

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 89979 / September 24, 2020

ADMINISTRATIVE PROCEEDING
File No. 3-20054

In the Matter of

**MORGAN WILSHIRE
SECURITIES, INC.,**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
PROCEEDINGS, PURSUANT TO SECTION
15(b)(4) OF THE SECURITIES EXCHANGE
ACT OF 1934, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 (“Exchange Act”), against Morgan Wilshire Securities, Inc. (“Morgan Wilshire” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings, Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds that:

Summary

1. From at least January 1, 2015 through March 31, 2019 (the “relevant period”), Morgan Wilshire registered representatives recommended that a number of their retail brokerage customers buy non-leveraged, inverse exchange-traded funds (“inverse ETFs”), without regard for holding period, without having a reasonable basis for believing those recommendations were

suitable, and, in certain cases, without making suitable recommendations in light of certain of these customers' risk profiles and investment objectives. Morgan Wilshire failed to implement its policies and procedures in order to reasonably supervise its registered representatives in connection with their recommendations to buy inverse ETFs, with a view to preventing and detecting the registered representatives' violations of Section 17(a)(3) of the Securities Act of 1933 ("Securities Act").

2. Inverse ETFs are complex financial instruments that seek investment results that are the inverse or opposite of the performance of an underlying index for a stated period, specifically a single day. When held longer than a day, particularly in volatile markets, investors who seek the inverse return of a given index may experience losses that exceed the inverse return of the index. For instance, and as disclosed in the inverse ETFs' prospectuses, an inverse ETF's return for periods longer than a single day may deviate from the underlying index's return when the level of the index is flat. Put differently, even if the index performance is zero percent, the inverse ETF will lose money. The prospectuses further disclose that inverse ETFs could lose money even if the level of the index falls, and warn that the products may not be suitable for all investors and should be used only by knowledgeable investors who understand the risks.

3. During the relevant period, certain Morgan Wilshire registered representatives recommended that a number of their retail customers buy inverse ETFs without regard to holding periods. Based on these recommendations, Morgan Wilshire customers purchased and held these inverse ETFs for longer than a single day, and in many cases, months, or years. Those registered representatives did not adequately understand all of the features and risks of inverse ETFs. Thus, the Morgan Wilshire registered representatives did not have a reasonable basis for their recommendations. In addition, some of the registered representatives recommended that certain customers buy the inverse ETFs despite the fact that, in certain instances, those recommendations were not suitable for those specific customers' risk profiles and investment objectives. As a result, during the relevant period, Morgan Wilshire's customers, collectively, sustained losses from these products.

4. During the relevant period, Morgan Wilshire did not establish systems to reasonably implement its policies and procedures to address the complexity and risks associated with the purchase of inverse ETFs. As a result, Morgan Wilshire did not prevent or detect its registered representatives' buy recommendations concerning these complex products where the registered representatives had no reasonable basis for making these recommendations and they made recommendations that were, in some cases, unsuitable for specific customers given their stated risk profiles and investment objectives. For example, Morgan Wilshire did not sufficiently train its registered representatives on inverse-ETF products or take other reasonable steps to adequately educate them so they sufficiently understood the products before they recommended them to their customers. Morgan Wilshire also did not implement its procedures so that supervisors could adequately review inverse-ETF buy recommendations. Morgan Wilshire's registered representatives' misconduct and Morgan Wilshire's supervisory failures continued through March 2019.

5. By making unsuitable recommendations to their customers to buy inverse ETFs, certain Morgan Wilshire registered representatives violated Section 17(a)(3) of the Securities Act. Morgan Wilshire's supervisory policies and procedures were not reasonably implemented to provide sufficient oversight of its registered representatives to prevent and detect their violations of Section 17(a)(3) of the Securities Act. As a result, Morgan Wilshire failed reasonably to supervise its registered representatives within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Respondent

6. **Morgan Wilshire** is incorporated in Delaware and has its sole and principal place of business in Garden City, New York. Morgan Wilshire is a broker-dealer registered with the Commission; and currently has nine employees.

Background

Risks Inherent in Buying Inverse ETFs for Retail Investors

7. In June 2009, the Financial Industry Regulatory Authority ("FINRA") issued FINRA Regulatory Notice 09-31 (the "Notice"), reminding securities firms of their sales practice obligations in connection with inverse and other non-traditional ETFs. The Notice, among other things, provided:

In particular, recommendations to customers must be suitable and based on a full understanding of the terms and features of the product recommended . . . and firms must have adequate supervisory procedures in place to ensure that these obligations are met.

8. The Notice also stated that most "inverse ETFs 'reset' daily, meaning that they are designed to achieve their stated objectives of tracking their respective underlying indices only on a daily basis. Due to the effect of compounding, their performance over periods longer than one day can differ significantly from the performance of their underlying index or benchmark during the same period of time." The Notice therefore cautioned, "inverse and leveraged ETFs typically are not suitable for retail clients who plan to hold them for more than one trading session, particularly in volatile markets." The Notice advised firms to establish an appropriate supervisory system, and train registered persons on these products and the factors that would make such products suitable or unsuitable for certain investors.

9. In August 2009, FINRA and Commission staff issued a joint alert highlighting the risk in holding non-traditional ETFs, including inverse ETFs, for weeks, months, or years.

10. In addition, the prospectuses for the inverse ETFs warn that over periods longer than a day, the results of inverse ETFs very likely will diverge from the inverse of the underlying index. According to the prospectuses, when these products are held longer than a day, inverse ETFs will lose money with respect to the underlying index's performance when the level of the

index is flat, and it is possible these products will lose money even if the underlying index falls. Over periods longer than one day, inverse ETFs do not perfectly mirror the inverse performance of an underlying index due to daily rebalancing, the underlying index's volatility, and the effects of compounding. Consequently, the prospectuses also state that investors "should actively manage and monitor their investments, as frequently as daily."

Morgan Wilshire Failed Reasonably to Implement Its Policies and Procedures Related to Suitability of Inverse ETFs

11. Morgan Wilshire's policies and procedures addressed suitability generally by requiring its registered representatives to review a customer's investing objectives, financial condition, and level of sophistication. Morgan Wilshire required its registered representatives to, among other things, consider a customer's ability to evaluate risk as well as a customer's ability to financially undertake and maintain a given transaction. The firm also required its registered representatives to have a reasonable basis to believe that the investments they recommended were suitable for any investor and that those recommendations were suitable for the particular customer for whom it was made.

12. Morgan Wilshire's policies and procedures were not reasonably implemented to prevent and detect unsuitable recommendations of inverse ETFs. For example, there is no evidence that Morgan Wilshire adequately trained its registered representatives and supervisors regarding inverse ETFs, nor did it adopt a process to sufficiently educate its registered representatives about inverse ETFs and their risks.

13. During the relevant period, there was no evidence that the relevant Morgan Wilshire registered representatives had a reasonable basis to believe that buying these inverse ETFs was suitable for any of their customers. In addition, these registered representatives failed to consider certain customers' investment experience, relative sophistication, and familiarity with complex investment products such as inverse ETFs, and thus, for certain customers, failed to conduct an adequate customer-specific suitability review.

Unsuitable Recommendations to Certain Brokerage Customers

14. During the relevant period, Morgan Wilshire registered representatives made recommendations to a number of their retail customers to buy inverse-ETFs, without regard to holding period, without a reasonable basis for believing such recommendations were suitable for the customer. The recommendations were inconsistent with the products' prospectuses, as described above.

15. These registered representatives did not sufficiently consider the warnings in the relevant prospectuses and related marketing materials, despite having read them. Moreover, they did not fully understand the inherent risks associated with the inverse ETFs when held for periods longer than one day as the positions over time may incur unexpected losses and actually perform worse than the projected inverse of the underlying index they are designed to track. As

a result, certain brokerage customers held the inverse ETFs in their accounts for weeks, months, and in some cases, years and suffered losses on these positions.

16. In addition, the relevant registered representatives did not fully understand all of the potential risks of the inverse ETF products when held for more than a single day. This misunderstanding was demonstrated by several registered representatives' erroneous belief that the inverse ETFs were suitable hedges in their customers' portfolios in instances where the inverse ETF was not an appropriate hedge. In addition, some inverse ETFs were held in accounts where the customer had no underlying exposure to the index they were designed to hedge against.

17. The relevant registered representatives also made unsuitable recommendations to buy inverse ETFs, without regard to holding periods, to certain brokerage customers whose individual financial circumstances and investing experience were not consistent with the risks inherent in inverse ETFs. Additionally, some of these customers had investment objectives inconsistent with a product designed to be traded and/or monitored on a daily basis, and some held the inverse ETFs in retirement accounts.

Morgan Wilshire's Failure to Supervise

18. Morgan Wilshire's compliance and supervisory policies and procedures were not reasonably implemented to adequately supervise its registered representatives with respect to their recommendations that customers buy inverse ETFs. For example, Morgan Wilshire failed to adequately train its registered representatives about inverse ETFs so that they understood the products and their risks sufficiently in order to form a reasonable basis that a recommendation to buy inverse ETFs was suitable for some customers. In addition, Morgan Wilshire failed to develop any mechanisms, such as alerts or exception reports, to assist supervisors in identifying unsuitable recommendations related to inverse ETFs or to monitor and surveil recommendations with respect to inverse ETFs. Morgan Wilshire also failed to develop systems to assess whether its registered representatives followed the firm's general suitability policies and procedures that were then in place and whether the recommendations to buy inverse ETFs made by its registered representatives were suitable in light of customers' risk profiles, relative sophistication, and investment objectives. Because of these failures, Morgan Wilshire was unable to prevent and detect unsuitable recommendations to buy inverse ETFs by its registered representatives.

19. In determining whether to accept Morgan Wilshire's Offer, the Commission has considered the firm's current financial condition.

Violations

20. Under Section 15(b)(4)(E) of the Exchange Act, broker-dealers are responsible for supervising, with a view to preventing and detecting violations of the federal securities laws, persons subject to their supervision. Morgan Wilshire was responsible for supervising its registered representatives in making suitable recommendations to brokerage customers. Morgan Wilshire failed reasonably to fulfill such supervisory responsibilities within the meaning of

Section 15(b)(4)(E) of the Exchange Act because Morgan Wilshire failed to establish a system for implementing its policies and procedures that would reasonably be expected to prevent and detect the violations of Section 17(a)(3) of the Securities Act by the registered representatives described above. If Morgan Wilshire had developed reasonable systems to implement its policies and procedures, it is likely that the firm would have prevented and detected the violations of its registered representatives.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Morgan Wilshire's Offer.

Accordingly, pursuant to Section 15(b)(4) of the Exchange Act, it is hereby ORDERED that:

- A. Respondent is censured; and
- B. Respondent shall pay disgorgement of \$87,609.09, prejudgment interest of \$16,408.08, and a civil monetary penalty of \$75,000.00, for a total of \$179,017.17 as follows, consistent with the provisions of this Subsection B:

(i) Payment shall be made in the following installments: (1) within fourteen (14) days of the entry of this Order, Morgan Wilshire shall pay \$44,754.29 (25 % of the total); (2) within seventy-five (75) days after the entry of this Order, Morgan Wilshire shall pay \$44,754.29 (25% of the total); (3) within one hundred and thirty-five (135) days after the entry of this Order, Morgan Wilshire shall pay \$44,754.29 (25% of the total); and (4) within one hundred and ninety-five (195) days after the entry of this Order, Morgan Wilshire shall pay \$44,754.29 (25% of the total). If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 and/or 31 U.S.C § 3717 shall be due and payable immediately, without further application. Payments shall be applied first to post order interest, which accrues pursuant to SEC Rule of Practice 600 and pursuant to 31 U.S.C. § 3717. Prior to making the final payment set forth herein, Respondent shall contact the staff of the Commission for the amount due. If Respondent fails to make any payment by the date agreed and/or in the amount agreed according to the schedule set forth above, all outstanding payments under this Order, including post-order interest, minus any payments made, shall become due and payable immediately at the discretion of the staff of the Commission without further application to the Commission.

(ii) At the time of any payment from the Fair Fund to a former or current customer as described below in paragraph (vi), Morgan Wilshire shall provide to these customers a letter describing the nature of the payment and a copy of the this Order.

(iii) Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties, disgorgement, and prejudgment interest described above for distribution to affected investors accounts. Regardless of whether any such Fair Fund distribution

is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within thirty (30) days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against the Respondent by or on behalf of one or more investors based on substantially the same facts alleged in the Order instituted by the Commission in this proceeding.

(iv) Respondent shall deposit the payments described in Paragraph (i) (the "Distribution Fund") into an escrow account at a financial institution not unacceptable to the Commission staff and Respondent shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely payment into the escrow account is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600-17 C.F.R. § 201.600 or 31 U.S.C. § 3717. Any payments made by Respondent after the final accounting described in Paragraph (xii) shall be made under Paragraph (x).

(v) Respondent shall be responsible for administering the Distribution Fund and may hire a professional to assist it in the administration of the distribution. The costs and expenses of administering the Distribution Fund, including any such professional services, shall be borne by Respondent and shall not be paid out of the Distribution Fund.

(vi) Morgan Wilshire shall pay from the Distribution Fund to each of the Morgan Wilshire customers who purchased unsuitable inverse ETFs that are the subject of this Order during the period January 1, 2015 through March 31, 2019 amounts calculated in the following order of priority until such amounts are exhausted: (1) a portion of the disgorgement equal to the commissions paid by each customer on the unsuitable inverse-ETF trades; (2) a portion of the prejudgment interest representing reasonable interest on commissions paid, calculated as the short-term Applicable Federal Rate compounded quarterly from the end of each year commissions were paid through the date of this Order; and (3) a portion of the civil penalty and any remaining prejudgment interest, such that the amount of civil penalty paid to the customer, as a proportion of the total civil penalty and the remaining prejudgment interest, is equal to the ratio of losses incurred by the customer compared to the total customer losses incurred by all effected customers. No portion of the Distribution Fund shall be paid to any affected account in which Respondent, or any of Morgan Wilshire's current or former officers or directors, or representatives who recommended the inverse ETFs, or their family members, has or had a financial interest.

(vii) Morgan Wilshire shall, within thirty (30) days from the date of this Order, submit a proposed disbursement calculation (the "Calculation") to the Commission staff for review and

approval. At or around the time of submission of the proposed Distribution Calculation to the staff, Morgan Wilshire shall make themselves available, and shall require any third-parties or professionals retained by Morgan Wilshire to assist in formulating the methodology for its Calculation and/or administration of the Distribution to be available for a conference call with the Commission staff to explain the methodology used in preparing the proposed Calculation and its implementation, and to provide the staff with an opportunity to ask questions. Morgan Wilshire also shall provide the Commission staff such additional information and supporting documentation as the Commission staff may request for the purpose of its review. In the event of one or more objections by the Commission staff to Morgan Wilshire's proposed Calculation or any of its information or supporting documentation, Morgan Wilshire shall submit a revised Calculation for the review and approval of the Commission staff or additional information or supporting documentation within ten (10) days of the date that the Commission staff notifies Morgan Wilshire of the objection. The revised Calculation shall be subject to all of the provisions of this Subsection B.

(viii) After the Calculation has been approved by the Commission staff, Morgan Wilshire shall submit a payment file (the "Payment File") for review and acceptance by the Commission staff demonstrating the application of the methodology to each harmed investor. The Payment File should identify, at a minimum: (1) the name of each affected harmed investor; (2) the exact amount of the payment to be made, including the exact amounts to be paid from the disgorgement amount, from the prejudgment interest amount, and from the civil penalty amount; (3) the amount of any *de minimus* threshold to be applied; and (4) the amount of reasonable interest paid.

(ix) Morgan Wilshire shall complete the distribution of all amounts payable to affected customer accounts within fifteen (15) days of the date that the Commission staff accepts the Payment File, unless such time period is extended as provided in Paragraph (xiii) of this Subsections B.

(x) If Morgan Wilshire is unable to distribute or return any portion of the Distribution Fund for any reason, including an inability to locate an affected investor or a beneficial owner of an affected investor or any factors beyond Morgan Wilshire's control, then Morgan Wilshire shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act when the distribution of funds is complete and before the final accounting provided for in Paragraph (xii) of this Subsection B is submitted to the Commission staff. Such payments must be made in one of the following ways:

1. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
2. Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
3. Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Morgan Wilshire as Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Thomas P. Smith, Jr., Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281.

(xi) A Distribution Fund is a Qualified Settlement Fund (“QSF”) under Section 468B(g) of the Internal Revenue Code (“IRC”), 26 U.S.C. §§ 1.468B.1-1.468B.5. Respondent shall be responsible for any and all tax compliance responsibilities associated with the Distribution Fund, including, but not limited to, tax obligations resulting from the Distribution Fund’s status as a QSF and the Foreign Account Tax Compliance Act (FATCA), and may retain any professional services necessary. The costs and expenses of tax compliance, including any such professional services, shall be borne by Respondent and shall not be paid out of the Distribution Fund.

(xii) Within thirty (30) days after Morgan Wilshire completes the disbursement of all amounts payable to affected customers, Morgan Wilshire shall return all undisbursed funds to the Commission pursuant to the instructions set forth in paragraph (x). Morgan Wilshire shall then submit to the Commission staff a final accounting and certification of the disposition of the Distribution Fund for Commission approval, which final accounting and certification shall include, but not be limited to: (1) the amount paid to each payee, with the reasonable interest amount, if any, reported separately; (2) the date of each payment; (3) the check number or other identifier of the money transferred; (4) the amount of any returned payment and the date received; (5) a description of the efforts to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (6) the total amount, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (7) an affirmation that Morgan Wilshire has made payments from the Distribution Fund to affected investors in accordance with the Calculation approved by the Commission staff. Morgan Wilshire shall submit proof and supporting documentation of such payment (whether in the form of electronic payments or cancelled checks) in a form acceptable to the Commission staff under a cover letter that identifies Morgan Wilshire and the file number of these proceedings to Thomas P. Smith, Jr. Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281. Respondent shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

(xiii) The Commission staff may extend any of the procedural dates set forth in this Subsection B for good cause shown. Deadlines for dates relating to the Distribution Fund shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

By the Commission.

Vanessa A. Countryman
Secretary