

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of

Department of Enforcement,

Complainant,

vs.

Castle Securities Corp.,
Freeport, New York

and

Michael Studer,
Rockville Centre, New York

Respondents.

DECISION

Complaint No. C3A010036

Dated: February 19, 2004

Castle Securities Corp. churned the account of a customer, and the firm and its president failed reasonably to supervise the trading in a customer account. The firm also induced a customer to guarantee the margin accounts of other customers in violation of NASD rules. Held, firm expelled and its president barred.

Appearances

For the Complainant: Roger Hogoboom, Esq., NASD Department of Enforcement.

For the Respondents: Michael Studer, Rockville Centre, NY, pro se.

DECISION

Respondents have appealed a Hearing Panel decision pursuant to NASD Procedural Rule 9311. The Hearing Panel ruled, in a decision dated March 28, 2003, that Castle Securities Corp. ("Castle Securities" or "the Firm") violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), SEC Rule 10b-5, and NASD Rules 2510, 2120, and 2110 by churning a customer's account. For that violation, the Hearing Panel fined Castle Securities \$88,300, representing a base fine of \$37,500 plus the Firm's profits of \$50,800 on commissions generated by the churning. In addition, the Hearing Panel found that Castle Securities and Michael Studer ("Studer") violated Rules 3010 and 2110 by failing reasonably to supervise the trading in a customer's account. For that violation, the Hearing Panel fined Castle Securities and Studer

\$37,500, jointly and severally, suspended Studer for 90 days in all capacities and ordered him to requalify as a principal. The Hearing Panel, however, dismissed an allegation that Castle Securities violated Rule 2110 by inducing a customer to guarantee the margin accounts of other customers.

After reviewing the record in this matter, we affirm the Hearing Panel's findings as to the churning and failure to supervise violations and reverse the Hearing Panel's findings regarding whether Castle Securities induced a customer to guarantee the margin accounts of other customers. In light of their extraordinary disciplinary history and several aggravating factors, we bar Studer and expel Castle Securities from NASD membership.

I. Background

Castle Securities has been a member of NASD since 1984.¹ Studer is an owner of Castle Securities and has been associated with the Firm since its inception.² During the relevant period, Studer was Castle Securities' president.

II. Procedural History

The Department of Enforcement ("Enforcement") filed a complaint on September 4, 2001 against Castle Securities and Studer. The complaint also included allegations against John Fisher ("Fisher"), a Castle Securities registered representative, Victor Soare ("Soare"), a former Castle Securities registered representative and Thomas Shaughnessy ("Shaughnessy"), Castle Securities' compliance officer. The complaint alleged that: (1) Castle Securities, Fisher and Soare churned the account of customer PS, in violation of Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2510, 2120, and 2110; (2) Castle Securities, Studer and Shaughnessy failed reasonably to supervise the trading in PS's account, in violation of NASD Rules 3010 and 2110; and (3) Castle Securities and Fisher improperly caused PS to guarantee the margin accounts of other Castle Securities customers, in violation of NASD Rule 2110. The respondents filed answers denying the allegations and requested a hearing before a Hearing Panel. The Hearing Panel held a hearing on December 16 and 17, 2002, in Melville, New York. Prior to the hearing, however, Fisher and Shaughnessy settled the matter with NASD.³

¹ Castle Securities is a wholly owned subsidiary of Castle Holding Corp. ("Castle Holding"), a publicly held company of which Studer is a shareholder.

² Studer entered the securities industry in December 1984. Studer is registered as a general securities principal, a financial and operations principal, a general securities representative, a municipal securities principal, and an equity trader.

³ NASD suspended Fisher for 30 days, fined him \$6,950 and ordered him to pay \$8,050 in restitution to PS's estate. NASD fined Shaughnessy \$5,000.

III. Facts

A. Respondents and Castle Securities' Active Account Program

In 1992, Castle Securities' business was failing, and the Firm suspended operations. Castle Securities' clearing firm, J.B. Oxford & Company ("J.B. Oxford"), suggested that the Firm consider a day-trading operation. In response, Castle Securities developed an Active Account Program ("AAP").

The AAP was a division of Castle Securities that started in December 1992 and allowed active customers quick executions using automated order entry systems. Most AAP customers opened margin accounts and gave trading authorization to a Castle Securities registered representative.

From December 22, 1992, to September 30, 1997, substantially all of Castle Securities' revenues were derived from the AAP. During that time, the number of day-trading customers at other firms using automated order entry systems increased steadily. The increased competition lowered the AAP's performance, which in turn resulted in departures of Castle Securities' AAP registered representatives and closings of branch offices in Glendale, California (in August 1997), Melville, New York (in September 1997) and Garden City, New York (in April 1998). For the years ending September 30, 1997, and 1998, AAP customer transactions totaled 184,654 and 33,041, respectively. By September 30, 1999, the AAP had only one remaining registered representative who day-traded on a full-time basis.

B. Trading in PS's AAP Account

PS opened an AAP account with Castle Securities in February 1993 with approximately \$100,000. At the time, she was an 86 year-old retired schoolteacher with a net worth of approximately \$500,000. Thus, her investment in the AAP account was approximately 20 percent of her net worth. She was generally a conservative investor, investing primarily in utility stocks, individual bonds and bond mutual funds. Fisher was PS's registered representative for a non-AAP account at Castle Securities, in which she invested in bond mutual funds.

PS had no relatives and Fisher testified that he was "totally responsible for her." Fisher, for example, paid PS's bills and hired aides to take care of her. PS paid Fisher \$750 per month for his assistance. Fisher, an accountant, also prepared PS's tax returns, for which he was paid a fee. In addition, since the late 1980's, he took care of all aspects of her life, including her shopping needs. Fisher testified that PS "became forgetful like most elderly people as time went on . . . [and] [s]ome days she was more on the ball than others."

Fisher's prior experience as a registered representative was limited to mutual funds; he had no experience selling individual stocks or other types of investments to PS or any other

customer. Nevertheless, after Studer described the AAP as "a safe investment," and "asked [Fisher] if [he] had customers that might want to go into it," Fisher recommended it to PS.

PS signed the new account forms to open her AAP account, including a form stating: "I hereby give Castle Securities Corporation Full Discretion and authorization to buy, sell and trade securities in my account, which may be a margin account. Please also be advised that I understand the account will be extremely active on a daily basis and I understand the inherent risks therein." Beyond this statement, there is no indication that the forms that PS signed provided any detail as to the nature, scope, or degree of the inherent risks associated with trading in the AAP. After PS opened the account, she initially received the confirmations and monthly statements from the account. After June 1993, however, Castle Securities sent the confirmations and account statements to Fisher, who did not provide them to PS. In September 1993, PS signed a general power of attorney giving Fisher full authority to manage her affairs, which remained in effect throughout the period at issue.

PS's AAP account was assigned to Soare, along with the AAP accounts of several other Castle Securities customers. Soare did not communicate with PS directly and had no knowledge of her physical or mental condition or the extent to which she relied on Fisher to take care of her. Soare was registered as a general securities principal and general securities representative with Castle Securities until his registration terminated on September 24, 1999. Soare day-traded for several of Castle Securities' customers, employing a strategy in which he opened long or short positions, and quickly closed them. In theory, this strategy allowed the customers to earn profits on short-term swings in stock prices. By the end of each trading day, the customers' AAP account positions were generally flat.

PS's AAP account was actively traded. Castle Securities paid Fisher a commission on every trade in PS's account. During 1993, Castle Securities made approximately 1,500 trades in PS's account from which she earned profits of \$9,505. Castle Securities charged \$58,870 in gross commissions on these trades. During 1994, Castle Securities made nearly 6,000 trades in PS's account resulting in trading losses of \$8,671 for PS and commissions of approximately \$87,834 for Castle Securities. During 1995, there were nearly 10,000 trades in PS's account, which resulted in trading losses of \$12,931 for PS and commissions of \$140,560 to Castle Securities.

By December 1995, PS had incurred more than \$12,000 in trading losses from her AAP account. Fisher testified that the trading losses concerned him, so Fisher proposed to Studer that he and Castle Securities contribute \$7,000 each to a "settlement" with PS. Studer accepted Fisher's proposal.

Castle Securities and PS then entered into an agreement stating that "a dispute has arisen with respect to the amount of commissions charged" to PS in her AAP account, and that to settle the matter, Castle Securities would pay \$14,000 to PS. The agreement did not mention that Fisher contributed \$7,000 to the settlement or the overall trading losses in PS's AAP account. Studer signed the agreement on behalf of Castle Securities. Castle Securities issued a check in the amount of \$14,000 to PS on December 29, 1995, which PS endorsed for deposit to her bank account. On the same date, using his power of attorney, Fisher issued a check drawn on PS's

bank account to Castle Securities to clear the trading losses in PS's AAP account. Soare had no involvement in the settlement and neither Fisher nor Studer informed Soare of the settlement.

At Studer's direction, Soare had stopped trading PS's AAP account in November 1995. In February 1996, however, Studer authorized Soare to resume trading the account. When trading resumed, neither Studer nor Fisher told Soare to change the manner in which he had been trading the account.

During the remainder of 1996, Soare made approximately 3,900 trades in PS's account, resulting in a net profit to her of approximately \$2,300 and commissions to Castle Securities of approximately \$70,000. In 1997, Soare made approximately 3,700 trades in PS's account, which resulted in a profit of approximately \$2,600 for PS and commissions of \$86,000 for Castle Securities. In 1998, there were about 3,700 trades in the account with a net loss of approximately \$1,300 for PS and commissions of about \$72,000 for Castle Securities. In 1999, before Studer halted trading in PS's account, there were nearly 2,200 trades resulting in a net profit for PS of approximately \$450 and commissions for Castle Securities of more than \$51,000.

Overall, from 1993 through 1999, Castle Securities made 30,794 trades in PS's account (effectively, 15,000 "round trips" opening and closing positions) leading to net losses of approximately \$8,000, not including the \$14,000 Castle Securities paid to PS in December 1995. If the 1995 payment is included, PS had a net gain over the six-year period of approximately \$6,000 or a return of roughly six percent on PS's initial investment of \$100,000. For the same six-year period, the rate of return for Dow Jones Industrial Average and the Russell 2000 Index was approximately 225 percent and 105 percent, respectively. Also during this period, Castle Securities' total gross commissions were \$567,635 and Fisher's total commissions, not including the \$7,000 that he contributed to Castle Securities' payment to PS, were more than \$30,000.

During this period, PS's account became a significant portion of Castle Securities' overall AAP business. As indicated in Castle Securities' 1998 10-K report, after a promising start, the AAP business fell off sharply. In 1993, the trades in PS's account represented about 0.5% of more than 322,000 total trades in Castle Securities' AAP accounts; in 1994, she accounted for about 1.5% of Castle Securities' approximately 385,000 AAP trades; in 1995, her trades were about 2.5% of Castle Securities' approximately 396,000 AAP trades; and in 1996, after the settlement and resumption of trading in the account, trades in PS's account were about 2% of Castle Securities' approximately 202,000 AAP trades. PS's share of the AAP total increased substantially in subsequent years. In 1997, her trades were about 5.2% of Castle Securities' total AAP trades, which fell to about 70,000; in 1998, they were roughly 14.3% of Castle Securities' approximately 26,000 AAP trades; and in 1999, her trades (which ended in June) represented about 9% of Castle Securities' approximately 24,000 AAP trades.

NASD examined Castle Securities in June 1999. During that examination, NASD staff reviewed the trading in all discretionary accounts at Castle Securities. Noting PS's advanced age and the heavy day-trading in her account over several years, the examiners focused their attention on her account. After the NASD examiners expressed concern, Castle Securities ceased trading PS's account in June 1999.

C. The Margin Guarantees

In January and February 1996, PS signed agreements guaranteeing five other customers' margin accounts. Specifically, she agreed: "If and when a margin call and/or a deficit is generated in the guaranteed account, JB Oxford has the authority without restriction to use the funds or securities in my account to carry the guaranteed account or to pay any deficit therein." In October 1996, J.B. Oxford transferred \$30,000 from PS's account to one of the accounts she had guaranteed to cover a margin call. The \$30,000 was re-paid to PS's account in November 1996.

Fisher testified that he asked PS to sign the agreements based on his understanding that: (1) there would be reciprocal agreements from the other customers guaranteeing PS's account, and (2) the margin agreements would increase the buying power in her account. Studer testified that J.B. Oxford required cross-guarantees among all the affected margin account customers in order to make any margin guarantee effective. Studer acknowledged, however, that the customers whose accounts PS guaranteed never executed cross-guarantees. For this reason, Studer claimed that the guarantees PS signed never became effective and should not have been used. Studer further claims that J.B. Oxford's use of one of the guarantees in October 1996 was an error, and that when the error was discovered, the funds were returned to PS's account.

IV. Discussion

After reviewing the record in this matter, we affirm the Hearing Panel's findings as to the churning and failure to supervise violations. We also find that Castle Securities also violated Rule 2110 by inducing PS to execute margin guarantees, and therefore reverse the Hearing Panel's dismissal of that allegation. We discuss each violation in turn.

A. Castle Securities Churned PS's Account

Churning violates Section 10(b) of the Exchange Act, SEC Rule 10b-5, and NASD Rules 2120 and 2110. As the SEC has explained, "[c]hurning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purpose of generating commissions."⁴ Churning has been found where: (1) trading in an account was excessive in light of the investment objectives; (2) the broker exercised control⁵ over the account; and (3) the broker acted with the intent to defraud or with reckless disregard

⁴ Sandra K. Simpson, Exch. Act Rel. No. 45923, 2002 SEC LEXIS 1278, at *52 (May 14, 2002) (quoting Olson v. E.F. Hutton & Co., 957 F.2d 622, 628 (8th Cir. 1992)).

⁵ It is undisputed that PS's account was a discretionary account and that Castle Securities exercised control over the AAP accounts through the registered representatives who were assigned to the AAP.

for the interests of the client.⁶ Churning, "in essence, involves a conflict of interest in which a broker or dealer seeks to maximize his or her remuneration in disregard of the interests of the customer."⁷ The essential issue of fact in a churning case is whether the volume of transactions, considered in light of the nature and objectives of the account, was so excessive as to indicate a purpose on the part of the broker to derive a profit at the expense of the customer.⁸ The Hearing Panel found that when Castle Securities executed trades in PS's account from February 1996 to June 1999, it was primarily for the purpose of generating commissions and without regard to PS's interest. We agree with the Hearing Panel and therefore sustain its finding that Castle Securities churned PS's account.⁹

1. PS Received Minimal Benefit from the AAP Account

PS opened her AAP account with the understanding that the account would be extremely active on a daily basis. Indeed, it was through very active trading that Castle Securities hoped to make a profit for PS. According to Studer, when PS opened her account in 1993, his experience with AAP customers was that "everybody made money every day . . . [and that] it was a lucrative thing for the customers."

By December 1995, however, it was clear that PS was not "making money every day" and that the AAP was not "lucrative" for her. To the contrary, PS had suffered substantial trading losses in her AAP account. Castle Securities was fully aware that PS's account was not profitable because Castle Securities, acting through Studer, agreed to pay \$7,000 to help cover the losses in the account.

2. Respondents Benefited from PS's Account at PS's Expense

As Castle Holding's 1998 10-K disclosed, through September 1997 substantially all of Castle Securities' revenues were derived from the AAP, and Castle Securities' AAP trading diminished steadily beginning in 1996, as customers left the program. We find that the trading in PS's account, commencing in 1996, became more significant for Castle Securities because it accounted for an increasing percentage of Castle Securities' overall AAP volume.

While the importance of PS's account grew for Castle Securities, PS was saddled with substantial risks. Castle Securities opened and then closed approximately 6,500 positions in PS's account from 1996 through 1999. Many of those positions were in excess of \$50,000, and while

⁶ Donald A. Roche, 53 S.E.C. 16, 22 (1997).

⁷ Id.

⁸ See Costello v. Oppenheimer & Co., 711 F.2d 1361, 1368 (7th Cir. 1983).

⁹ The Hearing Panel also dismissed the churning violations against Soare. Because neither Soare nor Enforcement appealed the dismissal, we do not have jurisdiction to review it.

they were open PS faced market risk, including the risk that, for example, a news release, trading halt or other unexpected development could cause substantial losses before Castle Securities could close the position. Overall, PS's participation in the AAP generated considerable commissions for Castle Securities while providing her with only modest gains and exposing her to tremendous risk.¹⁰ The Hearing Panel found and we agree that, as a practical matter, PS was providing significant benefit to Castle Securities without receiving a corresponding return.

From February 1996 to June 1999, Castle Securities continued to trade PS's account actively despite the fact that PS had suffered significant losses in the past from such active trading. Castle Securities' willingness to keep PS in a trading strategy that consistently generated significant commissions for the Firm but only minor gains or losses¹¹ for PS shows that Castle Securities had little regard for PS's interest. Consequently, we find that when Castle Securities, through Studer, resumed active trading in PS's account in February 1996, it was primarily for the purpose of generating commissions. We conclude that Castle Securities churned PS's account from February 1996 through June 1999.¹²

¹⁰ We also note that as president of Castle Securities, Studer knew or should have known that under the Firm's clearing agreement with J.B. Oxford, PS's margin guarantees associated with her AAP account benefited Castle Securities by giving more buying power to Castle Securities' other customers, thereby allowing Castle Securities to generate larger commissions from these customers. In addition, Studer knew that PS's margin guarantees benefited Castle Securities by shielding Castle Securities' from exposure to J.B. Oxford for losses arising from trades made by Castle Securities' other customers.

¹¹ Respondents argued that in assessing the benefits to PS from the trading in her AAP account, we should include more than \$75,000 that PS's estate received in 2000 and 2001 as her share of a settlement of the Nasdaq Market Makers Litigation class action. See Nasdaq Market-Makers Antitrust Litigation, 169 F.R.D. 493, 532 (S.D.N.Y. 1996) (granting, in part, plaintiff's motion for class certification). Neither Castle Securities nor PS, however, could have expected the settlement during the period when her AAP account was traded, and therefore it is irrelevant in determining whether, in trading the account, Castle Securities was pursuing its own interests at PS's expense.

¹² Studer argues that the Hearing Panel could not have found that Castle Securities churned PS's account without first finding that Soare, the employee effecting the trades in PS's account, churned the account. Studer contends that the doctrine of respondeat superior mandates this result. Respondeat superior is an indirect theory of liability under which an employer may be held liable for the misconduct of its employee. We find, however, that Castle Securities is directly liable for churning PS's account because the Firm approved the opening of PS's AAP account, it resumed trading in the account in February 1996 despite the trading losses PS suffered in the previous years, and it collected substantial commissions from the account without regard to PS's interests. Consequently, it is not necessary to find that Soare churned the account to establish Castle Securities' liability for churning.

B. Studer and Castle Securities Failed Reasonably to Supervise the Trading Activity in PS's Account

Rule 3010 requires that NASD members "establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [NASD]." The SEC has established that final responsibility for proper supervision of trading activities at a member firm may rest with the firm's president.¹³

1. Studer Was Responsible for Supervising Trading in PS's Account

Studer acknowledged that he had supervisory responsibility for Soare's trading of PS's account during the relevant trading period. We agree. Only Studer had all the relevant information needed to evaluate whether the trading in PS's AAP account was serving her interests. As of the end of 1995, he knew that PS was elderly and of limited means; that she had incurred substantial losses as a result of the trading to that point; that account statements and confirmations were going to Fisher rather than to her; and that Fisher, although he held a power of attorney on her behalf, had a fundamental conflict of interest because Castle Securities was paying him a commission for every trade in her account.

2. Studer Failed to Take Reasonable Steps to Avoid the Churning Violation

There were several "red flags" that Studer ignored that should have prompted him to remove PS from the AAP and avoid the churning violation. For example, Studer knew about the \$14,000 settlement agreement, including the fact that the agreement failed to disclose the trading losses in PS's account and Fisher's contribution to the settlement. Most importantly, Studer knew the amount of commissions that Castle Securities was earning from the trading and that there was an enormous disparity between the amount of commissions generated for the Firm and the profit made by PS for her participation in the AAP. Nevertheless, Studer failed to take any action to remove PS from the AAP or alter the trading strategy in the account to serve PS's interest better.

3. Studer Unreasonably Relied on Fisher to Represent PS's Interests

Studer argued that he was entitled to rely on Fisher to represent PS's interests and monitor trading in the account because she had given him a power of attorney. Studer's argument lacks merit. Fisher was associated with Castle Securities, and Castle Securities was paying him a commission for each trade in PS's account. Thus, Fisher earned money simply by allowing

¹³ See William H. Gerhauser, Sr., 53 S.E.C. 933, 940-41 (1998) (stating that "the president of a corporate broker-dealer is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient").

Castle Securities to continue to churn PS's account. In light of Fisher's own interest in continuing the trading, Studer could not reasonably rely upon him to represent PS's interests.

From February 1996 until June 1999, Studer allowed PS's account to be actively traded for Castle Securities' benefit without regard for PS's interests. Studer ignored several red flags, including the prior losses suffered by PS from participating in the AAP, Fisher's control over PS's funds via his power of attorney, and a fundamental conflict between Fisher and PS's interest regarding whether PS should remain in the AAP. We therefore find that Studer, and Castle Securities through Studer, failed reasonably to supervise the trading in PS's account, in violation of NASD Rules 3010 and 2110.

C. Castle Securities Induced PS to Execute Margin Guarantees

The focus of NASD rules is the "professionalization of the securities industry."¹⁴ Rule 2110 attempts to foster professionalism in the securities industry by requiring that member firms "observe high standards of commercial honor and just and equitable principles of trade." Rule 2110 has been applied in a variety of situations to ensure that NASD members conduct their business in a manner that is consistent with high ethical standards.¹⁵ We find that by inducing PS to sign margin guarantees that only benefited the Firm, Castle Securities engaged in conduct that was inconsistent with the high ethical standards required of NASD members under Rule 2110.

PS did not have any experience with margin guarantees, as she was a conservative investor, investing primarily in utility stocks, individual bonds and bond mutual funds. She had limited experience trading securities generally and even less experience trading in margin accounts. PS was elderly and relied on Fisher to make a number of important decisions in her life, including her investment decisions. It is unlikely that she understood the risk involved in guaranteeing the margin accounts of other Castle Securities customers. Castle Securities, however, was aware of these risks. Castle Securities also knew that PS relied on Fisher to make her investment decisions and that she was more likely to agree to the guarantees if Fisher asked her. Castle Securities persuaded Fisher to present the margin guarantees to PS¹⁶ and as a result,

¹⁴ Dep't of Enforcement v. Shvarts, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11 (NAC June 2, 2000).

¹⁵ See e.g., Dep't of Enforcement v. Josephthal & Co., Inc., Complaint No. CAF000015, 2002 NASD Discip. LEXIS 8, at *22 (NAC May 6, 2002) (finding that respondent violated Rule 2110 by failing to follow arbitration rules); Dep't of Enforcement v. Gilmore, Complaint No. C9B020037, 2003 NASD Discip. LEXIS 5, at *7 (OHO Jan. 8, 2003) (finding that falsifying records submitted to NASD is inconsistent with the ethical obligations imposed by Rule 2110).

¹⁶ Fisher testified that he asked PS to sign the agreements based on his understanding that there would be reciprocal agreements from other Castle Securities' customers. These reciprocal agreements were never executed.

Castle Securities was able to induce PS to sign margin guarantees that benefited the Firm and exposed her to significant risk.

For example, J.B. Oxford's apparent reliance on PS's margin guarantees in October 1996 led to a transfer of \$30,000 from PS's account to the account of another customer. According to Studer's testimony, J.B. Oxford required cross-guarantees from the other customers for the margin guarantees PS signed to become effective, and the other customers had not provided such cross-guarantees. Studer suggested that J.B. Oxford's transfer of the \$30,000 from PS's AAP account was therefore an error by J.B. Oxford. Respondent's characterization of this transfer as an error, however, is not relevant. The fact that the absence of cross-guarantees from other Castle Securities customers made PS's margin guarantees ineffective¹⁷ does not change the fact that respondents persuaded PS to enter into a high-risk agreement that was contrary to her interests and purely for the benefit of the Firm.

PS's margin guarantees benefited Castle Securities by giving more buying power to Castle Securities' other customers, thereby allowing Castle Securities to generate larger commissions from these customers. Castle Securities, through Studer, knew that PS's margin guarantees benefited Castle Securities by reducing Castle Securities' exposure to its clearing firm for losses arising from trades made by its other customers. In contrast, PS was exposed to substantial risk as evidenced by the \$30,000 transfer of funds out of her account before the error was corrected. We therefore find that Castle Securities improperly induced PS to sign margin guarantees that only benefited the Firm.

V. Sanctions

NASD Sanction Guidelines ("Guidelines") indicate that a "relevant" disciplinary history, which "may include (a) past misconduct similar to that at issue; or (b) past misconduct that, while unrelated to the misconduct at issue, evidences prior disregard for regulatory requirements, investor protection, or commercial integrity," is an aggravating factor that an adjudicator should consider in imposing sanctions.¹⁸

Castle Securities has a disciplinary history that includes two distinct market manipulation violations.¹⁹ We have recently recognized that market manipulation is one of the most egregious

¹⁷ We note it is permissible under the securities laws to execute margin guarantees of other customers' accounts without requiring cross-guarantees from those customers. Thus, the lack of cross-guarantees in this case did not make PS's margin guarantees ineffective by operation of law.

¹⁸ See Guidelines at 3.

¹⁹ See Appendix A, Summary of Disciplinary History, Civil Action No. 94-6608 and Complaint No. CMS940100.

violations that an NASD member can commit because it is a "direct assault on NASD's mission to bring integrity to the markets."²⁰ In addition, the Firm has a disciplinary history that also includes another failure to supervise violation.²¹ We find that these prior violations, like the case before us, involve both a complete disregard of the Firm's supervisory responsibilities and the integrity of the market. Thus, we consider the Firm's disciplinary history to be an aggravating factor supporting higher sanctions against the Firm.

The Hearing Panel imposed an \$88,300 fine on Castle Securities for the churning violation and a \$37,500 fine on Castle Securities and Studer, jointly and severally, for the failure to supervise violation. The Hearing Panel also assessed costs of \$3,568.18, jointly and severally, on Castle Securities and Studer, suspended Studer from acting in all capacities for 90 days, and required Studer to requalify in any principal capacity in which he seeks to be registered. The Hearing Panel dismissed the allegation that Castle Securities violated Rule 2110 by inducing PS to execute margin guarantees; therefore there was no accompanying sanction.

We affirm the fines imposed by the Hearing Panel on respondents for the churning and failure to supervise violations. In light of the respondents' extensive disciplinary history and other aggravating factors, however, we increase Studer's suspension from 90 days to a bar and expel Castle Securities from NASD membership. In addition, we find that Castle Securities violated Rule 2110 by inducing a customer to enter into margin guarantees and fine Castle Securities \$10,000 for this violation.²²

A. Churning

The Guideline for "Churning or Excessive Trading" recommends a fine of \$5,000 to \$75,000, plus the amount of any financial gain the respondent earned from his or her misconduct.²³ In addition, it recommends a suspension in any or all capacities for 10 business days to one year, and in egregious cases a longer suspension of up to two years or a bar.²⁴

²⁰ See Dep't of Market Regulation v. Elgindy, Complaint No. CMS000015, 2003 NASD Discip. LEXIS 14, at *35 (NAC May 7, 2003).

²¹ See Appendix A, Summary of Disciplinary History, Complaint No. C10940068.

²² These sanctions are within the range recommended in the applicable Sanction Guidelines. See Guidelines at 86 (Churning or Excessive Trading); Guidelines at 108 (Supervision – Failure to Supervise).

²³ See Guidelines at 86.

²⁴ Id.

B. Failure to Supervise

The Guidelines for a "Failure to Supervise" recommend a fine of \$5,000 to \$50,000.²⁵ In cases against member firms involving systemic supervision failures, the Guidelines suggest a suspension of the firm with respect to any and all activities or functions of up to two years or expulsion.²⁶ The Guidelines also recommend a suspension of the responsible individual in all supervisory capacities for up to 30 business days, and in egregious cases, a longer suspension of up to two years in any or all capacities, or a bar.²⁷

We have considered the Guidelines and find that respondents' misconduct is egregious enough to bar Studer and to expel Castle Securities from NASD membership. We find that the sanctions imposed by the Hearing Panel were too lenient given respondents' extensive disciplinary history and additional aggravating factors. We therefore modify the Hearing Panel's sanctions as follows.

The Guidelines explain that NASD's policy is to impose "progressively escalating sanctions on recidivists."²⁸ As to this violation, both Studer and Castle Securities have a clearly relevant disciplinary history. In 1994, the National Business Conduct Committee ("NBCC") found that respondents had failed to establish, implement, and enforce reasonable supervisory procedures. The NBCC fined Studer and Castle Securities \$25,000 and required them to pay more than \$13,000 in restitution, jointly and severally.²⁹ The NBCC also suspended Studer in all capacities for 30 days and required him to requalify as a principal.³⁰

In addition, we consider a U.S. District Court's July 21, 2003 opinion and permanent injunction order against Castle Securities and Studer ("Injunction Order") to be a relevant factor in determining sanctions.³¹ The Injunction Order stated that Castle Securities and Studer, along

²⁵ Id. at 108.

²⁶ Id.

²⁷ Id.

²⁸ Id.

²⁹ See Market Surveillance Comm. v. Castle Sec. Corp., Complaint No. CMS940100, 1996 NASD Discip. LEXIS 37, at *30 (NBCC Oct. 21, 1996), aff'd, Castle Sec. Corp., 53 S.E.C. 406, 416 (1998). We note that even while Studer was under investigation for other supervision-related violations, he ignored several red flags that would have led a reasonable supervisor to question the propriety of how PS's account was handled.

³⁰ Id.

³¹ The injunction is a final decision of a U.S. District Court and it is therefore proper to consider the injunction for sanctions determinations.

with other individuals, conducted a fraudulent blind pool offering, engaged in market manipulation, and fraudulently sold the securities of U.S. Environmental, Inc.³²

We find the Injunction Order to be particularly significant because during the period when the violations leading to the injunction were committed, respondents failed to discharge their supervisory responsibilities properly.³³ We also find it significant that the Injunction Order stated that there was a reasonable likelihood that respondents would continue to engage in violations of the federal securities laws.³⁴ As noted above, NASD has already required Studer to requalify as a principal on one occasion because of his failure to supervise his employees. Consequently, we find that respondents' recurring failure to perform their supervisory duties places investors at risk, and that Castle Securities' systemic supervision failures warrant Castle Securities expulsion from NASD membership. We also find that Studer should be barred in order to protect investors from future violations.

Studer admits that he was responsible for supervising the activity in PS's account during the period at issue. The "Failure to Supervise" Guideline lists specific considerations in setting sanctions for those violations, including whether the respondent "ignored 'red flag' warnings that should have resulted in additional supervisory scrutiny," and "the nature, extent, size and character of the underlying misconduct."³⁵

As discussed above, the \$14,000 settlement in 1995 as well as the obvious conflict of interest between Fisher and PS raised a variety of red flags. If Studer had exercised reasonable oversight and supervision, he would have realized at least by the end of 1995 that further trading in PS's AAP account would be for the benefit of Castle Securities rather than PS. His failure to heed these red flags was an aggravating factor. Studer ignored these red flags surrounding PS's AAP account even though the AAP accounts were central to the Firm's business. For example, in 1997 the AAP accounts accounted for approximately 75% of the Firm's total revenues and the success of the AAP required efforts from nearly all of the Firm's employees, including the compliance officer, the registered representatives and the president. Moreover, Studer's clear disregard of these red flags even after he was suspended and forced to requalify as a principal for

³² See SEC v. U.S. Env'tl. Inc., 2003 U.S. Dist. LEXIS 12580, at *1 (S.D.N.Y. July 21, 2003).

³³ We note that the Hearing Panel below was unaware of the Injunction Order because the District Court issued the Injunction Order several months after the Hearing Panel issued its decision. Consequently, the Hearing Panel did not consider the Injunction Order in its sanctions determinations.

³⁴ Id. at * 67 (finding that Castle Securities' manipulation of U.S. Environmental, Inc. stock was not an isolated event, because Castle Securities, through Studer, had been associated with three other securities frauds).

³⁵ See Guidelines at 108.

a prior failure to supervise violation shows that Studer was not sufficiently committed to performing his supervisory responsibilities with regard to the AAP.

Taking these factors into account, we affirm the \$37,500 fine imposed on Castle Securities and Studer, jointly and severally. We find that Studer's extensive disciplinary history and repeated neglect of his supervisory responsibilities demonstrates a disregard for regulatory requirements, investor protection and commercial integrity. We therefore increase the suspension imposed on Studer by the Hearing Panel from 90 days to a bar.

C. Inducing a Customer to Guarantee Other Customer's Margin Accounts

The General Principles Applicable to all Sanction Determinations from the Guidelines suggest that we consider whether a respondent's misconduct resulted in the potential for his or her monetary or other gain.³⁶ In this case, PS's guarantee of other customer's margin accounts benefited the respondents by giving the Firm's customers greater buying power, potentially allowing Castle Securities to recoup greater commissions from its other customers. In addition, PS's guarantees: (1) limited Castle Securities' exposure to its clearing firm for losses arising from trades made by its other customers; and (2) exposed PS to significant risk as evidenced by the \$30,000 that was initially taken from her account as a result of the guarantees. Thus, for inducing PS to guarantee the margin accounts of other customers, solely for the Firm's potential gain, we fine Castle Securities \$10,000.

VI. Conclusion

After reviewing the record in this matter and considering the parties' arguments, we find that Castle Securities violated Section 10(b) of the Exchange Act; Exchange Act Rule 10b-5; and NASD Rules 2110, 2120, 2510 and 3010. We also find that Studer violated NASD Rules 2110 and 3010. We reject respondents' claims that their supervision of PS's account was reasonable and find that allowing PS to participate in the AAP from 1996 to 1999 and guarantee the margin accounts of other customers served the Firm's interest at PS's expense.³⁷ We therefore modify the Hearing Panel's findings and sanctions as discussed above.

Respondents' violations drew fines totaling \$98,300 against Castle Securities, and \$37,500 against Castle Securities and Studer, jointly and severally. However, in light of our policy determination that, in certain cases involving the imposition of a bar or expulsion, no

³⁶ See Guidelines at 3.

³⁷ We have also considered and reject without discussion all other arguments advanced by respondents and Enforcement.

further remedial purpose is served by the additional imposition of a monetary sanction, we do not impose these fines for respondents' violations.

Accordingly, Castle Securities is expelled from NASD membership. In addition, Studer is barred from association with any NASD member firm in any capacity. The expulsion and bar will be effective as of the date of this decision.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary