

**STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION**

IN THE MATTER OF DETERMINING) Order No.: S-15-1636-18-CO01
Whether there has been a violation of the)
Securities Act of Washington by:) CONSENT ORDER
Randall Hayes,)
Respondent.)

INTRODUCTION

On March 14, 2018, the Securities Administrator of the state of Washington issued Statement of Charges and Notice of Intent to Enter Order to Cease and Desist, to Deny Future Registrations, to Impose Fines, and To Charge Costs (Statement of Charges), order number S-15-1636-17-SC01, against Respondent Randall Hayes.

Pursuant to the Securities Act of Washington, the Securities Division and Respondent Randall Hayes enter into this Consent Order to settle the allegations described in the Statement of Charges.

Respondent Randall Hayes neither admits nor denies the following Findings of Fact or Conclusions of Law:

FINDINGS OF FACT

Respondent

1. Randall Hayes (CRD #2224997) was registered with the Securities Division as an investment adviser representative and securities broker-dealer representative from 1992 to 2016. Randall Hayes lived and worked in Western Washington throughout this time. Most recently, Randall Hayes worked as a broker-dealer representative and investment adviser representative of Morgan Stanley Smith Barney, LLC, until 2016, when he resigned from the firm during the Securities Division's investigation.

Overview

2. From 2009 to 2013, in his capacity as a securities salesperson and investment adviser representative of Morgan Stanley Smith Barney, Randall Hayes invested in inverse and leveraged exchange-traded funds (ETFs) in client accounts, including in the account of Investor CM, a retired widow. Randall Hayes had a fiduciary duty to act in Investor CM's best interest. However, Randall Hayes invested approximately \$100,000 of Investor CM's advisory account in inverse and leveraged ETFs, investments which are generally not suitable for retail investors, if held for longer than one day. Randall Hayes held these investments in Investor CM's account for months and years, leading to over \$63,000 in losses. Randall Hayes investments and management of investments in inverse and leveraged ETFs in Investor CM's account were not suitable for Investor CM.

Risks Associated with Inverse and Leveraged ETFs

3. ETFs are open-end investment companies whose shares list and trade on national securities exchanges at market prices. ETFs, generally, invest in a specific index or sector. Inverse ETFs seek to deliver the opposite of the performance of the index or benchmark they track. Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track.

4. Most inverse and leveraged ETFs reset daily,¹ and thus only seek to achieve their stated investment objective for a single day. For example, an inverse or leveraged ETF that resets daily will provide the opposite or multiple, respectively, for that day only, of the index that the ETF tracks. To achieve this goal, the inverse or leveraged ETF will invest in derivatives that should have the same daily return characteristics as the opposite or the multiple of the index. These derivative holdings typically change on a daily basis, as the inverse or leveraged ETF rebalances its holdings to achieve its daily goals.

5. Due to the effects of compounding, over time, the performance of inverse and leveraged ETFs that reset daily can differ significantly from the underlying index or benchmark they seek to track. The following table provides a brief illustration of the potential effects of compounding for an inverse ETF that resets daily:

	Initial Value	Value after one day, if the index loses 20% in value in that day	Value after two days, if the index gains 25% in value in the second day
Index	100	80	100
Inverse ETF	100	120	90

6. The table illustrates that the index stayed even but that the inverse ETF lost 10% over the same period. Even though, in this example, the inverse ETF captured the inverse daily change of the index it tracked, as a result of compounding, the inverse ETF did not capture the point-to-point movement of the index over time. The long-term performance of an inverse ETF that seeks daily investment results will not perfectly mirror, and can sometimes dramatically diverge from, the inverse of the monthly performance of the index. This compounding effect is more pronounced over time, in more volatile markets, and with leverage.

7. The Financial Industry Regulatory Authority (FINRA) is a self-regulatory organization for broker-dealer firms and their representatives. In June 2009, FINRA issued Regulatory Notice 09-31, which reminded broker-dealer firms and their representatives of their sales practice obligations in connection with leveraged and inverse ETFs and advised

¹ Beginning March 2010, in Morgan Stanley Smith Barney only allowed the solicited sale of select inverse ETFs that reset daily in certain retail customer accounts.

1 that inverse and leveraged ETFs that reset daily, typically are unsuitable for retail investors who plan to hold them
2 longer than one trading session, particularly in volatile markets.

3 8. The issuing companies for inverse and leveraged ETFs identify similar risks for their products. Issuing
4 companies disclose that these investments are not suitable for all investors and should be used only by knowledgeable
5 investors who understand the risks of seeking daily inverse or leveraged investment results. Further, issuers note that
6 investors should actively manage and monitor these investments as frequently as daily.

7 9. Morgan Stanley Smith Barney, too, noted risks associated with inverse and leveraged ETFs, and identified
8 inverse and leveraged ETFs as appropriate for investors “looking to make short-term tactical trades if they perceive a
9 high likelihood of a strong market move occurring in a relatively short time period.” [sic]. The firm, from 2010 to
10 2013, also provided that in some instances, with some conditions, single-inverse ETFs may be appropriate tools for
11 investors seeking to hedge portfolio exposure. Although the firm’s policies have shifted over time, in August 2009,
12 Morgan Stanley Smith Barney policy provided that, for unsolicited sales of inverse and leveraged ETFs, these products
13 are most appropriate for investors with an aggressive or speculative investment objective and a short-term investment
14 time horizon. And in information that the firm was supposed to provide to investors, Morgan Stanley Smith Barney
15 advised investors that for inverse and leveraged ETFs that sought to achieve their objectives on a daily basis, these
16 investments were typically unsuitable for investors who plan to hold them for longer than one trading session unless
17 used as part of a sophisticated trading or hedging strategy.

18 Investor CM Background

19 10. Investor CM, a Texas resident born in 1936, is a widowed retiree, who has moderate investment objectives and
20 a moderate risk tolerance. As a widowed retiree, Investor CM needed to live off of her investments for at least ten
21 years or more.

22 11. Investor CM considers herself unsophisticated about investing and has trusted investment advisers to suitably
23 manage her money to finance her retirement. Prior to retaining Randall Hayes’ services, Investor CM’s previous
24 investment adviser invested Investor CM’s portfolio in a mixture of investments in mutual funds, corporate bonds,
25 money market funds, and stock of companies in the S&P 500. This portfolio, however, also held a substantial amount
of stock in American International Group, Inc. and during the financial crisis, she sought a new investment adviser.
Upon a recommendation, Investor CM arranged to speak with Randall Hayes about engaging his services, through his
office in Washington.

12. During her initial conversations with Randall Hayes, Investor CM explained that she sought to have the
principal of her investment protected.

13. Through the account paperwork that she completed, Investor CM further communicated this same investor
profile, by selecting one of Morgan Stanley Smith Barney’s moderate investment strategies. Specifically, Investor CM
selected a balanced growth investment strategy, which sought capital appreciation and some income through

investment in equity and fixed income instruments. Investor CM further confirmed with Morgan Stanley Smith Barney that she prioritized income over capital appreciation. Investor CM sought to achieve these investment objectives over a period of ten years or more, Morgan Stanley Smith Barney's longest investment time horizon. Investor CM further told Morgan Stanley Smith Barney that she had a moderate risk tolerance. And, when asked by Morgan Stanley Smith Barney whether speculation was allowed in her account, Investor CM told Morgan Stanley Smith Barney that speculation was not allowed in her account.

14. In April 2009, Investor CM signed an investment adviser agreement with Morgan Stanley to open a discretionary advisory account that Randall Hayes would manage. Investor CM also established with Randall Hayes and Morgan Stanley Smith Barney a brokerage account, which was invested in certificates of deposit during Investor CM's relationship with Morgan Stanley. Investor CM represents that part of the funds in Investor CM's two accounts contained the proceeds of the recent sale of Investor CM's home and that the funds in these two accounts represented nearly all of Investor CM's net worth.

15. Shortly after Investor CM submitted account paperwork identifying her moderate investment objectives, long investment time horizon, and moderate risk tolerance. Morgan Stanley Smith Barney mailed Investor CM account paperwork confirming this moderate investment profile. And over the years, through periodic account confirmation paperwork, Morgan Stanley continued to document this same moderate investment profile for Investor CM. At no point during her relationship with Morgan Stanley did Investor CM change her investment objectives, investment time horizon, or risk tolerance. Throughout her time with Morgan Stanley, Investor CM maintained her prohibition on speculation in her account.

Randall Hayes' Unsuitable Purchase of Inverse and Leveraged ETFs in Investor CM's Account

Purchase of Inverse and Leveraged ETFs in Client Account

16. Despite the documented risks associated with investing in leveraged and inverse ETFs and Investor CM's more moderate investment profile Randall Hayes purchased and held for time periods significantly longer than one trading session the following investments in leveraged and inverse ETFs in Investor CM's account:

Investment	Purchase Date	Sale Date	Days Held	Purchase Amount	Sale Amount	Decreases in Investment Value
ProShares UltraShort Financials	07/15/09	09/08/09	55	\$46,642.68	\$32,240.85	-\$14,401.60
ProShares Short QQQ	04/13/10	06/13/13	1,157	\$62,486.66	\$34,929.95	-\$27,556.71

1	ProShares Short S&P 500	04/19/10	06/13/13	1,151	\$24,739.74	\$14,841.00	-\$9,898.74
2							
3	ProShares Short S&P 500	04/21/11	06/13/13	784	\$39,412.80	\$28,110.60	-\$11,302.20
4							
5	ProShares Short S&P 500	03/18/13	06/13/13	87	\$5,685.60	\$5,354.40	-\$331.20
6							
7							

8 17. On July 15, 2009, Randall Hayes invested \$46,642.68 in ProShares UltraShort Financials in Investor CM's
9 account. The ProShares UltraShort Financials ETF is an inverse leveraged ETF, which seeks to return two times the
10 inverse of the daily performance of the Dow Jones U.S. Financials Index. In August 2009, Morgan Stanley prohibited
11 the solicited sale of leveraged ETFs in advisory accounts. After this prohibition became effective and after holding the
investment for 55 days in Investor CM's account, Randall Hayes sold the investment for a \$14,401.60 loss.

12 18. In April 2010, Randall Hayes invested approximately \$87,226.40 in two inverse ETFs in Investor CM's
13 account: \$62,486.66 in ProShares Short QQQ and \$24,739.74 in ProShares Short S&P 500. The ProShares Short QQQ
14 ETF is an inverse ETF, which seeks to return the inverse of the daily performance of the NASDAQ 100 Index. The
15 ProShares Short S&P 500 ETF is an inverse ETF, which seeks to return the inverse of the daily performance of the
S&P 500.

16 19. One year later, despite these investments having unrealized losses of \$17,903.70, Randall Hayes invested an
17 additional \$39,412.80 in ProShares Short S&P 500 in Investor CM's account. And on March 18, 2013, despite the
18 three previous inverse ETF investments having an ongoing \$44,250.04 unrealized loss, Randall Hayes invested
\$5,685.60 in ProShares Short S&P 500 in Investor CM's account.

19 20. Since Investor CM had established a discretionary advisory account with Randall Hayes, Randall Hayes could
20 buy and sell securities in Investor CM's account without receiving her approval prior to the execution of each trade.

21 21. The value of the inverse and leveraged ETFs in Investor CM's account decreased by \$63,490.45 during the
time period that Randall Hayes managed Investor CM's account.

22 *Unsuitability of Investments in Inverse and Leveraged ETFs in Client Account*

23 22. Randall Hayes' investments in inverse and leveraged ETFs in Investor CM's account were unsuitable because
24 these investments and Randall Hayes' management of these investments did not match or were contrary to Investor
CM's investment profile.

1 23. Randall Hayes' investments in inverse and leveraged ETFs in Investor CM's account did not match Investor
2 CM's investment objectives. In paperwork that Investor CM completed to open an account with Morgan Stanley Smith
3 Barney, Investor CM selected an investment strategy which sought some income and capital appreciation. Investor CM
4 further confirmed with Morgan Stanley Smith Barney that she prioritized income over capital appreciation.
5 Investments in inverse and leveraged ETFs do not provide for income, and instead, are used to make short-term tactical
6 trades to take advantage of the possibility of a strong market move occurring in a relatively short time period.

7 24. Investments in inverse and leveraged ETFs were riskier than Investor CM's risk profile allowed for. Investor
8 CM identified a more moderate risk tolerance to Morgan Stanley Smith Barney and never allowed speculation in her
9 account.

10 25. Investments in inverse and leveraged ETFs did not match Investor CM's investment time horizon. Investor
11 CM represented to Morgan Stanley Smith Barney that her investment time horizon was ten years or more, Morgan
12 Stanley Smith Barney's longest investment time horizon. However, Randall Hayes invested a large portion of investor
13 CM's account in inverse and leveraged ETFs, which seek their investment objectives on a daily basis.

14 26. Randall Hayes held these investments in Investor CM's account for time periods that were contrary to the
15 guidance of regulators. Each of the inverse or leveraged ETFs that Randall Hayes purchased in Investor CM's account
16 sought their investment objectives on a daily basis. As FINRA, ProShares, and Morgan Stanley Smith Barney advised,
17 due to the effects of compounding, holding investments that reset daily longer than one day can lead to returns that
18 differ significantly from the index or benchmark that the investments seek to track. These adverse consequences were
19 reflected in Randall Hayes' investments in Investor CM's account. Randall Hayes purchased investments that, on a
20 daily basis, sought to deliver the opposite performance of larger stock indices. However, as stock indices performed
21 well after 2008 and as Randall Hayes held these investments in Investor CM's account for longer than a day, these
22 investments began to and then continued to accumulate losses. Randall Hayes kept the leveraged ETF in Investor
23 CM's account until Morgan Stanley Smith Barney prohibited the product's solicited sale in advisory accounts and kept
24 the inverse ETFs in Investor CM's account until she closed her account with Randall Hayes.

25 27. While Randall Hayes claims that his intent was to purchase inverse and leveraged ETFs for Investor CM for
hedging purposes, as the investments were held over time, they were not an appropriate hedge against her other
holdings. Randall Hayes invested Investor CM's funds in an inverse ETF that seeks to return the inverse of the daily
performance of the NASDAQ 100 Index and an inverse ETF that seeks to return the inverse of the daily performance
of the S&P 500. Over the years that Randall Hayes held these investments in Investor CM's account, Randall Hayes
invested the funds in Investor CM's account in either few or no equity investments in companies listed on the
NASDAQ 100 and few equity investments in companies listed in the S&P 500. For a period of a year, investments in
two mining companies were the only common stock investments that Randall Hayes held in Investor CM's account.

1 28. Further, in paperwork that Investor CM completed to open an account with Morgan Stanley Smith Barney,
Investor CM noted that she could not afford to withstand large losses in her account for more than a market cycle, but
2 for months and years, at Randall Hayes' direction, these investments sat in Investor CM's account accumulating tens
3 of thousands of dollars in losses.

4 29. Although these investments continued to accumulate unrealized losses, Randall Hayes continued to invest in
inverse ETFs in Investor CM's account. For a long period of time, the value of inverse ETFs in Investor CM's account
5 totaled approximately \$100,000, which amounted to approximately 17 percent of Investor CM's portfolio. The size of
6 these positions amplified the unsuitability of the investments by increasing Investor CM's exposure to the risk and the
investment losses of the inverse ETFs.

7 30. Investor CM experienced losses of \$63,490.45 due to Randall Hayes' investments in inverse and leveraged
8 ETFs in her account, during a time when major stock market indices showed strong recovery after the 2008 recession.

9 *Investor CM Arbitration Claim*

10 31. In June 2013, Investor CM closed her account with Randall Hayes and Morgan Stanley. On the
recommendation from a friend, Investor CM hired an attorney to file an arbitration complaint against Randall Hayes
11 and Morgan Stanley through FINRA's Division of Dispute Resolution forum.²

12 32. In her complaint, filed in September 2013, Investor CM alleged a violation of the Texas Securities Act's anti-
fraud provision, breach of fiduciary duty, negligence, negligent misrepresentation, a violation of the Texas Deceptive
13 Trade Practices Act, breach of the duty of good faith and fair dealing, statutory fraud under the Texas Business and
14 Commerce Code, common law fraud, fraud by nondisclosure, and promissory estoppel based not just on Randall
Hayes' investments in inverse and leveraged ETFs in Investor CM's account, but on his management of her account as
15 a whole.

16 33. In January 2015, the parties reached a settlement, in which, among other terms, Randall Hayes and Morgan
17 Stanley denied any wrongdoing. Pursuant to the settlement agreement, Morgan Stanley paid Investor CM \$250,000, to
18 which Randall Hayes did not contribute. Investor CM then dismissed her arbitration claim against Randall Hayes and
Morgan Stanley with prejudice.

19 **CONCLUSIONS OF LAW**

20 Based on the above Findings of Fact, the following Conclusions of law are made:

21 1. Randall Hayes' investments in inverse and leveraged ETFs Investor CM's account, as described above,
constitutes the sale of securities as defined in RCW 21.20.005(14) and (17).

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23
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² It is common for advisory and brokerage contracts to require that investor complaints be heard through FINRA's arbitration
25 process.

2. Randall Hayes violated RCW 21.20.702, by purchasing inverse and leveraged ETFs in Investor CM's account without reasonable grounds to believe that these transactions were suitable for the customer, based upon a reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and other relevant information.

CONSENT ORDER

Based upon the foregoing and finding it in the public interest:

IT IS AGREED AND ORDERED that Randall Hayes shall cease and desist violating RCW 21.20.702.

IT IS FURTHER AGREED AND ORDERED that Randall Hayes shall be liable for and shall pay a \$7,000 fine to the Securities Division prior to the entry of this Consent Order.

IT IS FURTHER AGREED AND ORDERED that Randall Hayes shall be liable for and shall pay \$3,000 in investigative costs to the Securities Division prior to entry of this Consent Order.

IT IS FURTHER AGREED AND ORDERED that Randall Hayes voluntarily, will not apply to register as a securities broker-dealer, securities salesperson, investment adviser, or investment adviser representative in the state of Washington for a period of two years from the entry of this this Consent Order.

IT IS FURTHER AGREED that the Securities Division has jurisdiction to enter this Consent Order.

IT IS FURTHER AGREED that Randall Hayes entered into this Consent Order freely and voluntarily and with a full understanding of its terms and significance.

IT IS FURTHER AGREED that in consideration of the foregoing, Randall Hayes withdraws his request for a hearing and waives their right to a hearing in this matter pursuant to RCW 21.20.440 and Chapter 34.05 RCW.

WILLFUL VIOLATION OF THIS ORDER IS A CRIMINAL OFFENSE.

Signed this 24th day of July 2019.

_____/s/_____
Randall Hayes

SIGNED and ENTERED this 5th day of August 2019.



William M. Beatty
Securities Administrator

Approved by:

Presented by:

Suzanne Sarason
Chief of Enforcement



Eric Palosaari
Financial Legal Examiner

Reviewed by:



Jack McClellan
Financial Legal Examiner Supervisor