

ORIGINAL NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS

DOUG LITTLE - Chairman
BOB STUMP
BOB BURNS
TOM FORESE
ANDY TOBIN

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AZ CORP COMMISSION
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Arizona Corporation Commission

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MAR 14 2016

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In the matter of:
David J. Escarcega (CRD no. 4367584), an
unmarried man,
Respondent.
S-20956A-16-0090

DOCKET NO. S-20956A-16-0090
NOTICE OF OPPORTUNITY FOR HEARING
REGARDING PROPOSED ORDER TO
CEASE AND DESIST, ORDER FOR
RESTITUTION, ORDER FOR
ADMINISTRATIVE PENALTIES, ORDER OF
REVOCATION, ORDER OF DENIAL, AND
ORDER FOR OTHER AFFIRMATIVE
ACTION

NOTICE: RESPONDENT HAS 10 DAYS TO REQUEST A HEARING
RESPONDENT HAS 30 DAYS TO FILE AN ANSWER

The Securities Division ("Division") of the Arizona Corporation Commission ("Commission")
alleges that respondent David J. Escarcega has engaged in acts, practices, and transactions that constitute
violations of the Securities Act of Arizona, A.R.S. § 44-1801 et seq. ("Securities Act") and the Arizona
Investment Management Act, A.R.S. § 44-3101 et seq. ("IM Act").

I.
JURISDICTION

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona
Constitution, the Securities Act, and the IM Act.

II.
RESPONDENT

2. David J. Escarcega ("Escarcega") was an Arizona resident at all relevant times, and he
has been an unmarried man since 2012.

3. From April 12, 2010, to September 13, 2013, and from September 17, 2013, to the
present, Escarcega has been registered by the Commission as a securities salesman with CRD no.

1 4367584, and employed by registered securities dealer Center Street Securities, Inc. (CRD no. 26898)
2 (“Dealer”).

3 4. On December 19, 2014, Escarcega filed an application with the Commission for
4 licensure as an investment advisor representative for Center Street Advisors, Inc. (CRD no. 169329).

5 5. On February 29, 2016, a panel of the Financial Industry Regulatory Authority’s
6 (“FINRA”) Office of Hearing Officers issued a decision ordering that Escarcega be indefinitely
7 barred from association with any FINRA member firm. This bar will not become effective until the
8 decision becomes a final decision, which will not occur until the latter of either 45 days after service
9 of the decision or the resolution of any appeal from the decision.

10 6. Escarcega has been licensed as an Arizona insurance producer since 2001.

11 **III.**

12 **FACTS**

13 7. In 2012, Escarcega’s securities Dealer approved a new securities product for sale. The
14 product was a debenture (“Debenture”) issued by the parent company of a life settlement company,
15 a company in the business of purchasing life insurance policies, servicing the policies, and collecting
16 the death benefits.

17 8. The Debentures were registered by the Commission as a special registration pursuant
18 to A.R.S. § 44-1845(B)(1). This special registration imposed specific suitability requirements
19 pursuant to A.A.C. R14-4-144(C) on sales of the Debentures within Arizona. Specifically, A.A.C.
20 R14-4-144(C) requires that the securities dealer have a reasonable belief that each investor has a
21 minimum net worth of \$350,000, or \$400,000 when combined with spouse, exclusive of home, home
22 furnishings, and automobiles (“relevant net worth”), and the investment must not exceed 10% of the
23 relevant net worth. Alternatively, the securities dealer must have a reasonable belief that the investor
24 had a minimum gross income in the prior year of \$150,000, or \$200,000 when combined with spouse,
25 and a reasonable expectation that the investor will have such income in the present year.

1 9. The documents Escarcega submitted to Dealer for the purchase of Debentures by the
2 Arizona investors identified below did not reflect any gross income over \$150,000 or \$200,000 when
3 combined with spouse.

4 10. The Debentures were a speculative investment involving a high degree of risk,
5 including the risk of losing the entire investment. The Debentures were illiquid and not suitable for
6 investors that had any need for liquidity before the maturity date. The Debentures were not listed on
7 any exchange. Although the issuer voluntarily redeemed some Debentures early, investors had no
8 right to require the issuer to redeem the Debentures before their maturity date except in cases of
9 death, bankruptcy, or total disability.

10 11. From 2012 to 2014, Escarcega sold a total of \$4,144,531.39 worth of Debentures to
11 53 investors and received net commissions in the amount of approximately \$147,908.15 from those
12 sales.

13 12. For investors who purchased Debentures from him, Escarcega prepared an account
14 application describing their approximate income and assets and their general investment objectives.
15 Escarcega also prepared a suitability form describing in more detail their income, assets, and the
16 percentage of their net worth to be invested in the Debenture. The suitability form also characterized
17 their investment objectives. The account applications and suitability forms categorized investment
18 objectives on the same scale of five categories: income, balanced/conservative growth, growth,
19 aggressive growth, or speculation.

20 13. Escarcega also prepared a switch letter for some investors, which was a form required
21 if the investor had liquidated, redeemed, or exchanged another investment within 30 days before
22 purchasing a Debenture.

23 ESCARCEGA'S MISREPRESENTATIONS

24 14. Married Arizona residents J.B. and D.B. invested \$117,000 in a Debenture through
25 Escarcega, representing over 29% of their relevant net worth and exceeding Arizona's 10%
26 suitability limit. These investors could not have afforded to lose their entire \$117,000 Debenture

1 investment. Escarcega misrepresented to them that the Debenture interest payments were guaranteed
2 and that the Debenture investment was safe. Escarcega also misrepresented to Dealer on the
3 suitability form he prepared that the investors had a \$635,000 net worth, including bonds and mutual
4 funds. Their actual net worth was less than \$400,000, and they did not own any bonds or mutual
5 funds.

6 15. Arizona resident P.B. invested \$103,000 in a Debenture through Escarcega,
7 representing at least 17% of his relevant net worth and exceeding Arizona's 10% suitability limit.
8 This investor could not have afforded to lose his entire \$103,000 Debenture investment. Escarcega
9 misrepresented to him that the Debenture was guaranteed against market losses.

10 16. Arizona resident R.L. invested \$99,000 in a Debenture through Escarcega,
11 representing at least 16% of his relevant net worth and exceeding Arizona's 10% suitability limit.
12 This investor could not have afforded to lose his entire \$99,000 Debenture investment. Although the
13 Debentures were a speculative investment involving a high degree of risk, the investor's account
14 application and suitability form indicated that his investment objectives were in the most conservative
15 category. Escarcega repeatedly misrepresented to the investor that the Debenture investment
16 involved minimal risk and also misrepresented that the investor could liquidate the Debenture at any
17 time. Escarcega also instructed this investor to sign blank forms for his Debenture investment that
18 Escarcega completed later.

19 17. Arizona resident K.L.K. invested \$65,500 in a Debenture through Escarcega,
20 representing at least 22% of his relevant net worth and exceeding Arizona's 10% suitability limit.
21 This investor could not have afforded to lose his entire \$65,500 Debenture investment. Escarcega
22 misrepresented to the investor that he could liquidate his Debenture investment at any time. As part
23 of the investor's application, Escarcega had him sign and date a blank switch letter that Escarcega
24 intended to complete later.

1 18. Arizona resident R.E. invested \$67,000 in a Debenture through Escarcega.
2 Escarcega's handwritten notes on the investor's switch letter misrepresented to the investor that the
3 Debenture would provide a "guaranteed income stream."

4 19. California residents N.J. and R.J. invested \$52,875.23 in a Debenture through
5 Escarcega. Escarcega's handwritten notes on the investors' switch letter misrepresented to the
6 investors that the Debenture would provide "guaranteed interest."

7 20. California resident C.M. invested \$117,000 in a Debenture through Escarcega.
8 Escarcega's handwritten notes on the investor's switch letter misrepresented to her that the Debenture
9 would "maximize ... liquidity" compared to her longer term but redeemable fixed annuity.

10 21. California resident N.Z. invested in two Debentures through Escarcega totaling
11 \$64,500. Escarcega's handwritten notes on the investor's switch letters misrepresented to her that the
12 Debentures would provide a "guaranteed rate of return" unlike her fixed indexed annuity.

13 UNSUITABLE INVESTMENTS

14 22. Married Arizona residents D.K. and K.K. invested in four Debentures through
15 Escarcega totaling \$500,000, representing at least 28% of their relevant net worth and exceeding
16 Arizona's 10% suitability limit.

17 23. Arizona resident N.H. invested \$329,500 in a Debenture through Escarcega,
18 representing at least 28% of her relevant net worth and exceeding Arizona's 10% suitability limit.

19 24. Arizona resident P.A.B. invested in two Debentures through Escarcega totaling
20 \$267,000, representing at least 26% of her relevant net worth and exceeding Arizona's 10%
21 suitability limit.

22 25. Arizona resident S.C. invested \$78,000 in a Debenture through Escarcega,
23 representing at least 15% of her relevant net worth and exceeding Arizona's 10% suitability limit.

24 26. Arizona resident M.D. invested in two Debentures through Escarcega totaling
25 \$111,000, representing at least 13% of his relevant net worth and exceeding Arizona's 10%
26 suitability limit.

1 27. Arizona resident A.M. invested \$87,000 in a Debenture through Escarcega,
2 representing at least 12% of his relevant net worth and exceeding Arizona's 10% suitability limit.

3 28. Although the investors were fortunate, and the Debentures have performed adequately
4 so far, Escarcega's unsuitable Debenture sales improperly exposed investors to the risk of
5 catastrophic losses.

6 29. For Arizona investors who exceeded the 10% of net worth suitability limit, the issuer
7 of the Debentures subsequently partially refunded principal to those investors to bring them within
8 the suitability limit based on the net worth listed on their suitability forms.

9 OTHER DISHONEST AND UNETHICAL PRACTICES

10 30. California resident N.G. invested \$25,000 in a Debenture through Escarcega.
11 Escarcega did not tell her about the risks of the Debentures, and his seminar falsely implied that they
12 were low risk. She told Escarcega that she wanted a secure investment with no risk, and she believed
13 the Debentures were very low risk.

14 31. California residents W.J. and S.M. invested in two Debentures through Escarcega
15 totaling \$156,300. As part of the investors' application, Escarcega had them sign and date a blank
16 switch letter that Escarcega intended to complete later.

17 32. Escarcega also had investors R.L. and K.L.K sign and date blank forms, as alleged in
18 paragraphs 16 and 17, above.

19 33. Escarcega falsified data on a Debenture suitability form for investors J.B. and D.B.,
20 as alleged in paragraphs 14, above.

21 34. Escarcega told his customers that the Debentures involved some risk factors, but he
22 did not tell any of his customers that the Debentures involved a high degree of risk.

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1 IV.

2 VIOLATION OF A.R.S. § 44-1991

3 (Fraud in Connection with the Offer or Sale of Securities)

4 35. In connection with the offer or sale of securities within or from Arizona, Respondent
5 directly or indirectly: (i) employed a device, scheme, or artifice to defraud; (ii) made untrue statements
6 of material fact or omitted to state material facts that were necessary in order to make the statements
7 made not misleading in light of the circumstances under which they were made; or (iii) engaged in
8 transactions, practices, or courses of business that operated or would operate as a fraud or deceit upon
9 offerees and investors. Respondent's conduct includes, but is not limited to, the following:

- 10 a) Misrepresenting to investors J.B., D.B., P.B., R.E., N.J., R.S., and N.Z. that the
11 Debentures provided guaranteed interest, income, or rate of return or a guarantee against market losses;
12 b) Misrepresenting to investors R.L., K.L.K., and C.M. that the Debentures could
13 be freely liquidated;
14 c) Misrepresenting to investor R.L. that the Debentures involved minimal risk; and
15 d) Misrepresenting to Dealer the assets and net worth of investors J.B. and D.B.

16 36. This conduct violates A.R.S. § 44-1991.

17 V.

18 REMEDIES PURSUANT TO A.R.S. § 44-1962

19 (Denial, Revocation, or Suspension of Registration of Salesman; Restitution, Penalties, or other
20 Affirmative Action)

21 37. Respondent Escarcega's conduct is grounds to revoke Escarcega's registration as a
22 securities salesman with the Commission pursuant to A.R.S. § 44-1962. Specifically, Escarcega:

- 23 a) Has violated A.R.S. § 44-1991 by fraud in connection with the offer or sale of
24 securities, within the meaning of A.R.S. § 44-1962(A)(2); and
25 b) Has engaged in dishonest or unethical practices in the securities industry, within
26 the meaning of A.R.S. § 44-1962(A)(10), including:

- 1 i) Recommending the sale of Debentures to investors J.B., D.B., P.B., R.L., K.L.K., D.K.,
- 2 K.K., N.H., P.A.B., S.C., M.D., A.M., and N.G. without reasonable grounds to believe the
- 3 Debentures were suitable for those investors, as defined by A.A.C. R14-4-130(A)(4);
- 4 ii) Conducting a sales presentation to investor N.G. in a deceptive or misleading fashion by
- 5 implying that the Debentures were low risk, as defined by A.A.C. R14-4-130(A)(20);
- 6 iii) Conducting sales presentations in a deceptive or misleading fashion to all of his Debenture
- 7 investors by telling them the Debentures involved some risk factors without explaining that
- 8 the Debentures involved a high degree of risk, as defined by A.A.C. R14-4-130(A)(20);
- 9 iv) Instructing investors R.L., K.L.K., W.J. and S.M. to sign and date blank forms for their
- 10 Debenture investments; and
- 11 v) Falsifying data on a Debenture suitability form for investors J.B. and D.B.

12 38. Respondent Escarcega's conduct is grounds to assess restitution, penalties, and/or take
13 appropriate affirmative action pursuant to A.R.S. § 44-1962. Specifically, Respondent Escarcega
14 engaged in dishonest or unethical practices in the securities industry, and this conduct is grounds for an
15 order assessing restitution and penalties.

16 **VI.**

17 **REMEDIES PURSUANT TO A.R.S. § 44-3201**

18 **(Denial, Revocation, or Suspension of Investment Adviser or Investment Adviser Representative**
19 **License; Restitution, Penalties, or other Affirmative Action)**

20 39. Respondent Escarcega's conduct is grounds to deny Escarcega's application as an
21 investment adviser representative with the Commission pursuant to A.R.S. § 44-3201. Specifically,
22 denial of Escarcega's application would be in the public interest, and Escarcega has engaged in
23 dishonest or unethical practices in the securities industry within the meaning of A.R.S. § 44-
24 3201(A)(13) by:

- 25 a) Committing fraud in connection with the offer or sale of securities, contrary to
- 26 A.R.S. § 44-1991;

IX.

ANSWER REQUIREMENT

Pursuant to A.A.C. R14-4-305, if Respondent requests a hearing, Respondent must deliver or mail an Answer to this Notice of Opportunity for Hearing to Docket Control, Arizona Corporation Commission, 1200 W. Washington, Phoenix, Arizona 85007, within 30 calendar days after the date of service of this Notice. Filing instructions may be obtained from Docket Control by calling (602) 542-3477 or on the Commission's Internet web site at <http://www.azcc.gov/divisions/hearings/docket.asp>.

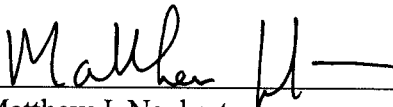
Additionally, the answering respondent must serve the Answer upon the Division. Pursuant to A.A.C. R14-4-303, service upon the Division may be made by mailing or by hand-delivering a copy of the Answer to the Division at 1300 West Washington, 3rd Floor, Phoenix, Arizona, 85007, addressed to Paul Kitchin.

The Answer shall contain an admission or denial of each allegation in this Notice and the original signature of the answering respondent or respondent's attorney. A statement of a lack of sufficient knowledge or information shall be considered a denial of an allegation. An allegation not denied shall be considered admitted.

When the answering respondent intends in good faith to deny only a part or a qualification of an allegation, the respondent shall specify that part or qualification of the allegation and shall admit the remainder. Respondent waives any affirmative defense not raised in the Answer.

The officer presiding over the hearing may grant relief from the requirement to file an Answer for good cause shown.

Dated this 14 day of March, 2016.


Matthew J. Neubert
Director of Securities