FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT
NO. 2019063821607

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

RE: Joseph Stone Capital L.L.C. (Respondent)
Member Firm
CRD No. 159744

Pursuant to FINRA Rule 9216, Respondent Joseph Stone Capital, L.L.C. 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 in this AWC.

I.

ACCEPTANCE AND CONSENT

A. Respondent accepts and consents to the following findings by FINRA without admitting or denying them:

BACKGROUND

Joseph Stone has been a FINRA member since February 2013. The firm, which has its headquarters in Mineola, New York, has 35 registered representatives working out of four branch offices, primarily in the New York metropolitan area.[1]

OVERVIEW

From January 2015 through June 2020, Joseph Stone failed to establish, maintain, and enforce a supervisory system, including written supervisory procedures (WSPs), reasonably designed to achieve compliance with the suitability requirements of FINRA Rule 2111 as they pertain to excessive trading. As a result, Joseph Stone failed to identify or reasonably respond to red flags of excessive trading in 25 customer accounts that caused the customers to pay more than $1,037,000 in commissions, fees, and margin interest. By this conduct, Joseph Stone violated FINRA Rules 3110(a) and (b) and FINRA Rule 2010.

[1] For more information about the firm, including prior regulatory events, visit BrokerCheck® at www.finra.org/brokercheck.

FACTS AND VIOLATIVE CONDUCT

A. The Applicable Rules

FINRA Rule 3110(a) requires that member firms "establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules." FINRA Rule 3110(b) requires that each FINRA member "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable FINRA Rules." To comply with these obligations, a firm must reasonably investigate red flags of potential misconduct and take appropriate action when misconduct has occurred. A violation of FINRA Rule 3110 also constitutes a violation of FINRA Rule 2010, which requires that member firms "observe high standards of commercial honor and just and equitable principles of trade" in the conduct of their business.

FINRA Rule 2111 requires that member firms and their associated persons "have a reasonable basis to believe that a recommended securities transaction or investment strategy involving a security or securities is suitable for the customer, based on information obtained through the reasonable diligence of the firm or associated person to ascertain the customer's investment profile." The rule imposes a "quantitative suitability" obligation that requires a member or associated person who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended securities transactions are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.

FINRA Rule 2111 Supplementary Material .05 (Rule 2111.05) states that "[n]o single test defines excessive activity, but factors such as the turnover rate, the cost-to-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation."

Turnover rate represents the number of times that a portfolio of securities is exchanged for another portfolio of securities. The cost-to-equity ratio measures the amount an account must appreciate just to cover commissions and other expenses. In other words, it is the break-even point where a customer may begin to see a return. A turnover rate above six or a cost-to-equity ratio above 20 percent generally indicates that an account has been excessively traded.

B. Joseph Stone failed to establish and maintain a supervisory system, and failed to establish, maintain, and enforce WSPs, that were reasonably designed to achieve compliance with FINRA's suitability rule.

From January 2015 through June 2020, Joseph Stone's WSPs did not provide reasonable guidance about how to identify accounts that were being excessively traded. The WSPs directed that one of the firm's principals review "actively traded accounts" by

considering "a calculation of Year to Date Cost Over Equity Ratio [in a customer's account] . . . as well as the number of trades in a time period (quarterly & Year to Date) and the client's [investment] objectives, risk tolerance, [and] experience as well as any other criteria deemed applicable by the reviewer." However, the WSPs did not provide guidance about how to apply those factors to identify accounts that were being excessively traded. For example, the WSPs did not identify what cost-to-equity ratio or turnover rate should trigger a further review until May 2019, when the firm revised its WSPs to reflect that a cost-to-equity ratio of greater than 20 percent or a turnover rate of six or more would be considered red flags of excessive trading that might require further action as the facts and circumstances dictate. Moreover, the WSPs did not provide reasonable guidance about what steps supervisors should take after identifying an account that was being excessively traded. For example, although the WSPs stated that supervisors should consider contacting customers with actively traded accounts, the WSPs did not provide guidance on when such contact was recommended. The WSPs also did not specify whether, or in what circumstances, supervisors at the firm should consider restricting the commissions that could be charged in a customer's account.

Additionally, during the same period, Joseph Stone's system for identifying excessively traded accounts was not reasonably designed. During the relevant period, Joseph Stone received exception reports through an online portal created by the firm's clearing firm, including an "active account report" that flagged accounts with high commission-to-equity ratios. However, prior to November 2017, the firm did not require the designated principal responsible for reviewing actively traded accounts to regularly review the active account reports. Instead, the designated principal attempted to identify excessively traded accounts based on his own manual calculations, which compared the commissions charged in an account to the account's current value, rather than its average net equity, and which often understated the cost-to-equity ratio.[2]

As a result of this manual review, the firm failed on numerous occasions to identify accounts that had red flags of excessive trading, including accounts with cost-to-equity ratios greater than 20 percent. For example:

- Joseph Stone received an active account report dated October 31, 2017, that showed Customer A had been charged more than $12,000 in commissions in the 10 months since the account was opened, resulting in a cost-to-equity ratio of more than 27 percent. The firm's designated principal did not review that report, and the firm principal instead erroneously calculated the account's cost-to-equity ratio as 14 percent. Because Joseph Stone failed to identify the excessive trading in Customer A's account, the firm did not take any steps to address it. Customer A was thereafter charged more than $10,000 in additional commissions until April 2018, when Customer A closed his account. Over the life of the account, the recommended trades

[2] In a separate AWC with FINRA, the principal at the firm responsible for reviewing actively traded accounts consented to findings that he failed to reasonably supervise customer accounts for potentially excessive trading, in violation of FINRA Rules 3110 and 2010. As part of the settlement, the principal consented to sanctions including a five-month suspension in all principal capacities, a $5,000 fine, and 20 hours of continuing education.

in Customer A's account resulted in an annualized cost-to-equity ratio of more than 44 percent and an annualized turnover rate of more than 13.

- Joseph Stone received an active account report dated April 30, 2016, that showed Customer B had been charged more than $4,000 in commissions in the three months since the account was opened, resulting in a cost-to-equity ratio of more than 21 percent. Joseph Stone's designated principal for reviewing actively traded accounts did not review this report and did not review trading in Customer B's account at all until December 2016, at which point the firm imposed a commission restriction on the account. By that time, however, Customer B had been charged over $19,000 in commissions in the ten months the account had been open, resulting in a cost-to-equity ratio in excess of 77 percent. Over the life of the account, the recommended trades in Customer B's account resulted in an annualized cost-to-equity ratio of more than 74 percent and an annualized turnover rate of more than 17.

Joseph Stone's system for responding to red flags of excessive trading also was unreasonable, both before and after the firm began using exception reports in November 2017 to identify excessively traded accounts. When Joseph Stone identified an account with red flags of excessive trading, the designated principal for reviewing actively traded accounts frequently restricted the commissions that the firm's representatives could charge the account going forward. However, the commission restrictions, in a number of instances, did not become effective until a month after the firm determined they were necessary, which allowed representatives to continue charging unrestricted commissions after the firm had determined that commissions should be restricted. In addition, the restrictions did not limit the number or frequency of trades or aggregate costs and commissions that could be charged to the affected accounts. As a result, after a restriction was in effect limiting the amount of commissions that could be charged for each individual trade, representatives were not prevented from placing more frequent trades in a customer's account, thus earning commissions on a higher number of trades. The firm also did not restrict commissions on certain trades where the customer made a realized gain, irrespective of the account's overall performance or the overall amount of commissions that had been charged. As a result, Joseph Stone customers were charged thousands of dollars in commissions even after their accounts had been flagged for excessive trading.

For example, in December 2016, Joseph Stone restricted the commissions that could be charged on trades in Customer C's account to a maximum of 1.5 percent on any purchase and no commission on any sale that resulted in a realized loss. At that time, the customer's cost-to-equity ratio was 20 percent for the six months the account had been open. Although the firm imposed progressively more stringent restrictions on the commissions Customer C could be charged on purchases, the firm never restricted the commissions that Customer C's representative could charge on sales that resulted in a realized gain. Between January 2017 and November 2019, Customer C was charged over $70,000 in commissions, primarily on individual sales where the customer realized a gain. Notwithstanding the commission restrictions imposed, the recommended trades in Customer C's account resulted in an annualized cost-to-equity ratio of more than 34 percent over the life of the account.

Finally, Joseph Stone did not have a reasonable system for enforcing the commission restrictions that it imposed or keeping track of what restrictions had been imposed. In fact, the firm lacked any automated system for enforcing commission restrictions that the designated principal had imposed, and instead relied on branch managers to monitor commission restrictions by reviewing trade blotters. On several occasions, the firm's representatives charged commissions that substantially exceeded restrictions the firm imposed.

As a result of these supervisory failures, Joseph Stone failed to identify or address red flags of excessive trading in 25 customer accounts handled by 15 registered representatives. The trades recommended in such accounts resulted in annualized turnover rates ranging from 6 to 57 and annualized cost-to-equity ratios ranging from 21 percent to 96 percent, making it unlikely that the customers' accounts would reach their break-even points or earn a positive return. Collectively, the trading caused the customers to pay over $1 million in commissions, fees, and margin interest.

By this conduct, Respondent violated FINRA Rules 3110(a) and (b) and FINRA Rule 2010.

B. Respondent also consents to the imposition of the following sanctions:[3]

- a censure;
- restitution of $825,607.59;[4]
- an undertaking that within 90 days of notice that this AWC has been accepted, a registered principal of Respondent shall certify in writing to Kerry Land, Senior Counsel, FINRA Department of Enforcement, Brookfield Place, 200 Liberty Street, 11th Floor, New York, NY 10281 (kerry.land@finra.org), that the firm has implemented a reasonable heightened supervision plan for the five registered representatives who are still associated with the firm and had customers who are the subject of this AWC and will maintain the plan for a period of no less than two years;[5] and

[3] Pursuant to the General Principles Applicable to all Sanction Determinations contained in the *Sanction Guidelines*, FINRA imposed no fine against the firm or pre-judgment interest on the restitution ordered in this case after it considered, among other things, the firm's revenues and financial resources, as well as its agreement to pay full restitution to the affected customers. *See* Notice to Members 06-55.

[4] Certain Joseph Stone registered representatives have already paid restitution in the amount of $211,487.71 to customers pursuant to other AWCs connected to this matter. This AWC orders restitution in the amount of $825,607.59, which includes the total costs (commissions, fees, and margin interest) paid by customers whose accounts were excessively traded ($1,037,095.30) minus the restitution already paid pursuant to other AWCs connected to this matter.

[5] Heightened supervision is ordered for the five representatives who remain registered through Joseph Stone and who handled certain of the customer accounts that are the subject of this AWC. The registered representatives are identified in Attachment B.

- an undertaking that within 90 days of notice that this AWC has been accepted, a registered principal of Respondent shall certify in writing to Kerry Land, Senior Counsel, FINRA Department of Enforcement, Brookfield Place, 200 Liberty Street, 11th Floor, New York, NY 10281 (kerry.land@finra.org), that the firm has adopted and implemented policies, procedures, and systems to address the violations described above, including identifying and responding to red flags of potentially excessive trading.

Restitution is ordered to be paid to the customers designated on Attachment A to this AWC in the total amount of $825,607.59.

A registered principal on behalf of Respondent shall submit satisfactory proof of payment of restitution (separately specifying the date and amount paid to each customer designated on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent. The email must identify Respondent and the case number and include a copy of the check, money order, or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 days after the date of the notice of 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 after the date of the notice of acceptance of the AWC, or such additional period agreed to by FINRA in writing, Respondent shall forward any undistributed restitution 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 FINRA in the manner described above, within 14 calendar days of forwarding the undistributed restitution to the appropriate state authority.

Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

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

Restitution payments to customers shall be preceded or accompanied by a letter, not unacceptable to FINRA, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

Respondent has demonstrated a limited ability to pay. In light of Respondent's financial status, the sanctions do not include a monetary fine or pre-judgment interest on the restitution ordered.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

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 it;

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 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 its acceptance or rejection.

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 action 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 its subject matter 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 right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party. Nothing in this provision affects Respondent's testimonial obligations in any litigation or other legal proceedings.

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.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's 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 the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

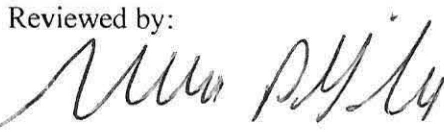
8-12-22
Date

Joseph Stone Capital L.L.C.
Respondent

Print Name: Damiano Maggio

Title: Ceo

Reviewed by:



Michael P. Gilmore, Esq.
Counsel for Respondent
Moss & Gilmore LLP
129 Third St.
Mineola, NY 11501

Accepted by FINRA:

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

September 8, 2022
Date

Kerry J. Land
Senior Counsel
FINRA
Department of Enforcement
Brookfield Place, 200 Liberty Street - 11th Floor
New York, NY 10281

Joshua J. Bone
Principal Counsel
FINRA
Department of Enforcement
99 High St. #900
Boston, MA 02110

Attachment A (Public Version)

Ordered restitution:

Customer	Ordered Restitution Amount
Customer A	$34,566.82
Customer B	$24,428.20
Customer C	$128,788.99
Customer D	$8,062.99
Customer E	$9,635.89
Customer F	$15,607.92
Customer G	$41,461.68
Customer H	$19,591.85
Customer I	$15,939.44
Customer J	$153,507.00
Customer K	$20,900.53
Customer L	$17,265.05
Customer M	$50,000.00
Customer N	$13,079.16
Customer O	$39,935.17
Customer P	$10,035.52
Customer Q	$11,281.19
Customer R	$17,080.99
Customer S	$62,439.20
Customer T	$132,000.00

Restitution already paid in connection with other AWCs in this matter:

Customer	Restitution already paid
Customer U	$147,031.50
Customer V	$10,357.00
Customer W	$11,097.00
Customer X	$7,653.21
Customer Y	$10,349.00
Customer G	$16,032 (partial)
Customer N	$5,058 (partial)
Customer P	$3,910 (partial)

Attachment B (Public Version)

Registered representatives for heightened supervision:

Name
Registered Representative 1
Registered Representative 2
Registered Representative 3
Registered Representative 4
Registered Representative 5