

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2013038756502**

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

RE: The GMS Group, LLC, Respondent
Member Firm
CRD No. 8000

Carmine C. Capone
General Securities Sales Supervisor
CRD No. 1124455

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondents submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondents alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondents hereby accept and consent, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

GMS has been a FINRA member firm since 1979. The Firm is headquartered in Livingston, New Jersey. GMS currently has approximately 109 registered individuals and 7 branch offices.

Capone has been associated with GMS since August 1985. He obtained his Series 6 registration in April 1983 and his Series 7 registration in October 1984 while associated with other FINRA member firms. In May 1990, while associated with GMS, Capone received his Series 8 registration and became a General Securities Sales Supervisor. Capone has also received his Series 52, 53, and 63 licenses.

OVERVIEW

GMS, acting through Capone, failed to adequately supervise the sales practices of J.F., a registered representative who (i) recommended and engaged in unsuitable

trading in nontraditional ETFs in four customer accounts, in violation of NASD Rule 2310 (before July 9, 2012) and FINRA Rules 2010 and 2111 (on and after July 9, 2012); and (ii) exercised discretion without having obtained prior written authorization in fourteen customer accounts, in violation of NASD Conduct Rule 2510(b) and FINRA Rule 2010.

As a result of the foregoing conduct, GMS and Capone violated NASD Rule 3010(a) and (b), and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

NASD Rule 3010(a) requires member firms (and their supervisory personnel) to establish and maintain a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations.

NASD Rule 3010(b) requires that member firms (and their supervisory personnel) establish, maintain and enforce written procedures to supervise their business and registered representatives that are reasonably designed to achieve compliance with applicable securities laws and regulations. An individual to whom supervisory authority is delegated violates Rule 3010(b) by failing to carry out his or her properly delegated responsibilities.

FINRA Rule 2010 requires that member firms and associated persons “observe high standards of commercial honor and just and equitable principles of trade.” A violation of NASD Rule 3010 also constitutes a violation of FINRA Rule 2010.

Non-traditional ETFs

Exchange traded funds, or “ETFs,” are typically registered investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. Unlike traditional mutual funds, shares of ETFs typically trade throughout the day on a securities exchange at prices established by the market. Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Inverse ETFs (also called “short” funds) seek to deliver the opposite of the performance of the index or benchmark they track. Like traditional ETFs, some leveraged and inverse ETFs (known collectively as “nontraditional ETFs”) track broad indices, some are sector-specific, and others are linked to commodities, currencies, or some other benchmark.

To accomplish their objectives, nontraditional ETFs use swaps, futures contracts, and other derivative instruments. In addition, nontraditional ETFs are designed to achieve their stated objectives only over the course of one trading session. Between one trading session and the next, the fund manager must generally rebalance the fund’s holdings in order to meet its objective. For most nontraditional ETFs, this happens on a daily basis, and is known as the “daily reset.” For each day’s trading session, a nontraditional ETF may come close to achieving its intended returns. But the correlation between a nontraditional ETF

and its linked index or benchmark is inexact, and there is typically at least a small difference, or “tracking error,” between a fund and its benchmark, which may compound over longer periods of time. This effect becomes more pronounced during periods of volatility in the underlying index or benchmark.

Both NASD Rule 2310 and FINRA Rule 2111 require that registered representatives not only have a reasonable basis for recommending a security, but that they also conduct a customer-specific inquiry to ensure that the security is suitable for that particular customer. A registered representative lacks a reasonable basis to recommend a security to its customers if he fails to investigate the security's characteristics sufficiently to understand the potential risks and rewards of the transaction. Moreover, a security is not suitable from a customer-specific standpoint if it does not align with an investor's financial situation, risk tolerance, and investment objectives.

In June 2009, FINRA issued Regulatory Notice 09-31, which dealt specifically with nontraditional ETFs. Among other things, Regulatory Notice 09-31 reminded firms and associated persons of their obligation “to fully understand the products and transactions they recommend. With respect to leveraged and inverse ETFs, this means that a firm must understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective, and the impact that market volatility, the ETF's use of leverage, and the customer's intended holding period will have on their performance.” The Notice further noted that “[w]hile the customer-specific suitability analysis depends on the investor's particular circumstances, inverse and leveraged ETFs typically are not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets.”

Regulatory Notice 09-31 further states:

Firms must train registered persons about the terms, features and risks of all ETFs that they sell, as well as the factors that would make such products either suitable or unsuitable for certain investors. In the case of leveraged and inverse ETFs, that training should emphasize the need to understand and consider the risks associated with such products, including the investor's time horizons, and the impact of time and volatility on the fund's performance. Training for all persons should emphasize that, due to the complexity and structure of these funds, they may not perform over time in direct or inverse correlation to their underlying index. This is particularly important as many investors may be turning to these funds as part of a long-term strategy to weather current market conditions.

GMS' Written Supervisory Procedures ("WSPs") provide that "[i]nvestors in [nontraditional] types of ETFs must be willing to assume higher risk." They note performance on nontraditional ETFs "can differ significantly from the underlying index or benchmark," particularly in volatile markets. Accordingly, GMS' WSPs require designated supervisors to "[r]eview for suitability of recommended ETFs, particularly non-traditional ETFs," to "[c]onsult with RRs, where appropriate, when non-traditional ETFs are sold to individual investors," and to "[i]nclude ETFs in training, particularly for non-traditional ETFs."

J.F.'s Misconduct

J.F. and Capone were both employed by GMS at the firm's Boca Raton, Florida branch office. Capone was assigned by GMS to supervise J.F.'s activities as a registered representative acting on behalf of GMS.

Between October 1, 2011 and October 30, 2013 (the "Relevant Time Period"), J.F. revised the investment strategy that he was recommending for four customer accounts, each of which was owned by unsophisticated and retired investors with limited investment experience and a moderate risk tolerance. Previously, these customers had been primarily invested in corporate bonds and mutual funds. A major component of the revised strategy, however, was leveraged and inverse-leveraged ETFs, including Proshares Ultra S&P 500, Proshares Ultrashort S&P 500 and Direxion ETF Daily Gold Miners Bull 3X shares, as well as related exchange-traded notes, including Barclay's Ipath S&P 500 VIX Short Term Futures ETN and Credit Suisse Velocity Shares Daily Inverse VIX ETN. Moreover, J.F. employed the use of leverage in each of the four accounts, which further exacerbated the amount of risk of his revised strategy.

J.F. recommended these nontraditional ETF transactions without first conducting adequate due diligence concerning the unique features and specific risks of these products. Specifically, J.F. failed account for the compounding of risk associated with holding nontraditional ETFs overnight, and the fact that they are designed to achieve their stated objectives within a single trading day. As a result of this misapprehension of the risks associated with holding nontraditional ETFs overnight, J.F. routinely failed to sell these products on the same day he purchased them without conducting any analysis as to whether it was appropriate to hold the product for an extended period of time. Indeed, J.F. held nontraditional ETFs in the four customers' accounts for more than one trading day on 118 occasions.

J.F. also failed to conduct an adequate customer-specific suitability analysis with respect to the purchase and sale of nontraditional ETFs on behalf of these four customers:

- Customer A.W. is a retired and unsophisticated 70 year old investor, with limited investment experience. Her income is limited to her investment account and social security. Her stated risk tolerance was “moderate” and her specified investment objective was “total return.” J.F. purchased nontraditional ETFs on behalf of this customer on 70 occasions. Of these 70 purchases, J.F. held the product for one to seven days on 42 occasions, between eight and 30 days on five occasions, and longer than 31 days on five occasions. These transactions collectively resulted in more than \$92,000 in realized losses.
- Customers L.W. and M.G.K. (the same M.G.K. who is referenced below) are sisters who jointly held an account at GMS. L.W., who was the decision-maker with respect to this account, is a 72 year old retired homemaker with no independent investment experience. Her GMS account comprised her entire liquid net worth. The risk tolerance for this account was “moderate” and the assigned investment objective was “income.” J.F. purchased nontraditional ETFs on behalf of these customers on 27 occasions, and held the ETFs between one and seven days on 11 occasions, between eight and 30 days on three occasions and longer than 31 days on four occasions. These transactions collectively resulted in more than \$36,000 in realized losses.
- Customers J.K. and M.G.K. are a retired and unsophisticated married couple, ages 75 and 54, respectively. Their highest level of education is high school. Their stated risk tolerance was “moderate,” and they identified “income,” “long-term growth” and “total return” as their investment objectives. J.F. purchased nontraditional ETFs on behalf of these customers on 47 occasions, and held the ETFs between one and seven days on 26 occasions, between eight and 30 days on four occasions and longer than 31 days on four occasions. These transactions collectively resulted in nearly \$32,000 in realized losses.
- Customer J.K. (the sister of the J.K. referenced above) is a retired 65 year old former beauty salon owner who is also unsophisticated, with high school being her highest level of education. She has a “moderate” risk tolerance and an “income” investment objective. J.F. purchased nontraditional ETFs on behalf of this customer on 29 occasions, and held the ETFs between one and seven days on 13 occasions, between eight and 30 days on three occasions, and longer than 31 days on four occasions. These transactions collectively resulted in approximately \$10,000 in realized losses.

During his association with the Firm, J.F. also exercised discretion in customers’ accounts even though he was not approved to do so. Specifically, between October 2011 and October 2013, J.F. exercised discretion in fourteen accounts, including three of the four accounts referenced above. J.F. did not have the customers’ written authorization to effect the discretionary trades.

GMS and Capone Failed to Adequately Supervise J.F.

During the Relevant Period, GMS failed to establish and maintain a supervisory system designed to achieve compliance with applicable NASD and/or FINRA rules in connection with the sale of nontraditional ETFs.

GMS allowed J.F. to recommend and sell nontraditional ETFs, but did not adopt any supervisory controls to properly supervise these transactions. In addition, GMS did not provide any training to J.F. regarding nontraditional ETFs.

Moreover, GMS, acting through Capone, failed to adequately supervise J.F.'s sales practices. Specifically, GMS and Capone allowed J.F. to execute 173 purchases of non-traditional ETFs, even though J.F. did not have a reasonable basis to recommend these securities and they were unsuitable from a customer-specific perspective.

During the Relevant Time Period, GMS and Capone were on notice of numerous red flags that J.F. had a propensity to engage in unsuitable trading on behalf of his customers, including the following:

- J.F. had been subject to a heightened supervision plan since June 23, 2009, as a result of three customer complaints by senior investors alleging unsuitable transactions in reverse convertible and structured notes. This plan specifically required supervisory review of J.F.'s new accounts, order tickets, and correspondence, as well as a detailed review of J.F.'s five largest accounts based on gross production.
- The account for customer A.W. appeared on a quarterly "Commission Analysis" report in September, 2012, December 2012, and March 2013. The account for customers J.K. and M.G.K. also appeared on this report in December 2011. This report lists accounts that either have \$15,000 in commission income, or \$9,000 in commission income and at least 20 transactions.
- J.F.'s transactions in nontraditional ETFs generated numerous exception reports during the Relevant Time Period.
- Each of the four accounts referenced above noted that the customers' risk tolerance was "moderate," which was inconsistent with the purchases of nontraditional ETFs in the accounts. Moreover, all of the customers were retired senior citizens.

- Each of the four accounts at issue was highly active, with turnover ratios ranging between 8 and 41. The cost-to-equity ratio for A.W.'s account during the Relevant Time Period exceeded 25%.
- The four accounts at issue generated commissions of \$210,754 during the Relevant Time Period.

Despite the foregoing red flags, GMS, acting through Capone, failed to take adequate steps to supervise J.F.'s sales activities. Indeed, Capone only contacted one of the customers at issue, J.K., in 2012. During this conversation, Capone did not ascertain whether J.F. was exercising discretion in the customer's account, did not discuss the amount of commissions being generated, and did not communicate the unique and substantial risks associated with trading nontraditional ETFs. Capone never spoke with the other customers, including A.W., about the activity in their accounts.

Moreover, GMS, acting through Capone, did not take any steps, other than speaking with J.F., to ascertain whether J.F. was exercising discretion without written authorization in any of the fourteen accounts at issue. For instance, Capone did not contact any of the customers involved, and he did not review phone records to ensure that each transaction in these active accounts was being approved on the same business day as the trade.

Finally, GMS and Capone failed to enforce GMS's Written Supervisory Procedures, including: (i) ensuring that customers' investment objectives and risk tolerance were consistent with the transactions in their accounts and were updated when there was a change in status; (ii) including "ETFs in training and adequate supervisory reviews for transactions in nontraditional ETFs;" and (iii) reviewing for suitability for transactions in nontraditional ETFs.

By failing to appropriately supervise the sales practices of J.F., GMS and Capone violated NASD Rules 3010(a) and (b), and FINRA Rule 2010.

B. Respondents also consent to the imposition of the following sanctions:

GMS: A censure and a fine of \$75,000.

GMS agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. GMS has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

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

Capone: A suspension in all principal capacities from association with a FINRA member firm for thirty business days, and a fine of \$10,000.

Capone agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Capone has submitted an Election of Payment form showing the method by which he proposes to pay the fine imposed.

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

Capone understands that if he is barred or suspended from associating with any FINRA member in a principal capacity only, he becomes subject to a statutory disqualification as that term is defined in Article III, Section 4 of FINRA's By-Laws, incorporating Section 3(a)(39) of the Securities Exchange Act of 1934. Accordingly, he may not be associated with any FINRA member in a principal capacity, during the period of the bar or suspension (see FINRA Rules 8310 and 8311). Furthermore, because he is subject to a statutory disqualification during the principal capacity suspension, if he remains associated with a member firm in a non-suspended capacity, an application to continue that association may be required.

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondents specifically and voluntarily waive the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against them;
- B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondents specifically and voluntarily waive any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondents further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondents understand that:

- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against them; and
- C. If accepted:
 - 1. this AWC will become part of Respondents' permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against them;
 - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
 - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
 - 4. Respondents may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondents may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondents': (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondents may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondents understand that they may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement

does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it..

SEPTEMBER 25, 2015
Date

The GMS Group, LLC, Respondent

By: 

Name: TIMOTHY J. DONOHUE

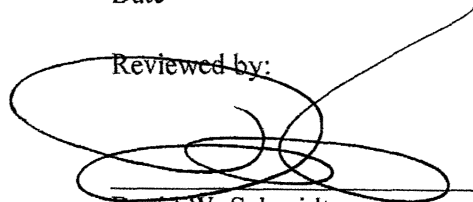
Title: EXECUTIVE V.P.

I certify that I have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that I have agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce me to submit it.

9/25/15
Date

Respondent Carmine C. Capone

Reviewed by:


David W. Schmidt
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Counsel for Respondents

does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it..

Date

The GMS Group, LLC, Respondent

By: _____

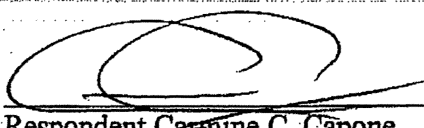
Name: _____

Title: _____

I certify that I have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that I have agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce me to submit it.

9/25/15

Date



Respondent Carmine C. Capone

Reviewed by:

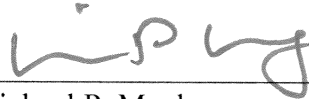
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Counsel for Respondents

Accepted by FINRA:

October 21, 2015
Date

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



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