

Bond Case Briefs

Municipal Finance Law Since 1971

Beyond 'Boring Bonds': SEC Settles with Former Executive Over Risky Investment Recommendations - Sherman & Howard

The Securities and Exchange Commission (SEC) has reached a settlement with the former head of the municipal bond desk at Aegis Capital Corporation (Aegis) Alan Appelbaum.

The SEC alleged Appelbaum violated customer-specific suitability requirements in both recommending and selling variable interest rate structured products ("VRSPs") to seven retail investors. The SEC stated in the complaint that Appelbaum either, "knew, was reckless in not knowing, or should have known that these securities were unsuitable for those customers." Appelbaum was obligated under both suitability requirements and internal Aegis policy to make recommendations only after considering a customer's risk tolerance, age, and investment time horizons.

VRSPs are high-risk structured products and pay interest at a fixed rate for an initial period, usually 1-3 years. After that, they are not guaranteed to pay any interest. The recovery of the principal at maturity is based on the operation of derivative features connected to equity indices like the Standard and Poor's 500 and the Russell 2000. Additionally, there is no assurance of liquidity. A secondary market may not exist for VRSPs, and if a secondary market does exist, it can be at a great discount to face value.

The complaint alleged Appelbaum made "over 140 unsuitable recommendations and purchases of highly complex structured products for [the] retail investors." All seven retail investors had a "moderate" risk tolerance, meaning they were unwilling to lose their entire investment principal. Additionally, the customers included in the complaint all had investment time horizons of up to 11 years. In contrast, the majority of VRSPs Appelbaum recommended or purchased for customers did not mature for 15 years.

Aegis policy required customers to sign a disclosure form prior to purchasing any VRSPs; however, Appelbaum failed to provide such form to any of the seven customers presented in the complaint. Additionally, Appelbaum did not attend the Aegis mandatory training on structured products. The complaint also alleged Appelbaum engaged in unauthorized trading. All the accounts managed by Appelbaum were "non-discretionary." Aegis policy required Appelbaum to obtain customer authorization before every transaction in a "non-discretionary" account. The SEC claimed Appelbaum failed to obtain the mandatory consent needed from customers before purchasing and selling VRSPs in their accounts.

Customers noticed losses and confronted Appelbaum about his investment strategies. The complaint alleged Appelbaum continued to make material misrepresentations to his customers, assuring them that he was investing in "boring bonds," and they would see a return on their investments in time. One customer lost over \$1 million, and another lost over \$200,000; in contrast, Appelbaum received at least \$1 million in compensation for the VRSP trades.

Without admitting or denying the allegations, Appelbaum and the SEC reached a settlement. The United States District Court for the Southern District of Florida entered final judgment on November 14, 2023. The final judgment permanently restrained and enjoined Appelbaum from any further violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. Appelbaum was also ordered to pay \$42,000 in disgorgement, (representing net profits gained as a result of the conduct alleged in the complaint), \$5,500 in prejudgment interest, and a civil penalty of \$50,000. The SEC also settled an administrative proceeding against Aegis and another against former Aegis broker Paul Gallivan, both for the improper recommendation and trading of VRSPs.

VRSPs are not, in fact, “boring bonds,” as Appelbaum put it. As indicated in the complaint; “Retail investors often rely on the recommendations of broker-dealers and their associated registered representatives when purchasing or selling securities. Registered representatives are required under, inter alia, FINRA and SEC Rules to recommend only securities transactions that are suitable for their customers...” The SEC views VRSPs as complex and risky structured products that are not suitable for retail investors with moderate risk tolerances, incompatible investment time horizons, and an unwillingness to lose their entire invested principal.

[Litigation Release: SEC.gov](#) | [Alan Z. Appelbaum](#)

[Complaint: Alan Z. Appelbaum \(sec.gov\)](#)

[Final Judgment: judg25895.pdf \(sec.gov\)](#)

Sherman & Howard L.L.C.

by Jessie Salas

January 9, 2024

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com