

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER AND CONSENT  
NO. 2014043089901**

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

**RE:** City National Securities, Inc., Respondent  
CRD No. 103705

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Respondent City National Securities, Inc. ("CNS") 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 CNS alleging violations based on the same factual findings described herein.

**I.**

**ACCEPTANCE AND CONSENT**

- A. CNS hereby 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**

CNS is a general securities broker dealer with 162 registered representatives and four non-registered individuals. One hundred nine of its registered representatives are dually-registered as investment adviser representatives. CNS engages in fixed income securities trading and offers investment advisory services through affiliated registered investment advisors.

**OVERVIEW**

From January 2008 through September 2014 (the "relevant period"), CNS failed to supervise certain of its registered representatives to ensure their compliance with FINRA rules relating to outside business activities, private securities transactions, and outside accounts. In particular, during the relevant period, although CNS was aware that registered representative DZ, who was employed by a CNS affiliated registered investment advisor ("affiliated RIA"), was engaging in outside business activities, held outside brokerage accounts through those outside entities, and was engaging in private securities transactions through at least one of those outside entities, the firm did not ensure that DZ properly disclosed those

outside business activities, private securities transactions, or outside brokerage accounts. CNS thus failed to adequately review or evaluate DZ's outside business activities, failed to supervise the activity in some of the outside brokerage accounts and the private securities transactions, failed to record the private securities transactions on CNS's books and records, and failed to identify and follow up on items that should have warranted further scrutiny of DZ's activities. As a result of the foregoing, CNS violated NASD Rules 3010<sup>1</sup> and 2110<sup>2</sup> and FINRA Rule 2010.

### **FACTS AND VIOLATIVE CONDUCT**

NASD Rule 3010 required that FINRA members establish and maintain a system, including written supervisory procedures ("WSPs"), to supervise the activities of each registered person that was reasonably designed to achieve compliance with applicable securities laws and rules. NASD Rule 3010 also required that FINRA members establish, maintain, and enforce WSPs to supervise the types of business in which it engaged and to supervise the activities of registered representatives, registered principals, and other associated persons that were reasonably designed to achieve compliance with applicable securities laws and regulations.

#### **CNS's Supervision Relating to Outside Business Activities**

NASD Rule 3030 provided, in relevant part, that "[n]o person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member." The successor to this rule, FINRA Rule 3270, which became effective December 15, 2010, likewise prohibits registered persons from engaging in outside business activities unless "he or she has provided prior written notice to the member, in such form as specified by the member."

The Supplementary Material to Rule 3270,<sup>3</sup> titled "Obligations of Member Receiving Notice," requires each member firm receiving notice of an outside business activity to (i) consider whether the activity would interfere with the person's responsibilities or be viewed as part of the firm's business and (ii) evaluate the advisability of imposing specific conditions or limitation on the outside business activity and whether the activity should be treated as an outside securities transaction subject to the private securities transaction rule. The

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<sup>1</sup> NASD Rule 3010 was superseded by FINRA Rule 3110 as of December 1, 2014. Because the conduct at issue occurred before December 1, 2014, NASD Rule 3010 is applicable.

<sup>2</sup> NASD Rule 2110 was superseded by FINRA Rule 2010 as of December 15, 2008.

<sup>3</sup> The Supplementary Material to Rule 3270 is also known as Rule 3270.01.

Supplementary Material also provides that a member must keep a record of its compliance with these obligations. FINRA Regulatory Notice 10-49 (October 2010), states that registered persons who were actively engaged in an outside business activity prior to December 15, 2010, firms had until June 15, 2011, to review such pre-existing activities under the standards set forth in FINRA Rule 3270, including the requirement that firms keep a record of their compliance with such standards.

During the relevant period, CNS's WSPs required its employees to disclose "any and all outside business activities," but failed to include any procedures about how and to whom outside business activity requests should be submitted for review and evaluation. Nor did CNS update its WSPs to reflect the requirements of the Supplemental Material of FINRA Rule 3270. In addition, at least one of the firm's OSJ managers did not know the procedure for evaluating or who evaluated outside business activities on behalf of CNS.

#### *CNS's Supervision Relating to Private Securities Transactions*

Under NASD Rule 3040,<sup>4</sup> before participating in a private securities transaction, an associated person was required to provide written notice to his member firm, "describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction." Rule 3040 defined a "private securities transaction" as "any securities transaction outside the regular course or scope of associated person's employment with member."

During the relevant period, CNS's WSPs reminded associated persons that "[i]t is a serious violation of FINRA rules for a Registered Representative to sell a security other than through the firm with which they are registered." The WSPs, however, focused only on private securities transactions involving CNS customers. The firm's WSPs did not address private securities transactions not involving CNS customers, even though dually-registered CNS representatives had investment advisory customers who were not also CNS customers.

#### *CNS's Supervision Relating to Outside Brokerage Accounts*

NASD Rule 3050<sup>5</sup> required representatives associated with a member firm, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, to notify both the employer member and the executing member, in writing, of his or her association with the other member. If the account was established prior to the association of the representative with the

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<sup>4</sup> NASD Rule 3040 was superseded by FINRA Rule 3280 as of September 21, 2015. Because the conduct at issue occurred before September 21, 2015, NASD Rule 3040 is applicable.

<sup>5</sup> NASD Rule 3050 was superseded by FINRA Rule 3210 as of April 3, 2017. Because the conduct at issue occurred before April 3, 2017, NASD Rule 3050 is applicable.

employer member, the associated person was required to notify both members in writing promptly after becoming so associated. In addition, NASD Rule 3050 required representatives, if requested, to provide duplicate copies of information related to such accounts. This rule was designed so that employer firms would exercise supervision over their representatives' outside accounts to evaluate account activity for compliance with securities laws and rules.

During the relevant period, CNS's WSPs stated that outside brokerage accounts would be approved by the President of City National Securities "on an exception basis only" and that such accounts, if approved, must provide account statements and confirmations to be reviewed by the Chief Compliance Officer. The WSPs, however, failed to address other aspects of compliance with Rule 3050, including (i) that a representative must provide written disclosure to CNS prior to opening an account, placing an initial order, or promptly after becoming associated with CNS and (ii) that a representative must also disclose his or her association with CNS to the outside brokerage firm.

#### *CNS's Supervisory Failures Related to Representative DZ*

During the relevant period, CNS registered representative DZ was involved in several business activities other than his registration with CNS and employment at the affiliated RIA, including serving as the managing member of a limited liability company that was an investment fund he operated for his friends, family, and himself. Individuals transferred money to the investment fund, and DZ placed trades on behalf of the investment fund through outside brokerage accounts. In October 2014, after issues with DZ and one of his outside business activities were elevated to personnel at CNS's home office and its parent company, CNS commenced an internal investigation that discovered DZ had misrepresented the value of the investment fund in an attempt to conceal losses the investment fund had incurred in 2007 and that the investment fund was worth a fraction of the value DZ represented to fund investors.<sup>6</sup>

During the relevant period prior to the investigation, however, CNS and personnel at the affiliated RIA had been aware of the investment fund, which DZ had been running before he became associated with CNS, and he discussed the investment fund and his involvement with it with various people associated with CNS and the affiliated RIA, including his OSJ manager. In addition, at least one individual associated with CNS invested in DZ's fund, and DZ used resources of the affiliated RIA to conduct business on behalf of the investment fund, such as making trades, sending wires, and emailing with fund investors.

DZ engaged in extensive outside business activities through the investment fund, but he did not provide CNS adequate written notice of the investment fund as required by NASD Rule 3030 and FINRA Rule 3270. DZ also failed to list the

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<sup>6</sup> DZ passed away on October 15, 2014.

investment fund as an outside business activity on his Uniform Application for Securities Industry Registration or Transfer ("Form U4"). Although CNS was aware of the investment fund, CNS did not conduct any analysis to determine whether the investment fund was an outside business that DZ needed to disclose, nor did CNS attempt to cause DZ to disclose the outside business in writing or update his Form U4. As a result, DZ's outside businesses were not reviewed or evaluated by CNS (including under FINRA Rule 3270), and his outside businesses were not disclosed on his Form U4 as required.

In addition, DZ did not provide CNS any written notice of the private securities transactions he conducted in connection with the investment fund, much less written notice describing in detail the transactions, his role in the transactions, and whether he received compensation for the transactions. During the relevant period, however, CNS knew that individuals invested in the investment fund, including at least one associated person of CNS and clients of the affiliated RIA, and that DZ then traded on behalf of the investment fund through outside brokerage accounts. Nevertheless, CNS did not conduct any analysis to determine whether these transactions were private securities transactions that DZ needed to disclose, nor did CNS attempt to cause DZ to disclose the private securities transactions in writing. As a result, CNS did not approve DZ's participation in the private securities transactions, record them on its books and records, or supervise them as if they were executed on behalf of CNS.

Also during the relevant period, DZ did not provide CNS written notice of certain outside brokerage accounts he held through his outside businesses, including the investment fund, did not receive approval from the President of CNS for these undisclosed accounts, and did not ensure that CNS received duplicate brokerage account statements and confirmations regarding his undisclosed outside accounts. CNS knew that DZ had several outside brokerage accounts through outside entities, but did not conduct adequate follow up to ensure that DZ's accounts had been properly disclosed to CNS, that the firm holding the outside accounts was properly notified that DZ was registered with CNS, or that CNS was receiving duplicate statements. As a result, CNS did not receive duplicate account statements or confirmations for certain of DZ's outside accounts and did not supervise those accounts or evaluate activity in them for compliance with securities laws and rules.

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

B. CNS also consents to the imposition of the following sanctions:

- a censure; and
- a fine in the amount of \$250,000.

CNS agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. CNS has submitted an Election of Payment form showing the method by which CNS proposes to pay the fine imposed.

CNS specifically and voluntarily waives any right to claim that CNS is unable to pay, now 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.

## **II.**

### **WAIVER OF PROCEDURAL RIGHTS**

CNS specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a Complaint issued specifying the allegations against CNS;
- 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, CNS 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.

CNS 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**

CNS 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 CNS; and
- C. If accepted:
  - 1. this AWC will become part of CNS's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against CNS;
  - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
  - 3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and
  - 4. CNS 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. CNS 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 CNS'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.
- D. CNS may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. CNS understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of the Firm, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that CNS 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 CNS to submit it.

7/31/2017  
Date (mm/dd/yyyy)

MICHAEL MINNELEE - PRESIDENT  
Respondent

City National Securities, Inc.

By: Michael Minnelee

Reviewed by:

John C. Massaro  
John Massaro  
Counsel for Respondent  
Arnold & Porter Kaye Scholer LLP  
601 Massachusetts Ave., NW  
Washington, DC 20001  
202-942-5122

Accepted by FINRA:

8/24/17  
Date

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

Meghan S. Bailey  
Meghan S. Bailey  
Principal Regional Counsel  
FINRA Department of Enforcement  
100 Pine Street Suite 1800  
San Francisco, CA 94111  
415-217-1123; 415.217.1201



### **Corrective Action Statement of City National Securities, Inc.**

In connection with the issuance of the Letter of Acceptance, Waiver and Consent No. 2014043089901 ("AWC"), City National Securities, Inc. ("CNS" or the "Firm") submits this statement describing certain of the actions it has taken related to the issues described in the AWC.<sup>1</sup>

The Firm has implemented several enhancements as part of its ongoing commitment to compliance, risk management, and supervision. In particular, the Firm notes specific steps it has taken to address issues raised in this AWC in the following areas:

- **Change to Personnel Affiliated with RIA:** As referenced in the AWC, Representative DZ was not employed by CNS and was not involved in CNS's core business. DZ was employed by an affiliated registered investment advisor ("affiliated RIA"); was registered with CNS for the limited purpose of offering certain investment funds for which CNS would act as the placement agent. After the details of DZ's outside business activities and his passing came to light, all registered representatives at the affiliated RIA were deregistered, the business of the RIA was acquired by another entity and the RIA continues with only minimal operations.

The individuals who directly supervised or who had direct knowledge of DZ's outside business activities prior to October 2014 are no longer associated with CNS or its parent companies and/or affiliates.

- **Compliance Software:** Through the Firm's Compliance 11 system, CNS has implemented a more extensive questionnaire to enhance its level of supervision of its registered representative outside business activities ("OBAs") and private securities transactions ("PSTs").
- **Branch Auditing:** CNS has expanded its branch audits and enhanced its procedures to greater scrutinize and examine its registered representative OBAs and PSTs reviews during the audits.
- **Undisclosed OBAs:** CNS has added OBA-type terms to its email review system and implemented quarterly Google search testing to try and detect whether any of its registered representatives have undisclosed OBAs.
- **Written Supervisory Procedures ("WSPs") Enhancement:** CNS has done, and continues to do, extensive review of its WSPs to ensure that they are up to date and reflect the latest rules and regulations such as FINRA supplemental material 3270.01.

CNS believes that the above-described, and other completed and planned, substantial enhancements will appropriately address the issues in the AWC.

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<sup>1</sup> This Corrective Action Statement is submitted by the Respondent. It does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA, or its staff.