BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee for District No. 1, Complainant, vs. Clyde Joseph Bruff Oakland, California, Respondent.	DECISION Complaint No. C01960005 District No. 1 Dated: August 11, 1997

This matter was appealed pursuant to Procedural Rule 9310. After a thorough review of the record and the arguments made on appeal, we find that respondent Clyde Joseph Bruff ("Bruff") violated Article III, Sections 1 and 2 of the NASD's Rules of Fair Practice (now known as and hereinafter referred to as "NASD Conduct Rules 2110 and 2310"). Accordingly, we order that Bruff be censured and barred from association with any member of the NASD in any capacity as of the date of this decision.

Background

Bruff entered the securities industry in 1976 as a general securities representative, and he first became registered as a general securities principal in 1985. In 1991, he became registered through Philip Grant McMichael & Co ("Philip Grant"). In March of 1992, he moved to Portfolio Asset Management ("PAM" or "the Firm"), where most of the conduct at issue occurred.[1] He left PAM in November of 1993, and he currently is registered with Strategic Assets, Inc. as a general securities representative and principal.

[1] The customer purchased the first security listed in Schedule A to the complaint on February 28, 1992, through her account at Philip Grant.

District Business Conduct Committee Proceedings

Complaint. The complaint, filed April 17, 1996 by the District Business Conduct Committee for District No. 1 ("DBCC"), contained one cause. It alleged that between February and September of 1994, Bruff exercised effective control over the account of customer RC and recommended or implicitly recommended to her purchases and sales of securities, as more fully set forth in Schedule A to the complaint, which were unsuitable for her in view of the size and frequency of the transactions and in view of her other security holdings and her financial situation and needs.

The complaint contained a typographical error, in that the allegedly violative conduct occurred between February and September of 1992, not 1994. This error was discussed at the DBCC hearing, and the DBCC found that, since the dates on Schedule A were accurate, Bruff had sufficient notice of the allegations against him. We affirm this ruling.

Answer. Bruff's answer denied that he was RC's broker of record and denied that he recommended purchases and sales of securities to RC.

DBCC Hearing and Decision. A DBCC hearing was held on July 2, 1996. In a decision dated September 30, 1996, the DBCC found that the trading was unsuitable for customer RC and in violation of Conduct Rules 2110 and 2310 by Bruff, as alleged in the complaint. The DBCC ordered that respondent Bruff be censured and barred from associating with any member of the NASD in any capacity.

This appeal followed.

National Business Conduct Committee ("NBCC") Appeal

Although Bruff submitted an appeal brief and attempted to adduce new evidence, the regional attorney did not make any appeal submission. The matter was heard by a subcommittee ("Subcommittee") of the NBCC on April 2, 1997. Bruff and the regional attorney who presented the matter to the DBCC participated in the appeal hearing.

Record Evidence and Findings

We find that Bruff's recommendations to customer RC were unsuitable, as alleged by the complaint.

The Customer. RC, the complaining customer, died in January 1996, prior to the DBCC hearing. Although she was unavailable to testify at the DBCC hearing, she had cooperated with NASD staff during her lifetime. The record contained notations made by an examiner who spoke with her, as well as records relating to an arbitration proceeding she had brought against Bruff. On May 12, 1994, after an arbitration hearing at which Bruff was represented by counsel, the arbitrators awarded RC

$126,419.[2] The record included, among other things, a transcription of r' testimony in the arbitration.[3] In addition, RC's son, Timothy Broderick ("Broderick"), testified about RC's investment experience and level of expertise.

RC was 48 years old, was divorced, and had two adult children when she met Bruff in 1992. She had no classroom or practical experience in the stock market or financial markets.[4] During RC's two marriages, her husbands had handled any family investments. In approximately 1990 or 1991, RC's sister, who then suffered from a terminal illness, gave RC $20,000 to assist RC in retaining her home after her divorce. RC deposited these funds in an account with Charles Schwab & Co, Inc. ("Schwab") on a short-term basis. She testified that she received no investment advice from Schwab and that the funds had been temporarily invested, prior to their investment in her house, in "government bonds. Or government securities, or something, certificates. Federal certificates?"

While RC's children were growing up, she did part-time work. After receiving her bachelor's degree from Hayward State University in 1980, she was employed in various customer service positions. She also was employed for two and one-half years in a shipping company's audit department. Her position involved reconciling bills with shipping manifests. RC first met Bruff at a point in time when she was unemployed, in approximately February of 1991, through the Forty Plus Club, a self-help group for individuals seeking new employment. In June of 1991, she accepted a position at Wells Fargo Bank in the customer service department. Her job was to take incoming calls from customers about credit card problems.

According to her tax returns, RC's adjusted gross income was $26,828 in 1991 and $27,681 in 1992. She received $300 per month in alimony. In 1991, RC owned a home, which she had acquired through her divorce settlement, a 1984 Honda Civic, personal property, and two IRA accounts together worth less than $10,000. She also had outstanding home mortgage loans of approximately $50,000 and approximately $4,000 in credit card debt. She lived with a housemate to minimize her expenses.

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[2] According to the arbitration award, PAM was dismissed from the arbitration because a stay order had been served by the Securities Investor Protection Corporation relating to an action filed against PAM in the United States Bankruptcy Court for the Western District of Texas. Bruff himself declared bankruptcy in 1994.

[3] We find that the hearsay evidence of RC's testimony before the arbitration panel is credible. We note that due to her death, it was impossible for the NASD to seek her participation in the DBCC hearing. We also note that she was subject to cross-examination by Bruff's attorney at the arbitration. We also note that her arbitration testimony was clear, credible, and consistent with documentation in the record, including notations made by an NASD examiner who spoke with her.

[4] She testified that in college, she took one class in business and finance, but it did not involve any study of the financial markets.

Bruff attempted to portray RC as a relatively sophisticated investor who understood his trading strategy for her and authorized every trade. Bruff also described RC as having been willing and able to take the risks associated with the trading in the account. (Bruff argued, for example, that RC had worked as an "auditor" at one point and thus had had the acumen to understand the recommendations he made to her. The record shows, however, that RC's work as an "auditor" consisted of verifying bills against shipping manifests.) Bruff also argued that RC's daughter, who had worked for a securities firm as an index clerk, and RC's boyfriend, who held a Masters in Business Administration degree and was a Certified Public Accountant, both served as sources of investment advice for her.

We find that RC was financially unsophisticated, in that she had little or no history of investing in securities and no educational or professional exposure to financial matters. We reject Bruff's attempts to portray her as a sophisticated investor. We also find that RC had almost no assets, apart from her home.

<u>The Destruction of RC's Home.</u> In 1991, a fire destroyed many homes in Oakland, California, including RC's home. According to RC's arbitration testimony and to the testimony of her son before the DBCC, the loss of the home had a devastating emotional effect on RC. Shortly after the fire, Bruff contacted RC. She told him that she would be receiving insurance payments to cover her losses.

Beginning in January or February 1992, RC began to receive insurance proceeds, which she deposited into her account at Schwab, which she had reactivated, or into her account at a savings and loan. Her arbitration testimony was that she received the proceeds incrementally, and that pending negotiations with the insurer, she did not know what the total proceeds would be. She ultimately received at least $320,000 to cover the replacement of her home (at fair market value), her personal effects, her living expenses, and other costs.

<u>Bruff's Recommendations to RC.</u> Bruff opened accounts for RC at Philip Grant and then, upon his employment change, at PAM. The PAM account was a margin account, and Bruff and RC discussed margin and the costs of a margin account. The PAM new account documents listed RC's investment objectives such as "income," "speculation," and "business risk growth."

When Bruff proposed that RC invest the insurance proceeds through him, he indicated that he could obtain a better rate of return than the three percent return that she was earning on the money at the time. According to RC's testimony, her objective was to place her money in short-term investments while she rebuilt her home. RC told Bruff that it would take about a year to rebuild her home, at which time she would need the money. She agreed, at his recommendation, to make short-term investments through him during the interim time period.

Bruff asserted that because RC was receiving so much money ($680,000 to $720,000), she decided to follow a risky trading strategy with the funds she invested through him. Bruff claimed that his strategy had been to place 20 percent of RC's assets into a structured portfolio. The foundation of the portfolio was comprised of five "base positions," and the remainder of the portfolio consisted of a "broad spectrum" of stocks traded on a short-term basis. Bruff asserted that his advice was basically sound and that until approximately June of 1992, there were profits of $17,800 in the account, with losses occurring only later.

We find that RC's objective was to preserve the principal invested to replace her home and personal possessions. We find that RC's intent was to seek returns more favorable than those offered by a bank during the time that her house was being rebuilt. We do not believe that RC had a supply of funds earmarked for speculation.

Between February and September of 1992, Bruff called RC periodically to chat about personal matters and suggest purchases of particular stocks. RC agreed to almost all of Bruff's recommendations. In addition, she made one investment in an initial public offering based upon the recommendation of her daughter. After each purchase, PAM billed her, and she remitted funds. Based on this record, we find that Bruff exercised effective control over the account and that RC placed reliance upon him.

RC testified at the arbitration hearing that she had one discussion with Bruff about the losses in her account during this early period. Bruff's response was to explain the fluctuations in the market and assure her of his optimism about his overall strategy. When she questioned why he seemed to be buying and selling the same stocks over and over, he described it as a strategy to offset "what was happening in the market."

RC's account with Bruff was liquidated in October of 1992. Bruff claimed that on August 24, 1992, he recommended to RC that she stop trading in the account. RC, however, testified that in approximately September of 1992, her boyfriend suggested that she have someone he knew review the activity in her account. After reviewing the account, this individual told her that the activity in the account was detrimental to her. On October 7, 1992, at the suggestion of the individual reviewing the account, she ordered Bruff to liquidate the account. We credit RC's testimony before the arbitration panel that she halted trading in the account because her friends advised her to do so, rather than on Bruff's advice.

Bruff argued that RC's October 1992 order to sell out her positions prevented her from recouping losses she had sustained, and that if she had held those positions, she would have recovered her losses. We find, however, that these arguments are irrelevant. We note that our finding that Bruff's recommendations to RC were unsuitable is based on the nature of the actual recommendations, rather than being based purely on the fact that the recommendations were not successful.

<u>Discussion</u>

The record shows that RC's account experienced unacceptably frequent trading, suffered very heavy losses, and generated extremely large commissions. We find that the record as a whole demonstrates such egregiously unsuitable trading that it is unnecessary to analyze the various ratios typically consulted in churning cases.[5]

Our finding of unsuitable recommendations is compelled by Schedule A to the complaint and a schedule of trading that Bruff submitted to the DBCC after the DBCC hearing.[6] The undisputed evidence demonstrates that Bruff actively bought and sold securities in RC's account and that many positions were held for only a few days. This pattern of highly aggressive trading simply was unsuitable for an investor like RC, who sought to conserve her principal. This sort of trading activity would be unsuitable

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[5] Due to certain apparent discrepancies in the calculations prepared by staff and to the egregious nature of the misconduct in this case, we do not base our findings on the staff's calculations of the modified Looper turnover rate and the commission/equity ratio.

We note that in some decisions issued by the Securities and Exchange Commission, turnover rates and commission/equity ratios have been the subject of detailed attention. E.g., In re Peter C. Bucchieri, Exchange Act Rel. No. 37218 (May 14, 1996) (affirming findings of excessive trading where the modified Looper turnover rates for five accounts were 7.2, 12.6, 13.6, 10.5, and 9.4, and the rates of appreciation necessary to cover commissions and other expenses were 22.4%, 25.6%, 29.9%, 21.8%, and 24.9%). The SEC, however, also has held that proper regulatory assessment of a level of trading does not rest on any "'magical per annum percentage.'" In re Gerald E. Donnelly, Exchange Act Rel. No. 36690 (Jan. 5, 1990). In Donnelly, the SEC rejected a respondent's argument that the NASD had erred by failing to calculate the cost/equity ratio. The SEC noted that proper assessment of trading activity depends upon evaluation of all of the relevant facts and circumstances. In Donnelly's case, where the NASD had demonstrated the nature of the relevant accounts, the extensive control that Donnelly exercised over them, the short-term nature of the trading, and the fact that the trading generated a significant portion of Donnelly's commissions, the SEC found that excessive trading had been established.

[6] We note that Bruff's final schedule corresponds to the schedules prepared by staff in terms of identification of the particular transactions executed. The parties differ, however, as to commissions, mark-ups, and other expenses.

Bruff notes that NASD staff obtained the copies of the account statements that are in the record from the record of RC's arbitration, and he alleges that the versions of the statements that RC submitted to the arbitration panel had been modified by her to hide the statements' disclosures as to commissions. We find it unnecessary to determine whether RC altered the statements to hide from the arbitrators the alleged fact that she was aware of the commissions generated on the trades. We find Bruff's allegations to this effect to be irrelevant to our analysis of suitability, and we note that Bruff does not otherwise question the accuracy of the statements. We also note that the record contains several documents summarizing Bruff's own analysis of the trading in RC's account and that these documents do not contradict RC's account statements with respect to the trading that actually occurred.

for virtually any investor, absent extraordinary circumstances, such as an investor's making a conscious decision to use an insignificant portion of his or her net worth to speculate. RC, by contrast, sought to retain her principal; her investments with Bruff represented a significant portion of her net worth; and she did not expect ever to receive any additional large sums of money.

Moreover, in numerous cases, Bruff continued to make additional investments in stocks whose prices were falling, even though dollar-cost averaging (i.e., a method of accumulating assets by investing a fixed amount of dollars at set intervals), was an inappropriate strategy for an investor who intended to maintain the account only during the brief period while her new home was under construction. RC invested a total of approximately $153,000 to $156,000 with Bruff, and Bruff does not dispute the staff's conclusion that she lost $133,578.15 in only nine months via his trading strategy.[7] According to the schedule prepared by Bruff which is attached hereto, 118 transactions were executed in the account between March 12, 1992 and October 16, 1992. Moreover, whether one accepts the staff's allegation that account expenses totaled $70,768.93 or Bruff's allegation that such expenses totaled $47,248.34, it is clear that Bruff accrued substantial income from the trading and that the account would have had to generate extraordinarily high returns to recoup those expenses.

We find that there could be no reasonable basis upon which Bruff could have engaged in the transactions set forth on Schedule A to the complaint. Because we are basing our findings on a review of the entire history of the trading in the account, rather than on application of the ratios often utilized in churning cases, we reject as irrelevant Bruff's arguments regarding the proper methodology for calculating the ratios.[8]

We reject Bruff's assertion that he should be excused because RC approved the trades. As the SEC stated in a New York Stock Exchange ("NYSE") case against Bruff:

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[7] RC claimed losses totaling $139,747 on her tax returns.

[8] We note, however, that both parties' calculations support our assessment that the trading was unsuitable. The examiner found that the annualized "modified Looper" turnover ratio, which was calculated by dividing total purchases during the time period by average monthly equity and then annualized, was 34, while Bruff asserted that the annualized "classic Looper" turnover ratio was 13. The examiner calculated the commission/equity ratio to be 2.03 on an annualized basis, i.e., that the account needed to earn 203% to recoup expenses, while Bruff concluded that the ratio was .33.

> Whether or not the [customer] ultimately considered . . . transactions appropriate is not the test for determining the propriety of Bruff's conduct. Having undertaken to act as an investment counselor for the [client], Bruff was required to make only such recommendations as were in [the client's] best interests.

In re Clyde J. Bruff, 50 S.E.C. 1266, 1269 (1992).

Thus, we conclude that Bruff engaged in the violations alleged by the complaint.

Procedural Arguments. Bruff challenged several evidentiary rulings made by the DBCC. First, he argues that the DBCC should have accepted tape recordings of the arbitration proceeding. We find, however, that it was proper and within the discretion of the DBCC for the DBCC to admit only the transcript of RC's testimony. Second, Bruff argued that the DBCC should have accepted a tape recording on the subject of Looper analysis purportedly reflecting Bruff's telephone communications with an individual who served as an expert witness in RC's arbitration, as well as a document purportedly reflecting another individual's views on Looper analysis. We find, however, that it was proper for the DBCC to reject this evidence because it was irrelevant.

We reject Bruff's assertions that NASD staff was biased against him. We find no evidence in the record to support these allegations. We note, moreover, that the NASD, not NASD staff, makes disciplinary decisions.[9] Thus, Bruff raises no substantive claim of bias, and the record shows that he was treated fairly.[10]

We also reject Bruff's argument that he was deprived of a fair hearing because the DBCC hearing panel curtailed his presentation. Having reviewed the record as whole, we find that the DBCC hearing panel acted properly within its discretion to limit Bruff's presentation of evidence on points irrelevant to the main issues in this case. We find that Bruff received a full and fair opportunity to present his defense. We also reject Bruff's arguments that the DBCC hearing panel had prejudged him and that an individual DBCC panelist unfairly expressed his opinions of Bruff's conduct during the hearing. See In re

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9 Thus, even if a member of the staff were biased, that would not make the decision biased. In re Frank J. Custable, Jr. et al, 51 S.E.C. 855, 862 (1993). The SEC has frequently observed that "the NASD staff is not responsible for the NASD's decision," and that even if the Commission were to find that a particular regional attorney were biased, "that would not suggest that the fairness of the hearing itself was compromised." In re Stephen Russell Boadt, 51 S.E.C. 683, 685 (1993).

10 On appeal, Bruff attempted to adduce a tape which contained a recording of a voicemail message left for him by the regional attorney. Bruff's appeal brief contained a transcription of the recording. Bruff argued that the recording was relevant "to demonstrate the man's capacity via inflection for attempted intimidation and/or vindictiveness." We decline to accept the evidence because we find it to be neither probative nor material.

Brooklyn Capital & Securities Trading, Inc., Exchange Act Rel. No. 38454 (Mar. 31, 1997), at 12 n. 33 (noting that panel questions that display disbelief are not improper because "facts learned by a judge during a hearing do not create improper bias").

We reject Bruff's claim that he was deprived of a fair hearing because the DBCC hearing panel lacked the proper expertise to consider his arguments. We note, first, that although Bruff argues that the DBCC panelists were not employed in jobs involving daily stock trading, Bruff has made no showing that the panelists lacked the proper expertise to evaluate his arguments. We note that the DBCC hearing panel was composed in accordance with the Code of Procedure. Moreover, we note that the DBCC as a whole exercised its industry expertise in evaluating whatever recommendations might have been made by the DBCC hearing panel and reaching a decision. In addition, we note that our own review of this matter assures the application of additional industry expertise. Finally, we note that the SEC has repeatedly rejected similar challenges. E.g., Boadt, supra; In re Rita H. Malm, Exchange Act Rel. No. 35000 (Nov. 23, 1994).

We also reject Bruff's argument that his offer of settlement was unfairly ignored. He alleges on appeal that the regional attorney never informed the DBCC hearing panel that Bruff's Exhibit 5 contained an offer of settlement.[11] We note that the DBCC hearing panel was certainly given copies of all of the respondent's exhibits, and that it was the responsibility of Bruff, not the regional attorney, to point out what those exhibits contained. We find that in any event, Bruff's informal offer of settlement did not comply with the guidelines in Procedural Rule 9226, see In re Willis H. Brewer, Jr., 51 S.E.C. 305, 309-10 (1993), and that respondents have no substantive rights to settlements.

Sanctions

In view of the egregiously unsuitable nature of the pattern of trading in this case and Bruff's disciplinary history, we find it necessary to affirm the DBCC's imposition of a bar.

We find the misconduct in this case to be very troubling. Bruff egregiously failed to honor his obligations to RC. She was a financially unsophisticated woman who had experienced the devastating loss of her home when Bruff began advising her. Yet over approximately nine months, Bruff made recommendations that caused her to lose approximately 80 percent of the funds that she had invested through him, or approximately $133,000. Moreover, Bruff's recommendations were very profitable for him. During the relevant nine-month period, RC's account generated commissions totaling at least $47,000, by Bruff's own calculations.

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[11] Bruff's Exhibit 5 contains Bruff's answer to the complaint and a letter from him, dated May 4, 1996, in which he summarized his view of the evidence and proposed a settlement consisting of a censure and enrollment in a continuing education program.

We note that throughout these proceedings, Bruff has displayed neither the understanding that his strategy was improper nor remorse for RC's losses. To the contrary, he has searched for reasons to minimize RC's losses and shift blame for them, by arguing that she received substantial insurance proceeds and by arguing that she brought problems on herself by constructing a large replacement home. We find Bruff's arguments to this effect irrelevant. First, even if RC had received a total of $1,000,000 in insurance proceeds, we still would find that the pattern of trading in the approximately $150,000 in funds entrusted to Bruff was egregiously unsuitable. Second, RC's use of the portion of the insurance proceeds which she did not entrust to Bruff is completely irrelevant to this action.

Bruff's disciplinary history weighs strongly in favor of the imposition of a bar. He was admonished in an NYSE disciplinary proceeding for conduct similar to that involved herein. In re Clyde J. Bruff, 50 S.E.C. 1266, 1269 (1992) (sustaining NYSE findings that Bruff engaged in improper recommendations of options transactions and affirming an 18-month bar). We note that the misconduct involved in that action occurred in 1984, that the NYSE's Board of Governors affirmed a hearing panel's findings in February of 1990, and that the SEC affirmed the NYSE's action in September of 1992. We reject Bruff's efforts to distinguish the misconduct in the NYSE action from that involved herein. Although the principles applicable to assessment of the suitability of trading in options are somewhat different from those applied in regular trading cases, the two types of cases share one paramount concern -- that appropriate recommendations be made by securities professionals to their customers.

We have given serious consideration to Bruff's claims of mitigation relating to the undiagnosed diabetes from which he appears to have suffered at the time of the misconduct. We note that he asserts that during or close in time to the relevant period, he also experienced two unexplained car accidents and damaged a computer by inexplicably dropping it, and we are sympathetic to his claims of illness and incapacitation. We note, however, that the trading in RC's account occurred over an extended period of time, and that each trade was preceded by a telephone discussion between Bruff and RC. Given these circumstances, we find that Bruff must have been acting with sufficient lucidity to be held responsible for his own misconduct. Moreover, we find that the public interest demands that we affirm the DBCC's imposition of the bar in order to protect the public from repeated misconduct by Bruff, regardless of its source.

We note that on September 13, 1994, subsequent to the misconduct at issue herein, Bruff's debts were discharged through a bankruptcy proceeding filed under Chapter 7 of the U.S. Bankruptcy Code. Thus, the DBCC did not impose any monetary sanctions, and we likewise do not impose any such sanctions.

We note that the NASD Sanction Guidelines ("Guidelines") for suitability and for churning[12] do not recommend the routine imposition of bars. Instead, the Guideline for churning recommends bars in

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[12] See Guidelines (1996 ed.) at 10 ("Churning" Or Excessive Trading) and 52 (Suitability: Article III, Section 2 of the Rules of Fair Practice). We note that both Guidelines appear to be applicable in

cases of more serious misconduct, and the Guideline for suitability is silent as to the imposition of bars. We find, however, as discussed above, that a bar is required to protect the public interest in this case. We also find that this conclusion is supported by reference to the factors listed in the Guidelines, including the respondent's disciplinary history, the high level of commissions generated, the extensive customer injury, the high number of unsuitable recommendations, the customer's lack of investment experience, sophistication, and resources, the lack of prompt and voluntary restitution, the high turnover rate in the account, and the degree of control that Bruff exercised over RC's investment decisions.[13]

Accordingly, Bruff is censured and barred from association with any member of the Association in any capacity. The bar is effective immediately upon the issuance of this decision.[14]

On Behalf of the National Business Conduct Committee,

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Richard G. Ketchum, Executive Vice President

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this matter.

[13] We reject Bruff's arguments that less severe sanctions have been imposed in similar cases. We note that each case is unique and that sanctions cannot be calculated by reference to other matters.

[14] We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.