

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

ADAM JAMES MAKKAI
(CRD No. 4025159),

Respondent.

Disciplinary Proceeding
No. 2018058924502

Hearing Officer—MJD

HEARING PANEL DECISION

Date: June 3, 2021

For paying commissions to an unregistered person, in violation of FINRA Rules 2040 and 2010, Respondent is fined \$2,000 and suspended for ten business days from associating with any FINRA member firm in any capacity. Respondent is also ordered to pay costs.

Appearances

For the Complainant: John R. Baraniak, Jr., Esq., and Michael P. Manning, Esq.,
Department of Enforcement, Financial Industry Regulatory Authority.

For the Respondent: Dochter D. Kennedy, Esq., and Joshua Miller, Esq.

I. Introduction

The Department of Enforcement filed a Complaint against Respondent Adam James Makkai (“Makkai”) on June 12, 2020. The sole cause of action charges Makkai with violating FINRA Rules 2040 and 2010 by paying \$27,037 in commissions to an unregistered person between December 2017 and March 2018. Makkai made the payments in consideration for the purchase of a former registered representative’s book of business. Makkai filed an Answer denying that his conduct violated FINRA rules and requested a hearing.

The Hearing Panel finds that Makkai violated FINRA Rules 2040 and 2010. For this misconduct, we impose a \$2,000 fine and suspend him for ten business days from associating with any FINRA member firm in any capacity.¹

¹ The hearing was held via videoconference pursuant to SR-FINRA-2020-027, SR-FINRA-2020-042, and SR-FINRA-2021-006, which temporarily amends FINRA Rules 9261 and 9830 to permit conversion of FINRA’s in-

II. Findings of Fact

A. Makkai's Background

Makkai entered the securities industry when he associated with a FINRA member firm in 1999. In 2009, he registered as a general securities representative, investment company and variable contracts products representative, and investment adviser with FINRA member firm LPL Financial LLC ("LPL" or the "Firm").² Makkai was also registered with Western Wealth Management LLC ("Western Wealth"), an investment advisor affiliated with LPL that also operated as an LPL branch office in Greenwood Village, Colorado.³ Makkai is also a licensed insurance agent and has taught business and finance at a local Denver university since 2002.⁴ Makkai's compensation from LPL was based solely on commissions he earned from securities transactions in customer brokerage accounts and fees for managing his advisory clients' accounts. Makkai estimated that while he was with LPL 70 percent of his compensation was from advisory fees and the remainder from brokerage commissions.⁵

According to a written statement the Firm submitted to FINRA during the investigation, LPL conducted an examination of the Greenwood Village branch in April 2018. During the examination, it learned from a whistleblower that Makkai was sharing commissions with an unregistered person. LPL then initiated an investigation to review Makkai's business practices and email communications.⁶

As a result of its findings, LPL terminated Makkai's employment on June 4, 2018.⁷ Makkai has not been registered with a FINRA member firm since June 20, 2018, when LPL filed a Uniform Termination Notice for Securities Industry Registration (Form U5).⁸ The Firm

person disciplinary hearings to videoconference hearings because of health and safety concerns caused by the COVID-19 pandemic.

² Complainant's Exhibit ("CX-_") 1, at 4, 10.

³ Hearing Transcript ("Tr.") 46-47, 407; CX-1, at 4, 6.

⁴ Tr. 53-54; CX-1, at 10.

⁵ Tr. 57-58, 569-70.

⁶ Tr. 520-21; CX-19, at 2.

⁷ CX-108. Makkai's termination from LPL caused FINRA staff to initiate the investigation that led to the filing of the Complaint in this disciplinary proceeding. *See* CX-19.

⁸ CX-1, at 3-4. Since leaving LPL, Makkai has been registered as an investment advisor with a non-FINRA member firm. Tr. 54, 589-90; CX-1, at 3-4, 12. Although Makkai is no longer registered or associated with a FINRA member firm, he is subject to FINRA's jurisdiction for purposes of this proceeding pursuant to Article V, Section 4, of FINRA's By-Laws. The Complaint was filed within two years of the effective date of termination of Makkai's registration with LPL and charges him with misconduct committed while he was registered with a FINRA member firm.

reported on the Form U5 that it had terminated Makkai's registration for "[s]haring commissions and fees with an unregistered person."⁹

B. LPL's Procedures Prohibited Sharing Commissions with Non-Registered Persons

Consistent with FINRA Rule 2040, LPL maintained written supervisory procedures ("WSPs") at the time of Makkai's alleged misconduct that prohibited its employees from sharing brokerage commissions with persons who were not registered with FINRA. LPL had three sets of WSPs for its employees: one was intended for persons registered through FINRA,¹⁰ another one for persons who were dually registered with FINRA and as investment advisors,¹¹ and a third for investment advisors only.¹² All three contained similar prohibitions on commission sharing.

According to the WSPs applicable to both registered persons and investment advisors, which the Firm called its "hybrid" compliance manual, among a registered person's "prohibited activities" is "[d]irectly or indirectly sharing commissions received for a securities transaction with an unregistered person, or a person registered with another broker-dealer, without the prior written approval" of LPL.¹³ Consistent with this prohibition, the hybrid manual also directed that non-registered persons could not share in securities transaction commissions or advisory fees.¹⁴

Specifically citing FINRA Rule 2040, in another section of the hybrid WSPs, the Firm cautioned its registered representatives that they are prohibited from "directly or indirectly shar[ing] commissions received for a securities transaction with an unregistered person."¹⁵ In another section, the Firm stated that its registered representatives are "prohibited from sharing revenue derived from securities commissions with any person or entity that is not securities registered with LPL Financial. This prohibition pertains to direct or indirect flows of securities commission generated revenue."¹⁶ The WSPs applicable to persons registered solely with

⁹ CX-1, at 4.

¹⁰ CX-4C.

¹¹ CX-4B.

¹² CX-4A.

¹³ CX-4B, at 17.

¹⁴ CX-4B, at 7.

¹⁵ CX-4B, at 23.

¹⁶ CX-4B, at 35.

FINRA contained similar prohibitions against sharing commissions derived from securities transactions with unregistered persons.¹⁷

C. LPL Transfers Former LPL Broker's Client Accounts to Makkai

The events that led to the Complaint began to unfold in late 2017. On October 5, 2017, LPL terminated the employment of SM, a colleague of Makkai's at the Firm and Western Wealth, for allegedly borrowing money from a client without giving the Firm prior notice and for being a joint owner of a bank account with a client in violation of Firm policies.¹⁸ LPL filed a Form U5 terminating SM's association on October 27, 2017. SM did not associate with another FINRA member firm again until August 23, 2018.¹⁹ Makkai knew at the time why SM had been terminated and that he was no longer associated with a broker dealer.²⁰

In early 2017, while SM was still associated with LPL, Makkai began managing accounts for some of SM's clients. Makkai was paid about \$1,500 per month for this service drawn from the commissions and fees paid by SM's customers.²¹ In the months before SM's termination from LPL, he approached Makkai about buying his book of business.²² According to Makkai, once LPL terminated SM, the manager of the branch office asked him if he was interested in buying SM's business. SM had planned to retire from the securities industry, at least in part because of LPL's ongoing investigation into his potential misconduct. Makkai thought it was a good business opportunity, so he agreed in principle to buy SM's entire book of business, which consisted of between 100 and 150 customers.²³ At the time, Makkai had about 300 brokerage and advisory accounts of his own, about 100 of which he had recently acquired from another retiring LPL registered representative.²⁴

¹⁷ CX-4C, at 82, 102. The WSPs for investment advisors also warned against sharing securities commissions and advisory fees with persons who are not registered. These WSPs also specifically cited the prohibitions against commission-sharing set forth in FINRA Rule 2040. *See* CX-4A, at 7, 18, 24, 36.

¹⁸ CX-2, at 3.

¹⁹ CX-2, at 3, 11. SM was associated with LPL beginning in 2013, and with Western Wealth beginning in September 2016, until he was terminated by both firms in October 2017. SM submitted a Letter of Acceptance, Waiver and Consent to FINRA, in which he consented to a \$5,000 fine and a four-month suspension, without admitting or denying FINRA's findings that he borrowed \$108,360 from a customer without providing LPL prior notice. SM repaid the customer in full, with interest. These sanctions against SM became effective in July 2019. CX-2, at 17-19. In a separate action, FINRA barred SM in June 2020 pursuant to an expedited proceeding brought under FINRA Rule 9552 for failing to provide information during an investigation. CX-2, at 19-21.

²⁰ Tr. 59-60, 66-67, 79, 181.

²¹ Tr. 158; CX-18, at 1. *See also* CX-105, at 1.

²² Tr. 176-79.

²³ Tr. 68-72, 179. *See also* CX-18, at 1-2.

²⁴ Tr. 48-50.

Immediately after SM's termination in early October 2017, LPL transferred all the brokerage and advisory accounts of SM's former customers to Makkai. To facilitate the transfer of the accounts and to allow Makkai immediately to begin receiving commissions from transactions in the accounts, the Firm created new representative codes for the re-assigned brokerage and advisor accounts—8KVK for the brokerage accounts and 8MJK for the advisory accounts.²⁵

On October 10, 2017, just a few days after SM was terminated, Makkai tried to arrange for SM to be employed by LPL as an unregistered relationship manager, but paid by Western Wealth, so that SM could continue to have access to client accounts and aid in the anticipated transition of the accounts to Makkai. LPL immediately rejected the idea, stating that SM could not be affiliated with LPL in any way given the circumstances surrounding his termination.²⁶

In early November 2017, SM emailed one of his former clients to announce that he had merged his practice with Makkai's, whom he identified as being registered with LPL and Western Wealth and who works out of the same Greenwood Village office. SM copied Makkai on the email. SM told the customer that he had moved his client accounts to Makkai "in anticipation of [his] eventual retirement," but that "under the terms of the merger" SM would continue to be the client's "point of contact for the next 5 years or so."²⁷ SM told the customer that he "look[ed] forward to our continued relationship" and that he would introduce him to Makkai "over time."²⁸

Makkai testified that he thought SM did not want to reveal to the customer that he had been terminated because he was "in a desperate situation."²⁹ Makkai did not follow up with the customer to explain that SM's email was inaccurate or misleading because "[t]hese were [SM's] relationships. [SM] communicated with [SM's] clients ... [who] had been with him for ... however long he had been in the business."³⁰

²⁵ Tr. 49-50, 74-76; CX-97, at 2-3. *See also* CX-64. During the investigation, Makkai acknowledged paying SM \$101,503.50 in brokerage commissions and advisory fees between late November 2017 and late March 2018. CX-25, at 3. Enforcement alleges that only brokerage commissions of \$27,037 that Makkai paid SM between mid-December 2017 and March 2018 violate FINRA Rule 2040. Thus, the advisory fees in the amount of \$74,466 that Makkai paid SM are not the subject of the Complaint. *See* Complaint ("Compl.") ¶¶ 14, 17; Enforcement's Pre-Hearing Br. 4-5; Enforcement's Post-Hearing Br. 5.

²⁶ Tr. 182-86; CX-99; CX-114, at 261-62.

²⁷ CX-114, at 174-75.

²⁸ CX-114, at 175. In late October, after LPL terminated his employment and three days before the Firm filed the Form U5, SM emailed another customer that he was "merging" his practice with Makkai's and that "[w]e are just changing the org structure." CX-114, at 79. In January 2018, SM emailed an assistant and Makkai inquiring about the status of the sale of stock held in a customer account and instructing that the sale needed to be reversed. *See* CX-114, at 427-28.

²⁹ Tr. 218-19.

³⁰ Tr. 219-20.

After being terminated, SM continued to meet with his former brokerage and advisory clients. Gerhardt E. Buenning (“Buenning”), the owner of Western Wealth and the LPL branch, who was also Makkai’s supervisor beginning November 1, 2017,³¹ permitted SM to continue to use an office there. All of SM’s former brokerage and advisory customers had insurance business with SM. According to Buenning, the “understanding” with SM was to let him continue to use an office to service the insurance business but that SM “could not go over any of their investment accounts.”³² Buenning knew that Makkai’s schedule did not allow him to join all of SM’s meetings with former customers.³³ But because Buenning did not work out of the Greenwood Village office, he acknowledged that he was not “totally” sure that SM did not discuss investment matters with former customers.³⁴

By continuing to be in the office, SM also could help transition the brokerage and advisory business and meet clients with Makkai.³⁵ According to Makkai, SM and SM’s assistant determined who should attend the client meetings but would include Makkai in any meetings that involved investment recommendations.³⁶ Makkai testified that he and the Firm made it “very clear” to SM that he could not make recommendations to customers.³⁷ But Makkai said that he could not participate in every meeting that SM scheduled with his former customers because he had his own clients to service.³⁸

D. Makkai Pays Commissions to Former LPL Broker

At around the end of November 2017, while Makkai and SM were still negotiating the terms of the sale of the business, SM asked Makkai to pay him the brokerage commissions and advisory fees that his former accounts generated.³⁹ Makkai agreed to this arrangement. In a written statement to FINRA during the investigation, Makkai explained that he felt “uncomfortable” and “a bit uneasy” keeping all the revenue from activity in the accounts. As Makkai put it, if he held on to the money, he would have received the benefit of SM’s many years servicing the customers. Makkai wrote that he believed that keeping the commissions

³¹ Tr. 161, 418-20, 451-52.

³² Tr. 485-86.

³³ Tr. 485.

³⁴ Tr. 486.

³⁵ Tr. 183, 484. Buenning received a letter of caution from LPL for permitting SM to maintain an office at the branch without having in place an office-sharing agreement with him. Tr. 474-77.

³⁶ CX-105, at 2. SM memorialized the substance of his office conferences with customers in written agendas. *See* CX-95.

³⁷ Tr. 580.

³⁸ Tr. 232-33. *See also* Tr. 485; CX-18, at 2.

³⁹ Tr. 205, 393-94, 399-400; CX-18, at 2. By late November 2017, LPL already had paid Makkai \$6,726 in commissions generated by activity in SM’s former customers’ brokerage accounts. Tr. 85-86; CX-64, at 4, 8, 12.

would also give him an “unfair advantage” in the negotiations to buy SM’s book of business.⁴⁰ “As a gesture of goodwill” Makkai agreed to pay SM all the revenue generated by his former customers while they continued to negotiate an ultimate sale price and other terms for the book of business. SM agreed that Makkai could pay himself \$1,000 per month (\$4,000 over four months) from the commissions and fees.⁴¹

LPL sent Makkai brokerage commission and advisory fee statements for SM’s former clients twice per month. The Firm also paid Makkai commissions and advisory fees twice per month by directly depositing them into a new personal checking account that Makkai had opened at Wells Fargo for that specific purpose.⁴² Makkai then transferred the commissions and fees to a separate business account at Wells Fargo, which he used to make payments to SM.⁴³

Using his LPL email account, Makkai sent SM copies of his LPL brokerage commission and advisory fee statements for SM’s former accounts, together with pages from his personal Wells Fargo bank account showing that LPL had transferred the funds to him. This way SM could confirm that Makkai was paying him the correct amount of commissions and fees generated from transactions by his former customers.⁴⁴ On the subject line of the emails to SM, Makkai wrote “commissions,” “commission statements,” or “payments.” LPL’s email surveillance software did not flag any of Makkai’s emails to SM for review by a supervisor.⁴⁵ Makkai testified at the hearing that his intent was to be “transparent” with SM and that he was not trying to hide his arrangement with SM from LPL.⁴⁶

According to the documentary evidence presented at the hearing, at least two former SM customers engaged in securities transactions after meeting with SM in early January 2018. The brokerage transactions occurred in late January and early February 2018, generating small commissions.⁴⁷ At the hearing, Makkai acknowledged that he made investment recommendations to SM’s former customers that resulted in securities transactions. He testified that he paid all the commissions generated from his recommendations to SM.⁴⁸

Makkai and SM could not agree on terms for the sale of SM’s book of business. In November 2017, LPL personnel told Makkai and SM that SM’s business was worth between

⁴⁰ CX-18, at 2.

⁴¹ CX-18, at 1-2.

⁴² Tr. 91-92.

⁴³ Tr. 102; CX-90; CX-91; CX-92; CX-93.

⁴⁴ Tr. 137-41.

⁴⁵ Tr. 525; CX-44, at 6-7.

⁴⁶ Tr. 138.

⁴⁷ CX-95, at 6, 8; CX-64, at 34, 39.

⁴⁸ Tr. 582-83.

\$520,000 and \$696,000.⁴⁹ In late February 2018, SM sent Makkai a draft agreement with a proposed purchase price of \$780,000.⁵⁰ The contract SM had drafted also contained a promissory note obligating Makkai to make periodic payments. Makkai objected to signing a promissory note.⁵¹ Makkai testified that because he had his own existing clients and had recently purchased the business of another former registered representative, he was “at capacity,” and “couldn’t do everything that [he] needed to do to service everybody the way that they needed to be.”⁵² He was also concerned that he could not sustain the high management fees that SM had been charging some of his more important clients, which reduced the attractiveness of the business to Makkai.⁵³

After deciding he no longer was interested in SM’s business, Makkai backed out of the negotiations by the end of March 2018. By this time, Makkai had made seven commission payments to SM totaling \$27,037.⁵⁴ Makkai did not ask SM to return any of the commissions that he had paid him.⁵⁵

During this same time period, in early 2018, Makkai completed LPL’s annual compliance questionnaire. In it, he certified that he had read LPL’s WSPs and, specifically, that he understood that he was prohibited from “paying or otherwise directing transaction based compensation to another person without prior LPL approval.”⁵⁶ At the hearing, Makkai explained that he did not believe he was violating the firm’s proscription because he was paying SM for his business, and did not think of the payments as constituting payments of commissions.⁵⁷

E. Makkai Did Not Disclose to LPL that He Was Paying Commissions to the Former Broker

At the hearing, the parties presented competing evidence concerning whether Makkai had disclosed to LPL that he was paying SM commissions and advisory fees in anticipation of buying the book of business. Enforcement claims that Makkai deceived LPL and Buenning by

⁴⁹ Tr. 387-88; CX-18, at 2; CX-115, at 7.

⁵⁰ CX-125, at 3, 15, 26.

⁵¹ Tr. 202.

⁵² Tr. 233.

⁵³ Tr. 568.

⁵⁴ Compl. ¶ 14; Answer (“Ans.”) ¶ 14; Tr. 91, 572.

⁵⁵ Tr. 565-66. SM stopped using Western Wealth’s Greenwood Village offices in April 2018, after negotiations with Makkai fell through. Tr. 356-57.

⁵⁶ Tr. 252-54, 257-58; CX-96, at 7.

⁵⁷ Tr. 251.

intentionally withholding the fact that he was paying SM. Makkai denies this, asserting that everyone in the office, including his supervisor Buenning, knew he was paying SM.⁵⁸

Makkai admitted at the hearing that he did not specifically inform Buenning that he was using commissions to pay SM.⁵⁹ He insisted, however, that by December 2017, he disclosed to Buenning that he had started making payments to SM. Makkai testified that if Buenning “at any point” told him, or “hinted,” that he should not pay SM, he “would not have paid him.”⁶⁰ Makkai said he would have had “no reason” to pay SM if he had been directed not to.⁶¹ According to Makkai, because Buenning did not ask him “how” he was paying SM, Makkai “just figured it was okay [to use commissions].”⁶² Makkai also did not tell Buenning how much he was paying SM or that he was turning over all of the commissions that he was receiving (less \$1,000 per month as he and SM had agreed).

Buenning gives a sharply contrasting account. According to Buenning, Makkai first asked him sometime in late 2017 or early 2018 if he could pay SM brokerage commissions and advisory fees before SM sold him the business. Buenning testified that he “specifically said no, that was not possible.”⁶³ According to Buenning, both Makkai and SM were told that “no payments could be exchanged” until they finalized and signed a contract.⁶⁴ In approximately February or March 2018, according to Buenning, Makkai again asked if he could forward commissions to SM because they still had not reached an agreement. In a letter to Enforcement during the investigation, Buenning wrote that he told Makkai he could not do so.⁶⁵

After considering all the evidence and assessing Makkai’s and Buenning’s testimony and demeanor, the Panel finds that the evidence is insufficient for us to conclude that Makkai was trying to deceive or hide the payments from LPL. The communications between Makkai and Buenning reflect considerable confusion about commission payments. It appears instead that

⁵⁸ See also Compl. ¶¶ 11-13, 15 (alleging that Makkai paid SM commissions even after LPL told him he could not do so); Ans. ¶¶ 11-13, 15.

⁵⁹ Tr. 584-85.

⁶⁰ Tr. 559.

⁶¹ Tr. 559.

⁶² Tr. 585-86. Makkai acknowledged that he did not describe to Buenning the “breakdown or the specifics” of the payments or the “mechanics of how the payments worked.” Tr. 585.

⁶³ Tr. 422-24. Buenning’s conversations with Makkai about paying SM took place in person and over the telephone. See CX-112.

⁶⁴ CX-111. Buenning testified that he did not learn that Makkai was paying SM commissions until after LPL initiated its internal investigation in approximately April 2018. Tr. 436-37.

⁶⁵ Tr. 428-29; CX-113. Buenning acknowledged that no “formal documentation” exists to show that he told Makkai he could not share commissions with SM. CX-112; CX-113. In a written response to FINRA during the investigation, LPL stated that Makkai did not seek the Firm’s approval to share commissions. CX-19, at 4.

Makkai thought Buenning knew of and approved the payments, whereas Buenning believed that he had made clear to Makkai that he could make no payments of any kind to SM.

III. Conclusions of Law

The sole cause of the Complaint charges that Makkai violated FINRA Rules 2040⁶⁶ and 2010 by paying SM, an unregistered person, \$27,037 in commissions from securities transactions conducted in the accounts of SM's former brokerage customers.

FINRA Rule 2040(a) provides:

No member or associated person shall, directly or indirectly, pay any compensation, fees, concessions, discounts, commissions or other allowances to:

(1) any person that is not registered as a broker-dealer under Section 15(a) of the [Securities Exchange Act of 1934 (“Exchange Act”)] but, by reason of receipt of any such payments and the activities related thereto, is required to be so registered under applicable federal securities laws and [Exchange Act] rules and regulations; or

(2) any appropriately registered associated person unless such payment complies with all applicable federal securities laws, FINRA rules and [Exchange Act] rules and regulations.

In determining whether a person may be acting in a capacity requiring registration as a broker or dealer under Section 15(a) of the Exchange Act, the National Adjudicatory Council (“NAC”) has relied on authority from the Securities and Exchange Commission (“SEC”).⁶⁷ In a recent decision, the NAC applied factors that the SEC has determined are relevant to a finding that a person or entity must be registered. The factors are whether a non-member (i) actively solicited investors; (ii) advised investors as to the merits of an investment; (iii) acted with a “certain regularity of participation in securities transactions”; or (iv) received commissions or

⁶⁶ FINRA Rule 2040 replaced former NASD Rule 2420 and NASD IM-2420-2 (Continuing Commissions Policy) effective August 24, 2015. See Securities Exchange Act Release No. 34-73954, 2014 SEC LEXIS 5051 (Dec. 30, 2014); FINRA Regulatory Notice 15-07 (Mar. 2015), http://www.finra.org/sites/default/files/Notice_Regulatory_15-07.pdf.

⁶⁷ See *Continuance in Membership Application of Firm A*, No. 20100226181, 2011 FINRA Discip. LEXIS 19, at *14 (NAC, Apr. 15, 2011) (denying member firm's application to change ownership and control) (citing *Joseph Kemprowski*, Exchange Act Release No. 35058, 1994 SEC LEXIS 3743, at *5 (Dec. 8, 1994)). Under Exchange Act Section 15(a)(1), 15 U.S.C. § 78o(a)(1), which governs the registration of brokers and dealers, “[a]bsent an exception or exemption, a broker-dealer that ‘effect[s] any transactions in, or ... induce[s] or attempt[s] to induce the purchase or sale of any security’ must register with the SEC.” A “broker” is “any person engaged in the business of effecting transactions in securities for the account of others.” 15 U.S.C. § 78c(a)(4)(A). A “dealer” is “any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise.” 15 U.S.C. § 78c(a)(5)(A).

transaction-based compensation.⁶⁸ Of the foregoing factors, the SEC elevates the receipt of commissions, or transaction-based compensation, to be the “hallmark of broker-dealer activity” requiring registration.⁶⁹

The SEC has determined that “any person receiving transaction-based compensation in connection with another person’s purchase or sale of securities typically must register as a broker-dealer or be an associated person with a registered broker-dealer.”⁷⁰ “[T]he receipt of securities commissions or other transaction related compensation is a key factor in determining whether a person or an entity is acting as a broker-dealer.”⁷¹ The SEC has explained that persons who receive such compensation must be registered under the Exchange Act “because, among other reasons, registration helps to ensure that persons with a ‘salesman’s stake’ in a securities transaction operate in a manner consistent with customer protection standards governing broker-dealers and their associated persons, such as sales practice rules.”⁷² “[P]roper registration and concomitant regulation,” the SEC has further explained, “are needed to prevent and curtail abusive sales practices.”⁷³

Makkai argues that his payments to SM fell within the scope of FINRA Rule 2040(b), which addresses how member firms may properly pay continuing commissions to a retiring representative. FINRA Rule 2040(b) provides:

(1) A member may pay continuing commissions to a retiring registered representative of the member, after he or she ceases to be associated with such member, that are derived from accounts held for continuing customers of the retiring registered representative regardless of whether customer funds or securities are added to the accounts during the period of retirement provided that:

(A) a bona fide contract between the member and the retiring registered representative providing for the payments was entered into in good faith while the person was a registered representative of the member and such contract, among

⁶⁸ *Dep’t of Enforcement v. Silver Leaf Partners, LLC*, No. 2014042606902, 2020 FINRA Discip. LEXIS 36, at *46 (NAC June 29, 2020), *appeal docketed*, No. 3-19896 (SEC July 28, 2020) (finding a violation of former NASD Rule 2420, the predecessor to FINRA Rule 2040) (citing *Continuance in Membership Application of Firm A*, 2011 FINRA Discip. LEXIS 19, at *15). *See also Joseph Kemprowski*, 1994 SEC LEXIS 3743, at *5.

⁶⁹ *Silver Leaf Partners*, 2020 FINRA Discip. LEXIS 36, at *46 (citing *Continuance in Membership Application of Firm A*, 2011 FINRA Discip. LEXIS 19, at *14). *See also Persons Deemed Not to Be Brokers*, Exchange Act Release No. 22172, 1985 SEC LEXIS 1217, at *13 (June 27, 1985) (“[T]he receipt of transaction-based compensation often indicates that [a] person is engaged in the business of effecting transactions in securities.”).

⁷⁰ *Brumberg, Mackey & Wall, P.L.C.*, 2010 SEC No-Act. LEXIS 406, at *2 (May 17, 2010).

⁷¹ *1st Global, Inc.*, 2001 SEC No-Act. LEXIS 557, at *5-6 (May 7, 2001) (“Absent an exemption, an entity that receives commissions or other transaction-related compensation in connection with securities-based activities that fall within the definition of ‘broker’ or ‘dealer’... generally is required to register as a broker-dealer.”).

⁷² *Id.* at *5.

⁷³ *Brumberg*, 2010 SEC No-Act. LEXIS 406, at *7.

other things, prohibits the retiring representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments; and

(B) the arrangement complies with applicable federal securities laws, [Securities Exchange Act] rules and regulations.

Makkai argues that the definition of “member,” as set forth in Article I of FINRA’s By-Laws, includes a natural person registered with FINRA.⁷⁴ He correspondingly argues that he is a “FINRA member.” The Panel rejects Makkai’s argument. Contrary to Makkai’s assertion, FINRA Rule 2040(b) allows only a “member” to pay commissions to a retiring representative under certain circumstances.⁷⁵ Makkai was not a FINRA member firm, but rather a registered person associated with a member firm.

Also, SM was not a retiring representative.⁷⁶ He was involuntarily terminated and then returned to the securities industry in August 2018, within five months of receiving his last commission payment from Makkai.

One of the conditions under which a member firm may properly pay continuing commissions to a retiring representative is when the firm and the retiring representative have entered into a bona fide contract while the person was still registered. There was no bona fide contract between a member firm and SM, as required by FINRA Rule 2040(b). The SEC Release approving FINRA Rule 2040 states that the new rule codified FINRA staff guidance for the payment of commissions by member firms to retiring representatives. The existing guidance calls for a bona fide “duly executed” contract covering the arrangement, which necessarily means that that it be in writing.⁷⁷ Because there was no written contract, Makkai strained at the hearing to show that he and SM had a valid oral contract in place before SM was terminated.⁷⁸

⁷⁴ See Tr. 29-30 (Resp’t opening statement), 637-38 (Resp’t closing argument); Resp’t Pre-Hearing Br. 2, 9; Resp’t Post-Hearing Br. 2-3. Also, FINRA Rule 0140 states that FINRA’s rules apply to all members and persons associated with a member. However, by its terms, FINRA Rule 2040(b) can apply only to member firms.

⁷⁵ See FINRA Regulatory Notice 15-07, at 3 (stating that Rule 2040(b) codifies prior FINRA and SEC guidance on circumstances under which a “member firm” can pay continuing commissions to retiring brokers). The SEC’s Release approving FINRA Rule 2040 makes it clear that subsection (b) applies to member firms, not associated persons. Exchange Act Release No. 73954, 2014 SEC LEXIS 5051, at *14 (Dec. 30, 2014) (“FINRA Rule 2040(b) ... codifies existing FINRA staff guidance on the payment by members of continuing commissions to retiring registered representatives. The [Rule] permits members to pay continuing commissions to retiring registered representative of the member, after they cease to be associated with the member ...”).

⁷⁶ FINRA Rule 2040(b)(2) defines “retiring registered representative” for the purposes of the rule as “an individual who retires from a member (including as a result of a total disability) and leaves the securities industry.”

⁷⁷ Exchange Act Release No. 73954, 2014 SEC LEXIS 5051, at *14, n.13 (Dec. 30, 2014) (citing FINRA Interpretive Letters to Ted A. Troutman, Esq. (Feb. 4, 2002); Joe Tully (Aug. 9, 2001); and Peter D. Koffer, Esq. (Jan. 21, 2000) issued under former NASD IM-2420-2, the predecessor to FINRA Rule 2040(b)), <http://www.finra.org/rules-guidance/guidance/interpretive-letters>.

⁷⁸ See, e.g., Tr. 157, 191, 195, 206, 333, 365.

The Panel rejects this claim. The evidence at the hearing showed that there was no contract at all between Makkai and SM at any time, much less a written contract. The Panel therefore finds that FINRA Rule 2040(b) does not provide a defense for Makkai.

SM received commissions, or transaction-based compensation, from Makkai. Because Makkai paid him all the commissions he received every two weeks (less \$1,000 per month), the Panel finds that SM also acted “with a certain regularity of participation in securities transactions.” SM expressly told at least one customer that he would continue to be involved in handling his account as he was merging his business with Makkai’s and transitioning to retirement, and that he would remain the point of contact. The evidence showed that SM met in the office with brokerage customers and did so at least occasionally without Makkai.

Makkai and SM did not agree on an installment payment plan, or some other fixed payment schedule, independent of the amount of commissions LPL paid Makkai. Instead, SM received from Makkai almost all the commissions paid by his former brokerage customers over a four-month period, including commissions generated specifically as a result of recommendations Makkai made to SM’s former brokerage customers. Given SM’s continuing contact with former customers and his receipt of commissions, which is the “hallmark of broker-dealer activity,”⁷⁹ the Panel finds that SM acted as a person who should have been registered.

SM was not registered when he received the commissions from Makkai. The Panel therefore finds that Makkai improperly paid commissions to an unregistered person. The Panel concludes that Makkai’s conduct violated FINRA Rules 2040 and 2010.⁸⁰

IV. Sanctions

In determining the appropriate sanctions, the Panel considered FINRA’s Sanction Guidelines (“Guidelines”), including the General Principles Applicable to All Sanction Determinations (“General Principles”) and the Principal Considerations in Determining Sanctions (“Principal Considerations”).⁸¹ We also considered all relevant facts and circumstances, including the nature of the underlying misconduct, any aggravating and mitigating factors, and the risk of future harm that Makkai poses to the investing public.

The Guidelines do not address violations of FINRA Rule 2040. The Panel therefore consulted the Guidelines for the most analogous rule violations.⁸² The NAC has found that the

⁷⁹ *Continuance in Membership Application of Firm A*, 2011 FINRA Discip. LEXIS 19, at *15.

⁸⁰ A violation of FINRA Rule 2040 also constitutes a violation of FINRA Rule 2010. *Silver Leaf Partners*, 2020 FINRA Discip. LEXIS 36, at *46 (finding that a violation of former NASD Rule 2420, the predecessor to FINRA Rule 2040, constitutes a violation of FINRA Rule 2010).

⁸¹ FINRA Sanction Guidelines at 2-8 (October 2020), http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf.

⁸² Guidelines at 1 (“For violations that are not addressed specifically, Adjudicators are encouraged to look to the guidelines for analogous violations.”).

guidelines for registration violations of FINRA Rule 1122 and NASD Rules 1000 through 1120 are the most analogous.⁸³ For registration violations, the Guidelines recommend a fine of \$2,500 to \$77,000 and a suspension in any or all capacities for up to six months. The Guidelines do not suggest a minimum term of suspension. In egregious cases, adjudicators should consider a suspension of up to two years or a bar.⁸⁴

The Guidelines also direct adjudicators to consider sanctions previously imposed by other regulators or previous corrective action imposed by a firm based on the same conduct.⁸⁵ The Panel finds that LPL terminated Makkai for the same conduct charged in the Complaint. When a firm has terminated a respondent's employment based on the same conduct at issue in a subsequent FINRA disciplinary proceeding, adjudicators should consider whether a respondent "has demonstrated that the termination qualifies for any mitigative value, keeping in mind the goals of investor protection and maintaining high standards of business conduct."⁸⁶ A respondent has the burden to prove that the termination "has materially reduced the likelihood of misconduct in the future."⁸⁷

Under the circumstances of this case, and after considering Makkai's testimony and all the evidence before us, the Panel finds that LPL's termination of Makkai materially reduces the likelihood of further misconduct and mitigates the sanctions the Panel imposes. The Panel carefully considered Makkai's demeanor and his testimony concerning his decision to pay SM commissions. We find Makkai's explanations credible and mitigating—that he did not believe he was paying commissions per se but using his LPL compensation for the limited purpose of buying SM's business. We also credit Makkai's statements that he did not feel he was fairly entitled to keep the commissions so long as he and SM were still negotiating the terms of the contract.

The Guidelines provide that a sanction must be remedial, not punitive.⁸⁸ Enforcement seeks a \$5,000 fine and a five-month suspension in all capacities.⁸⁹ The Panel finds that a sanction at the lower end of the sanctions range is properly remedial and anything greater would

⁸³ See *Silver Leaf Partners*, 2020 FINRA Discip. LEXIS 36, at *69-70 (confirming Hearing Panel's application of the Guidelines for registration violations of FINRA Rule 1122 and NASD Rules 1000 through 1120 to determine appropriate sanctions for paying commissions to unregistered persons in violation of former NASD Rule 2420).

⁸⁴ Guidelines at 45. The violation-specific principal considerations in determining sanctions for registration violations are not relevant in this instance.

⁸⁵ Guidelines at 5 (General Principles, No. 7).

⁸⁶ Guidelines at 5 (General Principles, No. 7).

⁸⁷ Guidelines at 5 (General Principles, No. 7). See also *Saad v. SEC*, 873 F.3d 297, 302-03 (D.C. Cir. 2017), *aff'd*, Exchange Act Release No. 86751, 2019 SEC LEXIS 2216 (Aug. 23, 2019), *petition for review denied*, No. 19-1214, 2020 U.S. App. LEXIS 35153 (D.C. Cir. Nov. 6, 2020) (recognizing that a firm's disciplinary action prior to regulatory detection may be considered mitigating).

⁸⁸ Guidelines at 2 (General Principles, No. 1).

⁸⁹ Tr. 611 (Enforcement's closing argument); Enforcement's Post-Hearing Br. 19.

be disproportionate and excessive in this case. The Panel applied the relevant Principal Considerations as set forth in the Guidelines. We considered that Makkai's misconduct spanned about four months and involved seven payments to SM totaling \$27,037 in commissions.⁹⁰ But we do not find the duration of the misconduct or the amount of the commissions paid to be significantly aggravating, as Enforcement argues.⁹¹ The Panel notes that certain aggravating factors are not present here. In particular, there is no evidence that Makkai's conduct caused injury to customers.⁹²

The Panel notes, however, that as a seasoned and experienced broker, Makkai should have known that sharing commissions with an unregistered person would violate of FINRA's rules. But the Panel disagrees with Enforcement that Makkai acted intentionally, in the sense that he knew he was engaged in improper conduct. We find it credible that Makkai believed he was simply using his compensation, which he received in the form of commissions, to pay for the book of business. The totality of the evidence before the Panel suggests that Makkai acted negligently, not recklessly or intentionally.⁹³ We also disagree with Enforcement's characterization that Makkai failed to accept responsibility for his misconduct.⁹⁴ The Panel finds that, consistent with a respondent's right to put on a defense, Makkai testified forthrightly about what he did, which under the circumstances prevailing in this case does not rise to the level of denying responsibility.⁹⁵

Consistent with the Guidelines, and after carefully considering the facts and circumstances of this case, the Panel concludes that a monetary sanction immediately below the low end of the recommended range is appropriate. Accordingly, after weighing both mitigating and aggravating factors, the Panel imposes a fine of \$2,000. The Panel also suspends Makkai for ten business days from associating in any capacity with any FINRA member firm. The Panel believes that the sanctions are appropriately remedial and will serve to dissuade others from engaging in similar misconduct.

⁹⁰ Guidelines at 7 (Principal Considerations, Nos. 8, 9, 17) (whether the respondent engaged in numerous acts and/or a pattern of misconduct; whether the respondent engaged in the misconduct over an extended period of time; the number, size and character of the transactions at issue).

⁹¹ Enforcement Post-Hearing Br. 12-13.

⁹² See *Dep't of Mkt. Regulation v. Naby*, No. 2012032080301, 2017 FINRA Discip. LEXIS 27, at *32 (NAC July 24, 2017) (finding that the absence of certain aggravating factors, such as disciplinary history, customer harm, and the potential for monetary gain may affect sanctions).

⁹³ Guidelines at 8 (Principal Considerations, No. 13) (whether the respondent's misconduct was the result of an intentional act, recklessness or negligence).

⁹⁴ Tr. 612-13 (Enforcement's closing argument); Enforcement's Post-Hearing Br. 18.

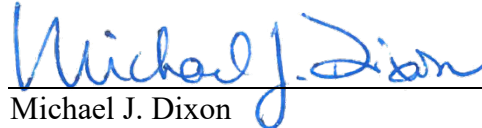
⁹⁵ Guidelines at 7 (Principal Considerations, No. 2) (whether an individual respondent accepted responsibility for his conduct).

V. Order

Respondent Adam James Makkai violated FINRA Rules 2040 and 2010 by paying commissions to an unregistered person, as alleged in the sole cause of action. He is (i) fined \$2,000, and (ii) suspended for ten business days from associating with any FINRA member firm in any capacity.

Makkai is also ordered to pay the hearing costs of \$5,565.38, consisting of a \$750 administrative fee and \$4,815.38 for the cost of the transcript.

If this decision becomes FINRA's final disciplinary action, the suspension shall become effective with the opening of business on Monday, August 2, 2021, and end at the close of business on Friday, August 13, 2021. The fines and assessed costs shall be due on a date set by FINRA, but not sooner than 30 days after this decision becomes FINRA's final disciplinary action in this proceeding.⁹⁶


Michael J. Dixon
Hearing Officer
For the Hearing Panel

Copies to:

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⁹⁶ The Hearing Panel considered and rejected without discussion all other arguments by the parties.