

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011029635101**

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

**RE: Summit Brokerage Services, Inc.
CRD No. 34643**

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent, or Summit Brokerage Services, Inc. ("Summit"), submits 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 Respondent alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

- A. Respondent hereby accepts and consents, 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

Summit is a full service brokerage firm and has been a member of FINRA since 1994. The firm currently has approximately 300 branch offices and approximately 600 registered representatives. Summit has no prior relevant disciplinary history.

OVERVIEW

Between June 2009 and December 2010, Summit, by and through certain of its registered representatives, recommended leveraged and inverse exchange-traded funds (collectively, "nontraditional ETFs") to certain customers without fully understanding the features and risks associated with them. Specifically, Summit allowed their registered representatives to make unsuitable recommendations to purchase nontraditional ETFs to certain customers by failing to conduct adequate due diligence on the products. As a result of this conduct, Summit violated NASD Conduct Rule 2310 and FINRA Rule 2010.

Additionally, during the same time period, Summit failed to establish and maintain an adequate supervisory system, including written procedures, reasonably designed to ensure that the firm's sales of nontraditional ETFs were in compliance with applicable federal securities laws and NASD and FINRA rules. As a result of this conduct, Summit violated NASD Conduct Rule 3010 and FINRA Rule 2010.

FACTS AND VIOLATIVE CONDUCT

A. Nontraditional ETFs

Exchange-traded funds ("ETFs") are typically registered unit investment trusts or open-end investment companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. Unlike unit investment trusts or mutual funds, ETFs typically trade throughout the day on an exchange.

Nontraditional ETFs differ from traditional ETFs in that they seek to deliver multiples of the performance of the underlying index or benchmark, the inverse of that performance, or both. 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 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 return. However, 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. FINRA advised its membership in June 2009 in FINRA Regulatory Notice 09-31 concerning nontraditional ETFs that "[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance . . . of their underlying index or benchmark during the same period of time."¹ FINRA Regulatory Notice 09-31 further advised broker-dealers that nontraditional ETFs "are typically not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets."

B. Unsuitable Sales of Non-traditional ETFs by Summit Registered Representatives

NASD Conduct Rule 2310 requires that a broker-dealer and its registered representatives must have an "adequate and reasonable basis" for any

¹ FINRA Reg. Notice 09-31.

recommendation that they make.² This basis is a prerequisite to any recommendation, because “a broker cannot determine whether a recommendation is suitable for a particular customer unless he has a ‘reasonable basis’ to believe that the recommendation could be suitable for at least some customers.”³

A broker-dealer lacks a reasonable basis to recommend a security to its customers if it or its representatives fails to investigate the security’s characteristics sufficiently to understand the potential risks and rewards of the transaction. Thus, to satisfy NASD Rule 2310, a broker-dealer and its registered representatives must exercise due diligence to understand the nature of the recommended security. With respect to nontraditional 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 ETFs’ use of leverage, and the customer’s intended holding period will have on their performance.”⁴

As detailed below, Summit allowed its registered representatives to recommend nontraditional ETFs to Summit customers without conducting adequate due diligence on the products. Summit also did not provide adequate formal training to their representatives regarding non-traditional ETFs before permitting them to recommend the products to customers. As a result, Summit’s registered representatives were insufficiently informed regarding the unique features and specific risks associated with nontraditional ETFs.

Nonetheless, Summit, through certain of its registered representatives, recommended nontraditional ETFs to retail customers. From June 2009 through December 2010, these recommendations resulted in Summit’s retail customers buying and selling approximately \$250 million worth of nontraditional ETFs. Several customers with conservative investment objectives who bought one or more nontraditional ETFs based on recommendations made by Summit registered representatives, and who held those investments for longer periods of time, experienced net losses. One customer purchased a nontraditional ETF for \$11,100, held it for seven months and then sold it for \$6,500, which represents a loss of \$4,600. A second customer purchased two nontraditional ETFs in the amount of \$21,800, held them for seven months and then sold them for \$17,100, which represents a loss of \$4,700.

Based on the above, Summit, acting through several of its registered representatives, violated NASD Conduct Rule 2310 and FINRA Rule 2010.

² *FJ Kaufman and Co.*, 50 S.E.C. 164, 168 (1989).

³ *Id.*

⁴ FINRA Reg. Notice 09-31.

C. Supervision

NASD Conduct Rule 3010(a) states, in part, that each member shall establish and maintain a system to supervise the activities of each of its registered representatives, registered principals, and other associated persons, and that this system must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD and FINRA rules. Final responsibility for proper supervision rests with the member.

NASD Conduct Rule 3010(b)(1) states, in part, that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its registered representatives, registered principals, and other associated persons, and that these procedures must be reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable NASD and FINRA rules.

During the relevant time period, Summit failed to provide their registered representatives with adequate training specifically geared to nontraditional ETFs, before permitting them to recommend those products to customers. Further, the firm did not have specific procedures addressing nontraditional ETFs, including procedures to address the risks associated with longer-term holding periods in nontraditional ETFs, and procedures designed to monitor the holding periods.⁵

Based on the above, Summit violated NASD Conduct Rule 3010 and FINRA Rule 2010.

B. Respondent also consents to the imposition of the following sanctions:

A censure;

A fine in the amount of \$250,000; and

Restitution in the amount of \$9,556.84, plus interest, to the affected customers.

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

Restitution is ordered to be paid to the customers listed on Attachment A hereto in the total amount of \$9,556.84, plus interest, at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from date of misconduct, until the date this AWC is accepted by the NAC.

⁵ In December 2010, prior to any inquiry from FINRA, Summit amended its policies to prohibit representatives from recommending the purchase of non-traditional ETFs to customers unless authorized by Summit's Chief Compliance Officer.

A registered principal on behalf of Respondent firm shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to Richard A. March, FINRA Senior Regional Counsel, 55 West Monroe Street, Suite 2700, Chicago, Illinois 60603, either by letter that identifies the Respondent and the case number (20130362921) or by e-mail from a work-related account of the registered principal of Respondent firm to EnforcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days from the date the AWC is accepted, or such additional period agreed to by a FINRA staff member in writing, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to the FINRA staff member identified above and in the manner described above, within 14 days of forwarding the undistributed restitution and interest to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction herein, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

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

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

II.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against me;
- 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, Respondent specifically and voluntarily waives any right to claim bias or prejudice 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.

Respondent further specifically and voluntarily waives 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

Respondent understands 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 Respondent; and
- C. If accepted:
1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against Respondent;
 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. Respondent 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. Respondent 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 Respondent's: (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. Respondent may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it 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 Respondent, 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 Respondent 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 Respondent to submit it.

11/20/2015
Date



Summit Brokerage Services, Inc.

By: Fred G. Fram, Esq., CCO

Accepted by FINRA:

12-2-15
Date

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


Richard March
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FINRA Department of Enforcement
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ATTACHMENT A

Customer	Restitution Amount	Date Loss Incurred
1	\$4,614.33	September 14, 2010
2	\$4,751.91	September 14, 2010
3	\$190.60	June 1, 2010