

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
LETTER OF ACCEPTANCE, WAIVER, AND CONSENT  
NO. 2019061651201**

TO: Department of Enforcement  
Financial Industry Regulatory Authority (FINRA)

RE: Triad Advisors LLC (Respondent)  
Member Firm  
CRD No. 25803

Pursuant to FINRA Rule 9216, Respondent Triad Advisors LLC submits this Letter of Acceptance, Waiver, and Consent (AWC) for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against Respondent alleging violations based on the same factual findings described in this AWC.

**I.**

**ACCEPTANCE AND CONSENT**

- A. Respondent hereby accepts and consents, without admitting or denying the findings and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

**BACKGROUND**

Triad has been a FINRA member firm since March 1990 and conducts a general securities business. The firm is headquartered in Atlanta, Georgia. As of September 2021, Triad has 1,051 registered representatives in 351 branch offices.

**OVERVIEW**

From September 12, 2016 to February 1, 2018, Triad failed to reasonably supervise representatives' recommendations of an alternative mutual fund—the LJM Preservation & Growth Fund (LJM).<sup>1</sup> Triad permitted the sale of LJM on its platform without conducting reasonable due diligence of LJM and without a sufficient understanding of its risks and features, including the fact that the fund pursued a risky strategy that relied, in part, on purchasing uncovered options. Triad also lacked a reasonable supervisory system to review representatives' LJM recommendations. Triad representatives sold \$2,267,000 in LJM to fifty-eight customers. LJM's value dropped 80% during an extreme volatility event in February 2018 and the fund ultimately liquidated and closed, resulting in

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<sup>1</sup> Ticker symbols were LJMIX, LJMCX, and LJMAX.

hundreds of thousands in losses for Triad's customers. By virtue of the foregoing, Triad violated FINRA Rules 3110 and 2010.

From March 27, 2014 to January 1, 2019, Triad failed to obtain required account information for customers who purchased the private offerings of LJM Partners, Ltd. and LJM Preservation & Growth Fund LP ("LJM Private Offerings"). Further, the firm failed to enforce written supervisory procedures reasonably designed to ensure that such information was obtained by the firm, in violation of FINRA Rules 4511, 3110, and 2010, NASD Rule 3010, and SEC Rule 17a-3.

### **FACTS AND VIOLATIVE CONDUCT**

This matter originated from FINRA's 2019 investigation of firms that sold LJM to retail customers.

#### ***Alternative Mutual Funds***

Alternative mutual funds are publicly offered mutual funds that seek to accomplish the funds' objectives through non-traditional investments and trading strategies. In its 2015 National Examination Priorities Letter, FINRA described the features of alternative mutual funds:

Alternative mutual funds are often marketed as a way for retail customers to invest in sophisticated, actively managed hedge fund-like strategies that will perform well in a variety of market environments. Alternative mutual funds generally purport to reduce volatility, increase diversification, and produce non-correlated returns and higher yields compared to traditional long-only equity and fixed-income funds, all while offering daily liquidity."<sup>2</sup>

In the same letter, FINRA identified alternative mutual funds as an area of review and noted concerns regarding firms' supervision and sale of such funds:

Despite their possible benefits, alternative mutual funds raise concerns when compared to conventional funds. In particular, FINRA is concerned that registered representatives and customers will not understand how the funds will respond to various market conditions or even the strategy in which the fund's adviser will engage in various market scenarios. In addition, FINRA has learned that some firms are not reviewing alt funds through their new-product review process, especially if the firm already has an existing agreement with the fund company.

Previously, FINRA issued Regulatory Notices highlighting the risks of "complex products," such as alternative mutual funds, and stressing the need for firms and their

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<sup>2</sup> 2015 FINRA Regulatory and Examination Priorities Letter (January 6, 2015) ("2015 Exam Priorities Letter").

representatives to understand their unique risks and features before recommending them, particularly to retail customers.<sup>3</sup>

### ***LJM and the Risks of an Uncovered Options Strategy***

LJM was an alternative mutual fund that launched on January 9, 2013. LJM marketed itself as “selling volatility” by seeking to profit from the “volatility premium”—the difference between implied volatility (investors’ forecast of market volatility reflected in options pricing) and realized (actual) market volatility. To achieve this goal, LJM invested primarily in purchased (long) and sold (short) call and put options on the S&P 500 futures index. LJM did not hold any underlying stock as a part of its strategy.

In its prospectus, LJM disclosed that “[i]n the aggregate, the Fund is typically ‘net short’ in the portfolio of contracts that it holds, which means the Fund holds more uncovered option contracts than covered.” The prospectus also disclosed the limited upside, and unlimited downside, risk associated with uncovered options.

The fact that LJM was typically “net short” or “short volatility” was also disclosed in various informational and marketing materials provided, or available, to registered representatives and their firms. This material disclosed that there were certain markets in which LJM was designed to do well, namely: (i) flat, (ii) choppy, (iii) eroding, or (iv) slowing rising or falling markets. Conversely, LJM disclosed that there were other markets in which its strategy would be “challenged,” namely: (i) sustained upward trending equity markets, (ii) quick reversals, or (iii) extreme volatility spikes or market moves. LJM employed a risk mitigation strategy through the use of put option spreads that was intended to mitigate the risks associated with the challenging markets, including major market downturns. However, LJM disclosed in its prospectus that “there can be no assurance that the Fund’s risk mitigation strategies will reduce risk or will be either available or cost effective.”

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<sup>3</sup> In January 2012, FINRA issued Regulatory Notice 12-03 regarding supervisory procedures governing “complex products.” In it, FINRA provided guidance to firms on the characteristics of complex products:

Any product with multiple features that affect its investment returns differently under various scenarios is potentially complex. This is particularly true if it would be unreasonable to expect an average retail investor to discern the existence of these features and to understand the basic manner in which these features interact to produce an investment return.

FINRA provided several examples of complex products, including “exchange-traded products [that] offer retail investors exposure to stock market volatility. ... The investable form of volatility may be in the form of futures on the CBOE Volatility Index (VIX) that reflect the market’s expectation of volatility.” FINRA stated that “complex” products present additional risk to retail investors.

Similarly, in June 2013, FINRA issued an Investor Alert, “Alternative Funds Are Not Your Typical Mutual Funds,” noting among other things: (1) in addition to the usual market and investment specific risks mutual funds have, alternative mutual funds carry additional risks from the strategies they use; and (2) many alternative mutual funds have limited performance histories, making it difficult to predict how they will perform in various market conditions, including downturns.

In July 2017, Morningstar issued a Fund Report for LJM that described the fund as “[a]n aggressive option seller with above-average returns and low correlation with equity markets, but high risk.” The Report further stated that “[t]he strategy is structured to generate high income but is relatively aggressive and exposed to a steep rise in equity volatility. Even though these volatility spikes and periods of heightened uncertainty are infrequent, they could have significant, negative impact on this fund’s future performance.”

***The Firm Did Not Have a Reasonably Designed Supervisory System with Respect to the Recommendation of Alternative Mutual Funds.***

NASD Rule 3010 and FINRA Rule 3110 set forth FINRA members’ supervisory obligations. Subsection (a) requires that each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD and FINRA Rules.<sup>4</sup> Subsection (b) requires that each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable NASD and FINRA Rules. Violations of FINRA Rule 3110 also constitute violations of FINRA Rule 2010.

FINRA Rule 2111 requires:

a member or associated person to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the member’s or associated person’s familiarity with the security or investment strategy. A member’s or associated person’s reasonable diligence must provide the member or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.<sup>5</sup>

Triad’s supervision of its representatives’ recommendations of alternative mutual funds was not reasonable in several respects.

***First***, during the relevant time period, the firm had no system or procedures to determine whether a new mutual fund constituted a “complex product” or was an alternative mutual fund before Firm representatives sold it, such that heightened due diligence of the product may be appropriate. Rather, in reviewing and approving new funds before Firm representatives sold them, including alternative mutual funds, the firm

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<sup>4</sup> FINRA Rule 3110 superseded NASD Rule 3010 effective December 1, 2014.

<sup>5</sup> FINRA Rule 2111.05(a) (Supplementary Material to Rule 2111).

subjected them to the same standards as traditional mutual funds, which did not evaluate the potential risks and rewards associated with the strategy of the funds. Further, the firm did not conduct any due diligence of mutual funds added to its platform by its clearing firm.

*Second*, the firm did not provide reasonable guidance or training to representatives regarding the risks and features of alternative mutual funds and did not have written supervisory procedures advising firm principals how to supervise recommendations of alternative mutual funds.

*Third*, the firm utilized an electronic trade review system to assist with the supervision of the trading activity of the firm's financial professionals. Triad personnel would utilize the electronic system, including regularly providing manual inputs into the system to help Triad flag investments for supervisory review. The firm, however, failed to consider whether the rules of the review system pertaining to traditional mutual funds were reasonable for use in reviewing alternative mutual funds that utilize a more complex strategy, such as LJM, or whether it may be necessary to tailor the tool's parameters to address particular risks and characteristics of alternative mutual funds, including LJM. As a result, Triad's LJM transactions were generally not identified for additional suitability review.

LJM first appeared on Triad's trading platform in September 2016, when the Firm's clearing firm added the mutual fund. Before it was added to the firm's trading platform, Triad conducted no review of LJM or its investment and trading strategy. The firm did not impose any limitations on the sale of LJM. Triad's first sale of LJM occurred on September 12, 2016, and the last occurred on February 1, 2018. During that time, one Triad representative sold approximately \$1,676,500 of LJMAX shares to thirty-seven customers.

On February 5, 2018, the S&P 500 fell 113 points (around 4.1%), which contributed to an unprecedented increase in market volatility, as measured by the CBOE Volatility Index (VIX). On February 5, 2018, the VIX more than doubled from 17 to 37, which at that time was the largest one day rise in its history. As a result of the market's increased volatility, the prices of the short option positions sold by LJM increased dramatically. On February 5 and 6, 2018, LJM lost about 80% of its value. On February 7, LJM announced that it was closing itself to new investors, and on March 29, 2018, LJM was liquidated and dissolved. Investors who held shares as of February 6, 2018, lost approximately 80% of their investment.

Based on the above, Respondent violated FINRA Rules 3110 and 2010.

***Triad Failed to Obtain and Record Private Placement Customers' Account Information in the Firm's Books and Records.***

SEC Rule 17a-3(a)(17) requires that broker-dealers maintain "an account record including the customer's or owner's name, tax identification number, address, telephone

number, date of birth, employment status (including occupation and whether the customer is an associated person of a member, broker, or dealer), annual income, net worth (excluding value of primary residence), and the account's investment objectives" for each account. FINRA Rule 4511 requires members to make and preserve books and records as required under the FINRA rules, the Exchange Act, and the applicable Exchange Act rules.

Between March 27, 2014 and January 1, 2019, Triad's supervisory procedures required OSJ Branch offices to submit copies of new account forms and sponsor specific documentation for direct fund and alternative investments to Triad's home office to ensure that representatives opened a Triad client account and obtained new account forms with customer suitability information for all direct fund and alternative investment purchases. The firm allowed one OSJ branch to offer the LJM Private Offerings. The firm failed to enforce its procedures by ensuring that the OSJ branch office provided new account forms and sponsor specific documentation to the home office. The Triad home office did not verify that representatives obtained required customer information prior to their investment in the LJM Private Offerings. In January 2019, Triad implemented an additional feature to its systems requiring branch offices to provide to the home office all such documentation for investments prior to receiving commission payments on the investments.

Based on the above, Respondent violated SEC Rule 17a-3, as well as FINRA Rules 4511, 3110 and 2010, and NASD Rule 3010.

B. Respondent also consents to the imposition of the following sanctions:

- a censure;
- a certification signed by an officer and registered principal of the firm that, as of the date of the certification, Triad has established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues, as described below;
- a \$195,000 fine; and
- restitution of \$510,256.57, plus interest as described below.

Respondent agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable.

Respondent has submitted an Election of Payment form showing the method by which it proposes to pay the fine imposed. Respondent specifically and voluntarily waives any right to claim an inability to pay, now or at any time after the execution of this AWC, the monetary sanction imposed in this matter.

Within 90 days of Notice of Acceptance of this AWC, Triad shall certify to FINRA in a submission signed by an officer and registered principal of the firm that, as of the date of

the certification, Triad has established and implemented policies, procedures, and internal controls reasonably designed to address and remediate the issues identified in this AWC. The certification shall be addressed to Seema Chawla, Senior Counsel, 120 W. 12<sup>th</sup> Street, Ste. 800, Kansas City, Missouri, 64105. Upon written request showing good cause, FINRA staff may extend the procedural date set forth above. Restitution is ordered to be paid to the customers listed on Attachment A to this AWC in the total amount of \$510,256.57, plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), from March 29, 2018 until November 27, 2018.

A registered principal on behalf of Respondent shall submit satisfactory proof of payment of restitution and prejudgment interest (separately specifying the date and amount of each paid to each customer listed on Attachment A) or of reasonable and documented efforts undertaken to effect restitution. Such proof shall be submitted by email to EnforcementNotice@FINRA.org from a work-related account of the registered principal of Respondent. The email must identify Respondent and the case number and include a copy of the check, money order, or other method of payment. This proof shall be provided by email to EnforcementNotice@FINRA.org no later than 120 days after the date of the notice of acceptance of the AWC.

If for any reason Respondent cannot locate any customer identified in Attachment A after reasonable and documented efforts within 120 days after the date of the notice of acceptance of the AWC, or such additional period agreed to by FINRA in writing, Respondent shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property, or abandoned property fund for the state in which the customer is last known to have resided. Respondent shall provide satisfactory proof of such action to FINRA in the manner described above, within 14 calendar days of forwarding the undistributed restitution and interest to the appropriate state authority.

The imposition of a restitution order or any other monetary sanction in this AWC, and the timing of such ordered payments, does not preclude customers from pursuing their own actions to obtain restitution or other remedies.

Restitution payments to customers shall be preceded or accompanied by a letter, not unacceptable to FINRA, describing the reason for the payment and the fact that the payment is being made pursuant to a settlement with FINRA and as a term of this AWC.

The sanctions imposed in this AWC shall be effective on a date set by FINRA.

## II.

### **WAIVER OF PROCEDURAL RIGHTS**

Respondent specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

- A. To have a complaint issued specifying the allegations against it;

- B. To be notified of the complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made, and to have a written decision issued; and
- D. To appeal any such decision to the National Adjudicatory Council (NAC) and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the Chief Legal Officer, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

### **III.**

#### **OTHER MATTERS**

Respondent understands that:

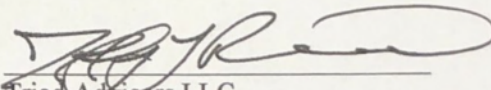
- A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA), pursuant to FINRA Rule 9216;
- B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and
- C. If accepted:
  - 1. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future action brought by FINRA or any other regulator against Respondent;
  - 2. this AWC will be made available through FINRA's public disclosure program in accordance with FINRA Rule 8313;
  - 3. FINRA may make a public announcement concerning this agreement and its subject matter in accordance with FINRA Rule 8313; and



4. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Respondent may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which FINRA is not a party.
- D. Respondent may attach a corrective action statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this statement. This statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA.

The undersigned, on behalf of Respondent, certifies that a person duly authorized to act on Respondent's behalf has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it; that Respondent has agreed to the AWC's provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth in this AWC and the prospect of avoiding the issuance of a complaint, has been made to induce Respondent to submit this AWC.

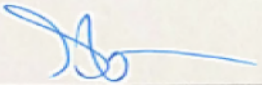
12/06/2021  
Date

  
Triad Advisors LLC  
Respondent

Print Name: Jeffrey L. Rosenthal

Title: President & CEO

Reviewed by:


  
Scott N. Sherman  
Counsel for Respondent  
Nelson Mullins  
Atlantic Station, Suite 1700  
201 17<sup>th</sup> Street NW  
Atlanta, GA 30363

Accepted by FINRA:

Signed on behalf of the  
Director of ODA, by delegated authority

December 29, 2021

Date



Seema Chawla  
Senior Counsel  
FINRA Department of Enforcement  
120 W. 12<sup>th</sup> St., Ste. 800  
Kansas City, Missouri, 64105