

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 61655 / March 5, 2010**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2995 / March 5, 2010**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13808**

**In the Matter of**

**First Allied Securities, Inc.,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS AND A  
CEASE-AND-DESIST ORDER,  
PURSUANT TO SECTIONS 15(b) AND  
21C OF THE SECURITIES  
EXCHANGE ACT OF 1934 AND  
SECTION 203(e) OF THE  
INVESTMENT ADVISERS ACT OF  
1940**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Section 203(e) of the Investment Advisers Act of 1940 (“Advisers Act”) against First Allied Securities, Inc. (“First Allied” 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 and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940 (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

These proceedings arise out of First Allied's failure to supervise Harold H. Jaschke ("Jaschke"), a registered representative who, between May 2006 and March 2008, executed unauthorized transactions, made unsuitable recommendations, and churned his customers' accounts. During this time, Jaschke was associated with First Allied. Jaschke violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by engaging in an unauthorized high risk, short term Treasury bond trading strategy on behalf of his customers. Jaschke's customers, the City of Kissimmee ("COK") and the Tohopekaliga Water Authority ("Toho") (collectively, the "Municipalities"), were required by ordinance to invest their funds in order to provide for safety of capital, liquidity of funds, and investment income, in that order of importance, and were prohibited specifically from using the proceeds of repurchase agreements and reverse repurchase agreements for the purpose of making investments. Despite being aware of the ordinances, Jaschke engaged in a high risk trading strategy and leveraged the Municipalities' accounts in violation of the ordinances. In addition, Jaschke lied to First Allied and to the Municipalities to conceal the risky nature of the investments, his use of leverage, and large unrealized losses the accounts experienced as a result of his misconduct.

First Allied failed to establish a reasonable system to implement its written supervisory policies and procedures and violated certain books and records provisions, which Jaschke aided and abetted. First Allied's supervisory failures were in addition to supervisory failures of Jeffrey Young, First Allied's former vice president of supervision.

#### Respondent

1. **First Allied Securities, Inc. ("First Allied")** is a New York corporation with its principal place of business in San Diego, California. Since 1993, First Allied has been registered with the Commission as a broker-dealer, and, since 1994, as an investment adviser. First Allied licenses over 900 independent contractor representatives and maintains approximately 600 branch offices nationwide. First Allied is solely owned by FAS Holdings Inc., which in turn is solely owned by Advanced Equities Financial Corp.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

### **Other Relevant Entities and Persons**

2. **Harold H. Jaschke (“Jaschke”)**, age 49, resides in Houston, Texas. Jaschke was associated with First Allied as a registered representative from June 2005 until August 2008, at which time First Allied terminated its association with Jaschke.

3. **Jeffrey C. Young (“Young”)**, age 45, resides in San Diego, California. Young has been associated with First Allied since 1997. From 2000 to August 2009, he was vice president of supervision. He is currently vice president of special projects.

### **Background**

4. Jaschke recommended that the Municipalities engage in a trading strategy involving long-term, zero-coupon United States Treasury Bonds, also known as “STRIPS” (which stands for Separate Trading of Registered Interest and Principal of Securities). Jaschke’s strategy involved buying and selling the same STRIPS within a matter of days, and sometimes within the same day, to take advantage of short term changes in the price of STRIPS. In addition to simply short-term trading in STRIPS, Jaschke used repurchase agreements, or “repos,” to finance purchases of STRIPS for the Municipalities. Repos are agreements in which a seller of securities agrees to buy the securities back from the purchaser at a specified price at a designated future date. In other words, repos are a type of short-term loan, which in this case were collateralized by STRIPS. The use of repos significantly increased the risks to which Jaschke’s customers were exposed, as repos effectively allowed the accounts to borrow large amounts of money in order to hold larger positions of STRIPS. As a result of Jaschke’s trading strategy, between May 2006 and June 2007, COK’s account value declined 56% and Toho’s account value declined 58%, an aggregate unrealized loss of more than \$47 million. The Municipalities closed their accounts in March 2008 at a profit.

5. The individuals responsible for making investment decisions on behalf of the Municipalities relied upon Jaschke for information regarding their investments in STRIPS. They also relied on Jaschke to ensure that any investing they engaged in through First Allied complied with their investment policies, which were substantially identical, and codified in municipal ordinances. The ordinances stated, among other things, that the Municipalities’ funds were to be invested to provide safety of capital, liquidity of funds, and investment income, in that order of importance. The ordinances, while allowing for the use of repos for liquidity, also specifically prohibited using repos for the purpose of making investments. Despite these restrictions, Jaschke engaged in risky trading and used repos in a manner that directly violated the terms of the Municipalities’ investment ordinances.

### **Jaschke’s Material Misrepresentations and Omissions**

6. Jaschke lied to the Municipalities regarding his use of leverage in their accounts. In fall 2006, the STRIPS market fell, causing Jaschke to significantly leverage the Municipalities’ accounts to allow him to continue his trading strategy. This, in turn, caused the percentage of equity in the Municipalities’ accounts to drop below the equity threshold required by Bear Stearns, the clearing agent. As a result, the accounts began receiving house calls that

required an infusion of cash to meet the required equity percentage. House calls could be satisfied by either wiring cash into the account, or by selling off securities.

7. Jaschke lied to the Municipalities about the house calls' existence. He instructed his customers to ignore communications on First Allied letterhead regarding the need to make deposits to cover the house calls. When Jaschke needed additional funds wired into one of the accounts to satisfy a house call, he contacted his customers purporting to offer them new STRIPS "investments," which typically involved an investment of a fixed amount that would be returned shortly with a specific rate of return. However, instead of investing his customers' funds as promised, Jaschke simply used the "investment" funds to meet house calls, then returned the funds plus the rate of return when the accounts no longer needed the cash to meet the required equity threshold. If the Municipalities weren't interested in making these "investments," or if Jaschke chose not to approach them, he would simply direct First Allied's margin clerks to sell securities to cover the calls without ever disclosing either the house call or the sale to his customers (although the Municipalities did receive trade confirmations and maintenance margin notifications).

8. Jaschke also lied to the Municipalities regarding their account activity and performance. Between December 2006 and June 2007, the Municipalities' accounts continuously lost value, and experienced extremely large, unrealized losses by the summer of 2007 when the STRIPS market rapidly declined. Jaschke never disclosed the unrealized losses to his customers. Although the Municipalities received account statements from Bear Stearns, Jaschke instructed them to ignore those statements. For example, when one customer noticed that Toho's account statement showed losses in December 2006, Jaschke told him that the statements were inaccurate due to problems with Bear Stearns' systems, and instructed him to instead rely on spreadsheets Jaschke had prepared. On at least one of Jaschke's spreadsheets, the market value of Toho's STRIPS was overstated by approximately \$25 million.

9. In late summer 2007, COK's and Toho's auditors began reviewing the Municipalities' investment activity and identified the unrealized losses. Jaschke blamed the losses on Bear Stearns and falsely claimed that the accounts had mistakenly been treated as margin accounts and were wrongfully liquidated, at a loss, to cover margin calls. In reality, Bear Stearns neither liquidated the Municipalities' accounts, nor directed anyone at First Allied to do so. Instead, the losses resulted from Jaschke's trading in the accounts while the STRIPS market suffered a dramatic decline, and Jaschke simply lied to deflect attention from his unauthorized activities.

### **Jaschke's Unauthorized Trading**

10. Between May 2006 and March 2008, Jaschke engaged in several different types of unauthorized trading in the Municipalities' accounts. Despite the fact that the Municipalities held non-discretionary accounts with First Allied, Jaschke conducted hundreds of short-term STRIPS transactions in the Municipalities' accounts without the full knowledge or authorization of his customers.

11. Additionally, the manner in which Jaschke used repos was unauthorized. Jaschke led the Municipalities to believe that the repos were used only to facilitate the transfer of funds

between the Municipalities and First Allied, and would not be used to leverage the Municipalities' investment portfolios. Despite his statements to his customers, Jaschke continually used repos to highly leverage both accounts.

12. Finally, Jaschke conducted unauthorized transactions to hide the numerous house calls the Municipalities received. Jaschke engaged in unauthorized sales of securities to meet some house calls, and lied to his customers about non-existent investment opportunities in order to secure funds to satisfy other house calls.

### **Jaschke's Unsuitable Recommendations**

13. Jaschke's trading strategy was unsuitable for the Municipalities in light of their investment ordinances and their conservative investment objectives. Their investment ordinances prioritized safety of capital above all else, and specifically prohibited using repos for the purpose of making investments. Jaschke was aware of, and had copies of, the Municipalities' investment ordinances, and the accounts were listed as having low or moderate risk tolerances within First Allied's internal account-tracking system. Nevertheless, Jaschke embarked on a risky trading strategy that involved short-term trading, a practice described as "trading" in First Allied's written definitions of investment objectives, which was not appropriate for customers with a low investment risk tolerance. Additionally, Jaschke used repos to invest in STRIPS, a practice he knew was specifically prohibited by the Municipalities' investment ordinances.

### **Jaschke's Churning**

14. Between May 2006 and March 2008, although COK's and Toho's accounts were set up as non-discretionary, Jaschke engaged in unauthorized trading and/or in effect had complete discretion over the accounts at all relevant times. Jaschke excessively traded the Municipalities' accounts for his own gain in disregard of his customers' interest in order to generate additional commissions. First Allied retained 10% of the commissions Jaschke earned from trading in the Municipalities' accounts.

### **First Allied's Failure Reasonably to Supervise Jaschke**

15. First Allied did not establish reasonable systems for applying its written supervisory procedures. First Allied failed to establish reasonable systems to direct follow up action in response to red flags regarding churning and suitability, and to monitor compliance with its rule prohibiting registered representatives from using their personal e-mail accounts to conduct firm business.

### **Inadequate Systems for Directing Follow Up Action in Response to Red Flags**

16. First Allied was first notified of abnormal trading in the Municipalities' accounts in September 2006 when automated account surveillance reports, or "exception reports," were generated by Bear Stearns. The exception reports showed turnover rates of 17 for COK and 21 for Toho, and indicated the possibility of churning in the accounts.<sup>2</sup> When a valid exception

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<sup>2</sup> A turnover rate measures the turnover in an account, which is the number of times during a given period that the securities are replaced by new securities, by dividing the total cost of purchases made during a given period

report was generated, First Allied's general practice was to send its customers a "negative response letter," i.e., no response is required. The negative response letter informed the customer of the type of activity shown on the exception report and provided the customer with the contact information for the regional supervisor responsible for the account in the event the customer had questions.

17. However, when First Allied received the September 2006 exception reports for the Municipalities, it did not send negative response letters to the Municipalities. Jeffrey Young, First Allied's vice president of supervision, was concerned because institutional (rather than retail) customers were involved, and he had had little experience dealing with such customers and was unsure whether to send out the typical negative response letter or whether to take some other action. Because he believed, based on representations from Jaschke, that the Municipalities were sophisticated and that the trading in the accounts was occurring at their direction, Young escalated the issue to get advice on the matter, and members of First Allied's senior management team decided not to send the Municipalities negative response letters. Bear Stearns generated additional exception reports in December 2006 indicating turnover ratios of 301 for COK and 106 for Toho, and highlighting the fact that COK's account underperformed the S&P by 40%. First Allied did not send negative response letters to the Municipalities with respect to these reports in light of the prior decision made with respect to the September 2006 exception reports.

18. In early 2007, shortly after First Allied received the December 2006 exception reports, First Allied's chief operating officer became concerned that the repo activity in the Municipalities' accounts violated their investment ordinances. She escalated the issue to other members of First Allied's senior management team, who made the decision to send positive response letters to the Municipalities which would require a written response from both the individuals responsible for making investment decisions on behalf of the Municipalities and their direct supervisors. The positive response letters were not sent until June 2007. The main purpose of the letters was to have the customers confirm that the repo activity in their accounts was consistent with their investment ordinances, because, internally, First Allied questioned whether the activity complied with the Municipalities' ordinances. The letters also requested that the Municipalities confirm that each transaction in their accounts had been authorized, and that neither Jaschke nor First Allied exercised discretion over the accounts. Rather than stating its concern over the repo activity up front, the letters sought the customers' confirmation of four separate items "in connection with [First Allied's] annual review." In fact, First Allied has no annual review process, does not typically send out annual review letters to its customers, and had never previously sent one to the Municipalities. Furthermore, the repo activity was listed as the last item in the letter and asked the customers to confirm that the activity complied with their investment ordinances without highlighting First Allied's concern over the activity. No one at First Allied, other than Jaschke, contacted the Municipalities until January 2008 to discuss their account activity or the purpose of the letters. Because the individuals responsible for making investment decisions on behalf of the Municipalities continued to believe Jaschke's lies regarding the trading in their accounts, they signed and returned the letters to First Allied.

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by the average amount invested during that period. A turnover rate that exceeds six is presumptive of churning. Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 767 F.2d 1498, 1502 (11th Cir. 1985); In the Matter of Al Rizek, 1998 SEC LEXIS 905, at 52.

19. First Allied's systems directing follow up action in response to red flags regarding churning and suitability were not reasonable, as they allowed First Allied to delay providing the Municipalities with any notice regarding the high turnover rates in their accounts for nine months, after which First Allied sent self-described "annual review" letters that failed to adequately inform the customers of the activity in their accounts. The Municipalities did sign and return those letters in June 2007 and did respond to First Allied's verbal inquiries in early 2008.

#### **Inadequate Systems to Ensure Review and Retention of Correspondence with Customers**

20. First Allied established a written supervisory procedure regarding the review of incoming and outgoing e-mails from each branch office, and prohibited the use of personal e-mail accounts to conduct business, as such e-mails could not be archived or screened for compliance. Despite First Allied's policies, Jaschke routinely used his personal e-mail account to correspond with his customers. As a result, almost none of Jaschke's e-mails to and from the Municipalities were archived or reviewed for compliance.

21. First Allied should have been aware of Jaschke's use of his personal e-mail account to conduct business because he routinely used this e-mail account to correspond with his supervisors and senior management. In fact, Jaschke went so far as to create an e-mail signature block that identified him as a First Allied representative and included his personal e-mail account as a contact. This signature block showed up on e-mails to Young and other members of senior management. Young and at least one member of senior management confronted Jaschke regarding the use of his personal e-mail account and received various excuses, but First Allied never did anything to verify that Jaschke had stopped using his personal e-mail account to conduct business. Additionally, during a 2007 broker-dealer examination conducted by the Commission's Office of Compliance Inspections and Examinations, an examiner noticed Jaschke's use of a personal e-mail account and asked the First Allied representative hosting the examination about review and retention. The representative asked Jaschke about the situation, and Jaschke falsely told her that his personal e-mails were automatically "journalled over" to his First Allied account. The representative did not verify Jaschke's statement and simply forwarded the false information on to the Commission's examiner.

22. Despite First Allied's written supervisory policy prohibiting registered representatives from using their personal e-mail accounts to conduct business, First Allied had no system in place to monitor compliance with the rule and effectively relied on its employees to supervise themselves. Accordingly, First Allied did not establish a reasonable system for applying its supervisory procedure regarding the use of personal e-mail accounts.

#### **First Allied's Failure to Preserve E-mails**

23. First Allied is required to maintain copies of all business-related communications, including e-mails, for a period of three years. First Allied was aware of this requirement and hired a third party e-mail archiving vendor to archive all of its e-mails. However, First Allied failed to properly configure the system to include all corporate employee e-mail addresses. As a result, certain e-mail addresses were omitted, and e-mails sent to and from the missing e-mail addresses were never retained. First Allied thereby failed to maintain all required business e-

mails from approximately May 2005 to December 2007. Additionally, as noted above, First Allied failed to preserve Jaschke's business-related e-mails.

### **Violations**

24. As a result of the conduct described above, First Allied failed reasonably to supervise Jaschke with a view to detecting and preventing Jaschke's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and willfully<sup>3</sup> violated Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) thereunder by failing to preserve e-mails.

### **First Allied's Remedial Efforts**

25. In determining to accept the Offer, the Commission considered remedial acts promptly taken by First Allied and cooperation afforded the Commission staff.

### **Undertakings**

Respondent undertakes:

- a. to retain, within 30 days of the date of entry of the Order, at its own expense, the services of an Independent Consultant not unacceptable to the Division of Enforcement of the Commission, to (i) review First Allied's written supervisory policies and procedures; and (ii) review First Allied's system for implementing its supervisory policies and procedures.
- b. to require the Independent Consultant, at the conclusion of the review, which in no event shall be more than 120 days after the entry of the Order, to submit a Report to First Allied and the Division. The report shall address the supervisory issues described above and shall include a description of the review performed, the conclusions reached, the Independent Consultant's recommendations for changes or improvements to the policies, procedures, and practices of First Allied and a procedure for implementing the recommended changes or improvements to such policies, procedures, and practices.
- c. to adopt, implement, and maintain all policies, procedures, and practices recommended in the Report of the Independent Consultant. As to any of the Independent Consultant's recommendations about which First Allied and the Independent Consultant do not agree, such parties shall attempt in good faith to reach agreement within 180 days of the date of the entry of the Order. In the event that First Allied and the Independent Consultant

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<sup>3</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

are unable to agree on an alternative proposal, First Allied will abide by the determinations of the Independent Consultant and adopt those recommendations deemed appropriate by the Independent Consultant.

- d. to cooperate fully with the Independent Consultant in its review, including making such information and documents available as the Independent Consultant may reasonably request, and by permitting and requiring First Allied's employees and agents to supply such information and documents as the Independent Consultant may reasonably request.
- e. that, in order to ensure the independence of the Independent Consultant, First Allied (i) shall not have the authority to terminate the Independent Consultant without the prior written approval of the Division; (ii) shall compensate the Independent Consultant, and persons engaged to assist the Independent Consultant, for services rendered pursuant to the Order at their reasonable and customary rates.
- f. to require the Independent Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with First Allied, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division of Enforcement in Los Angeles, California, enter into any employment, consultant, attorney-client, auditing or other professional relationship with First Allied, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such, for the period of the engagement and for a period of two years after the engagement.
- g. For good cause shown and upon timely application by the Independent Consultant or First Allied, the Commission's staff may extend any of the deadlines set forth above.

#### IV.

In view of the foregoing, the Commission deems it appropriate, and in the public interest, to impose the sanctions agreed to in Respondent First Allied's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent First Allied cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-4(b)(4) promulgated thereunder;

B. Respondent First Allied is censured.

C. Respondent First Allied shall, within 30 days of the entry of this Order, pay disgorgement of \$1,224,606 and prejudgment interest of \$233,699, for a total of \$1,458,305, to the United States Treasury. It is further ordered that Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of \$500,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies First Allied as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Michele Wein Layne, Division of Enforcement, Securities and Exchange Commission, 5670 Wilshire Blvd., Suite 1100, Los Angeles, CA 90036.

D. Respondent First Allied shall comply with the undertakings enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy  
Secretary