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## CCO, CEO suspended for supervisory failures linked to fraudulent rep

Firm executives can end up in hot water if they provide insufficient resources to their compliance departments – and fail to follow-up when they delegate supervisory duties. That's the lesson from a recent **SEC** case against a San Francisco-based broker dealer and its CCO.

The case makes clear that if you're going to hire a rep with a disciplinary history and place him on heightened supervision, then you better make sure that rep is indeed supervised according to that plan.

The Commission found that the former CCO/General Counsel and the former CEO of **Merriman Curhan Ford & Co.** failed to adequately supervise a rep who gave a customer the account statements of several other customers so that the first customer could alter them. The first customer then fraudulently used those altered account statements as collateral to get more than $45 million in personal loans.

In a second scheme, the same rep engaged in fraudulent, unauthorized trading in several customer accounts to get commissions from those unauthorized trades. That rep, **D. Scott Cacchione**, pled guilty to criminal securities fraud charges on March 31.

Under a settlement with the SEC, the firm's former CCO/General Counsel, **Christopher Aguilar**, was suspended from serving in a supervisory capacity for 12 months and fined $40,000, and the firm's former CEO, **D. Jonathan Merriman**, was fined $100,000, and similarly suspended from serving in a supervisory capacity for 12 months.



"It's the latest of several cases where the SEC and FINRA have focused on whether firms have adequate resources to reasonably supervise," said attorney **Brian Rubin**, a partner in the Washington office of **Sutherland** who once worked at the SEC and **NASD**.

The case also demonstrates the hazards of CCOs acting in a supervisory capacity, said **Amy Lynch**, president of **FrontLine Compliance, LLC**, a regulatory compliance consulting firm based in Leesburg, Va. and New York.

"CCOs that are also supervisory principals that hold the Series 24 and have supervisory responsibilities for the firm are basically putting themselves in the direct line of fire," Lynch said.

### Other cases

Among other cases, FINRA last July fined Houston-based **NEXT Financial Group** $1 million and its former CCO **Karen Eyster** $35,000 for having an unworkable supervisory system that resulted in the firm not detecting churning (*BD Week*, July 27, 2009). And in late June, the SEC filed administrative charges against **Prime Capital Services** and its parent company, **Gilman Ciocia**, headquartered in Poughkeepsie, N.Y., alleging inadequate support for supervision and compliance regarding the sales of variable annuities to seniors. (Last summer, the lawyer representing the firm and several respondents in the case said the problems cited had been settled in a 2005 FINRA case.)

As for the Merriman case, the SEC noted the following:

In December 2005, Merriman recruited his friend Cacchione, who had a disciplinary history with **FINRA**.

Cacchione came on board as the Managing

*(Merriman case, continued on page 2)*

## Merriman *(cont. from pg. 1)*

Director of the firm's new Client Services Group. He also brought along a customer base of more than 100 retail brokerage accounts. That substantially boosted the limited retail customer base at the firm, which had mainly been focused on institutional customers. As part of the hiring agreement, Cacchione was supposed to complete the Series 24 exam. He didn't pass the exam during his two-year tenure at the firm, yet was still allowed to continue supervising registered reps, in violation of FINRA rules.

Merriman, Cachione's direct supervisor, delegated some of the supervisory responsibility to Aguilar. Aguilar placed Cacchione on a heightened supervision plan in December 2005 that called for the compliance department to review his e-mails and trading activity on a daily basis.

But Aguilar delegated that review function to his subordinate, who held the title "Compliance Manager." That person also was responsible for most of the daily compliance functions, including random e-mail reviews of more than 100 reps. At the time, the compliance department had no more than four compliance workers, some of whom were also responsible for general legal work.

"Despite the extra burden of having to review Cacchione's e-mails and trading, no new staff was added to the Merriman Firm's compliance department to assist with Cacchione's heightened review and the expansion of the retail business line and addition of the Client Services Group to the Merriman Firm," the SEC said. It added that Aguilar was inexperienced with dealing with retail clients, and that his employment with the firm was his first job in the brokerage industry.

### Unauthorized trading

Between March 2006 and October 2007, Cacchione engaged in a pattern of unauthorized trading in some of his customers' accounts, the SEC alleged. Several customers complained by e-mail to Cacchione, including an elderly widow who wanted to find out why the purchases were made and how they could be undone. Ultimately, she contacted Merriman, and the firm paid her a settlement for her losses. Aguilar was involved in preparing the settlement papers that resolved her claims.

The SEC found that "Merriman's delegation of responsibility to Aguilar was unreasonable…because he never followed up to ensure that Aguilar was supervising Cacchione." Merriman didn't follow up even after he learned of the elderly widow's complaint and other red flags, the SEC said. In addition, Merriman didn't know that Cacchione had been placed on heightened supervision even though he knew of Cacchione's disciplinary history.

### Turnover in compliance

In May 2007, after turnover in the compliance department, Aguilar didn't tell his newly hired compliance manager about the heightened review of Cacchione's email, and so that review no longer was done.

The SEC found that the firm failed to follow up

*(Merriman, continued on page 3)*

## Merriman *cont. from pg. 2)*

on red flags related to the unauthorized trading. As part of the firm's settlement with the SEC, the firm agreed to come up with a plan for allocating adequate resources to supervision and to hire a consultant – subject to SEC approval – to review the firm's written policies and procedures for supervision and to make recommendations for the firm to implement. In reaching the settlement, the SEC took into account prompt remedial action the firm took, including firing Cacchione, separating the role of CCO from the role of General Counsel, hiring a former FINRA examiner as the CCO, scaling back the firm's retail accounts, and refocusing the firm's business on institutions, research and investment banking. ■