FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement, Complainant, v. Mercer Hicks III (CRD No. 245170), Respondent.	DISCIPLINARY PROCEEDING No. 2017052867301

COMPLAINT

The Department of Enforcement ("Enforcement") alleges:

SUMMARY

1. Between June 1, 2014 and July 31, 2017, Hicks made unsuitable recommendations to five senior customers (three of whom were widows) to purchase speculative non-traded real estate investment trusts ("REITs") and non-traded business development companies ("BDCs"). In addition, Hicks failed to conduct reasonable due diligence on the REITs and BDCs and failed to understand the risks and features associated with those investments before recommending them to his customers.

2. The prospectuses and subscription agreements for these non-traded REITs and non-traded BDCs stated that investing in these securities involved a high degree of risk, was speculative, was not suitable for persons who require immediate liquidity, guaranteed income, or seek short-term investments, and was only appropriate for those investors who could afford a complete loss of their investments.

3. But none of the five senior customers at issue in this case were seeking to make speculative, high-risk investments. When Hicks first recommended non-traded REITs and non-traded BDCs to them in 2014, their ages ranged between 73 and 87 years old. None of these customers were still working. The customers' account documents indicate that they were seeking either to preserve their capital or for their capital to appreciate. Some of these customers have encountered difficulties liquidating the investments to obtain funds that they needed to pay for medical care.

4. In the aggregate, Hicks recommended 18 purchases of unsuitable non-traded REITs and non-traded BDCs to the five senior customers totaling approximately $665,000. Hicks received a seven percent commission from each sale, totaling approximately $46,550.

5. Hicks' recommendations to these five senior customers were unsuitable in light of the customers' investment profiles including their investment objectives, financial situations and needs, risk tolerances and investment experiences.

6. In addition, Hicks failed to perform a reasonable investigation of the non-traded REITs and non-traded BDCs to understand the risks and features associated with these alternative investments before recommending them to the five senior customers. Therefore, Hicks lacked a reasonable basis to recommend the investments.

7. By recommending unsuitable investments to the five senior customers and failing to conduct reasonable due diligence on the investments, Hicks violated FINRA Rules 2111 and 2010.

RESPONDENT AND JURISDICTION

8. Hicks first entered the securities industry in 1972. In the past ten years, Hicks has been registered with FINRA through two member firms. From April 2009 through April 2014, he was registered as a General Securities Representative ("GSR") through Capital Investment Group Inc. (CRD No. 14752). Since April 2014, Hicks has been registered as a GSR through his association with Southeast Investments, N.C., Inc. (CRD No. 43035) ("Southeast" or the "Firm").

9. Hicks is currently registered with a FINRA member firm and is therefore subject to FINRA's jurisdiction.

STATEMENT OF FACTS

Hicks's Customers

10. Hicks finds his customers primarily by cold calling telephone numbers on club directories he obtains around his North Carolina community. Most of his customers are senior retirees with limited financial resources and knowledge.

11. Before he recommended non-traded REITs and non-traded BDCs, Hicks had recommended that four of his senior customers at issue here invest their funds in variable annuities, which had guaranteed income riders. In 2014, however, Hicks began recommending that these senior customers liquidate some or all of their variable annuities (at times incurring withdrawal penalties) to invest in non-traded REITs and non-traded BDCs.

REITs and BDCs

12. A REIT is a corporation, trust or association that owns or manages income-producing real estate. There are two types of public REITs: those that trade on a national securities exchange and those that do not. REITs in this latter category are generally referred to

as publicly registered non-exchange traded, or simply, non-traded REITs. Some of the major risks of non-traded REITs include illiquidity, restrictive early redemption of shares, high front-end costs and non-guaranteed distributions.

13. A BDC is a closed-end investment company that primarily invests in small and medium sized enterprises that cannot otherwise easily raise capital. As with non-traded REITs, non-traded BDCs are not traded on a national securities exchange. Non-traded BDC investments involve some of the same concerns as non-traded REITs and other private placements that expose investors to heightened levels of leverage and credit risk as well as illiquidity.

14. The prospectuses and subscription agreements for the non-traded REITs and non-traded BDCs that Hicks recommended to his customers stated that investing in these securities involved a high degree of risk, was speculative, was not suitable for persons who require immediate liquidity, guaranteed income, or seek short-term investments, and was only appropriate for those investors who can afford a complete loss of their investments.

Hicks Made Unsuitable Recommendations to Five Senior Customers

Customer TB

15. Customer TB is an 85-year old widow and retired minister living in North Carolina.

16. According to Southeast's new account documents for TB, dated June 20, 2014, her annual income was between $50,000 and $74,999, her liquid assets ranged between $150,000 and $249,999, and her net worth was approximately $650,000. TB's investment objective was marked as preservation of capital, her risk tolerance was conservative, and TB's investment knowledge was listed as low.

17. On or about December 23, 2014, Hicks recommended and purchased shares of Business Development Corporation of America ("BDCA"), a non-traded BDC, totaling $25,000 for TB.

18. The prospectus for BDCA disclosed that the investment "may be considered speculative and involves high degree of risk" and investors "may not have access to the money [they] invest for an indefinite period of time."

19. The prospectus and the subscription agreement for BDCA contained a disclosure for North Carolina residents that stated that BDCA required these residents to have either (i) a minimum liquid net worth and minimum annual gross income of $85,000, respectively or (ii) a minimum liquid net worth of $300,000.

20. TB's annual income was less than the $85,000 threshold for North Carolina residents to invest in BDCA. In addition, TB's liquid net worth was less than the $300,000 threshold for North Carolina residents to invest in BDCA. TB, therefore, did not meet the minimum suitability requirements to invest in BDCA.

21. The investment Hicks recommended to TB in BDCA was unsuitable based on TB's investment profile, including her financial situation, risk tolerance and investment objective.

<u>Customer NC</u>

22. Customer NC, an 85-year old retired teacher and widow living in North Carolina, had been a customer with Hicks for over 20 years.

23. The financial information listed on NC's new account documents was inaccurate in that the listed amounts for her net worth (over $500,000) and liquid net worth ($100,000-

$500,000) were inflated. NC's net worth was approximately $310,000 and her liquid net worth was considerably less than that. NC's annual income was approximately $35,000.

24. NC's investment objective was marked as income, her risk tolerance was moderate, and her investment knowledge was listed as good.

25. On or about November 5, 2014, Hicks recommended and purchased shares of BDCA totaling $27,600 for NC. NC withdrew the funds to invest in BDCA from a variable annuity with a guaranteed income rider that Hicks recommended and purchased for NC several years earlier.

26. NC's annual income was less than the $85,000 threshold for North Carolina residents to invest in BDCA. In addition, NC's liquid net worth was less than the $300,000 threshold for North Carolina residents to invest in BDCA. NC, therefore, did not meet the minimum suitability requirements to invest in BDCA.

27. On or about June 17, 2015, Hicks recommended and purchased shares of American Realty Finance Trust ("ARC Finance"), a non-traded REIT, totaling $15,000 for NC. The prospectus and the subscription agreement for ARC Finance disclosed that the investment involved a "high degree of risk," was illiquid and not suitable for investors seeking guaranteed income.

28. The investments Hicks recommended to NC in BDCA and ARC Finance were unsuitable based on NC's investment profile, including her financial situation, risk tolerance and investment objective.

Customer MM

29. Customer MM is a 92-year old retired widow who was diagnosed with dementia in 2017 and resides in an assisted-living nursing home. MM had been a customer of Hicks since 2010.

30. According to Southeast's account documents for MM, dated July 8, 2014, her annual income was between $25,000 and $50,000, her liquid assets ranged between $100,000 and $500,000, and her net worth was over $500,000. MM's investment objective was marked as capital appreciation, her risk tolerance was moderate, and MM's investment knowledge was listed as good.

31. In later account documents, dated June 2, 2015, her annual income was identified as between $25,000 and $50,000, her liquid assets ranged between $100,000 and $150,000, and her net worth was between $250,000 and $500,000. MM's investment objective was marked as capital appreciation, her risk tolerance was moderate, and MM's investment knowledge was listed as moderate.

32. MM's net worth, however, was actually under $200,000 and her liquid net worth was less than $100,000, at the time of the investments described below.

33. On or about July 12, 2014, Hicks recommended and purchased shares of American Realty Finance Retail Centers of America ("ARC Retail"), a non-traded REIT, in the amount of $37,900 for MM. The prospectus and the subscription agreement for ARC Retail disclosed that the investment involved a "high degree of risk", was illiquid and not suitable for investors seeking guaranteed income. MM withdrew the funds for this investment from a variable annuity with a guaranteed income rider that Hicks recommended and purchased for her several years earlier.

34. On or about June 10, 2015, Hicks recommended and purchased shares of American Realty Capital New York Recovery REIT, Inc. ("ARC New York"), a non-traded REIT, in the amount of $12,500 for MM. The prospectus and the subscription agreement for ARC New York disclosed that the investment involved a "high degree of risk," was illiquid and not suitable for investors seeking guaranteed income.

35. The prospectuses and subscription agreements for ARC Retail and ARC New York required investors to have either (i) a minimum net worth (excluding the value of the purchaser's home) and minimum annual gross income of $70,000 each, or (ii) a minimum net worth (excluding the value of a purchaser's home) of $250,000.

36. MM did not meet the suitability standards as prescribed in the prospectuses and subscription agreements for either REIT purchase because her annual income and net worth were below the requirements.

37. Hicks's recommendations of approximately $50,000 in non-traded REITs to MM resulted in an excessive concentration of MM's liquid net worth in those investments.

38. The investments Hicks recommended to MM in ARC Retail and ARC New York were unsuitable based on MM's investment profile, including her financial situation, risk tolerance and investment objective.

Customer NM

39. Customer NM was Hicks's customer for approximately eight years prior to her death in August 2018 at the age of 86.

40. According to Southeast's account documents for NM, dated June 9, 2014, her annual income was between $50,000 and $100,000, her liquid assets were over $500,000, and

her net worth was over $500,000. NM's investment objective was marked as capital appreciation, her risk tolerance was moderate, and her investment knowledge was listed as good.

41. Later account documents for NM, dated July 20, 2017, reflect an annual income for NM of $75,000 and much greater amounts for her net worth ($1.6 million) and liquid net worth ($1.1 million) than reflected on the June 2014 account forms.

42. NM's liquid net worth was inflated on the July 2017 Southeast account documents.

43. Between June 2014 and July 2017, Hicks recommended and made eight non-traded REIT purchases for NM totaling $459,272.39.

44. The funds for five of these investments came from withdrawals from a variable annuity Hicks recommended in July 2010. The variable annuity had a guaranteed lifetime income benefit.

45. On or about June 9, 2014, Hicks recommended and purchased shares of American Realty Capital Global Trust, Inc. ("ARC Global"), a non-traded REIT, in the amount of $53,850 for NM.

46. On or about July 29, 2014, Hicks recommended and purchased shares of ARC Retail in the amount of $39,800 for NM.

47. On or about December 19, 2014, Hicks recommended and purchased shares of ARC New York in the amount of $60,000 for NM.

48. On or about July 27, 2015, Hicks recommended and purchased shares of Phillips Edison Grocery Center REIT II, Inc. ("Phillips Edison"), a non-traded REIT, in the amount of $50,693 for NM.

49. On or about August 28, 2015, Hicks recommended and purchased shares of American Realty Capital Hospitality Trust Inc. ("ARC Hospitality"), a non-traded REIT, in the amount of $40,000 for NM.

50. On or about June 22, 2016, Hicks recommended and purchased shares of Steadfast Apartment REIT, Inc. ("Steadfast"), a non-traded REIT, in the amount of $30,000 for NM.

51. On or about July 17, 2017, Hicks recommended and purchased shares of Steadfast in the amount of $60,929.39 for NM.

52. On or about July 21, 2017, Hicks recommended and purchased shares of Steadfast in the amount of $124,000 for NM.

53. The risk factors identified in the prospectuses and the subscription agreements were similar for each of these non-traded REITs. The prospectuses and the subscription agreements disclosed that the investments involved a "high degree of risk", were illiquid and not suitable for investors seeking guaranteed income.

54. Hicks's recommendations of approximately $459,000 in non-traded REITs to NM resulted in an excessive concentration of NM's liquid net worth in those investments.

55. The investments Hicks recommended to NM in ARC Global, ARC Retail, ARC New York, Phillips Edison, ARC Hospitality and Steadfast were unsuitable based on NM's investment profile, including her financial situation, risk tolerance and investment objective.

<u>Customer RT</u>

56. Customer RT, a 78-year old retired school teacher living in North Carolina, had been a customer of Hicks for approximately 10 years but closed her account in 2018.

57. According to Southeast's new account documents for RT, dated June 18, 2014, her annual income was between $25,000 and $49,999, her liquid assets ranged between $100,000 and $149,999, and her net worth ranged between $250,000 and $499,999. RT's investment objective was marked as preservation of capital, her risk tolerance was moderate, and RT's investment knowledge was listed as low.

58. Between July 2014 and April 2015, Hicks recommended and made five non-traded REIT purchases for RT totaling $87,683.

59. On or about July 9, 2014, Hicks recommended and purchased shares of American Realty Capital Healthcare Trust II, Inc. ("ARC Healthcare"), a non-traded REIT, in the amount of $25,000 for RT.

60. On or about July 9, 2014, Hicks recommended and purchased shares of ARC Retail in the amount of $25,000 for RT.

61. On or about March 31, 2015, Hicks recommended and purchased shares of ARC New York in the amount of $10,000 for RT.

62. On or about April 13, 2015, Hicks recommended and purchased shares of ARC New York in the amount of $5,000 for RT.

63. On or about April 13, 2015, Hicks recommended and purchased shares of ARC New York in the amount of $22,683 for RT.

64. The risk factors identified in the prospectuses and the subscription agreements were similar for each of these non-traded REITs. The prospectuses and the subscription agreements disclosed that the investments involved a "high degree of risk", were illiquid and not suitable for investors seeking guaranteed income.

65. The prospectuses and subscription agreements for ARC Healthcare, ARC Retail and ARC New York required investors to have either (i) a minimum net worth (excluding the value of the purchaser's home) and minimum annual gross income of $70,000 each, or (ii) a minimum net worth (excluding the value of a purchaser's home) of $250,000.

66. RT did not meet the minimum suitability standards as prescribed in the prospectuses and subscription agreements for any of the REIT purchases because her annual income and liquid net worth were below the requirements.

67. Hicks's recommendations of approximately $87,000 in non-traded REITs to RT resulted in an excessive concentration of RT's liquid net worth in those investments.

68. The investments Hicks recommended to RT in ARC Healthcare, ARC Retail and ARC New York were unsuitable based on RT's investment profile, including her financial situation, risk tolerance and investment objective.

Hicks Failed to Perform Reasonable Due Diligence
on the Non-Traded REITs and Non-Traded BDCs He Recommended

69. Hicks failed to perform reasonable due diligence on the non-traded REITs and non-traded BDCs that he recommended to the five senior customers. Hicks admitted in on the record testimony that he merely "glance[d] over" prospectuses and otherwise left due diligence to "the compliance people for the firms [he] worked for." Hicks stated that he relied upon his Firm's due diligence but was unaware what, if any, due diligence Southeast performed.

70. Notwithstanding that the prospectuses for the non-traded REITs Hicks recommended warned that the investments had a high degree of risk and that investors should be able to afford a complete investment loss, Hicks considered them low risk. Hicks's view was based on the fact that he "trusted them more than [he] did the stock market."

71. Hicks recommended BDCA to two of his senior customers—TB and NC. BDCA is a non-traded BDC that primarily invests in the debt and equity of middle market companies. At the time Hicks recommended BDCA, he believed that BDCA was a REIT and did not understand there was a distinction between a REIT and a BDC. Hicks also was unaware at the time he recommended the investment that BDCA invested in the debt and equity of middle market companies, as opposed to making real estate-related investments.

FIRST CAUSE OF ACTION
Hicks Made Unsuitable Recommendations to Five Senior Customers
(Violations of FINRA Rules 2111 and 2010)

72. Enforcement re-alleges and incorporates by reference paragraphs 1 through 71 above.

73. FINRA Rule 2111(a) states that "[a] member or associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."

74. The Supplementary Material at FINRA Rule 2111.05(b) states that the "customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a)."

75. FINRA Rule 2010 requires FINRA member firms and associated persons to "observe high standards of commercial honor and just and equitable principles of trade." A violation of FINRA Rule 2111 constitutes a violation of FINRA Rule 2010.

76. Hicks's recommendations of non-traded REITs and non-traded BDCs were unsuitable for his customers TB, NC, MM, NM and RT, all of whom were senior investors with either conservative or moderate risk tolerances. Most of these retired senior customers had limited financial resources and all of them had limited investment knowledge and were seeking to either preserve their capital or for their capital to appreciate.

77. Hicks's recommendations that his customers MM, NM and RT invest in non-traded REITs and non-traded BDCs also were unsuitable because the recommendations resulted in those customers being over-concentrated in speculative, illiquid investments. The excessive concentrations were unsuitable in light of the customers' investment profiles, including their financial situations, risk tolerances and investment objectives.

78. Based on the foregoing, Hicks violated FINRA Rules 2111 and 2010.

SECOND CAUSE OF ACTION
Hicks Lacked a Reasonable Basis to Recommend Non-Traded REITs and Non-Traded BDCs
(Violations of FINRA Rules 2111 and 2010)

79. Enforcement re-alleges and incorporates by reference paragraphs 1 through 78 above.

80. The Supplementary Material at FINRA Rule 2111.05(a) states that "[t]he reasonable-basis obligation requires a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the

member's or associated person's familiarity with the security or investment strategy. A member's or associated person's reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule."

81. FINRA Rule 2010 requires FINRA member firms and associated persons to "observe high standards of commercial honor and just and equitable principles of trade." A violation of FINRA Rule 2111 constitutes a violation of FINRA Rule 2010.

82. Hicks failed to perform reasonable diligence with respect to the non-traded REITs and non-traded BDCs that he recommended to his customers. Hicks performed a limited review of the prospectuses and, although he claimed to rely on the due diligence conducted by Southeast, he was unaware of what, if any, diligence Southeast conducted.

83. Hicks did not understand the risks and features of the non-traded REITs and non-traded BDCs he recommended. For example, contrary to the statements in the prospectuses, Hicks believed that the non-traded REITs he recommended were low risk. Hicks also failed to understand the distinction between non-traded REITs and non-traded BDCs and believed that BDCs invested in real estate, as opposed to making investments in the debt and equity of middle market companies.

84. Based on the foregoing, Hicks violated FINRA Rules 2111 and 2010.

RELIEF REQUESTED

WHEREFORE, Enforcement respectfully requests that the Panel:

A. make findings of fact and conclusions of law that Respondent committed the violations charged and alleged herein;

B. order that one or more of the sanctions provided under FINRA Rule 8310(a) be imposed, including that Respondent be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest; and

C. order that Respondent bears such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.

FINRA DEPARTMENT OF ENFORCEMENT

Date: 12/20/2019

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GOVERNING RULES: You are directed to FINRA Rule 9000 *et seq.*—available at http://finra.complinet.com—for additional pertinent rules governing these proceedings.

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Enclosure: Complaint