STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION

IN THE MATTER OF DETERMINING Whether there has been a violation of the Securities Act of Washington by: Michael Fahsholtz; Stifel, Nicolaus & Co., Inc.; Respondents.	Order No. S-19-2660-23-CO01 CONSENT ORDER

INTRODUCTION

Pursuant to the Securities Act of Washington, RCW 21.20, the Securities Division and Respondents Michael Fahsholtz (CRD #2057306) and Stifel, Nicolaus & Co., Inc. (CRD #793) (collectively, "the Respondents") do hereby enter into this Consent Order in settlement of the matters alleged herein. The Respondents neither admit nor deny the Findings of Fact and Conclusions of Law as stated below.

FINDINGS OF FACT

Respondents

1. Michael Fahsholtz ("Fahsholtz") is a resident of Indian Wells, California. Fahsholtz is a former registered securities salesperson and investment adviser representative with the Wenatchee branch of Stifel, Nicolaus & Company, Inc., and resided in Washington at all times relevant to this action. He is not currently registered in the securities industry. Fahsholtz's Central Registration Depository ("CRD") number is 2057306.

2. Stifel, Nicolaus & Company, Inc. ("Stifel") is a registered broker-dealer. Stifel's CRD number is 793.

Nature of the Conduct

Overview

3. From approximately 2012 to 2019, Fahsholtz, while operating as a securities salesperson, sold large amounts of risky high-yield corporate bonds (popularly known as “junk bonds”) to a substantial majority of his customers, including numerous customers with conservative or moderate-conservative risk tolerances. In many cases, Fahsholtz’s sales resulted in his customers’ portfolios being heavily concentrated in these risky bonds, regularly exceeding Stifel’s recommended concentration limits for such bonds. These sales were unsuitable for many of Fahsholtz’s customers because high-yield bonds require the customers to take on significant risk of loss, in a manner which was inconsistent with their stated risk tolerances. At least four of the high-yield bonds sold by Fahsholtz have defaulted on payments, resulting in many of Fahsholtz’s customers (often elderly) incurring losses in their investment portfolios. Stifel has received at least seven reported complaints from Fahsholtz’s customers or former customers related to his high-yield bond sales, five of which resulted in arbitration claims filed with the Financial Industry Regulatory Authority. In total, Stifel has paid $296,000 to settle these claims.

4. Stifel failed to adequately supervise Fahsholtz by (a) failing to timely review many of Fahsholtz’s high-yield bond sales; (b) failing to take into account (or require Fahsholtz to document) how the trades were consistent with the customer’s investment objectives, risk tolerance, and age, as required by Stifel’s manual; and (c) failing either to note discrepancies between Fahsholtz’s justification for the trades and the customer’s documented holdings, or to require Fahsholtz to provide information sufficient for Stifel to meaningfully evaluate the trades.

Background

5. Suitability is a concept involving whether a given investment or mix of investments is appropriate for a particular investor. In order to comply with suitability obligations, financial professionals must generally (a) collect certain information about clients or customers such as their financial status, tax status, and investment objectives; and (b) have reasonable grounds to believe their investment

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recommendations are suitable based on that information. For instance, a portfolio of risky stocks might be suitable for a young investor who wants high returns and expects to have time to make up any losses, but that same portfolio might be unsuitable for an investor approaching retirement who would not have time to make up losses, even if the stocks would be expected to perform better on average than a more conservative portfolio.

6. High-yield bonds are corporate bonds issued by companies given poor credit ratings by firms such as Moody's or Standard and Poor's. Generally, these bonds carry a higher risk of default than better-graded bonds, but also pay higher interest rates to compensate for the increased default risk. Corporate bonds above a certain credit rating are generally referred to as "investment-grade," while bonds below that rating are commonly referred to as "high-yield," "speculative," or "junk." During the period of most of Fahsholtz's high-yield bond sales, Stifel's manual for its registered representatives stated that "[s]ince high yield debt securities generally involve a higher degree of risk, it is important that the [financial adviser] recommend such securities only to customers willing to risk loss of principal."

7. Convertible notes are an asset class which combine characteristics of bonds and stocks. Generally, convertible notes offer periodic interest payments like bonds, but have the potential to convert to equity in the lending company under certain circumstances. Because of the ability to convert to equity, convertible notes generally pay slightly lower interest rates than traditional bonds offered by the same company, even if they are similarly risky.

Fahsholtz's Sales

8. K.D. and R.D. are a married couple who were customers of Fahsholtz from approximately 2010 to 2020. K.D. and R.D. had two accounts at Stifel, an IRA in K.D.'s name and a joint account in both K.D. and R.D.'s names. The account statements for both accounts list K.D. and R.D.'s investment objectives as "Growth & Income" and their risk tolerance as "Moderate." In an interview with the Securities Division,

K.D. stated that they told Fahsholtz at their first meeting that they were "old, retired, and conservative," and that their objective for their retirement accounts was to be able to live on the funds as needed in their retirement." K.D. and R.D. invested a substantial majority of their retirement portfolio with Fahsholtz, and Fahsholtz sold K.D. and R.D. extremely high concentrations of high-yield bonds. For instance, at the end of March 2018, approximately 73.8% of K.D.'s IRA account value, and 60.2% of K.D. and R.D.'s joint account, was invested in high-yield bonds. At the beginning of 2018, K.D. and R.D.'s accounts were worth a combined total of about $432,000. The combined realized and unrealized losses on high-yield bonds in K.D. and R.D.'s accounts totaled just under $165,000—about 38% of the total value of the accounts at the beginning of 2018.

9. L.Z. is an 80-year-old Washington resident and was a customer of Fahsholtz for approximately 25 years. L.Z.'s Stifel IRA account statements list his investment objective as "Growth and Income" and his risk tolerance as "Moderate." L.Z. represented to Stifel that he would accept lower returns to preserve his investment principal as an inheritance for his children. L.Z. also stated to the Securities Division that Fahsholtz did not explain the credit rating of the bond when contacting L.Z. about particular investments, and that he would not have invested in these bonds if Fahsholtz had adequately explained that L.Z. could lose a substantial portion (or all) of his investment. As with his other customers, Fahsholtz recommended and sold to L.Z. extremely high concentrations of high-yield bonds. For instance, at the end of April 2018, approximately 62.8% of L.Z.'s IRA account value was in high-yield bonds. At the beginning of 2018, L.Z.'s IRA was worth approximately $525,000. The combined realized and unrealized losses on high-yield bonds in L.Z's IRA account totaled over $60,000, about 11.5% of the value of the account at the beginning of 2018.

10. G.H. is an 84-year-old Washington resident and was a customer of Fahsholtz for approximately 20 years. G.H. had two accounts at Stifel, an IRA and a standard brokerage account; the statements for both accounts list his investment objective as "Growth and Income" and his risk tolerance as "Moderate." In an interview with the Securities Division, G.H. stated that he told Fahsholtz at their initial meeting, when they

began working together at one of Fahsholtz's previous employers approximately twenty years earlier, that he wanted safe income, was not looking to make a lot of money, and had little or no risk tolerance for losses in his accounts. After several years at Stifel, Fahsholtz began recommending that G.H. invest in high-yield bonds; G.H. stated that Fahsholtz only discussed the interest rates and maturity dates of the bonds and downplayed or did not discuss the risk of the bonds. As with the customers described above, Fahsholtz recommended and sold to G.H. extremely high concentrations of high-yield bonds. For instance, at the end of March 2018, approximately 62.7% of G.H.'s IRA account value, and 67.0% of his standard brokerage account value, was invested in high-yield bonds. At the beginning of 2018, G.H.'s investment accounts were worth a combined total of approximately $678,000. The combined realized and unrealized losses on high-yield bonds in G.H.'s accounts totaled over $185,000, about 27.3% of the value of the accounts at the beginning of 2018.

11. J.M. and K.M. are a married couple who were customers of Fahsholtz for approximately five years. They held two accounts at Stifel, an IRA for J.M. and a joint brokerage account for both J.M. and K.M. The statements for J.M.'s IRA account lists her investment objective as "Growth & Income" and her risk tolerance as "Moderate"; the joint account statements list their investment objective as "Growth & Income" and their risk tolerance as "Moderate Growth." In an interview with the Securities Division, J.M. stated that they communicated to Fahsholtz that they are "medium risk" investors, and that Fahsholtz did not tell them that any of the investments he was purchasing were high-risk. Fahsholtz recommended and sold extraordinarily high concentrations of high-yield bonds to J.M. and K.M. For instance, at the end of March 2018, approximately 60.6% of J.M.'s IRA account value, and 91.2% of J.M. and K.M.'s joint brokerage account value, was invested in high-yield bonds. At the beginning of 2018, J.M. and K.M.'s accounts were worth a combined total of approximately $228,000. The combined realized and unrealized losses on high-yield bonds in J.M. and K.M.'s accounts totaled over $36,000, about 16% of the value of the accounts at the beginning of 2018.

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Inadequate Supervision by Stifel

12. From the beginning of Fahsholtz's employment with Stifel until January 2016, Stifel's manual for its registrants stated that "[s]ince high yield debt securities generally involve a higher degree of risk, it is important that the FA recommend such securities only to customers willing to risk loss of principal. Branch Mangers [*sic*] reviewing daily transactions should consider the suitability of recommended purchases of high yield debt securities in relation to the customer's investment objectives, risk tolerance, age, and other investments."

13. To assist with legal compliance, Stifel has a monitoring system in place to flag trades which meet certain criteria specified by the firm. From the beginning of Fahsholtz's employment with Stifel until September 2017, one such flag would be generated when a trade put a customer's account value over 75% in high-yield bonds. Stifel's system did not distinguish between different account risk tolerances during this time; the threshold was 75% regardless of whether the customer's stated risk tolerance for the account was conservative or aggressive. In September 2017, under its own initiative, Stifel updated its policies to set the threshold for flags to 25% for conservative or moderately conservative accounts, 50% for moderate accounts, 60% for moderate growth accounts, and 75% for moderately aggressive or aggressive accounts.

14. From approximately the beginning of 2016 until May 2018, Stifel failed to adequately supervise or monitor Fahsholtz's recommendations in several ways. First, for many of the trades placed by Fahsholtz, including multiple trades for at least one of the customers described above, Stifel's Wenatchee branch manager failed to review the trades until days or weeks later. In some instances, the Wenatchee branch manager took over a month to review Fahsholtz's trades, including at least one purchase of high-yield bonds for a customer described above. Stifel's goal during this period was that branch managers would review alerts daily, although the minimum standard was that anti-money laundering alerts should be reviewed within 15 days and most other types of alerts within 30 days. After a mid-2016 branch audit, Stifel staff flagged

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Fahsholtz's branch manager's late reviews of alerts as an issue and instructed her to set up calendar reminders to ensure that all reviews were timely completed. The branch manager failed to correct this issue over the subsequent two years, with Stifel staff flagging her late reviews as a "Repeat Finding" during both their 2017 and 2018 branch audits. Stifel did not discipline the branch manager in connection with these findings.

15. Second, Stifel's Wenatchee branch manager regularly accepted trade justifications from Fahsholtz that discussed the customer's outside assets, but failed to adequately explain why the trade was consistent with the customer's investment objectives, risk tolerance, and age, as required by Stifel's manual. For example, for several high-yield bond purchases in April 2017, Fahsholtz justified the trade by stating that "Client has $4,500 per month union pension and currently still working. Client is diversified with 3 separate properties as well." According to that customer's contemporaneous account statements, their investment objective was "Growth & Income," and their risk tolerance was "Moderate Growth," both of which are generally consistent with medium-risk investments and diversification rather than heavy concentration in high-yield bonds. Fahsholtz failed to provide any justification for why the trade was consistent with the customer's stated investment objectives or risk tolerance, and the Wenatchee branch manager did not document any further justification for the trade or ask Fahsholtz to update the account information to indicate that the customer was willing to accept higher levels of risk. Stifel management also did not review these transactions until over a month later. Stifel cautioned the Wenatchee branch manager about the issue of inadequate documentation during a 2017 branch audit, indicating that her "notes for ProSurv Trade Alerts, Account Daily Alerts and AML alerts did not evidence sufficient documentation of the review," and explained that branch managers' "documentation should give a third party the ability to understand what action was taken or why no action was taken, based on the alert." As with the findings on timeliness of reviews, Stifel did not discipline the Wenatchee branch manager on the issue of inadequate documentation.

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16. Third, in accepting Fahsholtz's justifications based on customers' outside assets, Stifel management failed to spot discrepancies in the customers' account paperwork, and further failed to require Fahsholtz to document those outside assets in a way that was sufficient to enable a meaningful evaluation of the customer's portfolio or the trade at issue. For instance, in the April 2017 high-yield bond purchases described in the preceding paragraph, Fahsholtz's statements that "Client is diversified with 3 separate properties" was inconsistent with the customer's account opening forms and Stifel's other paperwork. That client's account opening forms, from November 2014, have a category for the customer's "Other Investments," with the "None" box checked. Stifel's account statements also include a category for "Net Portfolio Assets not held at Stifel," which does not reflect any such properties. Stifel's Wenatchee branch manager did not note this discrepancy, and she did not ask Fahsholtz to further document the customer's outside holdings in a way sufficient to enable a meaningful evaluation of how the high-yield bonds would fit with their overall portfolio (for instance, the current value of the properties, whether they were commercial or residential properties, or whether they were subject to a mortgage). Stifel took no disciplinary action against the Wenatchee branch manager for these oversights and did not require her to more thoroughly document her supervisees' trades.

Based upon the above Findings of Fact, the following Conclusions of Law are made:

CONCLUSIONS OF LAW

1. Michael Fahsholtz's sale of the high-yield bonds described above constituted the offer and/or sale of a security as defined in RCW 21.20.005(14) and (17).

2. Michael Fahsholtz has violated RCW 21.20.702, because, as set forth in the Tentative Findings of Fact, he recommended high concentrations of high-yield bonds to customers without reasonable grounds for believing that such recommendations were suitable.

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3. Michael Fahsholtz engaged in a dishonest and unethical practice, as defined in WAC 460-22B-090(7), by recommending high-yield bond purchases without reasonable grounds to believe that such purchases were suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs. Such practice is grounds for the imposition of a fine and the denial of any future registrations with the Department, pursuant to RCW 21.20.110(1).

4. Stifel, Nicolaus & Company, Inc. has failed to reasonably supervise Michael Fahsholtz's sale of high-yield bonds, as set forth in RCW 21.20.110(1)(j). Such failure is grounds for the imposition of a fine, pursuant to RCW 21.20.110(1).

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

CONSENT ORDER

IT IS AGREED AND ORDERED that Respondent Michael Fahsholtz, and his agents and employees, shall cease and desist from violating RCW 21.20.702.

IT IS AGREED AND ORDERED that the Securities Administrator shall deny any applications for registration by Michael Fahsholtz as a securities salesperson, investment adviser representative, broker-dealer, or investment adviser for a period of one year from the date of entry of this order.

IT IS AGREED AND ORDERED that Respondent Michael Fahsholtz shall be liable for and pay a fine in the amount of $10,000, payable as follows: $2,500 on or before the entry of this Consent Order; $2,500 within 90 days of the entry of this Consent Order; $2,500 within 180 days of the entry of this Consent Order; and $2,500 within 270 days of the entry of this Consent Order.

IT IS AGREED AND ORDERED that Respondent Stifel, Nicolaus & Co., Inc. shall be liable for and shall pay a fine in the amount of $10,000.

IT IS AGREED AND ORDERED that Respondent Stifel, Nicolaus & Co., Inc. shall be liable for and shall pay investigative costs of $20,000.

IT IS AGREED that this Consent Order is not intended to form the basis for any Respondent's disqualification from registration as a broker-dealer, securities salesperson, investment adviser, investment adviser representative, or issuer under the laws, rules, and regulations of Washington or any other jurisdiction or self-regulatory organization, or to disqualify any Respondent from relying upon the securities registration exemptions or safe harbor provisions for which the Respondent or any of their affiliates may qualify under the laws, rules and regulations of Washington or any other jurisdiction or self-regulatory organization.

IT IS AGREED that Respondents Michael Fahsholtz and Stifel, Nicolaus & Co., Inc., enter into this Consent Order freely and voluntarily and with a full understanding of its terms and significance.

IT IS AGREED that the Securities Division has jurisdiction to enter this order.

IT IS AGREED that in consideration of the foregoing, the Respondents waive their right to a hearing and to judicial review of this matter pursuant to Chapter 34.05 RCW.

WILLFUL VIOLATION OF THIS ORDER IS A CRIMINAL OFFENSE.

Signed this __13th___ day of __May__, 2024.

Signed by:
Stifel, Nicolaus & Co., Inc.

____/s/__________________________
Joseph Rosa
Deputy General Counsel

Signed by:

__/s__________________________
Michael Fahsholtz, Individually

Approved as to form by:

____/s/_________________________________
Kendra Canape, Attorney for Respondents

SIGNED and ENTERED this 21st day of May, 2024.

______/s/_____________________________
William M. Beatty
Securities Administrator

Approved by:

____/s/___________________________
Brian J. Guerard
Chief of Enforcement

Presented by:

__/s________________________________
Adam N. Yeaton
Financial Legal Examiner

Reviewed by:

____/s/____________________________
Holly Mack-Kretzler
Financial Legal Examiner Supervisor

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