FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2011025548801

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

RE: Capitol Securities Management, Inc. (BD No. 14169)
Respondent

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent Capitol Securities Management, Inc. ("CSM" or the "Firm") 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 CSM alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. CSM accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

CSM has been a member of FINRA since May 1985. CSM is based in Glen Allen, Virginia and maintains approximately 63 branch offices and has approximately 205 registered representatives.

RELEVANT DISCIPLINARY HISTORY

CSM has no relevant formal disciplinary history.

OVERVIEW

From January 1, 2008 to August 31, 2011 (the "Relevant Period"), CSM, through registered representative RS, recommended and effected 24 unsuitable purchases of customized Reverse Convertible Notes ("RCNs") totaling approximately $4 million for the accounts of eight CSM customers. In addition, CSM failed to establish, maintain and enforce a supervisory system and written supervisory procedures ("WSPs") reasonably designed to supervise the sale of RCNs to retail customers.

From May 2011 to July 2012, CSM failed to implement a reasonably designed anti-money laundering ("AML") program to detect, investigate and report, if appropriate, suspicious activity related to the deposit and liquidation of low-priced securities. Also, from June 4, 2012 to April 14, 2013, CSM failed to implement an adequate Customer Identification Program ("CIP") for DVP/Institutional clients to form a reasonable basis for verifying the identities of customers.

At various times between January 2009 and February 2013, CSM failed to apply sales charge discounts to eligible Unit Investment Trust ("UIT") and mutual fund purchases. CSM also failed to establish, maintain and enforce a supervisory system and WSPs reasonably designed to ensure that customers received sales charge discounts on eligible UIT and mutual fund purchases.

From January 2009 to March 2010, CSM charged customers excessive commissions on 421 equity transactions. CSM also failed to establish, maintain and enforce a supervisory system and WSPs for the review of commissions charged.

From January 2009 to March 2010, CSM failed to establish, maintain and enforce a supervisory system and WSPs reasonably designed to record and supervise private securities transactions.

From May 2009 to March 2010, CSM failed to file an application for approval of a material change in business activities.

As a result, CSM violated numerous federal securities laws and NASD and FINRA rules.

FACTS AND VIOLATIVE CONDUCT

A. CSM's Unsuitable Sales of Reverse Convertible Notes

1. Reverse Convertible Notes

RCNs are short-term notes of an issuer that are tied to an underlying or "linked" equity and that pay a fixed interest rate. At maturity, the investor receives the interest payment plus either 100% of the original investment amount, or a predetermined number of shares of the linked equity (which, at the time of maturity, may be worth less than the original investment amount), depending on the performance of the linked equity during the term of the note and the price per share on the date of maturity.

In return for the interest payment, an RCN investor bears the downside risk of the linked equity under what is known as the "basic" structure, or much of the downside risk under the "knock-in" structure.

- In a "basic" RCN, the investor's initial investment is paid back if, on the date of maturity, the linked equity closes at or above a predetermined share

price. However, if at maturity the stock closes below the predetermined share price, the investor receives shares of the linked equity in lieu of his initial investment.

- A "knock-in" RCN, by contrast, provides some degree of downside protection by conditioning the payment of shares (in lieu of principal) on the linked equity closing below the predetermined price both on the date of maturity and on at least one prior date during the holding period.

RCNs are complex products that expose investors not only to risks traditionally associated with bonds and other fixed income products – such as the risk of issuer default and inflation risk -- but also to the additional risks of the underlying stocks, and the potential for loss of all or part of the principal invested. In addition, RCNs generally do not trade during the life of the RCN and therefore tend to be illiquid.

In February 2010, FINRA issued Notice to Members ("NTM") 10-09, which reminded firms of the need to perform reasonable basis suitability as well as customer specific suitability analyses in connection with the sales of RCNs. The Notice directed firms to make "reasonable efforts to obtain information concerning: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer." In sum, NTM 10-09 seeks to ensure that "[reverse convertibles] are only sold to persons for whom the risk of such products is appropriate."

2. CSM's RCN Business

During the Relevant Period, CSM representative RS sold approximately $80 million in RCNs to retail customers, including $63,650,000 in nine "customized" RCN offerings. In four of these customized offerings, the stock price of the linked securities dropped below the "knock-in" price, and the stocks were put to the customers at maturity, resulting in losses.

3. Unsuitable Sales of the Four Customized RCNs

CSM, acting through RS, recommended and effected 24 unsuitable purchases of customized RCNs totaling approximately $4 million for the accounts of eight customers. Most of the customers were over the age of 60 and had modest or conservative investment objectives and risk profiles. Furthermore, all of the customers' accounts were heavily concentrated in RCNs, with the amounts of these investments constituting a substantial portion of their net worth. RS's recommendations were unsuitable given the customers' risk tolerance, investment objectives, ages and net worth.

The following are examples of the unsuitable RCN purchases for two customers:

- Customer JL

JL's new account form indicated that she was 62 years old and worked as a self-employed artist. JL's annual income was listed at between $50,000 and $60,000 and her net worth (exclusive of her home) was between $400,000 and $500,000. JL's investment objectives were income and long-term growth and her risk tolerance was moderate.

JL invested a total of $995,000 in three customized RCN offerings. These investments constituted between 58% and 89% of her net worth. In addition, JL's RCN investments represented a significant concentration in her account, ranging between 56% and 74% of her month-end account value. JL's investments in these unsuitable RCNs resulted in approximately $102,000 in losses.

- Customer AB

AB's new account form indicated that she was 65 years old and retired. AB's annual income was listed at between $30,000 and $35,000 and her net worth (exclusive of her home) was between $400,000 and $500,000. AB's investment objective was long-term growth and her risk tolerance was moderate.

AB invested $426,000 in two customized RCN offerings. These investments constituted between 53% and 71% of her net worth. In addition, AB's RCN investments represented a significant concentration in her account, ranging between 61% and 63% of her month-end account value. AB's investments in these unsuitable RCNs resulted in approximately $44,900 in losses.

Based on the foregoing, CSM violated NASD Conduct Rules 2310 and 2110 and FINRA Rule 2010.

B. CSM Failed to Establish, Maintain and Enforce an Adequate Supervisory System and WSPs for the Sales of RCNs

CSM failed to establish and maintain a system for supervising its sales of RCNs that was reasonably designed to achieve compliance with the suitability requirements of NASD and FINRA rules. CSM did not have an adequate system or procedures for the review and approval of an RCN before RS or any other registered representative sold the RCN to a customer. Moreover, at no point during the Relevant Period, did CSM provide training to representatives regarding the sale of RCNs. Despite the large volume of RCNs that RS sold, neither RS nor his supervisor was required to take any RCN training.

In April 2010, CSM established WSPs that addressed the sale of RCNs, but those procedures were inadequate. CSM's newly-created procedures described RCNs in a general manner but did not provide any guidance regarding the consideration of customer-specific suitability for these products. For example, the Firm's WSPs were silent as to what customer account types, income levels, investment experience and

investment objectives would be suitable for RCN investments. Also, CSM's newly-created WSPs for RCNs did not provide any guidance or restrictions regarding the concentration levels of RCNs in customer accounts and CSM had no exception report that would detect concentration levels of RCNs in any customer account.

Based on the foregoing, CSM violated NASD Conduct Rules 3010 and 2110 and FINRA Rule 2010.

C. CSM Failed to Implement an Adequate AML Program

FINRA Rule 3310 requires member firms to develop and implement a written AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act ("BSA"), 31 U.S.C. §5311, et seq., and the regulations promulgated thereunder. Under FINRA Rule 3310(a), FINRA member firms are required to establish and implement policies and procedures "that can be reasonably expected to detect and cause the reporting" of suspicious activity and transactions.

From May 2011 to July 2012, the Firm's WSPs identified numerous "red flags" to look for when reviewing customers' trading activity, including situations where the customer engaged in transactions involving low-priced securities or engaged in transactions that lacked business sense or an apparent investment strategy. During that period, numerous "red flags" fitting this description were present in the customer accounts managed by CSM registered representative WR. Specifically, at least seven of WR's accounts displayed the following pattern: (1) the deposit of physical certificates of low-priced securities; (2) followed by the liquidation of a substantial portion or all of the securities; and (3) then, often, the wiring of the proceeds out of the accounts. Moreover, from May 2011 to July 2012, CSM's clearing firm flagged potentially suspicious activity in the seven accounts described above and sent inquires to CSM seeking additional information regarding the accounts and the securities.

While CSM established an AML program that was reasonably designed to detect and cause the reporting of potentially suspicious activity and transactions, the Firm failed to adequately implement that program by failing to adequately respond to the above-described red flags indicative of potentially suspicious activity including the deposit of thousands of penny stock shares followed by substantial sales with the proceeds promptly wired or disbursed from the accounts, even after multiple inquiries from its clearing firm.

Based on the foregoing, CSM violated FINRA Rules 3310(a) and 2010.

D. CSM Failed to Implement an Adequate CIP

Under FINRA rules, broker-dealers are required to establish, document and maintain a written CIP, which must include procedures to: (1) verify the identity of a customer within a reasonable time before or after a customer account is opened; (2) specify the verifying information that will be obtained and describe when the broker-dealer will use documentary methods, non-documentary methods, or a combination thereof to verify

customer identity; and (3) provide for the collection of required verifying information and the maintenance of the required records.

From June 4, 2012 to April 14, 2013, CSM failed to implement an adequate CIP by failing to collect and verify identifying information for certain new accountholders. Specifically, the Firm failed to collect tax identification numbers for seven DVP/Institutional accounts and failed to verify the identifying information provided for seventeen DVP/Institutional accounts out of a total sample size of twenty-eight accounts.

Based on the foregoing, CSM violated FINRA Rules 3310(b) and 2010.

E. CSM Failed to Apply Sales Charge Discounts to Eligible UIT and Mutual Fund Purchases

A UIT is a type of Investment Company that issues securities, typically called "units," representing undivided interests in a portfolio of securities that typically remains fixed for the term of the UIT. UITs are generally issued by a sponsor that assembles the UIT's portfolio securities, deposits the securities in a trust, and sells units of the UIT in a public offering. UIT units are redeemable securities that are issued for a specific term, and entitle investors to receive their proportionate shares of the UIT's net assets on redemption or at termination.

A UIT sales charge is typically made up of a combination of (1) a fee which is calculated from the public offering price, often called the initial sales charge, and (2) fees in fixed dollar amounts, which generally include a creation and development fee and a deferred sales charge. UIT sponsors typically set a maximum sales charge, expressed as a percentage of the public offering price, and comprised of the initial sales charge and the fixed dollar fees.

UIT sponsors offer investors a variety of ways to reduce the maximum sales fee charged on a purchase. The two most common sales charge reductions allow investors to reduce the sales fee by increasing the size of their UIT investments or through buying units of a trust using redemption or termination proceeds from another UIT during the initial offering period. These options are disclosed in prospectuses and are generally known, respectively, as "breakpoints" and "rollover and exchanges."

Similar to UITs, many front-end load mutual funds offer breakpoint discounts. Generally, an investor can procure a breakpoint discount through a single purchase large enough to reach a breakpoint or, in the alternative, through multiple purchases in either a single mutual fund or mutual fund family. An investor may aggregate current purchases with prior purchases in one or more accounts over time to meet an applicable breakpoint threshold through "rights of accumulation." Many mutual funds also offer breakpoints through "letters of intent," which are written statements by investors of their intent to purchase a certain amount of mutual fund shares over a specified period, typically thirteen months. Also, many mutual funds offer breakpoints by aggregating purchases in multiple accounts owned by the customer, or persons related to the customer, as long as

the shares owned in each account are properly linked together. The specific criteria for breakpoints vary among different mutual funds and mutual fund families.

At various time between January 2009 and February 2013, CSM failed to apply sales charge discounts to 101 eligible UIT purchases resulting in the customers paying excess sales charges of $18,254.10. Similarly, between June 2009 and March 2010, CSM failed to provide breakpoint discounts to 43 eligible Class A share mutual fund purchases, which resulted in customers paying $14,089.21 in excess sales charges.

Based on the foregoing, CSM violated NASD Conduct Rule 2110 and FINRA Rule 2010.

F. CSM Failed to Establish, Maintain and Enforce an Adequate Supervisory System and WSPs to Ensure Customers Received Sales Charge Discounts on Eligible UIT and Mutual Fund Purchases

Between January 2009 and April 2010, CSM failed to establish, maintain and enforce an adequate supervisory system and WSPs to ensure that customers purchasing UITs and mutual funds received applicable sales charge discounts. Initially, CSM relied on a daily blotter review and did not use any exception reports to monitor for sales charge discounts, and did not adequately train representatives and principals regarding applying appropriate sales charges discounts. While CSM later started using a third-party vendor to develop and implement exception reports to identify appropriate UIT sales charge discounts, the Firm failed to adequately monitor and supervise these reports.

Based on the foregoing, CSM violated NASD Conduct Rule 3010 and FINRA Rule 2010.

G. CSM Charged Excessive Commissions

NASD Conduct Rule 2440 provides that:

> [i]f a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances... If he acts as agent for his customer, the member shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances...

NASD established a policy in 1943 that mark-ups of five percent may be deemed unreasonable. In addition to the commission percentage, NASD IM-2440-1 sets forth other factors to be considered in determining fairness, including: (i) the type of security involved; (ii) the availability of the security; (iii) the price of the security; (iv) the size of the transaction; (v) whether disclosure of the transaction cost was made to the customer prior to the trade; (vi) any pattern of mark-ups; and (vii) the nature of the member's business.

Since 2006, CSM relied on an automated commission schedule provided by its clearing firm as CSM's default method for setting commissions for low-priced securities. This

commission schedule produced excessive commissions. Specifically, between January 1, 2009 and March 31, 2010, CSM executed 421 equity transactions in which the commission exceeded both: (1) 5% of the principal amount invested and (2) $100. For these 421 equity trades, the total amount of commissions that exceeded 5% and $100 was $32,784.13.

Based on the foregoing, CSM violated NASD Conduct Rule 2440 and NASD IM-2440-1, and FINRA Rule 2010.

H. CSM Failed to Establish, Maintain and Enforce an Adequate Supervisory System and WSPs for the Review of Commissions Charged

From January 2009 to March 2010, CSM failed to have an adequate system to monitor for excessive commissions. CSM's supervisory system was inadequate because the Firm relied exclusively on an outdated commission schedule and did not conduct any independent supervisory review, taking into consideration the factors used in considering the fairness of commissions as delineated in IM-2440-1.

Based on the foregoing, CSM violated NASD Conduct Rule 3010 and FINRA Rule 2010.

I. CSM Failed to Establish, Maintain and Enforce an Adequate Supervisory System and WSPs to Supervise Private Securities Transactions

Under NASD Rule 3040, before participating in a private securities transaction, an associated person must provide written notice to his member firm. Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of associated person's employment with member." Rule 3040(c)(2) requires a member that has approved an associated person's participation in a private securities transaction, where the person has received or may receive selling compensation, to record such transaction on its books and records and to supervise the person's participation in the transaction as if the transaction was executed on behalf of the member.

NASD NTM 94-44 and NASD NTM 96-33 clarified that member firms must supervise the securities activity of registered representatives who engage in investment advisory activities away from the firm where those registered representatives participate in the execution of securities transactions on behalf of their investment advisor clients.

From January 2009 to March 2010, three CSM registered representatives engaged in investment advisory business away from the Firm and caused securities transaction to be executed on behalf of their investment advisor clients. CSM, however, did not have any supervisory procedures for these outside transactions and failed to supervise them. CSM also did not record those transactions on its books and records.

Based on the foregoing, CSM violated NASD Conduct Rules 3010, 3040 and 3110(a), and FINRA Rule 2010.

J. CSM Failed to File an Application for Approval of a Material Change in Business Activities

NASD Rule 1017(a)(5) requires members to file an application with FINRA for approval of a "material change" in business operations. NASD Rule 1017(c)(3) prohibits a firm from implementing a material change in business operations unless the change is approved by FINRA.

CSM was not authorized under its Membership Agreement to engage in a research business. Despite this, from May 2009 to at least March 2010, CSM issued several research reports without first filing an application with FINRA for approval to conduct research.

Based on the foregoing, CSM violated NASD Membership and Registration Rule 1017 and FINRA Rule 2010.

B. CSM consents to the imposition of the following sanctions:

- censure; and
- fine of $470,000

CSM is also ordered to pay restitution in the amount of $226,448.90 to the customers listed in Attachments A hereto, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from September 1, 2011 until the date this AWC is accepted by the NAC.

A registered principal of CSM shall submit satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted to David F. Newman, Senior Regional Counsel, FINRA Department of Enforcement, 1835 Market Street, Suite 1900, Philadelphia, PA 19103, either by letter that identifies CSM and the case number or by email from a work-related account of the registered principal of CSM to EnofrcementNotice@FINRA.org. This proof shall be provided to the FINRA staff member listed above no later than 120 days after acceptance of the AWC.

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

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

actions to obtain restitution or other remedies.

CSM agrees to pay the monetary sanctions upon notice that this AWC has been accepted and that such payments are due and payable. CSM has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed.

CSM specifically and voluntarily waives any right to claim that it is unable to pay, not or at any time hereafter, the monetary sanction imposed in this matter.

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

I.

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 acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Respondent understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and

C. If accepted:

1. this AWC will become part of the Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about Respondent's disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313;

4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's: (i) testimonial obligations; or (ii) right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party; and

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 they may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf

has read and understand all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that the Firm has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce the Firm to submit it.

Capitol Securities Management, Inc.,

11/5/15
Date (mm/dd/yyyy)

By: _____
Mark Hamby
President

Reviewed by:

_____
Janet K. DeCosta, Esq.
Counsel for Respondent
1875 Eye Street, NW, Suite 500
Washington, DC 20006
Tel: (202) 638-3344
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jkdecoasta@jkdecosta.com

Accepted by FINRA:

October 20, 2015
Date

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

_____
David F. Newman
Senior Regional Counsel
FINRA Department of Enforcement
1835 Market Street, Suite 1900
Philadelphia, PA 19103
Tel: (215) 665-1180
Fax: (215) 496-0434
E-Mail: david.newman@finra.org

ATTACHMENT A
AWC NO. 2011025548801

CUSTOMER INITALS	AMOUNT OF RESTITUTION
MS	$2,159.28
SD	$81,005.29
JB	$53,365.52
RD	$19,531.57
BC	$25,486.82
AB	$44,900.42
TOTAL	$226,448.90