(F) & 78*o*(b)(4)(D) (including as a statutory disqualification from the securities industry willful violations of the federal securities laws).

64 *Ahmed*, 2017 WL 4335036, at *17.

65 15 U.S.C. § 78s(e)(2). Smith does not allege, nor does the record show, that the sanctions imposed create an unnecessary or inappropriate burden on competition.

66 *See Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007); *McCarthy v. SEC*, 406 F.3d 179, 188-91 (2d Cir. 2005).

67 *See, e.g.*, *John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 & n.68 (June 14, 2013).

68 *See, e.g.*, FINRA Sanction Guidelines, at 89 (2019), finra.org/sites/default/files/2020-10/2019_Sanctions_Guidelines.pdf (recommending bar for intentional or reckless omissions or misrepresentations of material fact unless mitigating factors predominate); *Gopi Krishna Vungarala*, Exchange Act Release No. 90476, 2020 WL 6867617, at *15 (Nov. 20, 2020) (sustaining FINRA bar based on fraudulent misrepresentations and omissions).

69 *See* Rule of Practice 420(c), 17 C.F.R. § 201.420(c) ("Any exception to a determination not supported in an opening brief that complies with [Rule 450(b)] may, at the discretion of the Commission, be deemed to have been waived by the applicant.").

An appropriate order will issue.[70]

By the Commission (Chair GENSLER and Commissioners PEIRCE, CRENSHAW, UYEDA and LIZÁRRAGA).

Vanessa A. Countryman
Secretary

[70] Because it would not significantly aid our decisional process, Smith's motion for oral argument is denied. *See* Rule of Practice 451(a), 17 C.F.R. § 201.451(a).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 100762 / August 19, 2024

Admin. Proc. File No. 3-20127

In the Matter of the Application of

ERIC S. SMITH

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by FINRA against Eric S. Smith is sustained.

By the Commission.

Vanessa A. Countryman
Secretary