

**COMMONWEALTH OF MASSACHUSETTS  
OFFICE OF THE SECRETARY OF THE COMMONWEALTH  
SECURITIES DIVISION  
ONE ASHBURTON PLACE, ROOM 1701  
BOSTON, MASSACHUSETTS 02108**

_____ IN THE MATTER OF:	) ) ) ) ) )	ADMINISTRATIVE COMPLAINT  E-2009-0059 E-2011-0001
RBC CAPITAL MARKETS, LLC & MICHAEL D. ZUKOWSKI		

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**I. PRELIMINARY STATEMENT**

The Enforcement Section (“Enforcement Section”) of the Massachusetts Securities Division of the Office of the Secretary of the Commonwealth (“Division”) files this administrative complaint (“Complaint”) in order to commence an adjudicatory proceeding against RBC Capital Markets, LLC and Michael D. Zukowski for violating M.G.L. c. 110A, the Massachusetts Uniform Securities Act (the “Act”), and 950 CMR 10.00 *et seq.* (the “Regulations”).

The Enforcement Section seeks an order (a) requiring RBC Capital Markets, LLC and Michael D. Zukowski to permanently cease and desist from committing any further violations of the Act and Regulations, (b) requiring RBC Capital Markets, LLC and Michael D. Zukowski to make full restitution to Massachusetts investors who have incurred monetary losses as a result of Michael D. Zukowski effecting unsuitable transactions in nontraditional exchange traded funds in their accounts, (c) requiring RBC Capital Markets, LLC and Michael D. Zukowski to pay an administrative fine in an amount and upon such terms and conditions as a Hearing Officer may determine, and (d) requiring RBC Capital Markets, LLC and Michael D. Zukowski to take any other action that a Hearing Officer may deem appropriate, in the public interest, and necessary for the protection of Massachusetts investors.

## II. SUMMARY

This administrative complaint addresses RBC Capital Markets, LLC (“RBC”) and its former registered representative who sold leveraged, inverse and inverse-leveraged exchange-traded funds (“ETFs”), otherwise known as nontraditional ETFs, to clients who did not understand what these products were, the risks associated with the products or, how these products were to be properly used in an investment portfolio. The Division received complaints from RBC clients who, at the recommendation of Michael Zukowski, a former registered representative of RBC, invested in these products and suffered substantial losses. The Division’s subsequent investigation has revealed that nontraditional ETFs were sold to RBC clients who had limited or no understanding of these products and the unique risks associated with them. The Division’s investigation has also revealed that prior to December 22, 2009, RBC did not provide any training on nontraditional ETFs to its registered representatives or those responsible for their supervision until late December of 2009. Supervisory failures by RBC allowed Zukowski to make numerous unsuitable recommendations and sales of nontraditional ETFs to Massachusetts investors.

ETFs are investment vehicles that track an index, a commodity or a basket of assets like an index fund. ETFs provide investors much of the same benefits as mutual funds, but ETFs differ because, unlike most mutual funds, ETFs trade like typical stocks. This provides investors considerable flexibility and lower fees. In light of these benefits, ETFs have become one of the fastest growing and most popular investment vehicles available to investors today.

However, certain types of ETFs hold substantial hidden risks for investors. Specifically, exotic ETFs, such as those designed to invest as if the investor is using borrowed funds (“Leveraged ETFs”), or those which typically capitalize on the opposite direction of a market or

index (“Inverse ETFs”), are particularly complex and risky. Furthermore, ETFs that are leveraged, inverse and/or leverage-inverse, not only seek to capitalize on the movements of a market or index, but do so mainly by using exotic financial instruments such as futures and swaps contracts. Although these esoteric ETFs may diversify and/or hedge a portfolio if utilized by a properly trained broker-dealer agent or investment adviser representative, most investors are unaware of the risks.

One of the often overlooked risks is the compounding over time of the *daily* returns that these nontraditional ETFs are designed to achieve. Due to the compounding effects of the ETF’s daily returns, an investor should not purchase a nontraditional ETF without being aware and willing to assume the risk that the long-term performance of the product may be vastly different than that of the ETF’s benchmark index. Many investors have been surprised and disappointed when certain market indices rose in value, only to see that a nontraditional ETF, which was supposed to return 200% of that index’s return, actually decline in value though the index had risen. Thus, these products are not suitable as long-term investments.

Beginning in at least January of 2007, RBC made these nontraditional ETFs available to Massachusetts clients without training its registered representatives and providing them with a complete understanding of how these products functioned and their associated risks. Except for an adviser planning to use these nontraditional ETFs in a discretionary account, registered representatives were not required to complete any training on these products from January 2007 until late December 2009, at which time RBC banned all but the unsolicited sale of these ETFs to clients. In addition to not providing any training to any of its registered representatives, RBC also did not provide any training on these products to the supervisors of the representatives. Finally, at no time prior to December 22, 2009, did RBC update its electronic trade blotter

surveillance program to automatically identify these types of products or patterns of trading for heightened scrutiny by those responsible for trade blotter review.

RBC's decision not to train those directly supervising its representatives, the Complex Directors and Associate Complex Manager, is all the more surprising because these supervisors were required to review and approve applications from certain RBC advisers wishing to use nontraditional ETFs. As early as 2006, RBC knew that nontraditional ETFs carried certain risks raising suitability issues. In 2006, RBC required advisers with discretion on client accounts to submit an application called *Portfolio Focus Portfolio Management Track – Application To Use Leveraged And Inverse Products* prior to engaging in nontraditional ETF transactions. However, neither the Complex Directors nor the Associate Complex Manager received any training on nontraditional ETFs or on how to evaluate these applications. Additionally, the fact that this application was required for those representatives with discretion on client accounts indicates that RBC knew these products carried higher risks and might lead to suitability issues and was thus a way to protect the firm.

In 2007, RBC's summer edition of *IAG Insider*, an intranet newsletter accessible on RBC Infonet, stated the following:

**Note:** These products are not suitable for all investors. Due to compounding and expenses, leveraged funds and ETFs do not necessarily return twice the daily returns of the underlying index.

Subsequently, on January 31, 2009 RBC released an article titled *Think Twice or Thrice Before Purchasing Leveraged ETFs*. This article not only raised suitability concerns in regards to these products, but also questioned whether these exotic ETFs were suitable for any investor other than perhaps a day trader. Regarding suitability, the article states that “we [RBC] would argue that these products are not suitable for any investors, if we define ‘investors’ as prospective

purchasers with longer-term holding periods (*e.g.* one week or one month.”) In June 2009, the Financial Industry Regulatory Authority (“FINRA”) released Regulatory Notice 09-31 (the “June 2009 Notice”), putting the entire industry on notice that nontraditional ETFs posed certain risks, not present in traditional ETFs. Remarkably, despite the serious suitability concerns raised by both RBC and FINRA, RBC did not implement any supervisory systems to address the offer and sale of nontraditional ETF products, and allowed its representatives to continue to sell them without proper supervision.

In addition, RBC’s general supervisory structure in Massachusetts contributed to the haphazard oversight of the RBC Osterville branch office where Zukowski worked. RBC’s supervision of its registered representatives is based on a regional “complex” structure, rather than a branch supervisory manager structure. The complex supervisory structure by design removes most supervisory functions from the branch director of the local branch office, to the Complex Director at the complex’s remote main office. Although both the former Norwell Complex Director and Norwell Associate Complex Manager considered the branch director to be the “eyes and ears” at the branch level, the branch director had almost no supervisory function other than to review incoming and outgoing correspondence. Compounding the issue, the Osterville branch office had no less than 5 branch directors during the 5 years that Zukowski worked at this office. This includes a period of time from July 2007 through December 2008 in which there was no full time branch director.

As a result of the supervisory lapses noted above, RBC failed to detect the trading in the nontraditional ETFs that its representatives, such as Zukowski, were engaging in. According to the Norwell Associate Complex Manager, Zukowski was the leading seller of nontraditional ETFs to retail clients in the Norwell Complex. The Division found during its investigation that

Zukowski misunderstood certain aspects of these products. For instance, in testimony to the Division, Zukowski described leveraged ETFs as being suitable replacements for traditional ETFs because an investor could access the same upside as traditional ETFs with only half the capital invested. However, as shown above, this is not the purpose of leverage ETFs. Furthermore, at Zukowski's recommendation some clients held these ETFs for several months at a time, and in some cases for over a year. Even after the June 2009 FINRA Notice, Zukowski recommended these products for longer term use. In testimony to the Division, the Norwell Associate Complex Manager stated that Zukowski's sales of nontraditional ETFs was not addressed because these products were not "on any of the flags on [the] trade blotter, so they were sort of under the radar."

. Since at least 2006, and certainly after January 2009, RBC knew that nontraditional ETFs were not suitable for all clients. However, RBC did not implement proper supervisory procedures reasonably designed to prevent and detect unsuitable sales of nontraditional ETFs until December 22, 2009, nearly 6 months after the FINRA Notice was released. RBC's supervisory failures directly led to Zukowski making unsuitable recommendations to customers to buy these products. These recommendations and subsequent purchases led to hundreds of thousands of dollars in losses to Massachusetts investors.

### **III. JURISDICTION AND AUTHORITY**

1. The Massachusetts Securities Division is a division of the Office of the Secretary of the Commonwealth with jurisdiction over matters relating to securities, as provided for by the Act. The Act authorizes the Division to regulate: 1) the offers, sales, and purchases of securities; 2) those individuals and entities offering and/or selling securities; and 3) those individuals and entities transacting business as investment advisers within the Commonwealth.

2. The Division brings this action pursuant to the enforcement authority conferred upon it by section 407A of the Act and M.G.L. c. 30A, wherein the Division has the authority to conduct an adjudicatory proceeding to enforce the provisions of the Act and all Regulations and rules promulgated hereunder.

3. This proceeding is brought in accordance with sections 204 and 407A of the Act and its Regulations. Specifically, the acts and practices constituting violations occurred within the Commonwealth of Massachusetts.

4. The Division specifically reserves the right to amend this Complaint and/or bring additional administrative complaints to reflect information developed during the current and ongoing investigation.

#### **IV. RELEVANT TIME PERIOD**

5. Except as otherwise expressly stated, the conduct described herein occurred during the approximate time period of July 22, 2005 to date (the "Relevant Time Period").

#### **V. RESPONDENTS**

6. RBC Capital Markets, LLC ("RBC") is an entity currently registered as a broker-dealer firm in Massachusetts. RBC is also an investment adviser registered with the Securities and Exchange Commission and notice filed in Massachusetts. RBC is currently assigned Central Registration Depository (hereinafter "CRD") number 31194. RBC's principal place of business is located at 3 World Financial Center, 200 Vesey St., New York, NY 10281. According to the CRD, RBC is also known as RBC Wealth Management.

7. Michael D. Zukowski ("Zukowski") is a natural person and is currently assigned CRD number 1922539. Zukowski was previously registered in Massachusetts as a registered representative of RBC from approximately July 22, 2005 until December 23, 2010. Zukowski

was also registered in Massachusetts as an investment adviser representative of RBC from approximately November 29, 2010 until December 23, 2010. Zukowski has passed the following FINRA series examinations: 7, 31, 63 and 65. From July 22, 2005 through November 30, 2010, Zukowski worked out of the RBC Osterville branch office, located at 804 Main Street, 2nd Floor, Osterville, MA 02655.

## VI. RELATED PARTIES

8. Norwell Complex Director is a natural person. Norwell Complex Director was the Complex Director of the Norwell Complex and thus was responsible for supervising Zukowski from July 22, 2005 to December 31, 2009. On January 1, 2010 the Norwell Complex merged with the Boston Complex. At this time Norwell Complex Director transitioned to become the branch director of RBC's Norwell Branch office. Norwell Complex Director is registered in Massachusetts as a registered representative and investment adviser representative of RBC. Norwell Complex Director has passed the following FINRA series examinations: 6, 7, 8, 31, 63, and 65.

9. Boston Complex Director is a natural person. Since July 2008 Boston Complex Director has been the Complex Director of the Boston Complex. From January 1, 2010 until December 23, 2010 Boston Complex Director was responsible for supervising Zukowski. Boston Complex Director is registered in Massachusetts as a registered representative of RBC. Boston Complex Director has passed the following FINRA series examinations: 3, 7, 8, 63 and 65.

10. Associate Complex Manager is a natural person. From 2004 to December 31, 2009 this person was the Associate Complex Manager for the Norwell Complex. On January 1, 2010 the Norwell Complex merged with the Boston Complex. Assistant Complex Manager has passed the following FINRA series examinations: 7, 9, 10, 31, 63 and 65.



## VII. ALLEGATIONS OF FACT

11. In or about 2006, RBC began offering leveraged, inverse, and leveraged-inverse exchange-traded funds (“ETFs”). These types of funds are otherwise categorized as “nontraditional ETFs” and will be referred to as such throughout the course of this administrative complaint.

12. Leveraged ETFs are exchange traded funds that seek to return, on a daily basis, 200% or 300% of the daily returns of a particular index or economic sector. Leveraged ETFs attempt to accomplish this daily objective by using financial derivatives such as futures and swaps contracts. For example, a product that aims to deliver 200% of the S&P 500 Index’s daily return will increase in value by 2% for every 1% increase in the S&P 500 on that given day.

Depending on the particular leveraged ETF, these products seek to achieve their stated aims on a daily, weekly or monthly basis. Thus, a leveraged ETF designed to return 200% of the daily return on the S&P 500 Index will not necessarily return 8% if held for a one month period in which the S&P 500 Index increases by 4%. This result is due to the compounding effects of the daily returns generated by the ETF for each day during the one month period that the investor holds the leveraged ETF.

13. Inverse ETFs are exchange traded funds that utilize derivatives to deliver the investor the opposite of the daily return of an index or economic sector that the particular leveraged ETF is tracking. Inverse ETFs attempt to accomplish this daily objective by using financial derivatives such as futures and swaps contracts. For example, an ETF that aims to deliver the inverse of the S&P 500 Index’s daily return will increase in value by 1% for every 1% decrease in the S&P 500 on that given day. Depending on the particular inverse ETF, these products seek to achieve their stated aims on a daily, weekly, or monthly basis. Thus, an inverse ETF seeking to achieve an

inverse return of the daily return on the S&P 500 Index will not necessarily return 4% if held for a one month period in which the S&P 500 Index declines by 4%. This result is due to the compounding effects of the daily returns generated by the inverse ETF for each day during the one month period that the investor holds the inverse ETF.

14. Inverse-leveraged ETFs are exchange traded funds that seek to return, on a daily basis, -200% or -300% of the daily returns of a particular index or economic sector. Inverse-leveraged ETFs attempt to accomplish this daily objective by using financial derivatives such as futures and swaps contracts. For example, a product that aims to deliver -200% of the S&P 500 Index's daily return will increase in value by 2% for every 1% decrease in the S&P 500 Index on that given day. Depending on the particular inverse-leveraged ETF, these products seek to achieve their stated aims on a daily, weekly, or monthly basis. Thus, an inverse-leveraged ETF designed to return -200% of the daily return on the S&P 500 Index will not necessarily return 8% if held for a one month period in which the S&P 500 declines by 4%. This result is due to the compounding effects of the daily returns generated by the inverse-leveraged ETF for each day during the one month period that the investor holds the inverse-leveraged ETF.

15. All three of these nontraditional ETF categories: leverage, inverse, and inverse-leveraged

ETFs share a similar characteristic, in that they are all affected by the compounding returns that these products produce on a daily basis. Since nontraditional ETFs seek daily return objectives, the products can create unpredictable returns even when they successfully achieve their stated daily objective day after day. When held for periods longer than one day, volatility present in the index that the ETF tracks skews the overall returns, even when the index or sector moves in the general direction the purchaser predicted or expected. The greater the volatility in the market during that course of time, the more likely it is that the particular nontraditional ETF will

produce an extreme and unpredictable result – thereby increasing the risk associated with these products.

16. In the summer 2007 release of *IAG Insider*, a RBC newsletter for its employees, RBC stated the following about leveraged ETFs:

*Note:* These products are not suitable for all investors. Due to compounding and expenses, leveraged funds and ETFs do not necessarily return twice the daily returns of the underlying index. (Emphasis in original).

*A true and accurate copy of IAG Insider summer 2007 release is attached hereto as Exhibit 1.*

17. In June 2009, FINRA released FINRA REGULATORY NOTICE 09-31 (hereinafter the “June 2009 FINRA Notice”) advising broker-dealers on suitability issues in the offer and sale of nontraditional ETFs. The June 2009 FINRA Notice reminded member firms of their specific training and supervision duties to ensure that FINRA’s suitability requirements were met when registered representatives sold nontraditional ETFs.

*A true and accurate copy of June 2009 FINRA Notice is attached hereto as Exhibit 2.*

18. The June 2009 FINRA Notice provided the following, which explains and illustrates the potential pitfalls of misunderstanding the nontraditional ETFs or not receiving proper guidance and education prior to attempting to use these products:

Most leveraged and inverse ETFs “reset” daily, meaning that they are designed to achieve their stated objectives on a daily basis. [internal footnote omitted] Due to the effect of compounding, their performance over longer periods of time can differ significantly from the performance (or inverse of the performance) of their underlying index or benchmark during the same period of time. For example, between December 1, 2008, and April 30, 2009:

- The Dow Jones U.S. Oil & Gas Index gained 2 percent, while an ETF seeking to deliver twice the index’s daily return fell 6 percent and the related ETF seeking to deliver twice the inverse of the index’s daily return fell 26 percent.
- An ETF seeking to deliver three times the daily return of the Russell 1000 Financial Services Index fell 53 percent while the index actually gained

around 8 percent. The related ETF seeking to deliver three times the inverse of the index's daily return declined 90 percent over the same period.

*See Exhibit 2.*

19. RBC made nontraditional ETF products available and allowed its registered representatives to offer and to sell them to clients without the registered representatives completely understanding how the products functioned and whether these products were suitable for a client account with conservative or moderate investment objectives.

**RBC and Zukowski Recommended Unsuitable Products to RBC Brokerage & Advisory Clients**

20. In or around October 2007, Zukowski began recommending nontraditional ETFs to certain Massachusetts clients.

21. In testimony to the Division, Zukowski stated that he had never read any of the prospectuses for any of the nontraditional ETFs that he recommended to his clients.

22. Zukowski did not receive any training from RBC on nontraditional ETF products, nor was he required to complete any training on nontraditional ETF products.

23. In testimony to the Division, Zukowski stated he learned of these products from RBC research on specific nontraditional ETFs.

24. In testimony to the Division, Zukowski stated that the nontraditional ETF recommendations that he made to clients were based on recommendations made by RBC on "particular sectors and which particular individual ETFs and leveraged ETFs we should be looking to purchase or recommend to our clients."

25. Zukowski further testified that "it was assumed under the [RBC] advisors that if it was being recommended by [RBC's] research department, that they had done the due diligence on that particular investment and so, therefore, that's where our recommendation came from."

26. In testimony to the Division, both the Boston Complex Director and the Associate Complex Manager responsible for supervising Zukowski's activities stated that they had no knowledge of, nor had seen, any RBC research on any specific nontraditional ETFs.

27. Based on documentation provided by RBC, between October 2007 and December 2009, Zukowski effected approximately 629 transactions in nontraditional ETFs for 35 of his RBC clients, including Massachusetts residents.

28. The vast majority of these transactions were marked as "solicited." According to information provided by RBC to the Division, 12 of these approximately 629 trades were unsolicited, the rest were solicited.

29. At RBC, the registered representative is responsible for marking the trade as "solicited" or "unsolicited."

30. In testimony to the Division, Associate Complex Manager stated that the term "solicited" means that "for RBC purposes, that the idea or the stock selection would be that of the [registered representative]."

31. 11 of these 35 clients have the identified investment objective of "Balanced/Conservative Growth-Focus is on generating current income and/or long-term capital growth. *Conservative.*" (Emphasis in original).

32. 18 of these 35 clients have the identified investment objective of "Growth." RBC's account opening documents define and/or describes "Growth" as the "[f]ocus is on generating long-term growth. *Moderate.*" (Emphasis in original).

33. The remaining 6 of these 35 clients have the identified investment objective of "Aggressive Growth" which is defined on the account opening documents as "[f]ocus is on

generating growth and/or income with a willingness to assume a high level of risk. *Aggressive.*” (Emphasis in original).

34. With the exception of one client, all of Zukowski’s clients have identified their investment experience as either “Average,” “Limited” or “None.”

35. 13 of the 35 clients have identified their annual income as \$50,000 or less.

36. 24 of the 35 clients have identified their annual income as \$99,999 or less.

37. In testimony to the Division, when asked what made nontraditional ETFs suitable for a particular client, Zukowski responded that “instead of utilizing a mutual fund, [nontraditional ETFs] were utilizing a sector in the economy and it was under the advisement of RBC Wealth Management that these were positively ranked and would be good for clients.”

38. In his testimony, Zukowski described leveraged ETFs as being a suitable product for an investor who had an investment objective of “conservative” because the investor is “using half as much money to basically get the same type of performance . . . but with half the amount of money . . . .”

39. Yet, due to the effects of the daily compounding of a nontraditional ETF’s daily returns, when held for periods longer than one day, these nontraditional ETFs are not likely to produce the same result as a traditional ETF.

40. In testimony to the Division, when asked whether investors with nontraditional ETFs could lose at a greater rate Zukowski responded, “No, because at that point it’s having – if you had \$20,000 invested without leverage and the market went down 20 percent, then you lose \$4,000; if you have \$10,000 invested it went down 20 percent and you lost twice as much, you still lose \$4,000, so you’re losing the same amount of capital at that point.”

41. On the contrary, the June 2009 FINRA Notice provides the following example/scenario “between December 1, 2008, and April 30, 2009: The Dow Jones U.S. Oil & Gas Index gained 2 percent, while an ETF seeking to deliver twice the index’s daily return fell 6 percent and the related ETF seeking to deliver twice the inverse of the index’s daily return fell 26 percent.”

Clearly, during the course of any length of time longer than one day, one cannot necessarily use a twice leveraged ETF and expect to necessarily obtain the same return as one would receive on a traditional ETF with only half the money.

*See Exhibit 2.*

42. Zukowski effected approximately 80 purchases or sales of nontraditional ETFs to clients after the June 2009 FINRA Notice, all of which were solicited.

43. In testimony to the Division, Zukowski described the inverse ETF as products for short term use, by this he clarified that he meant daily or weekly, and for hedging.

44. Notwithstanding his testimony, a review of all nontraditional ETF transactions effected by Zukowski indicates that he did not treat these products as short-term investment vehicles for daily or weekly maximum holding times. In some instances, Zukowski clients held nontraditional ETFs in client accounts for over one year. In many other instances, Zukowski’s clients held these products for months at a time.

45. Few if any of the nontraditional ETF transactions that Zukowski effected on behalf of clients were for hedging purposes, but instead were bets on the way Zukowski believed the market or certain sectors would move.

46. Zukowski’s RBC clients realized a net loss of approximately \$793,068.22 as a result of these nontraditional ETF purchase and sale transactions.

47. In late December 2009, RBC implemented a new policy which not only forbade solicited sales of nontraditional ETFs to clients, but also required that a “Non-traditional ETF Client Letter” be sent to a client that made an unsolicited purchase of a nontraditional ETF. The first letter was sent no later than December 30, 2009.

*True and accurate copies of excerpts from the RBC Compliance Manual is attached hereto as Exhibit 3.*

48. Upon review of all of the “Non-traditional ETF Client Letters” submitted to the Division pursuant to subpoena, none of Zukowski’s clients made an unsolicited purchase of any nontraditional ETFs after December 22, 2009.

#### **Transactions in Client A’s RBC Accounts**

49. Client A became a client of RBC and Zukowski on August 3, 2006, when he rolled over a 401(k) and opened an Individual Retirement Account (IRA) intended to be used for retirement.

50. Between August 2006 and November 2010, Zukowski was the registered representative assigned to this client’s account.

51. Client A worked as a floor manager at Sears since leaving Junior College in or around 1976.

52. According to account opening documents, Client A had “Average” investment experience, an investment objective of “Balanced/Conservative Growth.” This investment objective is defined and/or described on Client A’s account opening documents as the “[f]ocus is on generating current income and/or long-term capital growth. *Conservative.*” (Emphasis in original).

53. According to account opening documents, Client A had a liquid net worth of \$250,000 to \$499,999 and an annual income of \$50,000 to \$99,999.



54. During 2008 and 2009, Zukowski effected 16 trades in nontraditional ETFs to Client A. Most of the nontraditional ETFs purchased for this account were held for a week or longer and in some instances for a month or longer. Client A realized approximately \$27,515.32 in losses as a result of these transactions.

55. All of the nontraditional ETF trades executed in Client A's account were marked as "solicited."

56. In testimony to the Division, Zukowski stated that Client A's understanding of nontraditional ETFs came primarily from Zukowski's explanation of the products.

57. A review of Client A's activity on RBC Direct Connect, a website RBC provides for its clients, shows that the client never accessed any product information on RBC Direct Connect.

58. Furthermore, in testimony to the Division, Norwell Complex Director acknowledged that RBC Direct Connect is "probably one of the worst that's out there in the industry, to be honest with you, it's just not very client friendly to navigate."

59. In a statement to the Division, Client A stated that since becoming a client of Zukowski's in 2006 he never had discussions regarding specific securities or trades.

60. As a result, Client A was not familiar with nontraditional ETFs, nor did this individual understand how nontraditional ETFs functioned or how these products were suitable for his conservative portfolio as part of an overall investment strategy at the time the transactions occurred.

61. Zukowski also made some recommendations to Client A in which nontraditional ETFs were used in a speculative manner. For example, in August 2009, Zukowski recommended that Client A purchase an inverse ETF that shorted the real estate market. Several months prior to

this recommendation, Client A had liquidated all of his/her holdings due to losses that his/her account was incurring during the market downturn.

62. According to Zukowski, the decision to recommend that Client A purchase an inverse ETF product was made in the following manner:

Q (By the Division): [W]hat was the basis for that recommendation [to purchase 1500 shares of ProShares UltraShort Real Estate ETF] at that point in time?

A (By Mr. Zukowski): [Client A] had initiated that he wanted to make money in the stock market again, you know, whether he thought that it had come up too fast in too short a period of time and that, you know, was there a way of capitalizing on the stock market on the way down; and I had given him a recommendation for the Ultra Short Real Estate ETF.

A: In his opinion and my opinion that it was -- had gone to a short-term recovery high, so the stock market had gone down from -- the S&P 500 from basically 1,500 to 666 and had come back up to over a thousand, so had basically appreciated about 60 percent in a relatively short period of time for five months.

Q: And it was your opinion at that point that it might be going down again?

A: Correct.

Q: And then you advised him [Client A] to purchase this real estate ETF?

A: That is correct.

63. This transaction resulted in a loss of approximately \$9,350.50 in Client A's account.

64. Contrary to Zukowski's testimony, Client A informed the Division that Client A did not initiate contact with Zukowski on this trade.

65. Based on information provided to the Division by RBC, between July 2009 and September 2009, 11 other clients of Zukowski's in addition to Client A, also purchased the ProShares Ultra Short Real Estate ETF, the same security Zukowski recommended to Client A in August 2009. All of these trades were identified by RBC as "solicited." The investment objectives on these 11 accounts ranged from "Conservative" to "Aggressive."

66. Additionally, many of these clients held this product for over a month. Client A for example, held this product for approximately four months and at least 5 other clients held it for 60 or more days. Client A's position was sold on December 22, 2009, the same day that RBC implemented its new policy of forbidding solicited transactions in nontraditional ETFs.

#### **Transactions in Client B's RBC Accounts**

67. In 2005, Client B, a Massachusetts resident, opened four accounts at RBC for which Zukowski was the registered representative of record.

68. According to account opening documents, Client B had "average" investment experience.

69. The investment objectives across the accounts that Client B held varied from "Conservative Growth" to "Aggressive Growth." "Balanced/Conservative Growth" is defined and/or described on the account opening document as the "[f]ocus is on generating current income and/or long-term capital growth. *Conservative.*" (Emphasis in original). "Growth" is defined and/or described on the account opening document as the "[f]ocus is on generating long-term capital growth. *Moderate.*" (Emphasis in original). "Aggressive Growth" is defined and/or described on the account opening document as the "[f]ocus is on generating growth and/or income with a willingness to assume a high level of risk. *Aggressive.*" (Emphasis in original).

70. During the Relevant Time Period, the two accounts upon which the nontraditional ETFs were traded had investment objectives of "Balanced/ Conservative Growth" and "Growth." The larger of the two accounts had a value of approximately \$3.4 million and had an investment objective of "Balanced/Conservative Growth" as of September 2007.

71. According to account statements, account opening documents and changes made thereto, by February 2009, most, if not all, of Client B's accounts with Zukowski at RBC were changed

from brokerage accounts to advisory accounts for which Zukowski was the investment adviser representative.

72. The risk advisory profiles for these accounts ranged from “4” to “5.” According to RBC account statements and the *RBC Wealth Management Risk Profile Questionnaire* which is used to determine an advisory client’s risk profile, advisory risk profiles of “4” and “5” indicate that the client is willing to accept “higher risk.” According the *RBC Wealth Management Risk Profile Questionnaire* “[s]uitability is monitored by comparing the implemented strategy with the investor’s selected Risk Profiles over time.”

73. The *RBC Wealth Management Risk Profile Questionnaire* assesses an advisory client’s risk tolerance independently of that client’s stated brokerage account investment objectives. For instance, on at least one of Client B’s accounts, the account statement for February 2009 stated that “[t]he investment objective for this account is: Balanced/ Conservative Growth” and also stated “[t]he advisory risk profile for this account is: Profile 5.”

74. Nevertheless, according to RBC’s explanation of an account statement’s “investment objective” and “advisory risk profile,” found on page 2 of most account statements under the heading “ABOUT YOUR INVESTMENT OBJECTIVE AND ADVISORY RISK PROFILE” RBC states the following about the investment objective and advisory risk profiles on the account statement:

The Investment Objective noted on page 3 [the statement’s account summary page] of this statement is specific to this account and should reflect your investment goals and the level of overall risk you are willing to assume in seeking returns for this account. The Advisory Risk Profile, also noted on page 3, if applicable, is applied broadly across specified advisory accounts held at RBC . . .

*A true and accurate copy of page 2 of RBC Account Statement is attached hereto as Exhibit 4.*

75. It is the “Investment Objective” that determines the level of risk that is appropriate for each account.

See Exhibit 4.

76. All transactions in nontraditional ETFs took place in accounts of Client B that had stated investment objectives of “Balanced/ Conservative Growth” or “Growth.”

77. According to information supplied by RBC, during the period of fall 2007 to Spring 2009, over 150 transactions in nontraditional ETFs took place in Client B’s accounts.

78. All of the transactions in Client B’s accounts were “solicited.”

79. Client B held many of these nontraditional ETFs for a month or longer.

80. These transactions resulted in an approximate net realized loss of \$368,000.00 across Client B’s accounts.

81. In the twelve month period between July 2008 and July 2009, Client B’s accounts in total generated \$104,814.00 in gross commissions and advisory fees to RBC.

82. Between February 3-5, 2009, Zukowski recommended that Client B purchase 13,000 shares of the ProShares Ultra S&P 500 ETF, with returns that correspond to twice (200%) the daily performance of the S&P 500 index.

83. This particular account had a stated investment objective of “conservative growth.”

84. According to his account statements, Client B realized a net loss of approximately \$18,100 on this trade. Zukowski attributed this loss to political and market factors.

A (By Mr. Zukowski): [A]s government regulators and officials, Congressman, were either going to pass TARP or not pass TARP was going to dictate as to whether or not the economy would have enough money in its system to basically grow and at that point the stock market, which had moved up in the first couple of days of February, failed miserably from that date of February 9th all the way through March 9th, 10th, and 11th was the bottom.

Q (By the Division): And given the uncertainties of the TARP program, whether or not it was actually going to be established and funded, why were you recommending investments in ETFs at this time, given that uncertainty?

A: There is always uncertainty in the markets, always, and so therefore part of the investment objectives and what [Client B] was looking for was for short-term gains at that point.

Q: So is it fair to say then that in your opinion or recommendation for these ETFs, in order to get -- have the short-term capital gains, these were the most suitable investments at the time for him?

A: That is correct; and RBC had buy recommendations on these particular investments.

### **Transactions in Client C's RBC Accounts**

85. In August 2005, Client C, a Massachusetts resident, opened two brokerage accounts at RBC, an individual account and an IRA. Zukowski was the registered representative for both of these accounts. In 2007, Client C opened a third account, also an IRA, at RBC for which Zukowski was the registered representative.

86. At all times between 2005 and 2010, both of Client C's IRA accounts were commission-based brokerage accounts.

87. According to account opening documents for all three of Client C's accounts, Client C had "Average" investment experience and an investment objective of "Growth." This investment objective is defined and/or described on the account opening document as the "[f]ocus is on generating long-term capital growth. *Moderate.*" (Emphasis in original). This account was an advisory account and had an "advisory risk profile" of "5".

88. According to the account opening documents for Client C's individual account, Client C had a liquid net-worth of \$500,000 to \$999,999 and an annual income of \$50,000 to \$99,999.

89. All transactions involving nontraditional ETFs took place in Client C's individual account.

90. In October 2007, Zukowski recommended and purchased two leveraged ETFs for Client C's individual account.
91. These two nontraditional ETFs were sold 13 months later.
92. Client C realized an approximate loss of \$24,000.00 on these transactions.
93. During 2008, Zukowski recommended and completed 8 purchases and 7 sales of nontraditional ETFs for Client C. Client C held many of these nontraditional ETFs for well over a month. Client C realized losses from these transactions.
94. From August 2005 until January or February 2009, Client C's individual account was a brokerage account. In January or February 2009, this account was changed into an advisory account and Zukowski became the investment adviser representative on this account.
95. In 2009, the relationship between Zukowski and Client C for Client C's individual account changed from one of broker-dealer agent to investment advisor representative.
96. During 2009, when Zukowski was an investment adviser representative to Client C's individual account, Zukowski recommended and completed approximately 60 nontraditional ETF trades in this account. Of these approximately 60 trades, 22 of these trades were in leveraged or inverse-leveraged ETFs that were leveraged with the aim of returning 300% of the daily return of the referenced index.
97. In a statement to the Division, Client C stated that it was Client C's tax preparer that called his/her attention to the nontraditional ETFs in his account and the losses incurred as a result.
98. Prior to Client C's tax preparer informing Client C that the losses incurred were due to the purchase and sale of nontraditional ETFs in the account, Client C had never heard of nontraditional ETFs.

99. Client C realized net losses on the transactions in nontraditional ETFs between 2007 and 2009. These losses totaled approximately \$175,000.00.

100. In May 2010, Client C made a verbal complaint to the branch director of the RBC Osterville branch office regarding the losses he/she sustained on his/her accounts, mainly on the individual account.

101. On July 21, 2010 Client C received a letter from RBC stating that it found no merit to his/her claims.

*A true and accurate copy of RBC Response Letter is attached hereto as Exhibit 5.*

**RBC Failed to Supervise Their Registered Representatives' Sales of Nontraditional ETFs**

102. Between January 1, 2007 and January 1, 2010, RBC failed to put proper procedures in place to ensure that sales of nontraditional ETFs by RBC registered representatives were compliant with all relevant Massachusetts statutes and regulations, namely that these products were suitable for the clients to whom RBC and its representatives were recommending for purchase.

**RBC Complex Supervisory Structure**

103. RBC organizes and carries out supervision of its registered representatives' brokerage and advisory activities through a system of remote regional "complexes", rather than a localized branch supervisory manager system.

104. The daily activities of registered representatives in branch offices throughout each complex are supervised remotely by the Complex Director from the complex's main office.

105. The RBC complexes are structured such that the Complex Director of the complex has ultimate authority and responsibility for compliance and supervision of the activities of RBC's registered representatives within his complex.



106. The primary responsibility of the Associate Complex Manager is to assist the Complex Director in carrying out the supervisory and compliance duties.

107. Most of the supervisory duties of the Complex Director and the Associate Complex Manager are carried out in the complex's main office.

108. The Complex Director and the Associate Complex Manager are responsible for reviewing the daily trade blotter conducting monthly account reviews, and monitoring external e-mails sent by registered representatives.

109. The supervisory duties of branch directors of RBC branch offices are limited to review of incoming and outgoing correspondence between clients and registered representatives and forwarding client complaints to the Complex Director.

110. Branch directors are producing registered representatives. The complex structure allows the branch directors to "balance their personal [brokerage and advisory client] business and client relationships" with their supervisory duties.

*A true and accurate copy of the RBC Compliance Quick Reference is attached hereto as Exhibit 6.*

111. RBC requires that a Complex Director only visit each branch office twice per year.

112. An Associate Complex Manager is also required to visit each branch office only twice per year.

113. Prior to December 31, 2009, RBC maintained two separate regional complexes in eastern Massachusetts, the Boston Complex and the Norwell Complex.

114. Between late 2003 through December 31, 2009, Norwell Complex Director was the Complex Director for the Norwell Complex. During this period of time, Norwell Complex Director had ultimate responsibility for the supervision of the activities of RBC's registered

representatives within the Norwell Complex, including the Osterville, Massachusetts office and Zukowski.

115. During the period of July 22, 2005 through December 31, 2009, Norwell Complex Director had ultimate responsibility for the supervision of Zukowski at the Osterville branch office.

116. Between 2004 and December 31, 2009, the Associate Complex Manager of the Norwell Complex had the primary responsibility of assisting Norwell Complex Director in the supervision of RBC registered representatives in the Norwell Complex, including the Osterville branch office and Zukowski.

117. On January 1, 2010, the Norwell Complex and the Boston Complex merged into one single complex, now referred to as “the Boston Complex.” As of January 1, 2010, the Boston Complex included all RBC offices in eastern Massachusetts.

118. During the Relevant Time Period, Boston Complex Director was the Complex Director of the Boston Complex. From January 1, 2010 until December 23, 2010 Boston Complex Director was responsible for supervising Zukowski at the Osterville branch office.

**RBC’s Lack of Nontraditional ETF Training**

119. RBC did not have any required nontraditional ETF training in place during the period of January 1, 2007 through September 18, 2009.

120. RBC did not have a policy that specifically covered the purchase or sale of nontraditional ETFs during the period of January 1, 2007 through September 18, 2009.

121. In testimony to the Division, Norwell Complex Director stated that an important part of supervision “is really knowing your advisors, you know, knowing what they’re doing and how they do their business.” Zukowski began selling nontraditional ETFs in late 2007, yet in

testimony to the Division, Norwell Complex Director stated that the first time that he saw regarding nontraditional ETFs was in the middle of 2008.

122. In testimony to the Division, Norwell Complex Director described his understanding of nontraditional ETFs in the following manner:

Q (by the Division): [in mid-2008] what was your understanding of what [nontraditional ETFs] were and how they should be used?

A (by Norwell Complex Director): I think I know a lot more now than - - like everybody else in the industry - - than I did then, I think back then, you know, your sources really were what you went out and could try to find, whether it be, you know, on the internet or hearing it on the newspaper, or t.v. or what be it, but leveraged, inverse, you know, understood the concepts.

Q: Did you understand at that time that these are longer term investments or shorter term investments at that period [of time in mid-2008]?

A: I think we all now know that they're very short term type investments in most cases, but I can't say to what level at that time I, you know, would have been able to differentiate with certainty.

123. In testimony to the Division, Norwell Complex Director stated that RBC did not provide any formal training on nontraditional ETFs during the time he was Complex Director of the Norwell Complex.

124. In testimony to the Division, Norwell Complex Director stated that no one at RBC spoke with him about nontraditional ETFs after the June 2009 FINRA Notice was released, nor was the June 2009 FINRA Notice given to him directly by RBC.

125. Between the June 2009 FINRA Notice and mid-December 2009, RBC did not implement any procedures at the complex level, either temporarily or permanently, reasonably designed to monitor and/or ensure that RBC representatives knew and understood the suitability requirements for nontraditional ETFs.

126. In his testimony, Boston Complex Director stated that he was unaware of nontraditional ETFs prior to 2008.

127. In his testimony, Boston Complex Director stated that by 2009 he became aware that some RBC registered representatives were purchasing and selling nontraditional ETFs.

128. The individuals in charge of the supervision of registered representative activities (*i.e.*, Norwell Complex Director and Boston Complex Director) did not receive any training on nontraditional ETFs prior to December 2009 from RBC.

129. Aside from an informal and non-mandatory meeting in spring 2009, Boston Complex Director received no training on the use and suitability of nontraditional ETFs.

130. In light of the fact that RBC failed to provide any training on nontraditional ETFs, Boston Complex Director invited representatives from one nontraditional ETF product sponsor to the Boston branch office to provide education to RBC registered representatives interested in these products.

131. In late spring of 2009, representatives from Direxion came to the RBC Boston branch office to provide a presentation on leveraged and inverse ETFs.

132. Boston Complex Director testified that the Direxion representatives spent about half of the presentation discussing how the products should be used, suitability concerns and the associated risks.

133. The presentation was not mandatory for RBC registered representatives. Zukowski was not present, but he offered and sold Direxion products to his clients.

134. Prior to December 2009, RBC did not mandate any training to RBC employees selling or wishing to sell nontraditional ETFs.

135. No registered representative of RBC in the Norwell Complex received any training from RBC on nontraditional ETFs prior to December 2009.

136. Zukowski, while a registered representative of RBC, began soliciting nontraditional ETFs to customers in October 2007.

137. The vast majority of Zukowski's sales in nontraditional ETFs occurred between October 1, 2007 and December 31, 2009.

138. Zukowski was one of the Norwell Complex's top sellers of nontraditional ETFs.

139. Zukowski was the top producer in the RBC Osterville branch office.

140. Zukowski received RBC's Presidential Council Award in 2009 for generating a high level of commissions and advisory fees. In 2009, Zukowski effected approximately 440 transactions in nontraditional ETFs.

**RBC Treated Nontraditional ETFs as Traditional ETFs for Supervisory/Compliance Purposes**

141. In testimony to the Division, Norwell Complex Director acknowledged that prior to December 2009, RBC did not treat nontraditional ETFs any differently than any other product on RBC's platform of securities offered to customers for the purposes of supervision.

142. In addition to not providing any training on nontraditional ETFs to the Complex Directors, the Associate Complex Manager, branch director, or to the registered representatives; RBC did not implement any automated alert systems tailored to identify, flag, review or stop unsuitable nontraditional ETF purchases and/or sales.

143. Until December 2009, RBC's electronic trade blotter surveillance systems did not automatically treat nontraditional ETF transactions in a manner that would bring such transactions to the attention of the Complex Director, the individual ultimately responsible for

the review of the daily trade blotter in the Complex, or the Associate Complex Manager, to whom the trade blotter review was routinely delegated.

144. As far as conducting a suitability review of Zukowski's sales of nontraditional ETFs in clients accounts, Associate Complex Manager testified that he/she never discussed with Zukowski his selling nontraditional ETFs because these products were not "on any of the flags on trade blotter, so they were sort of under the radar."

145. RBC did have nontraditional ETF monitoring procedures in place for its advisory accounts. RBC's monitoring procedures for nontraditional ETFs in RBC advisor program accounts requires that RBC Portfolio Focus Accounts be no greater than 30% of the account value, and no greater than 50% of the account value in RBC Advisor and RBC Total Portfolio accounts

146. The thresholds identified in the paragraph above are not substantially different than for any other security in an advisory account. According to Associate Complex Manager, the individual in charge of carrying out the "Inverse Fund and ETF Guidelines and Monitoring," these thresholds are the same in RBC brokerage accounts.

147. The monitoring procedures pertaining to RBC advisory accounts only applied to Zukowski's RBC advisory accounts and not his brokerage accounts.

148. In regards to non-discretionary accounts at RBC, until December 2009, RBC did not treat nontraditional ETFs any differently than traditional ETFs, or any other basic security offered on RBC's platform for purposes of compliance and surveillance.

#### **RBC's Awareness of Risks Associated With Nontraditional ETFs**

149. RBC knew as early as 2006 that nontraditional ETF products functioned in a significantly different way than traditional ETFs, namely that the compounding effects and expenses

associated with the nontraditional products would lead to the products not returning their expected results during a given period of time.

150. For instance, since 2006 certain RBC registered representatives were required to fill out RBC's *Portfolio Focus Portfolio Management Track – Application To Use Leveraged And Inverse Products*. This application was updated periodically.

*True and accurate copies of RBC's Portfolio Focus Portfolio Management Track – Applications attached hereto as Exhibit 7.*

151. Only those RBC registered representatives with discretionary authority on a client's advisory account needed to submit this application before engaging in nontraditional ETF transactions. All other RBC registered representatives and investment adviser representatives were free sell these products to clients without prior RBC approval.

152. The Complex Directors and the Associate Complex Managers were responsible for reviewing and approving the *Portfolio Focus Portfolio Management Track* applications.

153. RBC did not provide the Complex Directors or the Associate Complex Manager any training or materials on how to evaluate these applications.

154. Zukowski did not have discretionary authority on any client accounts and did not need to submit this application prior to engaging in nontraditional ETF transactions.

155. In the summer 2007 release of *IAG Insider*, a RBC newsletter for its employees, RBC stated the following about leveraged ETFs:

**Note:** These products are not suitable for all investors. Due to compounding and expenses, leveraged funds and ETFs do not necessarily return twice the daily returns of the underlying index. (Emphasis in original).

*See Exhibit 1.*

156. In testimony to the Division, Norwell Complex Director stated that he never read this edition of *IAG Insider*, nor was he required to by RBC. Furthermore, he testified that he believed Associate Complex Manager had not read this edition either.

157. RBC InfoNet is an RBC intranet site where registered representatives can access various tools and information, including newsletters and product information.

158. Norwell Complex Director further testified that he believed that *IAG Insider* was maintained on RBC's Infonet and therefore would not be seen by just any RBC employee in the course of business, but only by those that affirmatively took steps to locate it on the Infonet system and read the publication regularly or those who wanted to read a specific edition.

159. By January 31, 2009, RBC further confirmed that volatility in the market made nontraditional ETFs more prone to loss in value.

160. The article, *Think Twice or Thrice Before Purchasing Leveraged ETFs*, stated that "the effects of compounding leveraged **DAILY** returns over the course of one week, one month, one quarter or one annum. . . . *can be significant – and more often than not deleterious – when both the magnitude of and directional swings of leveraged day-to-day price-percentage changes are heightened.*"

*A true and accurate copy of Think Twice or Thrice is attached hereto as Exhibit 8.*

161. The article, *Think Twice or Thrice Before Purchasing Leveraged ETFs*, was released two years after the 2007 summer release of *IAG Insider*. As stated above, RBC registered representatives that were advisers on RBC Portfolio Focus accounts with discretionary authority were required, as of at least March 2009, to attest that they had reviewed this publication.

*See Exhibit 8.*



162. In this article, *Think Twice or Thrice Before Purchasing Leveraged ETFs*, RBC listed several risks and suitability concerns in regards to nontraditional ETF transactions. Regarding suitability, the article states that “*we [RBC] would argue that these products are not suitable for any investors, if we define ‘investors’ as prospective purchasers with longer-term holding periods (e.g. one week or one month.)*” (Emphasis added).

*See Exhibit 8.*

163. Some of the other risks and concerns raised in this article include:

[T]he longer term performance of INVERSE, LEVERED and INVERSE-LEVERED products depends on the actual path of **DAILY** returns over the course of the specific time period . . . In short, *the larger the **DAILY** returns – either positive or negative – and the more the **DAILY** returns change direction from positive to negative and vice versa, the more the long-term performance of these products might differ from one’s intuitive but naïve expectations* [because] . . . the real - and all too often deleterious – consequences of compounding leveraged **DAILY** returns throughout more volatile financial markets, such as the recent and current tumultuous times.

[T]he effects of compounding leveraged **DAILY** returns over the course of one week, one month, one quarter or one annum. . . . can be significant – and more often than not deleterious – when both the magnitude of and directional swings of leveraged day-to-day price-percentage changes are heightened.

A common – and in our opinion the most unfortunate – misconception is that leveraged products with **DAILY** performance objectives should deliver price-percentage changes that are proportionate . . . to these products’ leveraged beta targets.

Since these products must reset to the leveraged beta target . . . each day, purchasers are not in fact leveraging the performance of a multi-day period. Such purchasers are therefore misguided if it is believed he or she can purchase a twice-leveraged or thrice-leveraged product, hold it for one week, one month, one quarter or one annum, and end up with double or triple the ultimate performance of the applicable benchmark indices.

Together, leveraged products’ **DAILY** performance objectives and the requisite **DAILY** rebalancing to the leveraged beta target represent their Achilles’ heel as ever being efficacious and viable long-term investment vehicles.

In our opinion, leveraged products are proof positive that prospective purchasers need to read the fine print. . . . prospective purchasers of these products should at a minimum peruse the prospectus' *Performance Objectives* and *Principal Risks*.

After seeing (and feeling) their portfolios crash . . . in 2008, a number of investors could be easily tempted to try and recoup those more recent losses all at once through the purchase of leveraged products. But such afflicted investors must fight the urge . . . to 'double down' or 'triple down' as part of a rash attempt to get well soon.

By definition, *leveraged products are riskier than otherwise comparable non-leveraged products*.

*Leveraged products operate as double-edged or triple-edged swords* and thus can record gains and losses in short-term time periods.

(Bold in the original, italics emphasis added)

*See Exhibit 8.*

164. The article, *Think Twice or Thrice Before Purchasing Leveraged ETFs*, repeatedly emphasized throughout the article that nontraditional ETFs seek to achieve the daily performance of the products stated goals. In the article the word "daily" appears in bold and all capital text eleven times emphasizing the daily nature of the product.

*See Exhibit 8.*

165. According to page 9 of *Think Twice or Thrice Before Purchasing Leveraged ETFs* the opinions expressed therein are not solely those of the article's author. Instead, "[a]ll opinions and estimates contained in this report constitute RBC Wealth Management's judgment as of the date of this report . . ."

*See Exhibit 8.*

166. RBC continued to sell nontraditional ETFs without any restrictions to retail brokerage clients even after the conclusions stated in its January 31, 2009 release of *Think Twice or Thrice Before Purchasing Leveraged ETFs*.

167. The March 2009 version of RBC's *Portfolio Focus Portfolio Management Track – Application To Use Leveraged And Inverse Products* also required that the registered representative acknowledge that he or she reviewed RBC's article *Think Twice or Thrice Before Purchasing Leveraged ETFs*.

*See Exhibit 7.*

168. In December 2009, RBC instituted new policies and procedures relating to the offer and sale of nontraditional ETFs.

169. According to the March 2010 update of the RBC Wealth Management Compliance Manual, as of December 22, 2009 inverse ETFs and leveraged-inverse ETFs may only be sold on an unsolicited basis, and also required that the registered representative enter the order into a special log for the sale of nontraditional ETFs. In addition, after each order, a letter of non-solicitation is mailed to the investor asking the investor to notify RBC if the sale was not in fact unsolicited.

*See Exhibit 3.*

170. Prior editions of the RBC Wealth Management Compliance Manual however contained no mention of nontraditional ETFs.

171. On December 22, 2009, an email was sent to the Branch Directors in the Norwell Complex informing them of this new policy.

*A true and accurate copy of this Email is attached hereto as Exhibit 9.*

**No Branch Director at Osterville Office**

172. Contributing to the breakdown in supervision under the complex structure, between July 2005 and present, there were no less than five branch directors at the Osterville branch office during Zukowski's tenure with the firm.

173. One of the five Branch Directors was the Associate Complex Manager, who acted as the branch director of the Osterville branch office from July 1, 2007 through December 5, 2008, a seventeen month period.

174. Therefore, from July 2007 through December 2008 there was no designated branch director at the Osterville branch office.

175. According to the RBC Compliance Quick Reference, branch directors perform “critical supervisory responsibilities.” Exhibit 6.

176. Norwell Complex Director and Associate Complex Manager assumed the duties of branch director of the Osterville branch office for a seventeen month period of time, while at the same time being expected to fulfill the duties required of their respective positions as Complex Director and Associate Complex Manager.

177. In testimony to the Division, Norwell Complex Director stated that during the time that the Associate Complex Manager was acting as the branch director, she was only required to be present in the branch office one or two days a week.

178. The Norwell Complex Director stated that he “would also pop down there [to the Osterville branch office] one day a week too.” According to Norwell Complex Director, he stopped into the Osterville branch office at least one day a week, but sometimes this visit would only be for half a day.

179. A review of Norwell Complex Director’s calendars and supervisory logs during this time period do not indicate that this individual visited the Osterville branch office on a weekly basis.

180. According to RBC’s Compliance Quick Reference, Complex Directors are required to properly document visits to branch offices. *See* Exhibit 6.

181. Although a branch director has limited supervisory duties, Associate Complex Manager described the branch directors as the “eyes and ears of the [RBC branch] office[s].”

182. In testimony to the Division, Norwell Complex Director also described the branch directors as the “eyes and ears” at the branch offices and RBC’s “first line of defense.”

183. In testimony to the Division, Zukowski stated that he had little interaction on a supervisory level with his branch director at the RBC Osterville branch office. According to Zukowski, the Osterville branch director mainly reviewed outgoing correspondence.

184. During the period of summer 2007 through December 2008, Zukowski was located at RBC’s Osterville branch office and effectuated approximately 188 transactions in nontraditional ETFs.

#### **Zukowski’s Heightened Supervision**

185. After the Division initiated an investigation into Zukowski’s use of nontraditional ETFs, Zukowski was placed on heightened supervision by RBC on July 26, 2010. This heightened supervision system was memorialized in a Heightened Supervision Memorandum signed by Zukowski and RBC on July 26, 2010. A true and accurate copy of the Heightened Supervision Memorandum is attached hereto as Exhibit 10.

186. In testimony to the Division, Boston Complex Director stated that Zukowski was placed on heightened supervision because “the number of complaints [Zukowski] had received reached a threshold where we put him on heightened supervision.”

187. A review of the various updated editions of the RBC Wealth Management Compliance Manual between April 2005 and June 2011 shows that none of these editions makes reference to any policy of heightened supervision for RBC representatives.

188. The Boston Complex Director also expressed confusion over what the RBC policy is for placing a RBC registered representative on heightened supervision. He stated, “I have to confess I’m a little confused if it’s two in three years or if its three in two, but he [Zukowski] had hit the threshold.”

189. According to the Associate Complex Manager, “A guideline I was told, which is I don’t believe a hard and fast rule, is two complaints within a three-year time frame or three complaints within five years is reason to place an FC [RBC registered representative] – if we believe it’s necessary, to place an FC [RBC registered representative] on heightened supervision.”

190. In the three year period of time prior to July 26, 2010, Zukowski received four customer complaints. These complaints were received in October 2008, September 2009, February 2010, and May 2010. RBC deemed three of these four complaints to be without merit before Zukowski was put on heightened supervision.

191. RBC placed Zukowski on heightened supervision approximately 5 days after informing Client C that the complaint made by Client C in May 2010 was without merit.

192. The Boston Complex Director was responsible for, among other things, monitoring and reviewing 100 percent of Zukowski’s external e-mail activity while he was under heightened supervision.

193. During the period of September 30, 2010 through October 31, 2010, while Zukowski was on heightened supervision, Boston Complex Director only reviewed 110 out of 922 of Zukowski’s external e-mails.

*A true and accurate copy of an Email Review Log is attached hereto as Exhibit 11.*

194. On November 30, 2010, Zukowski’s employment with RBC ended. According to Zukowski’s CRD registration summary he was “[p]ermitted to resign.” Additionally, according

to Zukowski's Form U5, the termination explanation for his withdrawal was: "Failure to Meet Firm Expectations."

## VIII. VIOLATIONS OF SECURITIES LAWS

### A. COUNT I – VIOLATIONS OF § 204(a)(2)(G) BY RBC

195. Section 204(a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:–

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.

196. 950 CMR § 12.204(1)(a)(4) provides in pertinent part:

(1) Dishonest and unethical practices in the securities business.

(a) Broker-Dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Acts and practices, including, but not limited to the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration, or such other appropriate action:

4. Recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer.

197. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.

198. The conduct of RBC as described above, constitute violations of M.G.L. c. 110A, § 204(a)(2)(G).

**B. COUNT II – VIOLATIONS OF § 204(a)(2)(G) BY RBC**

199. Section 204(a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:—

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.

200. 950 CMR § 12.204(1)(a)(28) provides in pertinent part:

(1) Dishonest and unethical practices in the securities business.

(a) Broker-Dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business. Acts and practices, including, but not limited to the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration, or such other appropriate action:

28. Failure to comply with any applicable provision of the NASD rules of Fair Practice.

201. The applicable NASD (now known as FINRA) rules provide in pertinent part:

**2310. Recommendations to Customers (Suitability)**

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

202. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.



203. The conduct of RBC as described above, constitute violations of M.G.L. c. 110A, § 204(a)(2)(G).

**C. COUNT III – VIOLATIONS OF § 204(a)(2)(G) BY RBC**

204. Section 204(a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:–

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.

205. 950 CMR § 12.205(9)(a) states in pertinent part:

**(9) Fraudulent Practices/Dishonest or Unethical Practices.**

(a) As used in 950 CMR 12.205(9), “adviser” refers to any person, including persons registered or excluded from registration under M.G.L. c. 110A, who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase and sale, whether through the issuance of analyses or reports or otherwise. It is a rebuttable presumption that such term includes all investment advisers and investment adviser representatives, as well as other persons who charge fees based on assets under management or portfolio performance for rendering investment advice.

206. 950 CMR § 12.205(9)(c) states in pertinent part:

... (c) The following practices are a non-exclusive list of practices by an adviser which shall be deemed “dishonest or unethical conduct or practices in the securities business” for purposes of M.G.L. c. 110A, § 204(a)(2)(G):

207. 950 CMR 12.205(9)(c)(1) provides that it shall be “dishonest or unethical conduct or practices in the securities business” for purpose of M.G.L. c. 110A, § 204(a)(2)(G):

Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the

client on the basis of information furnished by the client after reasonable inquiry concerning the client's overall portfolio, investment objectives, financial situation and needs, investment experience and any other information known or acquired by the adviser after reasonable examination of the client's records as may be provided to the adviser.

208. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.

209. The conduct of RBC, as described above, constitutes a violation of M.G.L. c. 110A, § 204(a)(2)(G).

#### **D. COUNT IV – VIOLATIONS OF § 204(a)(2)(G) BY ZUKOWSKI**

210. Section 204(a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:—

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business

211. 950 CMR § 12.204(1)(b)(8) of the Regulations provides:

(1) Dishonest and unethical practices in the securities business.

(b) Agents. Each agent shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of his or her business. Acts or practices, including, but not limited to, the following are considered contrary to such standards and constitute dishonest or unethical practices in the securities industry and are thereby grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration or such action as is appropriate:

4. Recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry

concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer.

212. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.

213. The conduct of Zukowski as described above, constitute violations of M.G.L. c. 110A, § 204(a)(2)(G).

**E. COUNT V – VIOLATIONS OF § 204(a)(2)(G) BY ZUKOWSKI**

214. Section 204(a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:—

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business

215. 950 CMR § 12.204(1)(b)(8) of the Regulations provides:

(1) Dishonest and unethical practices in the securities business.

(b) Agents. Each agent shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of his or her business. Acts or practices, including, but not limited to, the following are considered contrary to such standards and constitute dishonest or unethical practices in the securities industry and are thereby grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration or such action as is appropriate:

8. Engaging in conduct specified in 950 CMR 12.204(1)(a) 28.

216. 950 CMR § 12.204(1)(a)(28) provides in pertinent part:

(1) Dishonest and unethical practices in the securities business.

(a) Broker-Dealers. Each broker-dealer shall observe high standards of commercial honor and just and equitable principles of trade in the conduct

of its business. Acts and practices, including, but not limited to the following, are considered contrary to such standards and constitute dishonest or unethical practices which are grounds for imposition of an administrative fine, censure, denial, suspension or revocation of a registration, or such other appropriate action:

28. Failure to comply with any applicable provision of the NASD rules of Fair Practice.

217. The applicable NASD (now known as FINRA) rules provide in pertinent part:

**2310. Recommendations to Customers (Suitability)**

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

218. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.

219. The conduct of Zukowski as described above, constitute violations of M.G.L. c. 110A, § 204(a)(2)(G).

**F. COUNT VI – VIOLATIONS OF 204(a)(2)(G) BY ZUKOWSKI**

220. Section 204(a)(2)(G) of the Act provides in pertinent part:

(a) The secretary may by order impose an administrative fine or censure or deny, suspend, or revoke any registration or take any other appropriate action if he finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:—

(G) has engaged in any unethical or dishonest conduct or practices in the securities, commodities or insurance business.

221. 950 CMR § 12.205(9)(a) states in pertinent part:

(9) Fraudulent Practices/Dishonest or Unethical Practices.

(a) As used in 950 CMR 12.205(9), “adviser” refers to any person, including persons registered or excluded from registration under M.G.L. c. 110A, who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase and sale, whether through the issuance of analyses or reports or otherwise. It is a rebuttable presumption that such term includes all investment advisers and investment adviser representatives, as well as other persons who charge fees based on assets under management or portfolio performance for rendering investment advice.

222. 950 CMR § 12.205(9)(c) states in pertinent part:

... (c) The following practices are a non-exclusive list of practices by an adviser which shall be deemed “dishonest or unethical conduct or practices in the securities business” for purposes of M.G.L. c. 110A, § 204(a)(2)(G):

223. 950 CMR 12.205(9)(c)(1) provides that it shall be “dishonest or unethical conduct or practices in the securities business” for purpose of M.G.L. c. 110A, § 204(a)(2)(G):

Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client’s overall portfolio, investment objectives, financial situation and needs, investment experience and any other information known or acquired by the adviser after reasonable examination of the client’s records as may be provided to the adviser.

224. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.

225. The conduct of Zukowski, as described above, constitutes a violation of M.G.L. c. 110A, § 204(a)(2)(G).

**G. COUNT VII – VIOLATIONS OF § 204(a)(2)(J) BY RBC**

226. Section 204(a)(2)(J) of the Act provides in pertinent part:

The secretary may by order deny, suspend, or revoke any registration if he finds (1) that the order is in the public interest and (2) that the applicant or registrant (J) has failed reasonably to supervise agents, investment adviser representatives or other employees to assure compliance with this chapter.

227. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 194 above.

228. The conduct of RBC, failing to reasonably supervise agents, investment adviser representatives or other employees to assure compliance with the Act and/or Regulations in the manner described above, constitutes a violation of M.G.L. c. 110A, § 204(a)(2)(J).

## **IX. STATUTORY BASIS FOR RELIEF**

### Violations, Cease and Desist Orders and Costs

229. Section 407A(a) of the Act provides in pertinent part that:

(a) If the secretary determines, after notice and opportunity for a hearing, that any person has engaged in or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order issued thereunder, he may order such person to cease and desist from such unlawful act or practice and may take affirmative action, including the imposition of an administrative fine, the issuance of an order for accounting, disgorgement or rescission or any other relief as in his judgment may be necessary to carry out the purposes of [the Act].

230. The Division herein re-alleges and restates the allegations and facts set forth in paragraphs 1 through 228 above.

231. RBC and Zukowski directly and indirectly engaged in the acts, practices, and courses of business as set forth in this Complaint above, and it is the Division's belief that Respondents will continue to engage in acts and practices similar in subject and purpose, which constitute violations if not ordered to cease and desist.

## **X. PUBLIC INTEREST**

For any and all of the reasons set forth above, it is in the public interest and will protect Massachusetts investors to provide the relief requested in Section XI below.

## **XI. RELIEF REQUESTED**

Wherefore, the Enforcement Section of the Division requests that Hearing Officer take the following action:

- A. Find that all the sanctions and remedies detailed herein are in the public interest and necessary for the protection of Massachusetts investors;
- B. Find as fact the allegations set forth in paragraphs 1 through 231 of the Complaint; and
- C. Enter an order (a) requiring RBC Capital Markets, LLC and Michael D. Zukowski to permanently cease and desist from committing any further violations of the Act and Regulations, (b) requiring RBC Capital Markets, LLC and Michael D. Zukowski to make full restitution to Massachusetts investors who have incurred monetary losses as a result of Michael D. Zukowski effecting unsuitable transactions in nontraditional exchange traded funds in their accounts, (c) requiring RBC Capital Markets, LLC and Michael D. Zukowski to pay an administrative fine in an amount and upon such terms and conditions as a Hearing Officer may determine, and (d) requiring RBC Capital Markets, LLC and Michael D. Zukowski to take any other action that a Hearing Officer may deem appropriate in the public interest and necessary for the protection of Massachusetts investors.

**ENFORCEMENT SECTION  
MASSACHUSETTS SECURITIES DIVISION**

By and through its attorneys,



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Dated: July 20, 2011