

BEFORE THE ARKANSAS SECURITIES COMMISSIONER

Case No. S-14-0084

Order No. S-14-0084-15-OR05

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ARKANSAS SECURITIES DEPT.  
RESPONDENT

IN THE MATTER OF STEELE V. STEPHENS

**FINAL ORDER**

On November 4, 2014, the Staff of the Arkansas Securities Department (“Staff”) filed a Complaint alleging that Steele V. Stephens (“Stephens”) violated provisions of the Arkansas Securities Act (“Act”), Ark. Code Ann. § 23-42-101 through 23-42-509 and Rules of the Arkansas Securities Commissioner. In the Complaint, the Staff seeks revocation of the registration of Stephens and a fine.

On December 1, 2014, Stephens filed a response to the Complaint denying some of the factual allegations and denying that his registration should be revoked or a fine imposed.

On April 6-7, 2015, Scott Freydl, attorney for the Staff, and John Van Kleef, attorney for Stephens, appeared for a hearing for the referenced matter pursuant to Rule 607.01(c) of the Rules of the Arkansas Securities Commissioner. At the conclusion of the hearing, the parties were given the opportunity to submit post-hearing briefs, which the Staff and counsel for Stephens filed on April 21, 2015.

The following findings are based upon stipulations of the parties, the documentary evidence presented by the Staff and by Stephens, witness testimony, and all other matters properly before me:

**FINDINGS OF FACT**

1. Stephens, CRD number 1081772, was registered with the Arkansas Securities Department (“Department”) as an agent of St. Bernard Financial Services, Inc. from June 24, 2009 through May 21, 2013. (Stipulated Fact).

2. St. Bernard Financial Services, Inc. ("St. Bernard") is a securities brokerage company with its main office located in Russellville, Pope County, Arkansas, CRD number 36956. St. Bernard has been registered as a securities broker-dealer with the Department since November 1, 1994. (Stipulated Fact).

3. Stephens purchased or sold agency bonds in 85 trades on behalf of the Arkansas Treasurer's Office between July 2009 and December 2012. (Stipulated Fact).

4. The bond trades involved in this matter are:

<u>CUSIP Number</u>	<u>Date Purchased</u>	<u>Date Sold</u>
3133XUNE9	08/19/09	07/05/11
3133XUMJ9	10/19/09	10/26/11
3133XRFL9	07/30/08	01/21/10
3133XWRL5	02/19/10	
3134G2AB8	03/28/11	08/16/11
3136FRVP5	07/20/11	08/17/11
3136FRWU3	07/20/11	08/17/11
3136FRZL0	07/27/11	10/05/11

Stephens received commissions in the amount of \$121,979.00 with respect to the above trades.

Stephens received commissions in the amount of \$19,610.07 for the replacement bonds purchased with the proceeds from the trades referenced above. (Stipulated Fact).

5. Beginning in 2010 through 2012, Stephens made five (5) \$6,000.00 payments to an active securities client of Stephens, Arkansas Treasurer, Martha Shoffner. Stephens made a sixth (6<sup>th</sup>) separate payment of \$6,000.00 to Arkansas Treasurer, Martha Shoffner, as part of a controlled F.B.I. investigation with \$6,000.00 being provided by the F.B.I. (Stipulated Fact).

6. Stephens gave the money to Martha Shoffner with some hope of getting additional business from the Arkansas Treasurer's Office.

7. During the time period of 2010 through 2012, Stephens experienced an increase in the amount of securities business that Stephens received from the Arkansas Treasurer's Office. (Stipulated Fact).

8. Stephens made statements in emails to his client, the Arkansas Treasurer's Office, concerning the benefit, advantage or advisability of bond sales Stephens recommended. (Stipulated Fact).

9. In these emails, Stephens explained the need to sell bonds shortly before being called in order to capture a profit. (Stipulated Fact).

10. In addition, these emails stated that the aforementioned premium would be lost, if the bonds were held until the call date. (Stipulated Fact).

11. The possibility of receiving premium payments from the sale of bonds was the main factor Stephens used to persuade the Arkansas Treasurer's Office to adopt his recommendations. (Stipulated Fact).

12. During the time period listed in Paragraph 5, Stephens received copies of the entire bond portfolio of the Arkansas Treasurer's Office. (Stipulated Fact).

13. During time periods when St. Bernard's email service was not functioning properly, Stephens used his personal email account to make these statements to the Arkansas Treasurer's Office. (Stipulated Fact).

14. C. L. King and Associates, Inc. ("C.L. King") was the clearing agent for St. Bernard for the bond trades involving Stephens and the Arkansas Treasurer's Office. Mike Olsen ("Olsen") is registered in the State of New York as an agent of C. L. King. Stephens'

primary contact at C. L. King was Olsen. (Stipulated Fact).

15. Stephens communicated by email with Olsen. (Stipulated Fact).

16. Stephens communicated by email, telephone and in person with the staff of the Arkansas Treasurer's Office about the above listed bond trades. (Stipulated Fact). Stephens testified that he also communicated with the staff by text message.

17. Prior to the events at issue in this matter, there were no disciplinary proceedings against Stephens by securities regulatory authorities.

18. The investment policy and authorized investments for the Arkansas Treasurer's Office are governed by Arkansas statute.

19. The Arkansas Treasurer's Office was a sophisticated investor with resources to analyze the trades recommended by Stephens.

20. If a bond matures or is called, the bond holder pays no commission.

21. The seven (7) bond trades listed in Paragraph 4 all involved government agency bonds.

22. Agency bonds are issued by government sponsored entities. Agency bonds are issued with maturities from one (1) month to thirty (30) years. Some are callable, some are not. Agency bonds are issued with fixed, floating and step-up coupons. Some agency bonds are zero coupon bonds.

23. Agency bonds are extremely liquid. They can be bought and sold at small bid-ask spreads in substantial quantities without impacting the market value of the bonds. Although not backed by the full faith and credit of the US Treasury, agency bonds have very little credit risk. After adjusting for embedded options, agency bonds trade at small yield spreads above comparable US Treasury securities reflecting the Treasury securities' slightly greater liquidity

and greater quality.

24. If a bond is trading at a premium (above par), it is because interest on the bond is being paid at a higher rate than the current market rate. If the bond is sold and the proceeds, including the premium, are reinvested at the current market rate, assuming like securities, the yield on the new investment should be approximately the same as the yield on the bond that was sold during the term of the bond that was sold.

25. If a bond is trading at a premium there may be situations where it would make sense to sell it prior to call or maturity. However, commissions on the sale, if any, should be considered in properly analyzing the proposed sale.

26. It is common with the sale or purchase of bonds by a broker that the price of the bonds is marked up for purchases and marked down for sales. The compensation to the broker is the amount of the mark-up or mark-down.

27. The Arkansas Treasurer's Office did not engage in frequent sales before maturity/call. Accordingly, Autumn Sanson, Chief Investment Officer, was not experienced in such transactions. However, she had resources available to investigate the recommendations by Stephens.

28. Autumn Sanson testified that the yield on an investment was important to the Arkansas Treasurer's Office. Stephens testified that the yield on an investment was important to Martha Shoffner.

29. Autumn Sanson testified that it was her understanding that commissions are reflected in the yield.

30. Dr. McCann testified that the amount an investor is charged in a markup is critical and important information for an investor.

31. The amount of commission charged is material information in analyzing a sale prior to maturity or call.

32. St. Bernard received a large percentage of the bond business of the Arkansas Treasurer's Office during the period of 2010-2012.

33. Stephens did not appear to fully understand the transactions he recommended to the Arkansas Treasurer's Office and relied on Olsen and Robert Keenan to structure and/or analyze the proposed transactions.

34. There was no evidence presented of anything that should have put Stephens on notice to question a transaction analysis by either Olsen or Robert Keenan.

35. Stephens testified that he did not know the amount of commission to be charged on a transaction prior to completion of the transaction and that the amount of commission was determined by Olsen.

36. Stephens did not know what commissions would be charged on the sale before maturity/call but he was making recommendations based upon numbers without considering commissions.

37. Interest rates cannot be predicted with accuracy.

38. St. Bernard charged commissions in the form of mark-downs on sales prior to maturity or call, the evidence indicated that two (2) other broker-dealers did not.

39. The benefit to the Arkansas Treasurer's Office of some of the Stephens recommended transactions was overstated in his correspondence with Martha Shoffner on January 11, 2012. However, no further sales prior to maturity/call were made by Stephens after such correspondence.

40. On or about Jan. 21, 2010, Autumn Sanson asked Stephens in an email if the

Arkansas Treasurer's Office would "make more" by selling CUSIP 3133XRFL9 at that time rather than letting it mature. Stephens responded "yes if we wait till maturity it is @ par now were [*sic*] @ 107". Stephens' response to Ms. Sanson was neither complete nor accurate.

41. St. Bernard was involved in seven (7) out of thirty (30) transactions in which bonds were sold on behalf of the Arkansas Treasurer's Office prior to maturity or call.

42. The sales before maturity/call were solicited by Stephens.

43. Martha Shoffner was not experienced or knowledgeable with respect to bonds or bond transactions.

44. Stephens testified that he told both Martha Shoffner and Autumn Sanson that if they do not understand a transaction, they should not buy. Such testimony was not disputed.

45. Although mistakes were pointed out, the basic findings of the McCann Report were not disputed. Dr. McCann opined that when viewing the seven (7) transactions described in Paragraph 4 after the fact, the transactions would have been more favorable to the State if the bonds had matured or been called rather than sold prior to maturity or call.

46. The evidence indicated that it was the policy of the Arkansas Treasurer's Office that if a bond purchased from a certain broker were to sell, mature or be called, the Office would attempt to give preference for replacing the bond to the broker that had initially purchased the bond.

47. Although there was evidence that other brokers engaged in twenty-three (23) sales before maturity/call, the two brokers who testified at the hearing testified that no commissions were charged on such sales by their firms. However, there was no testimony by the brokers as to whether their firm purchased replacement securities and if so, what the mark-up was.

48. Even though the evidence indicates that St. Bernard was the only broker marking

down securities sold prior to call/maturity, there was no evidence as to the total commissions paid for both the sale and the purchase of a replacement.

49. The commissions charges by St. Bernard on the transactions with the Treasurer's Office were neither the highest nor the lowest but somewhere in the middle.

50. The bond trades described in Paragraph 4 were not made because of any liquidity needs of the Arkansas Treasurer's Office.

51. Stephens had no fiduciary duty to the Arkansas Treasurer's Office.

52. The Compliance Department of a broker-dealer is responsible to determine if a transaction is suitable. Robert Keenan testified that he was in charge of compliance at St. Bernard and he made a determination that the seven (7) transactions described in Paragraph 4 were suitable.

#### CONCLUSIONS OF LAW

53. Ark. Code Ann. § 23-42-308(a)(2)(G) states that the Commissioner may by order suspend or revoke any registration, if he finds that the registrant is engaged in dishonest or unethical practices in the securities business.

54. Rule 308.01(d) of the Rules states that recommending to a customer the purchase, sale or exchange of any security when a broker-dealer or agent does not have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of facts, if any, disclosed by the customer as to his other security holdings and as to his financial situation and needs, or encouraging a customer to invest beyond his immediate financial resources is considered unethical and grounds for denial, suspension or revocation of agent registration.

55. Stephens did not violate Ark. Code Ann. § 23-42-308(a)(2)(G) and Rule 301.01(d) by selling the securities described in Paragraph 4. This conclusion is based upon the

limited number of sales before maturity/call, the determination by the St. Bernard Compliance Department that the transactions were suitable and the sophistication level of the Arkansas Treasurer's Office. Based upon this information, Stephens had reasonable grounds for believing that the recommended transactions were suitable for the Arkansas Treasurer's Office.

56. Pursuant to Rule 308.01(y) of the Rules, the list of unfair, misleading or unethical practices enumerated in Rule 308.01(a)-(x) are not exclusive of other activities such as forgery, embezzlement, non-disclosure or misstatement of material facts, manipulations and various deceptions and will be considered grounds for suspension or revocation.

57. Stephens violated Ark. Code Ann. § 23-42-308(a)(2)(G) and Rule 308.01(y) of the Rules when he made cash payments to the Arkansas Treasurer as described in Paragraph 5.

58. The standard for materiality analyzes the total mix of information available to a reasonable investor. *SEC v. Morgan Keegan & Co., Inc.*, 678 F.3d 1233, 1248 (11th Cir. 2012) (citing *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1313, 179 L. Ed. 2d 398 (2011)). Materiality is an objective inquiry that examines the significance of an omitted or misrepresented fact to a reasonable investor. *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 441 (1976).

59. The amount of commissions was material information omitted during the transactions with the Arkansas Treasurer's Office. The Arkansas Treasurer's Office was concerned with yields and testimony and evidence reflects that commissions directly affect the amount of yield. Given the total mix of information available to the investor at the time, the omission of the commission amounts was material. Stephens violated Rule 308.01(y) by failing to disclose the amount of commission on the proposed sales before maturity/call described in Paragraph 4 above.

60. Stephens did not violate Ark. Code Ann. § 23-42-507.

61. Ark. Code Ann § 23-42-308(g) states that the Commissioner may for each violation of this chapter fine any agent of a broker-dealer not to exceed \$10,000 or an amount equal to the total amount of money received in connection with each separate violation.

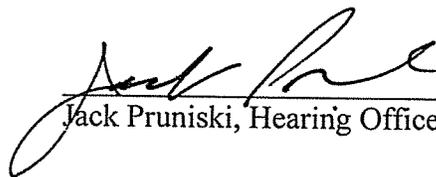
**ORDER**

Based on the evidence presented by the Staff and by Stephens, witness testimony, and all other matters property before me, it is hereby ordered:

1. The registration of Stephens as a securities agent in Arkansas is hereby revoked as of June 20, 2013, the last day on which his registration in Arkansas was effective for violations of Ark. Code Ann. § 308(a)(2)(G) and Rule 308.01(y) of the Rules of the Arkansas Securities Commissioner.

2. Stephens is hereby fined \$20,000.00 for violations of Ark. Code Ann. § 23-42-308(a)(2)(G) and Rule 308.01(y) of the Rules of the Arkansas Securities Commissioner. The payment of this fine shall be made to the Arkansas Securities Department within ten (10) days of the entry of this Order.

IT IS SO ORDERED on this 7th day of May, 2015.

  
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Jack Pruniski, Hearing Officer