

# Offers They Can't Refuse: SEC and FINRA Enforcement Settlements from January 2021

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During the past couple of months, film fans got to see a recut version of *The Godfather Part III* called, *Mario Puzo's The Godfather, Coda: The Death of Michael Corleone*. Francis Ford Coppola, the director and co-screenwriter of the “Godfather” movies (who is also Sofia Coppola’s father, Nicholas Cage’s and Jason Schwartzman’s uncle, and Talia Shire’s brother) (and a vintner) (who knew?), decided to re-release the movie, changing the “beginning and end and [making] alterations throughout to excavate and clarify the narrative that he always believed it contained about mortality and redemption.”<sup>1</sup> This “new” movie caused us to revisit the *Godfather* movies, including the first two (with the not-so-creative titles of *The Godfather* and *The Godfather Part II*), which the American Film Institute ranked, respectively, as the 2nd and 32nd greatest American film.<sup>2</sup> As we suspected, because these movies about the exploits of the Corleone family deal with business and regulation (as well as many other subjects like loyalty, betrayal, love, and murder), they provide an excellent theme for this month’s article on securities enforcement actions.<sup>3</sup>

If you don’t think the movies connect business and regulation, fuggedaboudit (even though that’s from *Donnie Brasco*).<sup>4</sup> For example, check out these classic quotes from *Godfather* movies:

- Licio Lucchesi (a powerful figure in Italian politics who is behind a plot against Michael Corleone): “Finance is a gun. Politics is knowing when to pull the trigger.”<sup>5</sup>
- Virgil “The Turk” Sollozzo (a narcotics gangster who tried, but failed, to have a working relationship with the Corleones, who were against drugs): “I don’t like violence, Tom. I’m a businessman. Blood is a big expense.”<sup>6</sup>
- Michael Corleone (played by Al Pacino; if you don’t know who he is, you never got out much, even before the Pandemic): “I don’t need tough guys, I need more lawyers.”<sup>7</sup>

## Hiring

Hiring the right personnel is important, regardless of your business. One storyline in *The Godfather* involves what happens when the “right” person isn’t hired for a job and how an employer might be “persuaded” to reconsider an employment decision. Don Vito Corleone (the Godfather, played by Academy Award Best Actor winner Marlon Brando) wanted his godson, Johnny Fontane, to be hired in a movie. He sent Tom Hagen, the consigliere (the family attorney) (but probably not the chief compliance officer), to Hollywood to speak with Jack Woltz, the studio head, to make him an offer “he can’t refuse” so that Johnny would get hired.

Tom Hagen: “I come from a personal friend of Mr. Johnny Fontane. That friend promises his undying friendship if you would do him a small favor.”

1. How Francis Ford Coppola Got Pulled Back In to Make ‘The Godfather, Coda’ - [The New York Times \(nytimes.com\)](https://www.nytimes.com).

2. AFI’S 100 YEARS...100 MOVIES — 10TH ANNIVERSARY EDITION | [American Film Institute](https://www.afi.com).

3. For other articles exploring the intersection between popular culture and securities enforcement, please check out our prior articles: “‘Luke, I am your father.’ (Or not.) Collective False Memory and SEC and FINRA Enforcement Issues from November and December 2020,” *Currents* (January 2020); “Back to the Future, But SEC and FINRA Enforcement Issues from the Present (October 2020),” *Currents* (November 2020); “Not Dead Yet: Just Flesh Wounds, Suspensions, and Fines (SEC, CFTC and FINRA Enforcement Actions in September 2020),” *Currents* (October 2020); “The Show, er, um, Article About Nothing (other than SEC, CFTC, FINRA, and State Securities Enforcement Actions in August 2020),” *Currents* (September 2020); “Just When You Thought It Was Safe to Go Back in the Office (Or at Least Think About It): SEC and FINRA Examinations and Enforcement Actions in July 2020,” *Currents* (August 2020); “Curb Your Enforcementism: SEC and FINRA Enforcement Cases in June 2020,” *Currents* (July 2020); “Killing Eve (all others are fined or suspended): SEC and FINRA Enforcement Cases in May 2020,” *Currents* (June 2020); “The Last Dance (But not the Last Enforcement Action): SEC and FINRA Enforcement Actions in April 2020,” *Currents* (May 2020); “Tiger King: Murder, Mayhem and March 2020 Enforcement Matters,” *Currents* (May 2020).

4. For those who are unfamiliar with the word “fuggedaboudit,” it means different things, depending on the context. And tone. For example:

- “You know, like, if you agree with someone.”
- “But then, if you disagree, like ‘A Lincoln’s better than a Cadillac.’ ‘Fuggedaboudit.’”
- “Or if something’s the greatest thing in the world. ‘Those peppers? Fuggedaboudit.’”
- “Or it’s like I know something you know, like, ‘He’s making two million a year, fuggedaboudit.’”
- “And then, sometimes, it just means forget about it.” [Donnie Brasco \(scriptslug.com\)](https://www.scriptslug.com).

5. [Licio Lucchesi | Villains Wiki | Fandom](https://www.fandom.com/wiki/Licio_Lucchesi).

6. [False memory - Wikipedia](https://en.wikipedia.org/wiki/False_memory).

7. [The Godfather, Part III - Transcript \(thegodfathertrilogy.com\)](https://www.thegodfathertrilogy.com).

Jack Woltz: “What’s that?”

Tom Hagen: “Give Johnny a part in that war movie you’re starting next week.”

[Mr. Woltz reacts “negatively” to this request.]

Tom Hagen: “Mr. Woltz, I’m a lawyer. I am not threatened.”

Jack Woltz: “I know almost every big lawyer in New York. Who the hell are you?”

Tom Hagen: “I have a special practice. I handle one client. Now, you have my number. I’ll await your call. By the way, I admire your pictures very much.”

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[Mr. Woltz subsequently learns who Mr. Hagen’s client is.]

Jack Woltz: “Tell your boss he can ask for anything else, but this is one favor I can’t grant him.”

Tom Hagen: “Mr. Corleone never asks a second favor once he’s refused the first, understood?”

[Mr. Woltz refuses.]

Tom Hagen: “Thank you for the dinner and a very pleasant evening. Have your car take me to the airport. Mr. Corleone is a man who insists on hearing bad news at once.”

**Spoiler Alert:** Shortly thereafter, Mr. Woltz wakes up to find in his bed the bloody severed head of his favorite racehorse. Mr. Woltz (understandably) screams. (It’s quite the scream. If you don’t believe us, check it out [here](#).) (Go ahead. Don’t be afraid. Even if you’ve seen it already.) Mr. Woltz later hired Johnny, who went on to win the Academy Award for his role in the film, proving that Johnny was the right person for the job.

Although securities firms don’t hire actors (well, not those kind of actors . . .), they do have to follow certain rules when they hire. And if they don’t, they can get sanctioned. For example, in January 2021, the SEC brought a settled case against a firm and its founder/Chief Executive Officer (CEO) for allowing a non-registered person to advise clients.<sup>8</sup> The SEC fined them \$20,000 for failing to adequately supervise an investment adviser representative (IAR), who had allowed his father, who was not associated with the firm, to advise firm clients. The IAR, who had no real securities experience, deceived advisory clients through this relationship. As part of the settlement, the SEC prohibited the CEO from acting in any supervisory capacity unless pre-approved by the Commission. The CEO agreed to take 30 hours of compliance training related to the Advisers Act.

The firm had hired an inexperienced IAR, who was supervised by the CEO. The IAR’s father, who had previously worked as an IAR, also tried to associate himself with the firm, but the firm wouldn’t accept him because the father was the subject of an ongoing FINRA investigation. The IAR allowed his father to advise firm clients even though the father was not formally associated with the firm. On at least 38 occasions, the father impersonated his son in communicating with firm clients. At all relevant times, the firm failed to disclose to its advisory clients that the father was not associated with the firm.

The SEC found that the firm knew or should have known that the father was advising firm clients through the IAR’s association with the firm. For instance, the CEO was aware that (i) the father

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8. <https://www.sec.gov/litigation/admin/2021/ia-5670.pdf>.

and son shared offices and telephone lines, (ii) all of the son's clients were originally his father's clients, and (iii) the son was inexperienced. Further, the CEO directly corresponded with the father to discuss certain issues, including advisory fees.

In addition, the CEO ignored the concerns of the firm's chief compliance officer (CCO) that advisory clients were not aware that the father was not associated with the firm. The CEO also ignored the CCO's recommendation that the representative be terminated.

- Takeaways:

- First, regulators are very concerned when non-associated persons interact with customers. In the past, we have seen cases involving statutorily disqualified persons, which is far worse. But any such interaction can be problematic.
- Second, firms need to effectively implement systems that supervise the activities of their associated persons and prohibit unassociated persons from advising firm clients. This case is more egregious because the CEO knowingly condoned the actions of the IAR and the father, and the CEO ignored the concerns and recommendations of the firm's CCO.
- Finally, this case is an excellent example of a CCO doing the right thing and apparently documenting his concerns. Regarding his own personal liability, it presumably did not matter that the firm and the CEO did not follow his recommendations. The CCO flagged an issue that should have been implemented by firm management, the CEO.

In January 2021, FINRA settled a very large case with a firm that failed to fingerprint and screen non-registered persons.<sup>9</sup> FINRA fined the firm \$1,250,000 for failing to maintain a reasonable supervisory system and written supervisory procedures (WSPs) to identify and screen individuals who became associated with the firm in a non-registered capacity. As part of the settlement, the firm agreed to review its systems/procedures to ensure that identification, fingerprinting and screening of non-registered associated persons fully complies with applicable securities laws and regulations.

According to the Letter of Acceptance, Waiver, and Consent (AWC), from 2015 to 2019, the firm's systems/procedures were not reasonably designed to ensure that the firm could identify, screen, and maintain records concerning approximately 5,150 persons associated with the firm in a non-registered capacity. The firm failed to timely fingerprint thousands of non-registered associated individuals and/or was unable to determine whether the firm had timely fingerprinted thousands of other non-registered associated persons. The firm implemented remedial efforts to fingerprint approximately 1,950 of the 5,150 non-registered associated persons, but was unable to fingerprint the remainder as they were no longer with the firm. In addition, the firm permitted two statutorily disqualified individuals to associate with the firm in a non-registered capacity because the firm had failed to timely submit the individuals' fingerprints for processing. The firm terminated both individuals soon thereafter.

- Takeaways:

- First, firms must focus on registered as well as non-registered persons.
- Second, as noted above, persons who are statutorily disqualified are particularly concerning to regulators.
- Third, self-reporting and remediation has benefits. The AWC noted that the firm: (i) initiated, prior to intervention by a regulator, an extensive review of the firm's systems,

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9. 2018059113701 Goldman Sachs & Co. LLC CRD 361 AWC sl.pdf (finra.org).

practices, and procedures with respect to fingerprinting and screening associated persons; (ii) shared the results of that review with FINRA; (iii) promptly commenced correcting supervisory deficiencies identified by the firm's internal review; and (iv) provided substantial assistance to FINRA in its investigation.

## Products and Services

In *The Godfather* movies, the families sold products and provided services, but they did not sell securities or provide investment advice. In contrast, in the television show *The Sopranos*, they did sell securities. To refresh your recollection (as we lawyers love to say), the main player in the securities business was Christopher Moltisanti (whom Tony, the boss, treated as his nephew, although he was actually a first cousin once removed of Carmela, Tony's wife, and a second cousin of Tony's children, Meadow and Anthony Jr.).<sup>10</sup> In the show, Christopher hired someone to take his Series 7 exam and shortly thereafter, Christopher became the "SEC compliance officer" at a boiler room involved with a "pump and dump" scheme, pushing a stock called "GameStop." No, actually, it was called, "Webistecs." When one of the firm's representatives provided actual investment advice to a customer, that rep was disciplined (not with a letter of caution, but with the pouring of hot coffee on him and a beating).<sup>11</sup> *Not for nothing* (although this is not legal advice): we do not recommend getting a compliance job or any other job with a mob-owned or mob-run securities firm (which is a real thing). As we say, "fuggedaboutit."<sup>12</sup>

Although the Corleone family did not sell securities, they were, nonetheless, very particular about their revenues and net profits. For example, they knew that:

- **Marketing and sales pitches matter**

Michael Corleone: "Well, when Johnny was first starting out, he was signed to a personal services contract with this big-band leader. And as his career got better and better, he wanted to get out of it. But the band leader wouldn't let him. Now, Johnny is my father's godson. And my father went to see this bandleader and offered him \$10,000 to let Johnny go. But the bandleader said no. So the next day, my father went to see him; only this time with Luca Brasi. And within an hour, he signed a release, for a certified check of \$1,000." Kay Adams (Michael's future wife) (and Michael's future ex-wife): "How'd he do that?" Michael: "My father made him an offer he couldn't refuse." Kay Adams: "What was that?" Michael Corleone: "Luca Brasi held a gun to his head, and my father assured him that either his brains or his signature would be on the contract. That's a true story."<sup>13</sup>

- **Product mix matters**

Vito Corleone: "It's true, I have a lot of friends in politics, but they wouldn't be friendly very long if they knew my business was drugs instead of gambling, which they rule that as a harmless vice. But drugs is a dirty business."<sup>14</sup>

In the securities world, similar concepts apply (although the cost/benefit calculus is different). Nonetheless, securities regulators focus on these matters and bring enforcement cases where they don't like how products are sold or if firms don't have adequate systems and procedures to supervise sales. For example, in January 2021, FINRA settled a case with a firm for variable

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10. Christopher Moltisanti | The Sopranos Wiki | Fandom.

11. Guy Walks into a Psychiatrist's Office... | The Sopranos Wiki | Fandom.

12. See, e.g., *The Mob On Wall Street - Bloomberg; 120 Charged in Probe Of Mob on Wall St.* - The Washington Post.

13. *The Godfather.PDF* (scriptslug.com).

14. *Id.*

annuity supervision. Through an AWC, FINRA fined a firm \$350,000 for several failures, including for not developing and implementing adequate WSPs to monitor inappropriate rates of variable annuity (VA) exchanges and for failing to adequately supervise additional investments in existing VAs.<sup>15</sup> FINRA found that the firm's WSPs failed to (i) detail the frequency of the review process, (ii) offer guidance as to the standard to be used, i.e., what constituted a "high rate" of VA replacements, and (iii) establish procedures to implement corrective actions.

Additionally, FINRA found that the firm's procedures required principal approval of transactions involving additional premium payments that involved a "qualified" VA or a premium payment that was funded by a partial or full surrender of an existing VA. The firm did not require principal approval of additional premium payments made to "non-qualified" VAs. As a result, the firm failed to review approximately 400 solicited transactions that involved additional investments into non-qualified VAs. In addition, the firm failed to timely report statistical information for written customer complaints from 2017 to 2018.

- Takeaways:

- First, variable annuities have been and continue to be a focus of FINRA. During the past year, FINRA has brought other significant VA cases. In addition, FINRA highlighted variable annuities in its 2021 Report on FINRA's Examination and Risk Monitoring Program, the only product highlighted with its own section.<sup>16</sup>
- Second, while this case focused on variable annuities, the issues highlighted are really nuts-and-bolts issues like surveillance, add-on investments, and customer complaint reporting.
- Finally, the AWC makes a case for extraordinary cooperation and taking remedial actions before the settlement is finalized. It states that, in determining the appropriate sanctions, FINRA considered that the firm took substantial remedial measures to address deficiencies by hiring additional personnel, retaining independent consultants, and implementing enhancements based on the consultants' recommendations. Furthermore, the firm's new processes and procedures related to the deficiencies were completed a year before the AWC was authorized by FINRA.

In January 2021, FINRA brought a settled case against a firm for private placement sales.<sup>17</sup> FINRA fined the firm \$35,000 for violations of FINRA's content standards in its distributions/communications to potential investors related to seven private placement offerings. FINRA found that from June 2018 to June 2020, the firm distributed offering documents and other communications to potential investors that failed to provide a "sound basis" to evaluate seven private placement offerings. Further, the documents contained misleading statements, which included (i) failing to provide reasonable disclosures about the associated risks involved in the business plan; (ii) mischaracterizing a private placement offering as having "enhanced liquidity" when it was an illiquid investment; (iii) failing to accurately describe the use of funds; and (iv) including improper projections of performance in five private placement offerings.

In addition to the content-based violations, the firm also failed to timely file 11 private placement offering documents. The firm's filings were on average 143 days late, or 158 days after the date of first sale.

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15. 2018060548501 VALIC Financial Advisors, Inc. CRD 42803 AWC jlg.pdf (finra.org).

16. 2021 Report on FINRA's Examination and Risk Monitoring Program | FINRA.org.

17. GCS AWC (12-21) GCS signed 2020\_12\_23.pdf (finra.org).

- Takeaways:
  - First, private placements are a priority for FINRA. They are highlighted in the 2021 Report on FINRA's Examination and Risk Monitoring Program.
  - Second, FINRA can carefully review private placement offering documents and other communications.
  - Finally, firms should not view filings as a low priority item. As such, firms may consider implementing a system to monitor and process private placement offering documents within 15 days of the date of first sale as required under Rule 5123.

FINRA also brought a settled action against a firm in January 2021 for residential mortgage-backed securities (RMBS) sales.<sup>18</sup> FINRA fined the firm \$250,000 for failing to address several red flags arising from 11 RMBS sales by an associated person. Specifically, FINRA found that the firm failed to supervise statements made, normally over Bloomberg Chat instant messaging, concerning bid/offer prices related to the 11 RMBS that could have misled counterparties about available bid or offer prices. The misleading statements concerned, among other things, the pricing of RMBS transactions, including the prices at which the firm was able to buy or sell the subject RMBS and the bids or offers counterparties communicated to the firm.

The firm's procedures required further review because the spreads the firm received on nine of the 11 RMBS transactions exceeded the 3% margin. As part of this review process, the associated person submitted a written statement concerning the pricing decisions. FINRA found that the firm was aware of additional information about the associated person that should have necessitated further investigation, including that (i) the associated person was on both side of the transactions; (ii) the associated person negotiated directly with the counterparties to get the greatest spreads; (iii) the associated person had firsthand access to the bids/offers sent to counterparties; (iv) the markups for these transactions exceeded 4.5%; and (v) that the profits for these transactions varied greatly. The firm failed to act on this information and didn't conduct a further review of the associated person's communications.

- Takeaways:
  - First, FINRA brings actions against firms that don't adequately enforce their WSPs, even when the firm takes steps to implement an effective one.
  - Second, regulators often second-guess responses to "red" or "pink" flags. Here, the AWC says that the firm's knowledge should have led to further investigation and that certain circumstances should have made the firm aware of a heightened potential for misleading communications. If possible, firms should consider erring on the side of investigating and reacting to issues, rather than doing nothing.

## Supervision

Since the *Godfather* movies concern business (and much, much more), they offer advice on management and supervision, such as:

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18. 2013037312201 Amherst Pierpont Securities LLC FKA Amherst Securities Group, L.P. CRD 150696 AWC va.pdf (finra.org).

- **Motivation Matters**

“I’m going to make him an offer he can’t refuse” (said by both Vito and Michael Corleone).<sup>19</sup>

- **Feelings Matter**

Michael Corleone: “Never hate your enemies. It affects your judgment.”<sup>20</sup>

- **Perspective Matters**

Tom Hagen: “This is business, not personal, Sonny!”

Santino “Sonny” Corleone (oldest son of Vito and brother of Michael): “They shot my father . . . that’s business? . . .”

Tom: “Even the shooting of your father was business, not personal, Sonny!”

Sonny: “Well, then, business will have to suffer, alright? And listen . . . do me a favor, Tom. No more advice on how to patch things up, please. Just help me win, please, alright?”<sup>21</sup>

In the securities world, when firms and individuals fall down on basic managerial and supervisory precepts, they may be sanctioned (even if the securities firms do not seek revenge for the perceived misdeeds of their peers and competitors). For example, in January 2021, FINRA settled a case with a firm and its CEO/CCO for outside business activity (OBA) and email failures.<sup>22</sup> FINRA fined the firm \$30,000 and fined the CEO/CCO \$10,000 and suspended him for two-months for failing to adequately supervise (i) OBAs that the firm’s registered representatives disclosed and (ii) electronic communications that its registered representatives sent and received.

The firm’s WSPs required that all registered representatives engaging in OBAs report the nature of the activities to the CEO/CCO. Here, a registered representative sold \$1,467,000 in promissory notes and made a disclosure to the CEO/CCO who failed to (i) conduct a reasonable investigation of an entity involved in the transaction or (ii) determine whether the sale constituted a securities transaction. The CEO/CCO relied on a single conversation with the registered representative to forego conducting any reasonable investigation.

In addition to those violations, the CEO/CCO also failed to reasonably review 474,768 electronic communications from the registered representative that were specifically flagged. He reviewed only 0.27% of all the emails requiring supervisory review. Yet, according to FINRA, even this limited review should have alerted him that the sales of the promissory notes were, in fact, a securities transactions.

- Takeaways:

- First, regulators continue to have concerns about OBAs and email communications.
- Second, firms and responsible individuals cannot “cut corners” regarding OBA or email reviews. Although this issue is not alleged in the AWC, if an email system generates too many false positives, the firm should change the review criteria rather than ignoring emails that have been flagged.

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19. [The Godfather.PDF \(scriptslug.com\)](#).

20. [Godfather Part 3 Script - transcript from the screenplay and/or Al Pacino movie \(script-o-rama.com\)](#).

21. [The Godfather.PDF \(scriptslug.com\)](#).

22. [2017052705802 Whitehall-Parker Securities, Inc. CRD 10608 Robert J. Yuloo CRD 1303331 AWC sl.pdf \(finra.org\)](#).



## Lessons Learned

In our articles, we like to emphasize that to keep up with the latest compliance trends, readers may want to review enforcement cases, regulatory notices, speeches, as well as take a slightly different look at their favorite movies, TV shows, and books. Pop culture can also provide important life lessons. For example, there's a song, "Mammas don't let your babies grow up to be cowboys." We think (but haven't confirmed) that mammas have the same feelings about babies becoming mobsters. (We've also heard some compliance officers say the same thing about their profession.) Nonetheless, the *Godfather* movies do provide important life lessons that apply to many of us. For example,

- ***Listen to your parents (even if they are gangsters)***

Michael Corleone: "My father taught me many things here -- he taught me in this room. He taught me -- keep your friends close but your enemies closer."<sup>23</sup>

- ***Health matters (and we don't just mean, stay away from bad people with guns)***

Hyman Roth (business partner and antagonist of the Corleones): "Good health -- the most important thing in the world. More than success, more than money -- more than power."<sup>24</sup>

- ***Lawyers are powerful (and cool—at least, that's what we tell our kids)***

Don Vito Corleone: "The lawyer with the briefcase can steal more money than the man with the gun."<sup>25</sup>

- ***Families matter (except when, y'know, they kill you or you kill them, see, e.g., Fredo Corleone)***<sup>26</sup>

Don Vito Corleone: "You spend time with your family?"

Johnny Fontane: "Sure I do."

Don Vito Corleone: "Good. 'Cause a man who doesn't spend time with his family, can never be a real man."<sup>27</sup>

- ***And finally, desserts matter***

Peter Clemenza (someone who was a friend of Vito Corleone after Vito came to New York from Sicily): "Leave the gun, take the cannoli."<sup>28</sup> ■

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23. [The Godfather Part II Transcript \(jgeoff.com\)](#).

24. *Id.*

25. [The Godfather.PDF \(scriptslug.com\)](#).

26. Fredo Corleone - Wikipedia.

27. [The Godfather.PDF \(scriptslug.com\)](#).

28. *Id.*