

BEFORE THE
DEPARTMENT OF FINANCIAL PROTECTION AND INNOVATION
STATE OF CALIFORNIA

In the Matter of:

THE COMMISSIONER OF BUSINESS
OVERSIGHT,

Complainant,

v.

SILICON VALLEY SECURITIES, INC.,

Respondent.

Agency No. 23696

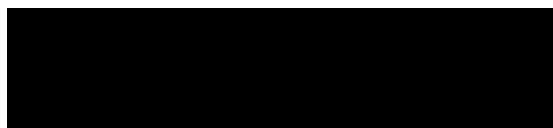
OAH No. 2020020457

DECISION

The attached Proposed Decision of the Administrative Law Judge is hereby adopted by the Department of Financial Protection and Innovation (formerly the Department of Business Oversight) as its Decision in the above-entitled matter.

This Decision shall become effective on February 20, 2021.

IT IS SO ORDERED THIS 21st day of January, 2021.



MANUEL P. ALVAREZ
Commissioner of Financial Protection and Innovation

**BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA**

In the Matter of:

THE COMMISSIONER OF BUSINESS OVERSIGHT, Complainant

v.

SILICON VALLEY SECURITIES, INC., Respondent

CRD No.: 23696

OAH No. 2020020457

PROPOSED DECISION

Marcie Larson, Administrative Law Judge, Office of Administrative Hearings (OAH), State of California, heard this matter in person on March 2, 2020, and telephonically on August 12 and 13, 2020, in Sacramento, California.

Joanne Ross and Noah Bean, Senior Counsel, represented complainant Manuel P. Alvarez, Commissioner of the Department of Business Oversight (Department).

Paul Magnuson, President of respondent Silicon Valley Securities, Inc., (SVS or respondent) represented SVS.

Evidence was received, and the record remained open for the parties to submit a confidential names list, which was filed on September 14, 2020. The record closed, and the matter submitted for decision on September 14, 2020.

FACTUAL FINDINGS

Background and Procedural History

1. The Department is the agency responsible for enforcing the California Corporate Securities Law, Corporations Code section 25000 et seq., and the regulations promulgated at California Code of Regulations, title 10, section 260.000 et seq.

2. On or about May 19, 1989, the Commissioner issued SVS Broker-Dealer Certificate, CRD No. 23696 (certificate).¹ SVS's principal place of business is in Saratoga, California.

3. On January 9, 2020, complainant issued a "Notice of Intention to Issue Order Revoking Broker-Dealer Certificate of Silicon Valley Securities, Inc." (Notice of Intention), pursuant to Corporation Code section 25215. On the same day, complainant filed an Accusation in support of the Notice of Intention.

¹ The Accusation states that the Broker-Dealer Certificate was issued on March 19, 1989. However, the certified copy of the Broker-Dealer Certificate lists a date of May 19, 1989.

4. Complainant seeks to revoke SVS's certificate based upon allegations SVS violated Corporations Code section 25241, and California Code of Regulations, title 10, sections 260.218.4 and 260.218.6, including failing to: adequately supervise its agents, maintain and enforce written supervisory procedures (WSP), properly identify in writing the reasons for having discretionary authority over customer accounts, and maintain required records. Respondent was informed of the right to file a Notice of Defense and request a hearing.

5. Mr. Magnuson, on behalf of SVS, timely filed a Notice of Defense with the Department.² The matter was set for an evidentiary hearing before an Administrative Law Judge of the OAH, an independent adjudicative agency of the State of California, pursuant to Government Code section 11500 et seq.

Applicable Portions of SVS's Written Supervisory Procedures

6. Pursuant to California Code of Regulations, title 10, section 260.218.4, SVS is required to maintain WSP. The "Introduction" portion of SVS's WSP provides in part:

It is the obligation of [SVS] to supervise the activities of its registered and associated persons. The procedures

² On February 27, 2020, after Mr. Magnuson filed a Notice of Defense on behalf of SVS, he filed a Motion to Dismiss the Accusation. It was not appropriate to dismiss the Accusation prior to hearing, because there are disputed issues of fact. (*Kramer v. State Board of Accountancy* (1962) 200 Cal.App.2d 163; *Frost v. State Personnel Board* (1961) 190 Cal.2d 1.) Legal arguments and evidentiary objections were raised by the parties at hearing. As a result, the motion is denied.

contained in this [WSP] are intended to enable [SVS's] designated supervisors to ensure compliance with rules and regulations of the SEC [Securities and Exchange Commission], FINRA [Financial Industry Regulatory Authority, Inc.] and applicable state jurisdictions and statement of policy there under, in which its Registered Representative (or "Representatives") are conducting business. Each principal assigned supervisory responsibility has the obligation to ensure that the rules, regulations, and policies applicable to the business of SVS are maintained and followed. This [SVS] is not to be construed as all inclusive, but rather serves as a guide in conducting the daily supervisory functions.

At this time, SVS engages in stocks, bonds, options, and other securities trade execution services and offers variable annuities, retirement plans, margin accounts, money market funds, and mutual funds.

FINRA is a private self-regulatory organization that oversees broker-dealer operations. However, FINRA does not enforce California law as it relates to broker-dealers. The Department is the only entity that enforces California law related to the activities of broker-dealers.

7. Mr. Magnuson, in addition to serving as President, also serves as the Chief Compliance Officer and Chief Operating Officer. Pursuant to the WSP, he "shall serve as the Registered Principal with responsibility for establishing supervisory systems and overall oversight of compliance functions." SVS's registered

representative Barry Gray, is listed in the WSP as the "Options Supervisor." The WSP provides that Mr. Magnuson and Mr. Gray "are the principals responsible for establishing, maintaining and enforcing the [SVS's] Supervisory Control Procedures."

8. WSP, section 4.1, sets forth the purpose of the WSP as follows:

The WSP sets forth the written procedures by which [SVS] supervises its activities. In addition, it contains the Supervisory control policies and procedures in place to test and verify that the WSP will, with respect to SVS and its associated persons, (1) achieve compliance with applicable laws, regulations and FINRA rules and (2) create additional supervisory procedures where the need is identified by such testing and verification.

9. WSP, sections 4.5 and 4.6, sets forth procedures to follow in the event a registered representative with SVS requires "heightened supervision." Indicators that can trigger heightened supervision include "personal or financial stress." Once a registered representative is identified as requiring heightened supervision, the WSP requires Mr. Magnuson to include the terms of the heightened supervision in the representative's personnel file. The "terms" of the heightened supervision could include "restrictions on the kinds of activities engaged in" and "recording of telephone conversations with clients."

10. Mr. Magnuson's duties as the Chief Compliance Officer are set forth in the WSP at Section 5.0, which includes periodic review and amendments to the WSP, conducting annual internal audits, and recording-keeping requirements. Mr. Magnuson is also responsible for reviewing and maintaining copies of "Exception

Reports” as described in section 5.4 of the WSP. Exception reports are “designed to detect irregularities in customer accounts such as unusual or high levels of activity or excessive commissions in customer accounts.” Mr. Magnuson is required to review Exception Reports on a daily to monthly basis depending on the type of report.

11. Pursuant to WSP section 7.9, loans to or from customers are prohibited as follows:

No registered person of SVS may borrow money from or lend money to any SVS customer unless the lending or borrowing arrangement is one of the permissible arrangements listed in subsection B of this section and, where required, written notification of the transaction is given and written notification of approved by SVS is received as set forth in subsection C of this section.

12. Permissible lending arrangements include a circumstance in which the customer is a member of a registered representative’s immediate family, a “personal relationship with the customer, such that the loan would not have been solicited, offered, or given had the customer and registered person not maintained a relationship outside of the customer-broker relationship,” or in instances when a “lending arrangement is based on a business relationship outside of the broker-customer relationship.”

13. WSP, section 12.3 addresses the requirements for order tickets, which provides in part:

More agency trades are placed by Registered Reps using [SVS’s] electronic order system, which requires that all

necessary information be entered before the trade will be submitted. In the case of hand-written tickets, in order to ensure accurate order transmission and compliance with SEC regulations and certain rules of the various SRO'S, SVS and its Registered Representatives shall take great care in preparing order tickets. Order tickets must include all details of the order, particularly the name and account number of the customer for whom the order is being executed, prior to the entry of the order. Before processing, each order ticket shall contain the following information:

- Name of security and amount;
- Buy or sell instruction and, if selling, indication of long or short. The preparer shall "short" except that this shall not apply to transactions in corporate debt securities;
- Account name and number;
- Price or instructions with regard to price;
- Whether transaction is solicited or unsolicited;
- Whether transaction is for personal/related accounts;
- Account executive's number; and
- Time and Date that the order was received.

Mr. Magnuson was required to “maintain records of all documents generated or approved” related to order tickets.

14. Pursuant to WSP section 15.7.5, Mr. Gray was the only Registered Options trader at SVS. Pursuant to WSP section 15.7.8., Mr. Gray was required to ensure option trading at SVS complied with the WSP, FINRA, and applicable state and federal laws.

15. WSP, section 18.10 prohibits unethical business practices, including:

[¶ . . . ¶]

2. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten business days after the date of the first transaction placed pursuant to the oral discretionary authority;

[¶ . . . ¶]

6. Borrowing money or securities from a client unless the client is a broker/dealer, an affiliate of the investment advisor, or a financial institution engaged in the business of loaning funds;

[¶ . . . ¶]

June 2018 Department Examination of SVS

16. Michael Nelson, Supervising Corporation Examiner, for the Department's Broker-Dealer Investment Advisor Division (BDIA), testified at hearing. His duties include assigning regulatory examinations of broker-dealers to BDIA examiners to determine whether broker-dealers are complying with California law. A regulatory examination consists of a fieldwork portion, which occurs when the examiners visit the broker-dealer office and review requested documents. The examiners typically review the WSP, customer files and account information, trade documentation, and Exception Reports. After the examination, the examiners prepare a regulatory examination report, which contains the examination findings, as well as a recommendation on how the broker-dealer can comply with applicable laws and regulations to correct identified violations.

17. The broker-dealer is allowed to send to the Department a formal response to the examination findings. If the response is satisfactory, the examination is closed. If the response is not satisfactory, BDIA will either send a follow-up letter to the broker-dealer asking for additional information concerning how the violations will be corrected or Mr. Nelson will make a referral the Department's enforcement section to pursue disciplinary action against the broker-dealer.

18. In approximately May 2018, Mr. Nelson assigned Eric Chandra, Corporation Examiner IV Supervisor, and Joel Saati, Senior Financial Institutions Examiner (collectively "examiners"), to conduct a routine examination of SVS. Mr. Chandra and Mr. Saati both testified at hearing. As part of the examination process, Mr. Saati sent Mr. Magnuson an email and letter on June 8, 2018, confirming the Department would be conducting an examination of SVS's broker-dealer services. The on-site examination was scheduled to begin on June 18, 2018. The letter included a list

of documents the examiners wanted to inspect, including Exception Reports for the previous three months, purchase and sales blotters from March to May 2018, correspondence and emails from March to May 2018, and SVS's WSP.

19. Starting on June 18, 2018, Mr. Chandra and Mr. Saati conducted an on-site inspection at SVS. They issued a report concerning their findings, which are set forth in a September 10, 2018 letter to Mr. Magnuson, signed by Mr. Nelson. The results of the examination found several violations as set forth below.

BORROWING MONEY FROM SVS AND CLIENTS

20. The examination revealed that Mr. Gray, former Vice President of SVS, borrowed money from SVS and two brokerage clients, in violation of the WSP, while he was employed by SVS. Specifically, SVS produced records that demonstrated on October 5, 2017, Mr. Gray borrowed \$1,600 from SVS to purchase a security for his personal brokerage account with a promise to repay this money once he sold the security. A month later, Mr. Gray sold the security and transferred the money to his personal bank account. He did not repay SVS as promised. Mr. Magnuson told the examiners that when he approached Mr. Gray concerning why he did not repay the loan to SVS, Mr. Gray stated that he did not recall borrowing any funds from SVS. Mr. Gray never repaid SVS the \$1,600.

21. On an undisclosed date in 2017, Mr. Gray borrowed \$7,500 from Client 1, through a promissory note, with a promise to repay the loan with seven percent interest, for a total loan amount of \$8,550. After making one payment to Client 1, Mr. Gray defaulted on the loan. In January 2018, Client 1 contacted SVS concerning Mr. Gray's failure to repay the loan. Mr. Magnuson wrote a check to Mr. Gray for \$7,300 and deposited the check into Mr. Gray's bank account so that he could repay the loan

to Client 1. Mr. Gray then wrote a check to Client 1 in the amount \$7,296.88, which represented the remaining balance of the loan. Before Client 1 cashed the check, Mr. Gray spent \$2,700 of the \$7,300 Mr. Magnuson gave him to pay off the loan. As a result, the check written to Client 1 bounced for insufficient funds. Client 1 attempted to cash the check two more times, but the check bounced each time. Eventually, Mr. Magnuson wrote Mr. Gray another check to fully repay Client 1.

22. On July 28, 2017, Mr. Gray borrowed \$10,000 from Client 2, through a promissory note, with the promise to repay the loan with eight percent interest, for a total of \$10,800. Mr. Gray made four payments to Client 2, totaling \$1,800. His last payment to Client 2 was on January 6, 2018, and no further payments were made by Mr. Gray. In February 2018, Mr. Gray informed Mr. Magnuson of the loan he took from Client 2. Mr. Gray resigned his position from SVS effective on February 23, 2018, because he wanted to retire. Mr. Gray was 85 years old.

After Mr. Gray's resignation, Mr. Magnuson took no action to investigate the status of the loan until June 13, 2018, when an employee of SVS contacted Client 2 to find out if there was a remaining balance on the loan taken by Mr. Gray. Client 2 informed SVS that Mr. Gray still owed \$9,000. On June 18, 2018, the first day of the examination, Mr. Magnuson wrote Client 2 a check for \$9,000 from the SVS account to pay off Mr. Gray's loan.

23. Mr. Saati explained that Mr. Gray borrowing funds from SVS and not repaying those funds is suspicious behavior. Under SVS's WSP, evidence that a registered representative is under financial or personal stress should have prompted Mr. Magnuson to place Mr. Gray under heightened supervision as outlined in the WSP. Mr. Magnuson informed the examiners that he did not place Mr. Gray under

heightened supervision and that he had never placed a registered representative under heightened supervision.

FAILURE TO PROPERLY COMPLETE ORDER TICKETS

24. During the course of the examination, the examiners reviewed daily trading activity reports listing trade activity. Thereafter, the examiners requested SVS provide a sample of trades out of customer accounts and then selected order tickets to review. SVS provided the examiners with handwritten order tickets. No electronic tickets were provided.

25. The examiners found three instances of order tickets that were not correctly marked to disclose whether the trade was solicited, unsolicited, or discretionary, as required by the WSP. The orders included "buy" orders on April 17, 2018, May 22, 2018, and May 25, 2018. Mr. Chandra explained that this information should have been completed by the agent completing the trade. Mr. Magnuson was also required to review the order tickets to ensure that all the required information was included.

26. Mr. Chandra further explained that the reason for ensuring that the type of order is recorded on the ticket is to determine why the trade was made, whether the client was asking to buy the specific stock or if the agent had recommended the stock purchase. Adherence to the WSP ensures the proper procedures are being followed to mitigate against any operational risks to the clients.

INADEQUATE REASON FOR OBTAINING DISCRETIONARY AUTHORITY

27. Documentation SVS provided to the examiners identified that SVS's registered representative John Kellam had discretionary authority to buy and sell

securities, including options, from at least two client accounts. Mr. Nelson explained broker-dealers are prohibited from having discretion in their clients' accounts unless prior written authorization is given by the client that explains the reason for giving the authority. A client is required to provide a reason for granting the authorization because of the lack of safeguards in place to avoid the registered representative from stealing money or "acting unscrupulously" by having discretion to buy and sell from a client's account. By providing a reason, there is clear written authorization that may help mitigate the risks to the clients.

Mr. Nelson explained that unscrupulous behavior can include "churning" a client's account, which is a practice of actively trading a client's account to generate commissions. "Front running" is also another type of conduct that occurs when a registered representative owns a security and buys the stock from a client's account to drive-up the stock price. The registered representative will then sell their stock or security at a higher price making a profit for themselves and harming the clients. Churning and front running are more likely to occur when a registered representative has discretionary authority over a client's account, because he does not have to contact the client to get permission to trade from the account and can do so without the client's knowledge.

28. Mr. Kellam obtained his clients' written authorization to exercise discretion over their accounts, but there is no explanation as to the reason the authorization was given. Mr. Nelson explained under California Law, the written authorization must include some justification for why the client wants the registered representative to have that discretionary authority. The purpose of this requirement is to avoid the client from being harmed.

IMPROPER OPTIONS TRADING

29. SVS also provided documentation to the examiners that Mr. Kellam was trading options without the required qualifications. An option is similar to a contract for the sale or purchase of a stock or security. According to SVS's WSP, Mr. Gray was designated as the options principal to supervise options trading. Mr. Gray was allowed to supervise selling options because he had a "Series 4 Senior Registered Options" qualification. After Mr. Gray resigned on February 23, 2018, Mr. Magnuson did not update the WSP to designate a new options principal.

30. Mr. Kellam did not pass the Series 4 and as a result could not sell options without supervision from an options principal. Between March 2018 and May 2018, Mr. Kellam engaged in options trading without supervision. For example, on March 7, 2018, Mr. Kellam placed for a client an options contract for Diamondback Energy stock. On May 25, 2018, he placed for a client an options contract for "Qualcomm Incorporated" stock. On May 31, 2018, Mr. Kellam placed for a client an options contract for AT&T stock.

31. Mr. Chandra explained that Mr. Magnuson is the SVS Compliance Officer. Mr. Magnuson reviewed, initialed, and dated daily activity reports listing the option contracts placed by Mr. Kellam. Mr. Magnuson should have ensured the WSP was being followed and that Mr. Kellam was not trading options without supervision from an options principal designated in the WSP. Instead, he allowed the conduct to occur.

FAILING TO MAINTAIN REQUIRED RECORDS

32. Broker-dealers are also required to review and retain Exception Reports. Exception Reports are a surveillance tool that broker-dealers use to find irregularities in client or agent accounts. Mr. Chandra explained that a broker-dealer is entrusted

with a level of due diligence. Reviewing Exception Reports is a way a Compliance Officer can look at hundreds of accounts at a single time to determine if there is an agent violating the broker-dealers' policies and procedures, which can cause client harm. Broker-dealers have a custodian that maintains the Exception Reports. The broker-dealer is responsible for maintaining and preserving all reports to review for unusual activity in a client's account until 18 months after the report is generated.

33. The examiners requested SVS to provide three months of Exception Reports. No exception reports were provided. SVS disclosed to the examiners that Raymond James & Associates (RJA) was the custodian that provided the Exception Reports for SVS, but SVS did not keep copies of the Exception Reports. SVS also did not provide the examiners with any documentation indicating that SVS was reviewing customer accounts for any irregular trading activities.

Events After June 18, 2018

34. After the examiners completed the examination of SVS, the examiners issued a September 10, 2018 regulatory report, which was sent to Mr. Magnuson. The report set forth the violations and requested Mr. Magnuson to provide explanations for the violations. Mr. Nelson reviewed the examiners working papers, regulatory report, Mr. Magnuson's responses, and an enforcement memorandum that was ultimately sent the Department's Enforcement Division with a recommendation to take formal disciplinary action against SVS.

35. On March 26, 2019, Mr. Magnuson filed a Uniform Termination Notice for Securities Industry Registration, referred to as a "U5 form." Broker-dealers use this form to terminate an individual's registration. Mr. Magnuson filed the U5 form for

himself and all registered representatives of SVS. The U5 has a disclosure which provides in part:

Even if you are no longer registered you continue to be subject to the jurisdiction of regulators for at least two years after your registration is terminated and may have to provide information about your activities while associated with the firm.

36. On December 20, 2019, Mr. Magnuson filed with the Department a request to surrender SVS's certificate. On January 6, 2020, the Department determined that a surrender was not appropriate and issued an "Order Imposing Conditions on Surrender of Certificate as Broker-Dealer." Mr. Nelson explained that because the Department had an enforcement action pending against SVS when Mr. Magnuson filed the request to surrender, the decision was made to continue with the enforcement action.

Additional Evidence Submitted by Respondent

37. Mr. Magnuson explained that Mr. Gray was the founder of SVS. Mr. Magnuson worked with Mr. Gray for 30 years and never had any issues with Mr. Gray borrowing money from clients. SVS reviewed all of Mr. Gray's account transactions on a regular basis. The two clients who lent Mr. Gray money made the loans out of their personal bank accounts. Client 2 had a portfolio worth over \$3 million and had worked in the securities and banking business. The client told Mr. Magnuson that he gave Mr. Gray a personal loan to a "fellow Rotarian" he had known for 50 years. Mr. Magnuson contended that loan had "nothing to do with [SVS]."

Mr. Magnuson further explained Client 1 "was not as wealthy" as Client 2 and lent Mr. Gray less money. Mr. Magnuson explained that he paid off the loans to Clients 1 and 2, so no clients were harmed and "everybody is fine." He also contended that the Department determined Mr. Gray should have been put on heightened supervision. However, SVS "went a step further" by having Mr. Gray retire. Mr. Gray died shortly after the examination was completed. As a result of the efforts that SVS undertook to address the loans taken by Mr. Gray, Mr. Magnuson does not believe disciplinary action should be taken against SVS's certificate.

38. Concerning the order tickets, Mr. Magnuson explained that in 1989, when SVS started as a broker-dealer, all trades were filled out on paper order tickets and given to a wire operator, who entered the tickets into the RJA Trade Execution System. Starting in 2000, brokers had a choice to either enter the orders directly into the computer or give their paper order tickets to their brokers' assistants and have the trades entered. By 2010, all brokers entered their orders on their computers. However, Mr. Kellam used paper tickets to write on while he was contemplating what stocks or securities to buy or sell. He would then enter the information into the computer. The tickets Mr. Kellam entered into the computer were required to have all the information or the orders would not execute. Once the ticket is entered into the computer, SVS could print a copy of the order.

Mr. Magnuson contends that the three written order tickets identified by the examiners as not having been properly marked as solicited, unsolicited, or discretionary, were just "scratchpads" not the official orders. The orders were properly completed when entered into the computer to make the trade. Mr. Magnuson admitted that SVS only provided the examiners with written order tickets. However, he explained that if requested, the electronic orders could have been provided. Mr.

Magnuson does not believe SVS's certificate should be disciplined for using the written order tickets as scratch paper and then properly entering the order tickets in the computer.

39. Concerning the discretionary authority authorization, Mr. Magnuson explained that SVS used a FINRA-approved limited trading authorization. He believed the language in the authorization was sufficient to meet the Department's requirements. Mr. Magnuson also explained that FINRA was reviewing options contracts placed by Mr. Kellam after Mr. Gray retired. Mr. Magnuson believed it was sufficient to have FINRA review the options contracts, rather than designate a new options principal in the WSP.

40. Mr. Magnuson explained that RJA does not provide copies of Exception Reports. Mr. Magnuson contended that if the examiners had asked SVS to generate a report with the same information on the Exception Reports, SVS would have complied.

41. Mr. Magnuson does not want SVS to "go down in history" as a "bad broker-dealer." He believes that the Department's examination and findings were made in an effort to sabotage his ability to leave the industry in an "honorable way." Mr. Magnuson contends the Department found "insignificant items" to justify taking action against SVS's certificate, and that the alleged violations do not rise to the level requiring revocation of SVS's broker-dealer certificate.

Analysis

42. The Department established SVS violated provisions of the Corporations Securities Law of 1968, and regulations designed to protect clients and consumers. SVS employee Mr. Gray borrowed money from SVS and two clients and then defaulted on the loans. His conduct violated SVS's WSP. Despite knowing that Mr. Gray was

under financial stress when he borrowed and failed to repay \$1,600 from SVS, Mr. Magnuson did not place Mr. Gray under heightened supervision. As a result, after borrowing money from SVS, Mr. Gray borrowed money from two clients without Mr. Magnuson's knowledge, which potentially harmed the clients. Mr. Magnuson ultimately repaid the loans, after receiving a complaint from one of the clients. Mr. Magnuson's contention that no one was harmed by Mr. Gray's conduct and that the clients were happy with the outcome, demonstrates his disregard and a lack of understanding for the prohibition on soliciting and receiving loans from clients.

43. The evidence also established that SVS violated the WSP by failing to properly complete three order tickets. Mr. Magnuson's contention that the written order tickets were nothing more than scratch paper and that the correctly completed orders are electronic and could have been provided to the examiners if requested, was not supported by the evidence. SVS was given the opportunity to provide the examiners with all documentation demonstrating that the orders were properly completed. No information other than the written order tickets was provided to the examiners during the examination period.

44. Likewise, SVS failed to provide the examiners with Exception Reports. The examiners specifically requested these reports. SVS told the examiners that it did not have Exception Reports. SVS should have been reviewing the Exception Reports to identify any irregularities in customer accounts. Failure to maintain the reports as required by the WSP demonstrates disregard for complying with procedures designed to protect clients.

45. The evidence also established that SVS failed to obtain an explanation from two customers as to the reason discretionary authority was given to Mr. Kellam. Although SVS used a FINRA-approved agreement, FINRA is a private regulatory

organization that does not enforce California law. The Department is responsible for ensuring broker-dealers comply with applicable California law. The limited trading authorization agreement SVS used failed to meet the legal requirements to provide Mr. Kellam with discretionary authority. Additionally, Mr. Kellam was given discretionary authority to trade options, without the supervision of an options principal. Mr. Gray retired and SVS did not designate in the WSP a new options principal. As a result, SVS was in violation of the WSP.

46. The violations by SVS are not insignificant. Rather, SVS and its employees engaged in conduct that placed customers at risk. As a broker-dealer, SVS has a duty to ensure adherence to its WSP and applicable law to protect the interests of its clients. SVS repeatedly failed to do so. As a result, the only appropriate discipline for public protection is to revoke SVS's broker-dealer certificate.

LEGAL CONCLUSIONS

1. The Commissioner is authorized to administer and enforce the provisions of the Corporate Securities Law of 1968 (Corp. Code §25000 et seq.) The Commissioner may bring a disciplinary action against the holder of a broker-dealer certificate pursuant to Corporations Code section 25212.

2. A "'broker-dealer' means any person engaged in the business of effecting transactions in securities in this state for the account of others or for that person's own account. 'Broker-dealer' also includes a person engaged in the regular business of issuing or guaranteeing options with regard to securities not of that person's own issue." (Corp. Code, § 25004.)

Burden of Proof

3. The burden of proof in this matter is on complainant to establish the charging allegations by clear and convincing evidence. (*Ettinger v. Board of Medical Quality Assurance* (1982) 135 Cal.App.3d 853, 857.) The key element of clear and convincing evidence is that it must establish a high probability of the existence of the disputed fact, greater than proof by a preponderance of the evidence. (*People v. Mabini* (2001) 92 Cal.App.4th 654, 662.)

Applicable Law

4. Corporations Code section 25212 provides, in pertinent part:

The commissioner may, after appropriate notice and opportunity for hearing, by order censure, deny a certificate to, suspend for a period not exceeding 12 months or revoke the certificate of, any broker-dealer if the commissioner finds that the censure, denial, suspension, or revocation is in the public interest and that the broker-dealer, whether prior or subsequent to becoming a broker-dealer, or any partner, officer, director, or branch manager of the broker-dealer, whether prior or subsequent to becoming associated with the broker-dealer, or any person directly or indirectly controlling the broker-dealer, whether prior or subsequent to becoming such, or any agent employed by the broker-dealer while so employed has done any of the following:

[¶ . . . ¶]

(i) Has violated any provision of this division or the rules thereunder or, in the case of an applicant only, any similar regulatory scheme of the State of California or a foreign jurisdiction.

5. Corporations Code section 25241 provides:

(a) Every broker-dealer and every investment adviser licensed under Section 25230 shall make and keep accounts, correspondence, memorandums, papers, books, and other records and shall file financial and other reports as the commissioner by rule requires, subject to the limitations of Section 15(h) of the Securities Exchange Act of 1934 with respect to broker-dealers and Section 222 of the Investment Advisers Act of 1940 with respect to investment advisers.

(b) All records so required shall be preserved for the time specified in the rule.

(c) All records referred to in this section are subject at any time and from time to time to reasonable periodic, special, or other examinations by the commissioner, within or without this state, as the commissioner deems necessary or appropriate in the public interest or for the protection of investors.

(d) For the purpose of avoiding unnecessary duplications of examinations, the commissioner, insofar as he or she deems

it practicable in administering this section, may cooperate with the securities administrators of other states, the Securities and Exchange Commission and any national securities exchange or national securities association.

(e) Unless otherwise provided by rule, every investment adviser subject to Section 25230 and every broker-dealer, including an applicant for a license under Section 25210 or 25230, shall furnish an authorization for disclosure to the commissioner of financial records of the licensee's broker-dealer or investment adviser business pursuant to Section 7473 of the Government Code.

6. Corporation Code section 25242, subdivision (a) provides:

(a) Surrender of a certificate as a broker-dealer or investment adviser becomes effective 30 days after receipt of an application to surrender that certificate or within a shorter period of time as the commissioner may determine, unless a revocation or suspension proceeding is pending when the application is filed or a proceeding to revoke or suspend or to impose conditions upon the withdrawal is instituted within 30 days after the application is filed. If a proceeding is pending or instituted, withdrawal becomes effective at a time and upon any conditions as the commissioner by order determines.

7. California Code of Regulations, title 10, section 260.218.4 provides in pertinent part:

(a) Every broker-dealer shall exercise diligent supervision over the securities activities of all of its agents.

[REDACTED] . . . [REDACTED]

(c) As part of the responsibility under this rule, every broker-dealer shall establish, maintain and enforce written procedures, a copy of which shall be kept in each business office, which shall set forth the procedures adopted by the broker-dealer to comply with the following duties imposed by this section, and shall state at which business office or offices the broker-dealer keeps and maintains the records required by Section 260.218.5 of these rules.

[REDACTED] . . . [REDACTED]

(2) The frequent examination of all customer accounts to detect and prevent irregularities or abuses;

(3) The prompt review and written approval by the designated supervisor of all securities transactions by agents and all correspondence pertaining to the solicitation or execution of all securities transactions by agents;

[REDACTED] . . . [REDACTED]

8. Pursuant to California Code of Regulations, title 10, section 260.218.6:

No broker-dealer and no agent employed by such broker-dealer shall exercise any discretionary power or authority for any customer unless such customer has given prior written authorization to exercise such power or authority to a stated individual who is a broker-dealer or agent, and has indicated the reasons for such authorization. This Section does not apply to transactions in which the broker-dealer's discretion is limited to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed.

Causes to Revoke SVS's Broker-Dealer Certificate

9. As set forth in Factual Findings 20 through 23, the evidence established Mr. Gray borrowed money from SVS and two clients in violation of SVS's WSP and California Code of Regulations, title 10, section 260.218.4, subdivision (c)(2). Therefore, cause exists to revoke SVS's broker-dealer certificate pursuant to Corporations Code section 25212.

10. As set forth in Factual Findings 24 through 26, the evidence established that in at least three instances SVS failed to properly complete order tickets, in violation of California Code of Regulations, title 10, section 260.218.4, subdivisions (a), (c)(2), and (c)(3). Therefore, cause exists to revoke SVS's broker-dealer certificate pursuant to Corporations Code section 25212.

11. As set forth in Factual Findings 27 and 28, the evidence established that Mr. Kellam, a SVS registered representative, had discretionary authority over two

customer brokerage accounts, without providing a written reason for giving the discretionary authority, in violation of California Code of Regulations, title 10, section 260.218.6. Therefore, cause exists to revoke SVS's broker-dealer certificate pursuant to Corporations Code section 25212.

12. As set forth in Factual Findings 32 and 33, the evidence established SVS did not have Exception Reports, in violation of Corporations Code section 25241. Therefore, cause exists to revoke SVS's broker-dealer certificate pursuant to Corporations Code section 25212.

13. As set forth in Factual Findings 29 through 31, the evidence established SVS failed to comply with its WSP and supervise its registered representative when it allowed Mr. Kellam to trade options without a designated options principal supervising the transactions, in violation of California Code of Regulations, title 10, section 260.218.4, subdivisions (a), (c)(2), and (c)(3). Therefore, cause exists to revoke SVS's broker-dealer certificate pursuant to Corporations Code section 25212.

Conclusion

14. As set forth in the Factual Findings as a whole, complainant met its burden of establishing all causes for discipline by clear and convincing evidence. Public protection requires revocation of SVS's broker-dealer certificate.

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ORDER

Broker-Dealer Certificate, CRD No. 23696 issued to Silicon Valley Securities, Inc.,
is REVOKED.

DATE: October 13, 2020

DocuSigned by:

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MARCIE LARSON

Administrative Law Judge

Office of Administrative Hearings