FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. DAVID M. LEVY (CRD No. 2255938), ANTONIO COSTANZO (CRD No. 2580765), and DONALD A. BARTELT (CRD No. 1377935), Respondents.	Disciplinary Proceeding No. 2012030564701 Hearing Officer—DMF **DEFAULT DECISION** **October 17, 2016**

Summary

(1) Each Respondent recommended quantitatively unsuitable trading in, and churned, the accounts of customers; (2) Respondents Levy and Costanzo recommended qualitatively unsuitable investments to customers; and (3) Respondents Levy and Costanzo attempted to obstruct FINRA's disciplinary process by conditioning offers of restitution on the customers' refusal to cooperate with FINRA's investigation and by attempting to dissuade customers from testifying at a FINRA disciplinary hearing. For these violations, each Respondent is barred from association with any FINRA member firm and ordered to pay restitution and a fine.

Appearances

For the Complainant: Payne L. Templeton, Esq., Joel T. Kornfeld, Esq., Jill L. Jablonow, Esq., and John Luburic, Esq., Department of Enforcement, Financial Industry Regulatory Authority.

Respondents Levy and Costanzo, *pro se*.

No appearance by or for Respondent Bartelt.

DECISION

I. Introduction

A. Procedural History

The Department of Enforcement filed the Complaint in this matter on July 28, 2014, naming eight Respondents: Newport Coast Securities, Inc., a FINRA member firm; two former registered principals of the firm, Marc A. Arena and Roman Tyler Luckey; and five former registered representatives ("RRs") of the firm, Douglas A. Leone, Andre V. LaBarbera, David M. Levy, Anthony Costanzo, and Donald A. Bartelt. The Complaint set out a total of nine causes of action against those Respondents. Arena and Luckey subsequently settled the charges against them, and the charges against Respondents Newport Coast, Leone and LaBarbera were addressed in an Extended Hearing Panel Decision. In accordance with FINRA Rule 9269, this Default Decision addresses the charges against Respondents Levy, Costanzo and Bartelt.

The charges addressed in this decision are that:

(1) Levy, Costanzo and Bartelt engaged in excessive trading in the accounts of certain customers, referred to as "quantitative unsuitability," in violation of NASD Rules 2310 and 2110 and IM-2310-2, and FINRA Rules 2111 and 2010;[1]

(2) Levy, Costanzo and Bartelt "churned" the accounts of certain customers, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110;

(3) Levy and Costanzo, made unsuitable recommendations of transactions involving leveraged or inverse Exchange Traded Products ("ETPs") to certain customers, referred to as "qualitative unsuitability," in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010; and

(4) Levy and Costanzo attempted to obstruct FINRA's disciplinary process by conditioning offers of restitution to certain customers on the customers' refusal to cooperate with FINRA's investigation and by attempting to persuade the customers to refuse to testify at FINRA's disciplinary hearing, in violation of FINRA Rule 2010. [2]

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[1] The conduct rules that apply to the allegations against Respondents are those that were in effect at the time of the alleged misconduct. The Complaint defines the relevant time period as September 2008 through May 2013. Complaint ("Compl.") ¶ 1. During that period, several NASD rules that had applied to Respondents' conduct were replaced by parallel FINRA rules, but there were no substantive changes in the applicable rules. Where different rules applied to Respondents' conduct during the relevant period, the time period covered by each applicable rule is identified in the Hearing Officer's conclusions on each charge addressed in this Decision.

[2] Enforcement's investigation grew out of a 2011 sales practice examination that focused on Newport Coast's Long Island, New York, branch office. Tr. 5093, 5095-96.

Because Levy, Costanzo and Bartelt were all held in default, the Hearing Officer deems the allegations in the Complaint against those Respondents admitted by them, pursuant to FINRA Rule 9269(a)(2). In addition, however, the findings and conclusions set forth below are supported by the extensive evidentiary record compiled during the hearing related to the charges against Newport Coast, Leone and LaBarbera.[3]

B. Respondents

Levy entered the securities industry in 1992. He was associated with several FINRA member firms before becoming associated with Newport Coast. He was registered with Newport Coast as both a General Securities Representative and a General Securities Principal from July 2008 until August 2012. After leaving Newport Coast he was associated with other FINRA member firms, but has not been registered since March 2015. Levy was barred from association with any FINRA member firm in September 2015 for reasons not related to this proceeding.[4]

Costanzo entered the securities industry in 1995 and was also associated with a number of FINRA member firms before becoming associated with Newport Coast. He was registered as a General Securities Representative through Newport Coast from August 2008 until August 2012. Like Levy, he was associated with other FINRA member firms until March 2015. He too was barred from association with any FINRA member firm in August 2015 for reasons not related to this proceeding.[5]

Prior to associating with Newport Coast, Levy and Costanzo formed a partnership with LaBarbera through which they shared commissions, and that partnership continued during the partners' associations with Newport Coast. Each of the partners, however, had his own customers and the Hearing Officer evaluated each partner's conduct based solely on the evidence regarding his customers.[6]

Bartelt entered the securities industry in 1989 and was registered through a number of FINRA member firms before becoming associated with Newport Coast. He was registered in several capacities through Newport Coast from May 2010 through August 2014. He has not been registered since then.[7] Although Levy, Costanzo and Bartelt are not currently registered, they remain subject to FINRA jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4(a) of FINRA's By-Laws because (1) the Complaint was filed within two years after the effective date of termination of their registrations with member firms, and (2) the Complaint charges them with misconduct that commenced while they were associated with a member firm.

[3] Record citations in this Default Decision refer to the transcript of the hearing and the exhibits admitted in evidence during the hearing.

[4] CX-143B.

[5] CX-70A.

[6] Tr. 3435-37.

[7] CX-197A.

II. Quantitative Unsuitability

A. Facts

Enforcement alleges that Levy, Costanzo and Bartelt each engaged in quantitatively unsuitable trading of the accounts of certain specifically identified customers. The evidence regarding the trading in Levy, Costanzo and Bartelt's customers was as follows:[8]

- NK, a Levy customer, owns a water conditioning business that has one part-time employee, apart from him. In 2010, the gross revenues for the business were $130,000 to $140,000, with net revenues of approximately 20% of the gross. NK has three years of college education, studying accounting and to become a minister. Prior to opening a Newport Coast account with Levy, based on a cold call, NK's investing experience was limited to a one-time $3,500 investment in one stock, on which he lost about $1,000. NK did not recall having any prior brokerage accounts and he did not have any retirement accounts, but he did purchase some stock in a non-public company owned by a friend and in a cartoon network. He also invested in silver through a broker while his Newport account was open.

  Levy told NK that he could make a significant return if he trusted Levy. According to NK's new account documents, his annual income was $50,000, his net worth (excluding primary residence) was $500,000, and his liquid net worth, which NK added to the documents by hand, was $100,000. NK's liquid net worth consisted of an inheritance he had just received, and he used part of that money to fund his Newport Coast account. The new account documents listed NK's investment objective as Aggressive Growth and his risk tolerance as Speculation; NK testified his objective was simply to make money and that he told Levy he could take some risk, but not a lot. Initially NK invested just $1,700, which he quickly withdrew just to test whether he would be allowed to withdraw funds from his account. Once he succeeded, he invested additional funds totaling more than $60,000, but he also withdrew funds from the account on several occasions. NK testified he had very limited discussions with Levy about the investments in the account; Levy made the decisions.[9]

[8] In addition to the customers discussed below, the hearing record includes documentary evidence regarding Levy customer RH and Costanzo customer JM. *See* CX-93A; CX-94A; CX-95A; CX-156A; CX-157A; CX-158A; CX-554A. Although the trading in RH's and JM's accounts was consistent with the trading in the accounts of the Levy and Costanzo customers discussed below, neither RH nor JM testified at the hearing and, in light of the other evidence regarding Levy and Costanzo's customers, the Panel found it unnecessary to determine whether the trading in RH's and JM's accounts was quantitatively unsuitable.

[9] Tr. 1683-1804; CX-170A; CX-171A; CX-172A; CX-477.

NK invested approximately $64,000 in his account, but while the account was open, he withdrew approximately $25,000. His account was open from January 2010 through June 2012, but nearly all of the trading in the account took place from July 2010 through June 2012. During that active period, total purchases in the account were about $894,000 and total sales were approximately $860,000. For the active period, Enforcement calculated an annualized turnover rate of 16.15 and an annualized cost-to-equity percentage of 66.30%. Total costs were over $36,000 and losses were nearly $37,000.[10]

- BNS, another Levy customer, is a psychiatrist. He invested with Levy following a cold call, making a small initial purchase for about $1,600. Levy told him there would be short-term trading in his account. BNS testified Levy also told him that both sides of his initial investment, buying or selling, would be without cost, "except for, I believe, a small brokerage fee." Later in 2010, BNS asked about cost, and he complained to Levy that the cost of one trade was exorbitant. The charges for that trade were reduced somewhat but BNS otherwise received no response to his inquiries about costs. At the time, most of BNS's investments were through his employer and he had a small IRA, so he wanted to be a bit more aggressive in his Newport Coast account, but he told Levy he would need the money later in the year so he wanted to keep the risk low. BNS's prior investing experience included a brokerage account that allowed him to do his own trading in 1999 and 2000. The value of that account started at $25,000, increased to about $100,000, and then decreased to about $25,000 again. In addition, some years earlier, he had invested $5,000 through a broker, but lost it all. He told Levy about that experience, saying it was traumatic, and Levy said it was unlikely to happen in his Newport account. On cross-examination, BNS admitted he had purchased two or three private placements about 15 years ago. He also testified he had traded his own account in 1999 and 2000, and believed he had NASDAQ Level 2 access when doing so.

  The new account documents were already completed when BNS received them. They indicated that his annual income was $300,000, his net worth was $3 million, and his liquid net worth was $500,000. The stated net worth on the new account form of $3 million was high; it should have been $1 million, which was mostly in retirement accounts. But BNS signed the documents without changing that amount. The documents indicated that his investment objective was Aggressive Growth and his risk tolerance was Speculation, but in reviewing the documents BNS scratched out Speculation and checked "Aggressive" as his risk tolerance. He signed a margin agreement as a "just in case" option, but they did not plan to use it. He also signed the Short Term Trading Letter used by LaBarbera, Levy and Costanzo.

  BNS testified he received and reviewed his account statements and confirmations until he took a trip to Brazil in August 2010. Some of the confirmations he reviewed included

[10] CX-565A, at 1 (There was no meaningful difference between the turnover rate and cost-to-equity percentage for the active trading period and the turnover rate and cost-to-equity percentage for the entire period that the account was open.).

disclosures that he had been charged markups and markdowns, but BNS testified he does not recall that registering with him and he was not familiar with the concepts of markups and markdowns at that time; he only learned about markups and markdowns from FINRA when they contacted him during the investigation. BNS does not believe he discussed any of the trading in the account with Levy after he returned from his trip in September 2010, but Levy continued to trade the account actively. After his trip, BNS decided it was too stressful to follow his account, because he was obsessing on the trading, so he did not open any more statements until he gave them to his accountant at tax preparation time in 2011. He did not close his account at that time because his statements showed he had a profit in his account for 2010. He continued to avoid looking at the account statements and confirmations he received in 2011 until tax time in 2012, by which time his account had incurred substantial losses. BNS closed his account in April 2012.[11]

BNS invested approximately $33,000 in his Newport account, which was open from January 2010 through April 2012. Purchases totaled more than $647,000, with total sales of more than $627,000. Enforcement calculated an annualized turnover rate of 14.42 and an annualized cost-to-equity percentage of 68.82%. Total costs were almost $31,000 and total losses were over $27,000.[12]

- JS, a Levy customer, was employed in stage craft (building stages and erecting sound systems) for more than 40 years before retiring in 2009, prior to opening his Newport Coast account, although he continued working on some small jobs before fully retiring in 2010. Before opening his Newport Coast account through Levy after a cold call, he had never owned any individual stocks or bonds. Levy did not discuss his investment strategy or ask about JS's investment experience, risk tolerance, or objectives.

  When JS received his new account documents, they indicated where he was to sign, so he signed and returned them. The documents stated that his income was $50,000, his net worth (excluding primary residence) was $1 million, and his liquid net worth was $50,000. They indicated his investment objective was Aggressive Growth, but he testified he does not know what that means, and they indicated his risk tolerance was Speculation, but he testified he is "not a speculator … not a gambler." His new account documents indicated that he was retired. The documents that JS signed included a "Customer Margin Account Agreement" and the Short Term Trading letter used by LaBarbera, Levy, and Costanzo. JS testified he did not understand a margin account and did not know why Levy would want to put him on margin. Although the "Account Information Form" in JS's new account documents did not list any prior investing experience, the documents also included a "Customer Option Agreement" that indicated JS had 20 years of experience investing in options, with a usual size trade of "15," and that he had 30 years

[11] Tr. 1859-1985; CX-164A; CX-165A; CX-166A; CX-479.

[12] CX-563A, at 1.

of experience investing in stocks and bonds, with a usual size trade per year of "30." In fact, JS did not have any such experience. The Customer Option Agreement also indicated that the anticipated options transactions included covered calls, but JS testified he did not know what covered calls are.

Levy recommended all the purchases in JS's account. JS testified that sometimes Levy would call him about purchases in his account and sometimes he did not. There were short sales in his account, but JS testified he does not even know what a short sale is and Levy never explained to JS why he was doing short selling in JS's account. Levy never told JS that he was paying markups or markdowns on purchases in his account and JS did not know what markups or markdowns were, or what a riskless principal transaction was. In May 2012 he transferred his Newport account balance to a local broker at another FINRA member firm.[13]

JS invested over $75,000 in his Newport account, which was open from March 2010 through May 2012. Purchases totaled over $1.345 million, with sales of nearly $1.32 million. Enforcement calculated an annualized turnover rate of 11.81 and an annualized cost-to-equity percentage of 50.7%. Total costs were nearly $58,000, with losses of almost $37,000.[14]

- DS, a Costanzo customer, has owned his own fuel oil distribution company since 1990; in 2011 the company had about six employees. DS opened a Newport Coast account in the name of his company in February 2011 after receiving a cold call from Costanzo. At that time he had an account at another FINRA member firm, in which he had invested since he was young, with a value of about $100,000, invested primarily in mutual funds recommended by the RR for that account.

  DS's Newport Coast new account documents indicate his annual income was $100,000, his net worth (not including primary residence) was $2 million, and his liquid net worth was $175,000. The documents indicate that he had 25 years of experience investing in equities, and they state that his investment objective was Aggressive Growth and his risk tolerance was Speculation. The new account documents also included a Customer Margin Account Agreement and the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo.

  After opening his Newport Coast account, DS only glanced at his account statements and did not open them all; he opened confirmations just to see what he had bought and the price. He had no discussions with Costanzo about commissions or markups. Although he now understands he was paying markups, he did not discuss that with Costanzo at the time. There were short sales in his account, but he does not have a good understanding of what a short sale is. He closed the account in November 2011. On cross-examination, DS

[13] Tr. 3313-3426; CX-159A; CX-160A; CX-161A; CX-162.

[14] CX-564A, at 1.

acknowledged that he had opened other accounts based on cold calls both before and after he opened his Newport Coast account; that he understood Costanzo was being paid somehow for the trades in his account; and that short-term trading and the use of margin in his account was acceptable to him if recommended by Newport Coast. DS testified that he depends on the broker to make recommendations about what to do and focuses his attention on his business.[15]

DS invested more than $254,000 in his Newport account, although he also withdrew $150,000 while the account was open and received approximately $61,000 when he closed the account. During the period February 2011 through November 2011, purchases in DS's account totaled nearly $1.6 million, with sales of over $1.5 million. Taking into account DS's withdrawal of $150,000 in April 2011, Enforcement calculated an annualized turnover rate of 27.41 and an annualized cost-to-equity percentage of 104.72%. Total costs were over $60,000, with losses of over $43,000.[16]

- RS, a Costanzo customer, owned a dental technician business, which he sold in 2010 for $1 million. The terms of the sale required that he stay on for at least three years full time, drawing a salary of about $120,000. He also owned the building in which the business was located and rented it to the business. Before he opened his Newport Coast account, RS's primary investing experience involved buying blue chip stocks, as well as gold bullion, to fund his retirement, but in 1999 he was forced to sell all his investments when his business was destroyed by a flood and he needed the funds to rebuild. He acknowledged that he had an account at another FINRA member firm while his Newport account was open, but he did not recall the value of that account and was not asked what his investments were in that account.

  RS opened his Newport Coast account after a cold call from Costanzo. According to RS, Costanzo did not explain what investments he was recommending or his strategy, but said it was supported by Newport Coast. RS's new account documents indicated that his annual income was $100,000, his net worth (excluding primary residence) was $1 million and his liquid net worth was $100,000. The documents list Aggressive Growth as his objective and Speculation as his risk tolerance, but RS testified that was not his actual objective or risk tolerance. Rather, he was looking to invest on a long-term basis for his retirement. RS's new account documents also included a Customer Margin Account Agreement and he signed the Short Term Trading Letter used by LaBarbera, Levy and Costanzo. RS testified that he and Costanzo never discussed what Costanzo's charges would be, and that Costanzo made all the purchase and sale decisions in the account. RS had never used margin in the past and was not aware that margin was being used in his

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[15] Tr. 2308-99; CX-84A; CX-85A; CX-86; CX-96.

[16] CX-556A, at 1.

account. He recalls speaking to Costanzo once or twice but after that Costanzo did not contact him about trades in the account.[17]

RS invested over $15,000 in his Newport account, which was open from March 2011 through February 2012. Purchases totaled over $210,000, with sales of nearly $200,000. Enforcement calculated an annualized turnover rate of 23.18 and an annualized cost-to-equity percentage of 110.38%. Total costs were over $10,000, with losses of approximately $14,600.[18]

- AB, a Costanzo customer, is a retired engineer. In the 1980s and 1990s he obtained an insurance license as well as Series 6 and Series 63 securities licenses for a side business, but that business did not work out for him so he did not use those licenses. He and his wife later learned about FOREX currency trading by joining a club and then became clients of a Canadian company that provided training and technical assistance, initially investing $5,000 to $10,000. They are still doing FOREX trading. AB testified that at the time his Newport Coast account was open, he had probably four or five mutual funds, which he selected, with about $50,000 invested. He and his wife also invested in some pre-IPO private placements, but apart from the private placements he had no experience investing in individual stocks before opening his Newport Coast account. He also had a net investment of about $400,000 in real estate and about $25,000 to $30,000 invested in silver when he opened his Newport Coast account in 2011.

  AB opened his account in response to a series of cold calls from Costanzo in which Costanzo urged him to make a small investment in a particular stock. AB's new account documents indicate that his income was $125,000, his net worth was $500,000 and his liquid net worth was $40,000. The documents listed his objective as Aggressive Growth and his risk tolerance as Speculation. AB's new account documents included a Customer Margin Account Agreement and he also signed the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo. AB testified that his objective with his Newport Coast account was to find a short-term opportunity to make a little money—short term being less than a year—and that he viewed the investment as riskier than normal. He acknowledged that the objective and risk tolerance shown on his new account form were accurate for the $2,500 he initially agreed to invest.

  After AB's initial investment, Costanzo called with another great opportunity—a company that had almost completed FDA studies —and he invested an additional $10,000. Costanzo called again urging him to buy more of the same company and he invested another $15,000. AB thinks he took a signature loan from his credit union to obtain that money. After a while the stock Costanzo had recommended was not doing well, but Costanzo called again and persuaded him to buy more of the stock on margin.

[17] Tr. 2499-2566; CX-88A; CX-89A; CX-90A; CX-106.

[18] CX-555, at 1.

When the company continued to not do well, Costanzo recommended selling that stock and moving the money to a different stock and AB agreed, but told Costanzo to get rid of the margin in his account because he did not want to pay margin interest. AB testified that Costanzo did not talk to him about other purchases and sales in his account in November 2011. When AB realized transactions he had not authorized were occurring he tried to call Costanzo without success, so he called Newport's general number and spoke to someone who told AB that he would look into the matter and get back to him. AB did get a return call and spoke to the person, whose name he does not recall, on several occasions. AB's primary concern was the continued use of margin in his account. At some point, seeing his account value dropping, AB called Newport and asked to have trading in the account frozen, and then closed the account. Costanzo did not explain riskless principal trading and AB does not know what that is; similarly, Costanzo did not discuss markups or markdowns. He did not understand short sales when he received confirmations indicating they had been made in his account.[19]

AB invested approximately $28,000 in his Newport Coast account, which was open from January 2011 through March 2012. Purchases totaled over $600,000, with sales of nearly $590,000. Enforcement calculated an annualized turnover rate of 24.66 and an annualized cost-to-equity percentage of 100.02%. Total costs were over $24,000, with losses of nearly $20,000.[20]

- MZ, a Costanzo customer, is an 81-year-old retired teacher. In 2010, when he opened his Newport Coast account, his income was $1,100 per month in social security and a pension of $1,700 per month. At that time, he had a small account with another FINRA member firm worth about $2,000 to $3,000, which he opened after taking an investing course at that firm. But he never picked stocks in any of his accounts himself; they were always recommendations from the RR.

  While MZ's testimony was not clear, it appears that MZ may have done business with Costanzo when he was associated with another FINRA member firm prior to associating with Newport Coast. In any event, MZ opened his Newport Coast account in January 2010. He received pre-completed new account documents, but corrected a number of items in the documents before returning them to Newport Coast. As corrected by MZ, the documents indicated that his income was $35,000, his net worth (excluding primary residence) was $500,000, and his liquid net worth was $25,000. The documents, as corrected by MZ, also indicated that his primary source of wealth was "Retirement Funds" and that the source of funds to fund his Newport Coast account was also "Retirement Funds." The pre-completed documents listed his objective as Aggressive Growthand his risk tolerance as Speculation, but MZ changed his risk tolerance to "Medium" before signing the documents. MZ also signed a Customer Margin Account

[19] Tr. 2163-2307; CX-101A; CX-102A; CX-103A; CX-104; RX-42.

[20] CX-557A, at 1.

Agreement and the Short Term Trading Letter used by LaBarbera, Levy, and Costanzo. MZ funded his Newport account with cash and with stock transferred from his account at another FINRA member firm. MZ testified that Costanzo made the investment decisions in his account. Costanzo never discussed charges with him and MZ does not know the meaning of markups or markdowns or riskless principal trades.[21]

MZ invested approximately $21,500 in his Newport Coast account, including the value of the stock he transferred into the account, which was open from January 2010 through August 2011. Purchases totaled almost $437,000, with sales of over $427,000. Enforcement calculated an annualized turnover rate of 26.9 and an annualized cost-to-equity percentage of 120.71%. Total costs were over $19,000, with losses of over $19,000.[22]

- MG, a Bartelt customer, is an 87-year-old widow who retired in 1990. When she was employed, she was an executive assistant. Her late husband, who was a purchasing agent, met Bartelt at a securities class, and he and Bartelt were the only two members of the class who subsequently obtained securities licenses. Her husband only worked in the securities business for a couple of months before returning to his work as a purchasing agent. MG's husband took care of their investments before he was diagnosed with Alzheimer's disease in about 2007; he died in 2009. Bartelt and MG's husband were very close friends and spoke every morning. MG and her husband moved their investments to Bartelt before her husband died and she continued with Bartelt after that. When MG's husband died she received $100,000 in life insurance, and after giving $10,000 to each of her daughters she invested the remaining $80,000 through Bartelt. She had no experience with investments apart from listening to her husband and Bartelt discuss them.

  MG had three Newport Coast accounts: an individual account, an IRA, and a trust account. The new account documents for all three accounts list her annual income as $65,000 to $124,999 and her net worth as $250,000 to $499,999. The documents for her individual and IRA accounts listed her objective as "long term growth with greater risk—Aggressive Growth (trade volatile securities that have wide change in price)," while the documents for her trust account listed her objectives, inconsistently, as both "long term growth with safety (long term capital appreciation with relative safety of principal)" and as "short term growth with high risk (appreciation with acceptance of high risk)." In fact, MG testified she wanted "growth but minimal risk." MG testified that Bartelt made all the investment decisions in all three accounts.[23]

  MG's individual account was opened in June 2010 with a transfer of approximately $22,000 from Bartelt's prior firm. During the period from June 2010 through December

[21] Tr. 2567-2695; CX-107; CX-108A; CX-109A; CX-110A; CX-112; CX-113.

[22] CX-558A, at 1.

[23] Tr. 2400-90; CX-292A; CX-293A; CX-294A; CX-295; CX-296; CX-454; CX-458; CX-459; CX-460; CX-482.

2012, when the account was actively traded, purchases totaled more than $436,000 and sales totaled more than $445,000. For this period, Enforcement calculated an annualized turnover rate of 22.74 and an annualized cost-to-equity percentage of 52.96%. Total costs were over $10,000 and losses totaled over $22,000, virtually the entire value of the account. MG's Newport Coast IRA was also opened in June 2010 with a transfer of approximately $60,000. For the active trading period from June 2010 through November 2012, purchases and sales each totaled approximately $3 million. Enforcement calculated an annualized turnover rate for the active period of 27.60 and an annualized cost-to-equity percentage of 57.42%. Total costs were more than $63,000 and total losses were nearly $45,000. During the same period, in her trust account, which was opened with a transfer of approximately $46,000, total purchases were approximately $2.9 million and total sales were approximately $3 million. For the active period, Enforcement calculated an annualized turnover rate of 31.01and an annualized cost-to-equity percentage of 67.26%. Total costs were more than $63,000 and total losses were almost $42,000.[24]

- LW, a Bartelt customer, is MG's daughter. She is 57, has a college degree in accounting, and worked as a bookkeeper before retiring in 1999 to care for her daughter, who is ill. She had some money in an IRA with another FINRA member firm that she transferred to Bartelt before he joined Newport Coast. The value of the securities that LW transferred into her Newport Coast IRA was approximately $6,000, plus a non-marketable Real Estate Investment Trust investment worth about $4,000. She had no experience in personally managing or selecting her investments before investing through Bartelt.

  After Bartelt moved to Newport Coast, LW signed her Newport Coast IRA new account documents without reading them closely because she trusted Bartelt. According to the documents, her income was $65,000 to $124,999 and her net worth was $125,000 to $249,999. Those amounts were correct only if the income figure applied to her husband's income—she was retired—and if the net worth amount included the value of the house she and her husband owned. The new account documents listed her objective as "long term growth with greater risk—Aggressive Growth (trade volatile securities that have wide change in price)," but in fact she wanted long-term growth with stability. Bartelt made all the trading decisions in her IRA account. He did not discuss the trades with her and she did not review her IRA statements or confirmations when she received them. In 2012, she realized that Bartelt was making a lot of trades in her account because of the number of confirmations she was receiving, and she asked him to stop trading her account. Bartelt continued to trade in her account and because she does not like confrontations she did not challenge him.[25]

  LW's Newport Coast IRA account was actively traded from June 2010 through January 2013. During that period, purchases were nearly 357,000 and sales were more than

[24] CX-567B, at 1; CX-568A, at 1; CX-569A, at 1.

[25] Tr. 897-988; CX-290A; CX-291.

$368,000. For this period, Enforcement calculated an annualize turnover rate of 18.93 and an annualized cost-to-equity percentage of 60.86%. Total costs were more than $11,500 and total losses were approximately $8,000.[26]

- LAC, a Bartelt customer, is a software engineer. He met Bartelt at a restaurant where Bartelt's sister worked and they became casual, friendly acquaintances. LAC invested with Bartelt before Bartelt moved to Newport Coast and continued to invest with him there.

  LAC had both an IRA and an individual account at Newport Coast. LAC's Newport Coast new account documents indicated his income was $125,000 to $249,999 and his net worth was $500,000 to $999,999. Neither of those figures was accurate. The documents also indicated that he had over 10 years of experience investing in stocks, averaging 10 purchases a year, and over 10 years of experience investing in bonds, averaging two purchases a year. In fact, his only investing experience prior to Bartelt was purchasing some stock of an employer, at an employee discount, between 1987 and 1990, and investing in retirement funds offered in his 401k plan. The documents for both accounts listed his objective as "long term growth with greater risk—Aggressive Growth (trade volatile securities that have wide change in price)," but he testified he wanted long-term growth with some aggressiveness, but not wide changes in price. The new account documents for LAC's individual account also included the word "yes" under "Margins Approved," but there was no evidence that LAC signed a separate margin agreement and he testified he did not recall Bartelt discussing margin with him. LAC does not believe he spoke to Bartelt after opening his Newport Coast accounts and he did not discuss the trades in his accounts with Bartelt. LAC testified he did not realize the extent of the losses in his accounts until FINRA staff contacted him.[27]

  LAC transferred $42,000 from another account to fund his Newport Coast IRA. During the active period from June 2010 through May 2013, purchases totaled over $2 million and sales also totaled over $2 million. Enforcement calculated an annualized turnover rate of 28.48 and an annualized cost-to-equity percentage of 60.35%. Total costs were almost $46,000, with total losses of nearly $40,000. LAC transferred approximately $8,000 in June 2010 to fund his individual account at Newport Coast. Bartelt did not trade the account until May 2011, by which time the value of the transferred investments had increased to more than $11,000. From May 2011 through December 2011, purchases totaled over $200,000 and sales also totaled over $200,000. For that period, Enforcement calculated an annualized turnover rate of 72.22 and an annualized cost-to-equity

[26] CX-572A, at 1.

[27] Tr. 2802-66; CX-286A; CX-287A; CX-288A; CX-289A; CX-456; CX-457.

percentage of 200.49%. Total costs were approximately $5,700 and total losses were over $10,000.[28]

- Although Levy, Costanzo and Bartelt defaulted and did not appear or testify at the hearing, portions of their investigative testimony designated by the parties were received in evidence at the hearing. None of that testimony contradicted or was otherwise inconsistent with the testimony of their customers or the documentary evidence regarding the trading in their customers' accounts. As noted above, Levy and Costanzo were in a partnership with LaBarbera and although each partner had his own customers, they conducted their business in the same manner. Each recommended the same securities during the same time periods, and each employed riskless principal trading with large markups or markdowns, most often on opening positions, and charged smaller commissions, most often on closing trades. Each used the same Short Term Trading Letter which was sent to their customers with the customers' new account documents. Bartelt stands apart from Levy and Costanzo in that he did not obtain his customers at issue in this proceeding through cold calling but through personal relationships. [29]

B. Conclusions Regarding the Quantitative Unsuitability Charge

1. Standards

FINRA, and previously NASD, has long required that member firms and their associated persons have a reasonable basis for believing that recommended investment transactions are suitable for their customers. This requirement represents a specific application of the general requirement, currently set forth in FINRA Rule 2010 and previously in NASD Rule 2110, that member firms and their associated persons "observe high standards of commercial honor and just and equitable principles of trade." Traditionally, and during the relevant time period, the suitability requirement applied to each transaction recommended by a firm or its RRs, and mandated a customer-specific evaluation of the suitability of the transaction for that customer, based on "the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." [30] This requirement is referred to as "qualitative suitability."

In addition, the suitability rules have long been interpreted to prohibit "quantitative unsuitability," which looks at the frequency and cost of recommended trading, rather than the qualities of the particular investments being recommended, to identify excessive trading in customer accounts initiated by the firm or its RRs. The quantitative unsuitability prohibition reflects concern that recommendations leading to frequent, high-cost trading are more likely to

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[28] CX-570A, at 1; CX-571A, at 1.

[29] CX-626; CX-627; CX-628.

[30] NASD Rule 2310 (in effect during most the relevant period); *cf.* FINRA Rule 2111 (current suitability rule).

serve the interests of the firm and its RRs than the customers, and therefore are inconsistent with the "fair dealing" standard embodied in the rules.[31]

The National Adjudicatory Council ("NAC") has explained: "To demonstrate excessive trading, or quantitative unsuitability, requires proof of two elements. The first element is broker control over the account in question. The second element is excessive trading activity inconsistent with the customer's financial circumstances and investment objectives."[32]

The first element, that the RR exercised *control* over trading in the customer's account, represents a significant distinction from qualitative unsuitability, which requires only that the RR have *recommended* an unsuitable investment. An RR exercises control over a customer's account if the RR makes the trading decisions, either because the RR has formal discretionary authority, or because the RR makes trades without obtaining prior authorization from the customer. Even if the RR does obtain the customer's authorization for every trade, however, the Securities and Exchange Commission ("SEC") has held that:

> **a broker's de facto control over an account may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions. Alternatively, de facto control exists where a customer routinely follows a registered representative's recommendations. In that context, we have considered whether the customer had sufficient understanding to make an independent evaluation of the broker's recommendations.**[33]

The second element, excessive trading activity, focuses on the frequency and cost of trading. For that reason, the SEC and the NAC have considered the rate of turnover of the account and the costs incurred by the customer as compared to the value of the account as the key considerations in determining whether the trading was excessive. High turnover is viewed as inconsistent with traditional investment guidance, while high cost-to-value makes it less likely that the customer can profit from the trading and more likely that the firm and the RR will be the primary beneficiaries. These considerations are typically expressed as numerical values, the annualized turnover rate and the annualized cost-to-equity percentage. As the SEC recently explained:

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[31] NASD IM-2310-2(b)(2); *John M. Reynolds*, 50 S.E.C. 805, 809 N. 13 (1991).

[32] *Dep't of Enforcement v. Davidofsky*, No. 2008015934801, 2013 FINRA Discip. LEXIS 7, at 27 (NAC Apr. 26, 2013) (internal quotation marks and footnotes omitted).

[33] *Ralph Calabro*, Exchange Act Release No. 75076, 2015 SEC LEXIS 2175, at *18 (May 29, 2015) (internal quotation marks and footnotes omitted); *see also Dep't of Enforcement v. Medick*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, at *34 (NAC July 20, 2009) ("*De facto* control is established when the client routinely follows the broker's advice because the customer is unable to evaluate the broker's recommendations and to exercise independent judgment.") (internal quotation marks and footnote omitted).

The turnover rate represents the number of times in one year that a portfolio of securities is exchanged for another portfolio of securities and is calculated by dividing the total account purchases by the average account equity and annualizing the number. The cost-to-equity ratio measures the amount an account has to appreciate annually just to cover commissions and other expenses and is obtained by dividing total expenses by average monthly equity. While there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading, we have held that a turnover rate of 6 or a cost-to-equity ratio in excess of 20% generally indicates that excessive trading has occurred. … Other relevant factors in determining the existence of excessive trading include the number and frequency of trades; the client's investment objectives and financial condition, age, and retirement status; and the existence of unauthorized trades.[34]

2. Control

As explained above, the first issue in determining whether there was quantitatively unsuitable trading is whether the RRs controlled the customers' accounts. In this case, none of the RRs exercised formal discretionary authority over any of the accounts at issue—indeed, Newport Coast prohibited its RRs from exercising formal discretionary authority over any customer account—but as set forth above, a number of the customer witnesses testified that the RRs made trades in their accounts without obtaining their prior authorization.[35]

Insofar as Levy, Costanzo or Bartelt did obtain the customers' authorizations before making the trades, the Hearing Officer finds they still exercised de facto control over the accounts because the customers relied on their RR to such a degree that the RR controlled the volume and frequency of transactions in the customers' accounts, and because the customers routinely followed the RRs' recommendations. All of the customers testified, credibly, that they relied entirely on the RR and that the RR selected each of the securities that were purchased in their accounts, and decided when the security should be purchased, how much of the account should be invested in the security and when the security should be sold. In the investigative testimony offered in evidence, Levy, Costanzo and Bartelt did not claim that any of their customers initiated any of the trading in the customers' accounts.

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[34] *Calabro*, 2015 SEC LEXIS 2175, at *32-34 (internal quotation marks, footnotes, and citations omitted); *see also Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *30 and nn.29, 30, and cases cited therein.

[35] *See, e.g.*, *Sandra K. Simpson*, 55 S.E.C. 766, 796 (2002) ("De facto control was shown by the many unauthorized transactions and the customers' general lack of investment knowledge and sophistication, which left control of the account in the hands of [the RR]"); *Frederick C. Heller,* 51 S.E.C. 275, 278 (1993) (finding an RR exercised *de facto* control over a customers' account where the customers "were not consulted, nor typically even made aware of, the particular trades executed in their account until well after the fact"); *see also Calabro*, 2015 SEC LEXIS 2175, at *18 n. 20 (citing *Simpson* and *Heller*, and stating: "Where a broker engages in unauthorized transactions, he operates as though he has been delegated discretionary authority (and thus formal control) by the client, although he has not been.").

Further, even insofar as the customers were aware of the trading in their accounts, they did not have "sufficient understanding to make an independent evaluation of the broker's recommendations." Most of the customers were inexperienced, naïve investors. Of the Levy, Costanzo and Bartelt customers who testified, BNS might be described as a knowledgeable investor, based on his past investing experience, but the Hearing Officer credited his testimony that from September 2010 on, Levy traded the account on his own, without obtaining BNS's approval of the trades.[36] As a result, Levy exercised control over the account. The Hearing Officer finds, therefore, that the control element is satisfied.[37]

3. Excessive Trading

The Hearing Officer also finds that the trading activity in all of the customer accounts at issue was excessive and inconsistent with the customers' financial circumstances and investment objectives. As noted above, the SEC and the NAC have indicated that a turnover rate of over six and a cost-to-equity percentage in excess of 20% are indications of excessive trading. For Levy's three customers, the annualized turnover rate ranged from 11.81 to 16.15 and the annualized cost-to-equity percentage ranged from 50.7% to 68.82%; for Costanzo's four customers, the annualized turnover rate ranged from 23.18 to 27.41 and the annualized cost-to-equity percentages ranged from 100.02% to 120.71%; for Bartelt's three customers' six accounts, the annualized turnover rate ranged from 18.93 to 72.22 and the annualized cost-to-equity percentage ranged from 52.96% to 200.49%.

Trading with the turnover rates and especially the cost-to-equity percentages that the RRs generated in the customer accounts at issue would not be suitable for any customer, regardless of the customer's financial circumstances and investment objectives. The Hearing Officer acknowledges that active trading leading to turnover rates well above six could conceivably be

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[36] Costanzo customer AB had experience investing in other arenas, but had never before invested in individual stocks, and the Hearing Officer did not find him to be capable of independently evaluating Costanzo's recommendations. Moreover, the Hearing Officer credited AB's testimony that much of the trading in his account was undertaken by Costanzo without AB's prior approval.

[37] *See Calabro*, 2015 SEC LEXIS 2175, at *21 and n.23 (finding that the RR "exercised de facto control over [the customer's] account because [the customer] routinely followed [the RR's] recommendations. [The customer] deferred to [the RR] with respect to establishing (and altering) account strategy, selecting securities, and determining when and in what quantities to trade them. When [the RR] informed [the customer] of transactions that [the RR] selected or had already implemented, [the customer] felt he could not object to them because of his lack of knowledge and expertise"); *see also Michael David Sweeney*, 50 S.E.C. 761, 766 (1991) (finding control where "[w]ith few exceptions, the customers did not initiate the transactions in their accounts, nor did they fully understand the trading therein. When the customers decided to effect the transactions at issue, they were relying totally on the [RRs]. Indeed, the [RRs'] consultations with their customers on investment choices were merely a formality, since the customers invariably followed their recommendations"); *Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *43 (May 27, 2011), *aff'd* 693 F.3d 251 (1st Cir. 2012) (finding that respondent "maintained *de facto* control because the Customers did not independently evaluate his recommendations but rather acquiesced in his trades"); *Joseph J. Barbato*, 53 S.E.C. 1259, 1277 (1999) (concluding that the RR exercised de facto control where the customer "testified that he placed his trust and confidence in [the RR] and allowed him to decide what to buy or sell in the account").

suitable for certain sophisticated customers who understand the risks associated with such trading. The Hearing Officer can conceive of no customers, however, for whom turnover rates coupled with cost-to-equity percentages at the levels found in this proceeding would be suitable. For Levy's customers, the break-even annualized returns were 50.7% to 68.82%; for Costanzo's, 100.02% to 120.71%; and for Bartelt's, 52.96% to 200.49%. No customers, regardless of their financial circumstances and investment objectives, would make a rational decision to invest on such a basis because they would know they would be highly unlikely to profit from the trading, and that the trading would primarily benefit the RR.[38]

Looking to the financial circumstances and investment objectives of the customers at issue in this proceeding, the Hearing Officer finds that the amounts many of them invested were important to their future financial well-being. JS, who was retired and of modest means, invested and lost more than the entire amount of his liquid net worth, as reflected in his Newport Coast new account documents; MZ, also retired and of modest means, similarly invested and lost most of his liquid net worth as shown in his Newport Coast new account documents. MG, an elderly widow, lost nearly all of her IRA, trust and individual account funds, and her daughter LW lost nearly all of her IRA investment as a result of Bartelt's excessive trading in their accounts. All of these customers were inexperienced, naïve investors who did not understand the manner in which their accounts would be handled, and the level and cost of trading in their accounts was clearly unsuitable for them.

Even if some customers invested only money that they were prepared to lose and understood that their accounts would be invested in speculative securities, the trading that actually occurred in their accounts was excessive. Those customers accepted market risk, that is, the possibility that the securities they invested in might decrease in value, costing them the funds they had invested. But in fact the customers' losses were not primarily attributable to market risk, but rather to the RRs' greed in trading the customers' accounts for their own benefit. Indeed, in some of the customers' accounts there was little or no net loss on the trades themselves; rather those customers lost significant amounts of money because of the extraordinary amounts, including commissions, markups and markdowns, and other costs, that they were charged for the trades.[39] Even if the funds they invested were insignificant to their total financial circumstances, none of the customers intended that their investments serve primarily to benefit the RR through whom they invested.

The Hearing Officer also considered that the customers signed Newport Coast new account documents stating financial means, investment experience, and high risk investment objectives and risk tolerance that some of the customers now disavow. In addition, some of the customers signed active trading letters provided by Levy or Costanzo purporting to approve of active trading in their accounts.

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[38] *See Clyde J. Bruff*, 53 S.E.C. 880, 885 (1998) ("where a trading strategy results in costs so high as to make the generation of any profit unlikely, the trading is excessive").

[39] *See* cost and loss figures for customers AB, MZ, MG (IRA and trust accounts), LW, and LAC (IRA account) set forth above.

Even if the customers were held to the information and disclosures they signed, it would not justify the trading in their accounts. The SEC has stated:

> **Even if we were to assume that the customers authorized the [respondents] to manage their accounts aggressively, they did not authorize them to deplete those accounts through commissions, markups and margin charges. There is a difference between aggressive investing and excessive trading. A primary test for excessive trading is the relationship between the net amount of money invested and the transaction costs that are incurred.**[40]

As explained above, the cost-to-equity figures in this case dwarf those found to be excessive in prior cases and clearly evince the RRs excessive trading of the customers' accounts for their own benefit.

Accordingly, the Hearing Officer concludes that Levy, Costanzo and Bartelt each engaged in quantitatively unsuitable trading in customer accounts. The Hearing Officer further concluded that Levy, Costanzo and Bartelt violated NASD Rule 2310 and IM-2310-2 (for conduct during the period September 2008 through July 8, 2012), FINRA Rule 2111 (for conduct after July 8, 2012), NASD Rule 2110 (for conduct through December 14, 2008) and FINRA Rule 2010 (for conduct after December 14, 2008).

III. Churning

Quantitative unsuitability is a violation of FINRA rules, while churning is a type of fraudulent conduct that violates Section 10(b) of the Securities Exchange Act and Rule 10b-5. Nevertheless, the standards applicable to both are essentially the same, with one exception. As with quantitatively unsuitable trading, a finding of churning requires proof that the RR controlled trading in the customer's account, either formally or de facto, and that the trading was excessive. In addition, however, churning requires that the RRs acted with scienter, which "requires proof that a respondent intended to deceive, manipulate, or defraud, or acted with severe recklessness involving an extreme departure from the standards of ordinary care."[41] In a recent churning case finding scienter, the NAC noted that "[t]he cost-to-equity ratio and turnover rate for [the customer's] account were so high that [the respondent] must have known that he was acting in reckless disregard of [the customer's] interests – [the customer] had to earn nearly 45 percent per year simply to break even." The NAC also stated that "the amount of commissions that [the

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[40] *Sweeney*, 50 S.E.C. at 765.

[41] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *31-32 (internal quotation marks and footnotes omitted). A finding of a violation of Section 10(b) and Rule 10b-5 also requires proof that the Respondents used "any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5. This requirement is plainly satisfied here because the RRs communicated with the customers by telephone and the excessive trades were effected through various means of interstate commerce and the facilities of national securities exchanges.

respondent] generated from trading [the customer's] account demonstrates that he acted with scienter."[42]

Application of the NAC's reasoning to the facts of this case leads inevitably to the conclusion that Levy, Costanzo and Bartelt acted with scienter. The cost-to-equity ratios and turnover rates for all the customers in this case were astronomical and for most of the customers far above the levels found to indicate churning in prior cases. In all of the customer accounts at issue, the benefits to the RR far outstripped any likely return to the customers from the trading, making it manifest that the RRs were trading for their own benefit without regard to the interests of the customers. Accordingly, the Hearing Officer concluded that Levy, Costanzo and Bartelt acted in willful and reckless disregard of the customers' interests. The Hearing Officer therefore concludes that Levy, Costanzo and Bartelt churned customer accounts in violation of Section 10(b) and Rule 10b-5. Furthermore, their violations of Section 10(b) and Rule 10b-5 were also violations of, NASD Rules 2120 and 2110 (for conduct through December 14, 2008) and FINRA Rules 2020 and 2010 (for conduct after December 14, 2008). [43]

IV. Qualitative Unsuitability

A. Facts

In addition to the quantitative unsuitability charge, the Complaint charges that Levy and Costanzo recommended certain qualitatively unsuitable investments. Enforcement's qualitative unsuitability charge relates to the purchases of various ETPs in the accounts of one customer of Levy (NK) and two customers of Costanzo (AB and MZ). Some of the purchases were of leveraged and, in some cases, inverse Exchange Traded Funds ("ETFs"), while other purchases were of a different type of product, the iPath S&P 500 VIX Short Term Futures Exchange Traded Notes ("ETNs"), which traded under the symbol VXX.

Costanzo recommended three ETF purchases in MZ's account between March 2010 and September 2010. The ETFs recommended by Costanzo were: (1) Direxion Daily Clean Energy Bull 3X Shares (ERX); (2) Direxion Daily Small Cap Bear 3X Shares (TZA); and (3) ProShares Ultra DJ-UBS Crude Oil (UCO).[44] The ETFs recommended by Costanzo were designed to generate daily leveraged and, in some cases, inverse returns on a defined benchmark. Specifically, ERX and UCO were designed to generate daily returns that were 300% or, for UCO, 200% of the daily performance of their benchmark, while TZA was designed to generate daily returns that were inverse, or opposite, to the daily performance of its benchmark by 300%.

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[42] *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at 33.

[43] NASD Rule 2120 provided, and FINRA Rule 2020 provides: "No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." The churning of customer accounts is a violation of these rules, and a violation of these rules is a violation of NASD Rule 2110 or FINRA Rule 2010, for conduct that occurred while each respective rule was effective. *See, e.g.*, *Davidofsky*, 2013 FINRA Discip. LEXIS 7, at *26 n.27.

[44] CX-592.

All these ETFs were high risk investments designed to be traded over a single day and were intended to be used by highly sophisticated investors. For example, the prospectus for TZA explained:

> **The Fund seeks daily investment results, before fees and expenses, of 300% of the inverse (or opposite) of the price performance of the Russell 2000® Index ("Index").** ***The Fund seeks*** **daily** ***leveraged investment results and does not seek to achieve its stated investment objective over a period of time greater than one day.*** **The Fund is different and much riskier than most exchange-traded funds.**
>
> **The Fund is designed to be utilized only by knowledgeable investors who understand the potential consequences of seeking daily leveraged investment results, understand the risks associated with shorting and the use of leverage, and are willing to monitor their portfolios frequently. The Fund is not intended to be used by, and is not appropriate for, investors who do not intend to actively monitor and manage their portfolios.**[45]

The prospectuses for the other ETFs Costanzo recommended contained similar warnings regarding the risks of investing.[46]

In his investigative testimony, Costanzo was asked why the ETFs he recommended and sold to MZ, the retired school teacher, were suitable. In response, Costanzo claimed that he had previously believed that they were suitable for MZ, but acknowledged that, based on his understanding at the time he testified, the type of ETFs he recommended "are not geared or suited for retail clients."[47]

Levy recommended one purchase of VXX in NK's account in February 2012, while Costanzo recommended one purchase of VXX in MZ's account in June 2010, as well as one purchase of VXX in AB's account in February 2012.[48]

The prospectus for VXX, which also covered a related ETN, explained:

> **Each series of ETNs are medium-term notes that are uncollateralized debt securities and are linked to the performance of an underlying Index that is designed to provide investors with exposure to one or more maturities of futures contracts on the VIX Index, which reflect implied volatility of the S&P 500® Index at various points along the volatility forward curve. The**

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[45] CX-333, at 139-40 (emphasis in original).

[46] *See* CX-333 (ERX); CX-343 (UCO).

[47] CX-626, at 51-58, 60-68. MZ testified that Costanzo did not explain the ETFs to him. Tr. 2599, 2615.

[48] CX-593.

VIX Index is calculated based on the prices of put and call options on the S&P 500® Index.[49]

The prospectus further explained that the VXX ETN was "linked to the performance of the S&P 500 VIX Short-Term Futures™ Index TR that is calculated based on the strategy of continuously owning a rolling portfolio of one-month and two-month VIX futures to target a constant weighted average futures maturity of 1 month …."[50] The prospectus listed numerous risks associated with an investment in VXX and suggested VXX might be an appropriate investment for an investor who, *inter alia*, was "willing to accept the risk of fluctuations in volatility in general and in the prices of futures contracts on the VIX Index in particular."[51]

In the portions of his investigative testimony offered in evidence by the parties, Levy did not address the suitability of VXX for NK, but in Costanzo's investigative testimony, he acknowledged that his comment that the ETFs he sold were "not geared or suited for retail clients" also applied to VXX.[52]

B. Discussion

NASD Rule 2310, which was the governing standard during the relevant time period, required that in recommending an investment to a customer, RRs have "reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

As their prospectuses make plain, the leveraged and inverse ETFs recommended by Costanzo were complex investment products suitable only for certain sophisticated investors. Indeed, in June 2009, prior to Costanzo's recommended purchases in MZ's account, FINRA issued a Regulatory Notice addressing the sale of leveraged and inverse ETFs. The Notice stated that, "[w]hile such products may be useful in some sophisticated trading strategies," they "typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets." The Notice further explained that to perform the suitability assessment required by NASD Rule 2310 in connection with the recommendation of leveraged or inverse ETFs, the first step would be to determine that the particular ETF was suitable for at least some customers, "an analysis that requires firms and associated persons to fully understand the products and transactions they recommend." Assuming the firm and the RR concluded that the particular ETF was suitable for at least some customers, the Notice advised that the firm and the RR would also need to determine that the ETF was suitable for the

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[49] CX-347, at 4.

[50] CX-347, at 4.

[51] CX-347, at 6-7.

[52] CX-626, at 67-68.

particular customers to whom it was being recommended.[53] There is no indication that Costanzo performed or was capable of performing either a general analysis of the suitability of the ETFs he sold or a specific assessment of the suitability of those ETFs for MZ. On the contrary, in his investigative testimony Costanzo conceded they were not suitable for MZ.

If anything, VXX was an even more sophisticated and complex product than leveraged and inverse ETFs, as the descriptions from the prospectus quoted above make clear. Certainly the record provides nothing from which any reasonable RR could have reasonably concluded that VXX was a suitable investment for NK, MZ or AB, and as noted above, Costanzo acknowledged it was not suitable for any retail investor. Even assuming that VXX might have been a suitable investment for some highly sophisticated customers, NK, MZ and AB were not sophisticated investors.

Accordingly, the Hearing Officer concluded that Levy and Costanzo made qualitatively unsuitable recommendations of ETPs and thereby violated NASD Rules 2310and 2110, and FINRA Rule 2010.

V. Obstruction of FINRA's Disciplinary Process

A. Facts

In January 2014, Enforcement sent Levy and Costanzo Wells notices advising them that Enforcement had "made a preliminary determination to recommend that disciplinary action be brought against you" for, *inter alia*, recommending quantitatively unsuitable transactions in, and churning, certain customer accounts, including the accounts of Levy customer NK and Costanzo customer MZ.[54] In February 2014, Levy traveled to Iowa to meet with NK. During the meeting, which NK's son recorded, Levy conceded that, having received the Wells notice, "for me to offer [NK] restitution in exchange for [NK] not cooperating with [FINRA's] investigation is illegal." Nevertheless, Levy went to state: "[W]hat I was suggesting or thinking about, but I can't really make this suggestion," was that, if NK would sign a letter to FINRA prepared by Levy stating that NK would not testify in Enforcement's proposed disciplinary proceeding, Levy would assist NK in pursuing an arbitration claim against Newport Coast. After the meeting, however, NK advised Levy that he would not sign the letter.[55]

Similarly, in February 2014, Costanzo called MZ and dictated a letter that Costanzo asked MZ to send to Enforcement. The substance of the letter was that MZ would not cooperate with Enforcement's investigation and would not testify at any hearing. Costanzo told MZ that Enforcement's proposed action would affect his livelihood. MZ then drafted a letter to FINRA that differed somewhat from the text dictated by Costanzo, but still indicated he would not cooperate with Enforcement's investigation and would not testify. Instead of sending the letter to

[53] FINRA Regulatory Notice 09-31 (June 2009), http://www.finra.org/industry/notices/09-31; CX-253, at 1, 3.

[54] CX-327; CX-328.

[55] Tr. 1743-50; CX-469; CX-470.

Enforcement, however, MZ took his draft to his financial planner, JE, who advised him not to send the letter.[56] Costanzo subsequently called JE and repeated his desire to have MZ send a letter to Enforcement stating that he refused to testify at the hearing. Costanzo indicated to JE that "he would somehow manage to compensate [MZ] if such a letter was sent." MZ did not send the letter that Costanzo requested. Instead, JE sent MZ's notes of his conversations with Costanzo and MZ's draft letter to Enforcement, and both MZ and JE testified at the hearing.[57]

B. Discussion

Enforcement charged that Levy and Costanzo's actions in contacting NK and MZ obstructed FINRA's disciplinary process, in violation of FINRA Rule 2010.[58] As Levy recognized during his conversation with NK, any attempt to dissuade a customer from cooperating with a FINRA investigation or proceeding is improper. The SEC has explained:

> An integral aspect of the statutory scheme for regulating broker-dealers and protecting investors is the responsibility of self-regulatory organizations such as the NASD to investigate allegations that members and their associated persons have engaged in misconduct and to impose sanctions when appropriate. To fulfill this responsibility properly, [FINRA] must not be impeded from obtaining the cooperation of customers in its investigations, as well as that of members and their associated persons. Attempts such as [respondent's] to pressure customers to withdraw their [FINRA] complaints can undermine [FINRA's] ability to obtain such cooperation.[59]

The same reasoning applies to Levy's and Costanzo's efforts to dissuade NK and MZ from cooperating with FINRA's investigation and from testifying at the hearing in this matter. Their conduct plainly violated Rule 2010's requirement that member firms and their associated persons "observe high standards of commercial honor."

VI. Sanctions

Enforcement requested that the Hearing Officer bar Levy, Costanzo and Bartelt from association with any FINRA member firm and also order them to pay restitution to the injured customers and substantial fines.

The violations found in this case were closely interrelated. The churning violation arose from the same excessive trading as the quantitative suitability violation and the qualitatively unsuitable recommendations were made as part of the quantitatively unsuitable trading, and Levy and Costanzo attempted to interfere with FINRA's disciplinary process regarding that

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[56] JE is a financial planner, and is not associated with any FINRA member firm. Tr. 2700-01.

[57] Tr. 2624-30, 2703-09; CX-321; CX-322; CX-323.

[58] Compl. ¶ 441.

[59] *William Edward Daniel*, 50 S.E.C. 332, 335-36 (1990).

misconduct. Accordingly, the Hearing Officer concludes that a single set of sanctions should be applied to each Respondent to address that Respondent's misconduct.[60]

The Hearing Officer first considered Enforcement's request that Levy, Costanzo and Bartelt be barred. The primary violation in this case was the excessive trading of the customers' accounts. For excessive trading or churning, the Sanction Guidelines recommend a suspension in any or all capacities for a period of 10 business days to one year, or in egregious cases a longer suspension of up to two years or a bar. Similarly, for unsuitable recommendations, the Guidelines provide: "Where aggravating factors predominate, strongly consider a bar for an individual respondent."[61] Levy's, Costanzo's and Bartelt's excessive trading and churning of customer accounts was plainly egregious. Several of the applicable relevant factors listed in the Guidelines apply to Respondents: (1) none of the Respondents has accepted any responsibility for or acknowledged his misconduct; (2) none of the Respondents, prior to detection, attempted to remedy his misconduct or to pay restitution to the injured customers; (3) each of the Respondents engaged in numerous acts and a pattern of misconduct; (4) each of the Respondents engaged in the misconduct over an extended period of time; and (5) the misconduct caused substantial injury to the affected customers.[62] The Hearing Officer discerns no mitigating factors relating to the RRs' excessive trading and churning violations. Accordingly, the Hearing Officer concludes that Levy, Costanzo and Bartelt should be barred for those violations.

The Hearing Officer also agrees with Enforcement that restitution is an appropriate sanction in this case. The Sanction Guidelines provide: "Adjudicators may determine that restitution is an appropriate sanction where necessary to remediate misconduct. Adjudicators may order restitution when an identifiable person … has suffered a quantifiable loss proximately caused by a respondent's misconduct." Further, "Adjudicators should calculate orders of restitution based on the actual amount of the loss sustained by a person … as demonstrated by the evidence. Orders of restitution may exceed the amount of the respondent's ill-gotten gain. Restitution orders must include a description of the Adjudicator's method of calculation."[63]

In this case, the customers suffered quantifiable losses as a result of the excessive trading of their accounts. Enforcement contends that the proper amount of restitution to the customers would be the total amount of losses in their accounts, but the Hearing Officer disagrees. Those losses reflect the market results of the trades placed by the RRs, as well as the costs imposed by the excessive trading. Apart from Levy and Costanzo's recommendations of ETPs in a few

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[60] *See Dep't of Enforcement v. Fox & Co. Invs., Inc.*, No. C3A030017, 2005 NASD Discip. LEXIS 5, at *37 (NAC Feb. 24, 2005) ("[W]here multiple, related violations arise as a result of a single underlying problem, a single set of sanctions may be more appropriate to achieve [FINRA's] remedial goals.") (citation omitted), *aff'd*, 58 S.E.C. 873, 894 (2005).

[61] FINRA Sanction Guidelines at 77, 94 (2015), http://www.finra.org /industry/sanction-guidelines.

[62] Guidelines at 6.

[63] Guidelines at 4.

customer accounts, Enforcement did not allege that any market losses in the customers' accounts were attributable to qualitatively unsuitable recommendations.

The Hearing Officer finds that the loss proximately caused by Respondents' misconduct was the costs imposed on the customers as a result of the excessive trading in their accounts. Although they received only a partial payout of the commissions, markups and markdowns and other costs, Respondents initiated the excessive trading and determined the amount of commissions, markups and markdowns that were charged. Accordingly, the Hearing Officer will order each Respondent to pay restitution to his customers in the full amount of the costs incurred by those customers, together with interest on those amounts. Because the costs were imposed and collected over an extended period that varied from customer to customer, interest will run from the end of the relevant time period, *i.e.*, May 31, 2013.

The Hearing Officer will also order Levy, Costanzo and Bartelt to pay fines for their misconduct. Under the particular circumstances of this case, the Hearing Officer finds it appropriate to impose substantial fines against each Respondent, but to give each Respondent a credit against the fine for any amounts that the Respondent pays to customers to satisfy the Hearing Officer's order of restitution.

VII. Order

The Hearing Officer concluded that:

(1) Respondents Levy, Costanzo, and Bartelt engaged in quantitatively unsuitable trading in the accounts of customers, in violation of NASD Rules 2310 and 2110, FINRA Rules 2111 and 2010, and NASD IM-2310-2;

(2) Respondents Levy, Costanzo, and Bartelt churned the accounts of customers, in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5, FINRA Rules 2020 and 2010, and NASD Rules 2120 and 2110;

(3) Respondents Levy and Costanzo made qualitatively unsuitable recommendations of transactions involving leveraged or inverse ETPs to customers, in violation of NASD Rules 2310 and 2110 and FINRA Rule 2010; and

(4) Respondents Levy and Costanzo attempted to impede FINRA's disciplinary process, in violation of FINRA Rule 2010.

For these violations, Respondents Levy, Costanzo and Bartelt are barred from association with any FINRA member firm in any capacity.

In addition:

(1) Levy shall pay restitution to his customers NK, BNS and JS in the amounts listed on Addendum A to this Decision, plus interest at the rate established for the underpayment

of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a) from May 31, 2013, until paid.[64] Levy shall also pay a fine in the amount of $150,000, less any amounts that Levy can demonstrate he has paid in restitution to his listed customers.

(2) Costanzo shall pay restitution to his customers RS, DS, AB and MZ in the amounts listed on Addendum A to this Decision, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a) from May 31, 2013 until paid. Costanzo shall also pay a fine in the amount of $150,000, less any amounts that Costanzo can demonstrate he has paid in restitution to his listed customers.

(3) Bartelt shall pay restitution to his customers MG, LW and LAC in the amounts listed for those customers on Addendum A to this Decision, plus interest at the rate established for the underpayment of income taxes in Section 6621(a) of the Internal Revenue Code, 26 U.S.C. § 6621(a) from May 31, 2013 until paid. Bartelt shall also pay a fine in the amount of $250,000, less any amounts that Bartelt can demonstrate he has paid in restitution to his listed customers.

The restitution and fines shall be payable on a date set by FINRA, but not less than 30 days after this Decision becomes FINRA's final disciplinary action in this matter. If this Decision becomes FINRA's final disciplinary action, the bars shall be effective upon service of this Decision.

David M. FitzGerald
Hearing Officer

Copies to: David M. Levy (via first-class and electronic mail)
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[64] The customer accounts listed on Addendum A are more specifically identified in Addendum B to this Decision, which is served only on the parties, and in the exhibits cited in Addendum A.

ADDENDUM A
Costs Restitution Schedule

Customer	Costs
Levy Customers	
NK	$36,854.48[65]
BNS	$30,969.99[66]
JS	$57,827.04[67]
Levy Customer Total	**$125,651.51**
Costanzo Customers	
RS	$10,078.23[68]
DS	$60,591.81[69]
AB	$24,542.39[70]
MZ	$19,629.09[71]
Costanzo Customer Total	**$114,841.52**

65 CX-565A, at 1.

66 CX-563A, at 1.

67 CX-564A, at 1.

68 CX-555A, at 1.

69 CX-556A, at 1.

70 CX-557A, at 1.

71 CX-558A, at 1.

Bartelt Customers

MG Individual Account	$10,314.51[72]
MG IRA Account	$63,116.13[73]
MG Trust Account	$63,568.98[74]
LW	$11,696.21[75]
LAC Individual Account	$ 5,719.96[76]
LAC IRA Account	$45,914.87[77]
Bartelt Customer Total	**$200,330.66**

[72] CX-567B, at 1.

[73] CX-568A, at 1

[74] CX-569A, at 1.

[75] CX-572A, at 1.

[76] CX-570A, at 1.

[77] CX-571A, at 1.