

TRAVIS J. ILES  
SECURITIES COMMISSIONER



CRISTI RAMÓN OCHOA  
DEPUTY SECURITIES COMMISSIONER

Mail: P.O. BOX 13167  
AUSTIN, TEXAS 78711-3167

Phone: (512) 305-8300  
Facsimile: (512) 305-8310

## *Texas State Securities Board*

208 E. 10th Street, 5th Floor  
Austin, Texas 78701-2407  
www.ssb.texas.gov

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IN THE MATTER OF THE INVESTMENT      §  
ADVISER REGISTRATION OF FQI            §  
CAPITAL MANAGEMENT, LLC               §

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**Order No. IC-24-CAF-03**

TO: Derek Atkinson, Managing Member and Owner  
FQI Capital Management, LLC (CRD No. 298931)  
8317 Victoria Lane, Suite 1725  
Lantana, TX 76226

### **DISCIPLINARY ORDER**

Be it remembered that FQI Capital Management, LLC (“Respondent”) appeared before the Securities Commissioner of the State of Texas (“Securities Commissioner”) and consented to the entry of this order (“Order”), the Undertaking incorporated by reference herein, and the Findings of Fact and Conclusions of Law contained herein. This Order is entered into solely for the purpose of resolving the investigation and is not intended to be used for any other purpose.

### **FINDINGS OF FACT**

1. Respondent has waived (a) Respondent’s right to notice and hearing in this matter; (b) Respondent’s right to appear and present evidence in this matter; (c) Respondent’s right to appeal this Order; and (d) all other procedural rights granted to the Respondent by The Securities Act, Tex. Gov’t Code §§ 4001.001-4008.105 (“Texas Securities Act”), and the Administrative Procedure Act, Tex. Gov’t Code Ann. §§ 2001.001-2001.903.
2. On December 4, 2018, Respondent registered with the Securities Commissioner as an investment adviser. This registration is currently effective.
3. In or around August 23, 2023, the staff of the Texas State Securities Board (the “Staff”) initiated an inspection of Respondent (the “Inspection”) pursuant to Section 4007.052(a) of the Texas Securities Act.

**An investment adviser representative of Respondent implemented a high-risk strategy intended for sophisticated investors in certain client accounts.**

4. Beginning in or around May 2020 through November 2022 (the “Relevant Period”), an investment adviser representative (“IAR”) of Respondent implemented a trading strategy (the “Strategy”) across a number of his clients’ accounts.
5. Generally, the Strategy consisted of purchasing certain target exchange-traded funds (“ETFs”); leveraged or inverse ETFs; and single stocks in the S&P 500, NASDAQ, Russell 2000, biotechnology, energy, micro-cap, and small-cap sectors.
6. More specifically, the ETFs and leveraged and inverse ETFs in the Strategy included ones where the fund’s sector was oversold by some metric. The Strategy also included buying and holding ETFs with sectors where the companies within that sector appeared undervalued.
7. The products the IAR utilized to implement his Strategy hold high levels of risk and volatility and are intended for sophisticated investors who can understand the risks associated with the products and who are willing to accept that level of risk.
8. Complex products such as inverse or leveraged exchange-traded products that are designed primarily as short-term trading tools for sophisticated investors may not be in the best interest of a retail client absent an identified, short-term, client-specific trading objective and, to the extent that such products are in the best interest of a retail client initially, they would require daily monitoring by the adviser.<sup>1</sup>
9. Leveraged and inverse ETFs have extra risks for buy-and-hold investors because they reset daily and their performance over longer periods of time can differ significantly from the stated multiple or inverse of the performance of their underlying index or benchmark during the same period of time, magnifying its effect in volatile markets.<sup>2</sup>
10. One such security the IAR utilized in his Strategy was VXX—an exchange traded note (“ETN”) designed to provide investors with exposure to equity market volatility that is linked to the daily price changes in CBOE Volatility Index.
11. Composed of derivative contracts,<sup>3</sup> VXX can be influenced by many unpredictable factors and the price can fluctuate substantially between now and the maturity date.
12. Another security the IAR utilized in his Strategy was UVXY, a leveraged ETF with an objective of seeking returns that are one-and-a-half times (1.5x) the return of its underlying benchmark, the S&P 500 VIX Short-Term Futures Index.

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<sup>1</sup> Commission Interpretation Regarding Standard of Conduct for Investment Advisers (sec.gov)

<sup>2</sup> SEC.gov | Updated Investor Bulletin: Leveraged and Inverse ETFs

<sup>3</sup> Derivative contracts’ value derive from the performance of underlying market factors such as interest rates, currency exchange rates, and commodity, credit, and equity prices.

13. Both the prospectuses for VXX and UVXY state that investing in the note/fund involves significant risks not applicable to other types of investments and that the note/fund may be highly volatile and warns investors that they could lose the full principal value of their investment within a single day.
14. As stated previously, the IAR's Strategy also utilized single stock purchases in the S&P 500, NASDAQ, Russell 2000, biotechnology, energy, micro-cap; and small-cap sectors.
15. When an adviser is assessing whether high risk products—such as penny stocks or other thinly-traded securities—are in a retail client's best interest, the adviser should generally apply heightened scrutiny to whether such investments fall within the retail client's risk tolerance and objectives<sup>4</sup>.
16. And while all investments involve risk, microcap stocks are among the most risky.<sup>5</sup>

**Respondent permitted the utilization of the high-risk Strategy for certain client accounts in which the Strategy was not suitable.**

17. Respondent's WSPs state that it will reasonably supervise the activities of its IARs, including that it will respond appropriately, and in a timely manner, to any actual or suspected wrongdoing, undisclosed conflicts of interest, ineffective internal controls, or other compliance risks.
18. And Respondent's WSPs state that it is their policy to obtain and maintain sufficient information regarding the client's financial circumstances to help determine whether particular advice and/or services are suitable.
19. Further, the WSPs state that each IAR, prior to rendering investment advice to a client, must ensure that their advice is suitable and consistent with that client's most current suitability information.
20. Respondent permitted the IAR to utilize the Strategy described above for in or around twenty-two (22) client accounts that had conservative and moderately conservative risk tolerances.
21. On Respondent's Suitability Information Form, a risk tolerance of "conservative" was defined in part as "to minimize the chance for loss, willing to accept the lower long-term returns provided by conservative investments" and a risk tolerance of "moderately conservative" as "able to accept infrequent and very modest losses during difficult phases in a market cycle."
22. As an example, in or around April 17, 2020, one individual ("Client A") opened two (2) accounts with Respondent, for a total of \$331,463.09 across both accounts.

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<sup>4</sup> Commission Interpretation Regarding Standard of Conduct for Investment Advisers (sec.gov)

<sup>5</sup> SEC.gov | Investor Bulletin: Microcap Stock Basics (Part 3 of 3: Risk)

Respondent contends that IAR represented to Respondent that he would utilize the Strategy conservatively, such as a hedge to reduce risk.

23. When she opened these accounts, she executed an Investment Management Agreement (“IMA”). She concurrently executed ‘Exhibit A’ to the IMA, titled “Investment Guidelines,” which described the Strategy.
24. Client A was 57 years old and unemployed at the time she opened her account with Respondent.
25. Client A had a moderately conservative risk tolerance, a time horizon of more than seven (7) years, an annual income between \$50,000 and \$99,000, and a net worth and liquid net worth between \$250,000 and \$499,999.
26. Notably, prior to opening an account with Respondent, Client A’s only investment experience included over five years of investing in bank savings, CDs, money market funds, and mutual funds—all traditionally very conservative investments.
27. Shortly after Client A opened her account, Respondent’s IAR started trading in Client A’s account using the Strategy.
28. At the end of March 2022, Client A requested that Respondent’s IAR stop using the Strategy in her accounts and that all positions in her account be sold and liquidated to cash.
29. By this point, Client A had lost approximately half her account (\$156,013.86) while utilizing the Strategy—more than the “infrequent and very modest losses” she had planned on as a moderately conservative investor.
30. In another example, on or around April 29, 2020, another individual (“Client B”) opened an account with Respondent totaling \$115,705.52. Client B also executed an IMA, which included the “Investment Guidelines” exhibit that described the Strategy.
31. Client B was a retired 91-year-old at the time she opened her account with Respondent.
32. Client B had a moderately conservative risk tolerance, a time horizon of four (4) to seven (7) years, an annual income between \$20,000 and \$49,999, and net worth and liquid net worth between \$100,000 and \$249,999.
33. Client B also had more than five (5) years of experience investing in bank savings, CDs, money market funds, stocks, bonds, and mutual funds, and less than five (5) years of experience investing in options and futures.
34. Client B closed her account in May 2022—at which point Client B had lost approximately almost half of her account (\$56,066.24) while utilizing the Strategy.
35. And as another example, also on or around April 29, 2020, two individuals (“Clients C”) opened four (4) separate accounts with Respondent and two (2) joint accounts

for a total of \$281,917.64. Clients C also executed an IMA, which included the “Investment Guidelines” exhibit that described the Strategy.

36. Clients C were both 69 years old and retired at the time they opened their accounts with Respondent.
37. Clients C had a conservative risk tolerance, a time horizon of more than seven (7) years, an annual income between \$50,000 and \$99,999, a net worth between \$250,000 and \$499,999, and a liquid net worth between \$100,000 and \$249,999.
38. Clients C also had more than five (5) years of experience investing in bank savings, CDs, money market funds, stocks, bonds, mutual funds, and variable annuities, and less than five (5) years of experience investing in options and futures.
39. While Respondent’s IAR did not implement the Strategy in one (1) of the joint accounts, he did implement it for the other five (5) accounts of Clients C.
40. Ultimately, Clients C lost approximately a fourth of their account (\$63,375.82) while utilizing the Strategy—more than the minimal losses they had planned for as conservative investors.
41. In January 2022, Respondent began implementing trading restrictions on IAR’s client accounts, including:
  - a. prohibiting holding leveraged securities in client accounts who are not qualified and accredited;
  - b. prohibiting from holding options in accounts with net liquidation value below \$50,000;
  - c. prohibiting pattern day trading in accounts below \$50,000; and
  - d. prohibiting positions over 10% of the unleveraged account value without written authorization signed by client.
42. During Respondent’s 2021 annual compliance review (“2021 Review”) conducted in or around March 2022, Respondent noted that, because of the IAR’s Strategy performance, he would be required to move actively managed accounts, including Clients A, B, and C’s accounts, where they could be monitored by Respondent on a daily basis.
43. Additionally, during the 2021 Review, Respondent prohibited the purchase of VXX, UVXY, and all VIX related products for all client accounts and restricted the purchase of 3x leveraged products to only qualified and accredited accounts.
44. These trading restrictions were formalized in writing and provided to all of Respondent’s IARs in or around April 2022.

45. And in or around November 2022, the IAR's actively managed accounts were involuntarily moved by Respondent and required approval prior to the IAR executing trade orders which was formalized in writing by a revised agreement executed on April 27, 2023.

46. Despite Respondent's efforts to supervise and impose trading restrictions on the IAR during and after the Relevant Period, clients suffered losses.

**Respondent failed to enforce its own firm-imposed requirement, permitting the utilization of the Strategy for client accounts in which Respondent did not have a record of a completed Risk Disclosure Form.**

47. Respondent required all its clients to complete certain client investment forms in connection with opening an account. For example, all clients were required to execute the aforementioned IMAs.

48. And Respondent required clients investing in high-risk positions or portfolio management techniques to complete additional forms.

49. One such disclosure document, the Risk Disclosure Form, is required if a client opts to invest in high-risk positions or portfolio management techniques such as: the use of high leverage, portfolio margin, concentrated positions, and investing in higher volatility positions/instruments including options and futures.

50. The Risk Disclosure Form required a client to add his or her initials acknowledging certain high-risk positions or portfolio management techniques listed on the form that the client was willing to tolerate in his or her account.

51. And finally, the form asked the client to acknowledge those positions and/or techniques as risky.

52. Specifically, the Risk Disclosure Form stated, "in certain instances, the Client agrees to allow the Adviser to maintain or utilize certain high risk positions or portfolio management techniques which would not generally be advisable for an average investor ..." and "the Client makes certain acknowledgements set forth below in connection with the Client's agreement to maintain or utilize certain high risk positions or portfolio management techniques that can lead to extreme loss or volatility in the Client's Account(s)."

53. Another form, the Suitability Information Form, which recorded a client's financial profile information, included a section for a client to 'check' boxes indicating understanding and acknowledgement of the Risk Disclosure Form; that the management style keeps with the client's risk tolerance, goals and objectives; and that the client is not relying on any representations not set forth in the investment management agreement and Risk Disclosure form ("Disclosure Information Section").

54. In other words, the disclosure information section of the Suitability Information Form confirmed the clients' understanding and acknowledgement of the Risk Disclosure Form. The two forms went hand in hand.
55. Notably, certain clients who did not have a Risk Disclosure Form on record still checked the boxes of the disclosure information section on the Suitability Information Form.
56. And Respondent permitted the utilization of the Strategy described above for these client accounts in which Respondent did not have a record of a completed Risk Disclosure Form.
57. More specifically, the Staff reviewed records for sixteen (16) clients with conservative or moderately conservative risk tolerances.
58. For thirteen (13) of those clients, including Client A, Respondent did not have a record of a completed Risk Disclosure Form. And all sixteen (16) client accounts were utilizing the Strategy described above.<sup>6</sup>

**Respondent failed to verify inconsistent client information in clients' account opening forms.**

59. The WSPs state that Respondent "will collect suitability information for each client. The information collected will include, minimally, a record listing the client's: (1) birth year; (2) employment status, including occupation; (3) annual income; (4) net worth, excluding the value of the client's primary residence; (5) investment objectives; and (6) risk tolerance."
60. The WSPs further state that at least annually, Respondent will also request that the client notify them if their suitability information has changed.
61. A client's suitability information may be obtained and maintained through the use of various documents such as an IMA, a Suitability Information Form, or a Risk Disclosure Form.
62. Certain clients with conservative and moderately conservative risk tolerances had inconsistent suitability information listed in their account opening forms.
63. For example, on April 29, 2020, Clients B and C completed Suitability Information Forms, indicating the clients as having a moderately conservative and conservative risk tolerance, respectively, but also completed Risk Disclosure Forms on the same day, indicating tolerances to certain high-risk positions and portfolio management techniques that were inconsistent with their individual tolerances but consistent with the tolerances needed to implement the IAR's Strategy.

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<sup>6</sup> All sixteen (16) clients, however, executed an IMA with an "Investment Guidelines" exhibit that described the Strategy.

64. As another example, on April 16, 2020, Client D completed a Suitability Information Form indicating the client as having a moderately conservative risk tolerance, but less than two weeks later, on April 28, 2020, completed a Risk Disclosure Form indicating tolerances that were once again inconsistent with Client D's individual risk tolerances but consistent with the tolerances needed to implement the IAR's Strategy.
65. Shortly after Clients B, C, and D executed the Risk Disclosure Forms and the IMAs, Respondent's IAR traded leveraged and inverse ETFs, including VXX and UVXY, and micro-cap and small-cap stocks in the accounts as part of the Strategy.
66. Notably, on March 21, 2022, Respondent reminded all IARs of the to update the Suitability Information Forms, including requiring them to have all clients that had been with the firm since December 31, 2020, and any others who need to make changes fill out new Suitability Information Forms, as required by the Respondent's WSPs.
67. And in or around September 14, 2022, Respondent audited up to six (6) of the IAR's accounts and again instructed the IAR to move his accounts so they could be actively monitored by Respondent.
68. Further, Respondent instructed him to have these clients complete new Suitability Information Forms and IMAs.
69. The Suitability Information Forms for these clients were not updated upon completion of the Risk Disclosure Form or IMAs according to the procedures regarding updating suitability described above.
70. And despite these inconsistencies, Respondent permitted the utilization of the IAR's Strategy in the aforementioned client accounts.

#### CONCLUSIONS OF LAW

1. Respondent's failure to review clients' suitability information, which resulted in its IAR to utilize the Strategy in client accounts that was not suitable to the risk tolerances reflected on the accounts' Suitability Information Forms was a failure to enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws.
2. Respondent's failure to ensure that its IAR followed Respondent's policy that clients complete Risk Disclosure Forms prior to its IAR using the Strategy for those clients was a failure to enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws.



3. Respondent's failure to verify inconsistent client information on client investment forms were failures to enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws.
4. The aforementioned failures to enforce a supervisory system reasonably designed to achieve compliance with applicable securities laws constitute violations of §116.10 of the Board Rules.
5. Pursuant to Section 4007.106(a)(3) of the Texas Securities Act, the aforementioned violation of the Board Rules constitutes bases for the assessment of an administrative fine against Respondent.

### ORDER

1. It is therefore ORDERED that FQI Capital Management, LLC shall pay an ADMINISTRATIVE FINE in the amount of Twenty-Five Thousand Dollars (\$25,000.00) to the general fund of the State of Texas.
2. It is further ORDERED that FQI Capital Management, LLC COMPLY with the terms of the Undertaking, incorporated by reference herein.

SIGNED AND ENTERED BY THE SECURITIES COMMISSIONER this 19<sup>th</sup> day  
of September, 2024.



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TRAVIS J. ILES  
Securities Commissioner

Respondent:



FQI Capital Management, LLC  
By: Derek Atkinson,  
Managing Member and Owner

**Approved as to Form:**



Cristi Ochoa,  
Deputy Securities Commissioner



D. Lance Currie  
Counsel for Respondent



Nadda Rungruangphol,  
Attorney  
Legal & Investigations Division