BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 1, Complainant, v. Joel Dean Moore Redding, CA, Respondent.	Decision Complaint No. C01970001 Dated: August 9, 1999

Registered representative violated his duty to customers by failing to understand the risks associated with a security that he recommended and also by failing to make a customer-specific suitability determination prior to making the recommendation. Held: findings of violations and imposition of sanctions modified.

The July 24, 1998 decision of the District Business Conduct Committee for District No. 1 ("DBCC") regarding Joel Dean Moore ("Moore") was called for review pursuant to NASD Procedural Rule 9312. The DBCC found that Moore made unsuitable recommendations to nine customers, and fined him $11,900 (equal to $5,000 plus his commissions on the violative transactions). We called the case for review to reassess the sanctions imposed. We affirm the DBCC's finding of violation and impose the following sanctions: censure; $25,000 fine; 10-day suspension from associating with any Association member in any capacity; requirement to requalify within 90 days of the release of this decision; and DBCC costs.

Factual Background

The facts of this case are undisputed. Moore was employed by California One Investments, Inc. as a general securities representative from January 1991 to February 1994.[1] During that period, Moore recommended and sold to nine customers $209,609.27 of Trust Deed Participation Program securities, commonly known as "Trudy Pats." A Trudy Pat is a fractionalized interest in loans secured by a deed of trust. The proceeds raised from the sale of fractionalized interests are used to develop the real estate subject to the deed of trust.

Moore sold three different Trudy Pats to his customers: Chartered Land and Cattle Cypress Lakes ("Chartered Land"); Stewart Thomas Development II Ahwanee Estates ("Stewart Thomas"); and The Ved Projects at Mission Santa Fe ("Mission Santa Fe"). Proceeds from the sale of Chartered Land Trudy Pats were to be used to develop a residential community in Contra Costa County, California. The Stewart Thomas proceeds were to be used to develop a residential community and country club in Madera County, California. The Ved Corporation issued the Mission Santa Fe Trudy Pats to develop a residential community in San Diego County, California.

The minimum financial suitability standard for these Trudy Pats, as stated in each prospectus, was annual income of $35,000 and a net worth (excluding principal residence, furnishings and cars) of $35,000; or a net worth (with exclusions) of $100,000. The offering circular for each Trudy Pat disclosed numerous risk factors, including the issuer's possible inability to make interest payments; low liquidity; and default or foreclosure. In fact, each Trudy Pat eventually ceased making regular interest payments, and each currently operates in a reorganized form.

Customers JR, WT, JC, TA, and WS testified at the hearing. JR and her husband purchased $20,000 of Mission Santa Fe Trudy Pats from Moore on March 3, 1993. JR had a high school degree and was unemployed. Her husband was employed by the California Highway Patrol, where he earned $45,000 annually. Together they had $30,000 of equity in their home and $35,000 in cash from their divorce settlements. Moore's sales presentation focused on Mission Santa Fe's high interest rate and short term. He told JR that Mission Santa Fe paid a higher interest rate than a bank and that their principal would be returned after eighteen months. JR testified that Moore discussed no investment alternatives to Mission Santa Fe, and that he discussed none of Mission Santa Fe's risks. JR and her husband received a monthly interest check of $195.83 from Mission Santa Fe until August of 1993. Then the payments were reduced until December of 1997, when they ceased completely.

WT and his wife bought $25,000 of Mission Santa Fe Trudy Pats on April 5, 1993.[2] WT

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[1] Moore, who entered the securities industry in 1990, is currently registered as a general securities representative with another NASD member.

[2] WT and his wife initially invested $50,000 in the program, but Mission Santa Fe was over

had an eleventh grade education and worked in construction until 1989 when he retired on disability. WT's assets included an $87,000 disability settlement, a mobile home, a car, and a pickup truck. WT testified that he told Moore that his investment objectives were safety of principal and capital gains, and that he wanted to supplement his social security income. WT invested primarily because of the high interest rate and short term that Mission Santa Fe offered. Moore did not discuss any risk factors with WT. WT is receiving no payments from Mission Santa Fe.

JC purchased $50,423.27 of Mission Santa Fe Trudy Pats on July 19, 1992. JC was 75 years old and retired. His sole sources of income were social security and a pension. He had a home valued at $102,000, $20,000 in proceeds from selling his business, and the $50,000 that he invested with Moore. JC had prior investment experience with certificates of deposit and mutual funds, and his investment objectives were safety of principal and income. Moore and JC did not discuss the risk factors listed in Mission Santa Fe's circular, and they never discussed the possibility that JC might not receive interest payments or lose his principal. JC received approximately $500 per month until August of 1993, when the payment was reduced and, later, terminated.

On September 16, 1992, TA purchased $25,186 of Mission Santa Fe Trudy Pats. TA was a 73-year-old widow. She had a $150,000 home, a car, $40,000 in liquid assets, and a mortgage note valued at $31,500, and her monthly income was $1,100. She had previous experience with mutual funds and certificates of deposit, and her investment objectives were safety of principal and income. TA specifically told Moore that she could not afford any risk to her principal. TA testified that Moore did not disclose the risk factors presented in Mission Santa Fe's circular, and that she never saw the circular. TA claims that Moore told her the investment was safe because it was backed by a first deed of trust and that she could foreclose to recover her principal. TA received approximately $400 per month from Mission Santa Fe until August of 1993, when the payments were reduced and, later, terminated.

On September 22, 1992, WS purchased $20,911.04 of Mission Santa Fe Trudy Pats. WS was a 79-year-old widow who retired in 1982 from her job as an elementary school teacher. WS owned a home valued at $65,000. WS' investment objectives were safety of principal and income. Moore did not discuss any risk factors listed in the offering circular. Like the other investors, WS received interest payments for a period of time. Those payments became sporadic and later ceased.

The NASD Regulation staff introduced customer questionnaires and documentation concerning four other customers, FT, AB, LD, and VC, who purchased Trudy Pats from Moore. FT purchased $25,000 of Chartered Land Trudy Pats, $10,000 of Stewart Thomas Trudy Pats, and $2,000 of Mission Santa Fe Trudy Pats At the time of her purchases, she was 73 and retired. She lived on less than $25,000 annual income, had net assets of between $200,000 and $250,000, and liquid assets exceeding $100,000. She had no prior investment experience. FT said, in a written statement, that Moore told her that there was a risk in holding a mortgage but that she

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subscribed and $25,000 was returned.

"would not lose" because she would be paid first if the property was sold at foreclosure. He also told her that she would get her principal back in two years unless she decided to extend her investment. FT reviewed promotional pamphlets for the Trudy Pats, but not the circulars.

When AB invested $10,000 in the Mission Santa Fe Trudy Pat, she was a 67-year-old housewife living on less than $25,000 annual income. She had no prior investment experience, and listed her investment objectives as income through short-term trading, her net assets at $100,000, and her liquid assets at $50,000. She claimed that Moore told her the investment was safe and that she would get her money back in 18 months.

LD purchased $29,000 of the Mission Santa Fe Trudy Pat. At the time, he was 63 years old, had more than $200,000 in net assets and more than $200,000 in liquid assets. LD listed his investment objective as income through short-term trading. He had prior investment experience with mutual funds and certificates of deposit. For the two years before he purchased the Trudy Pats, LD's annual income was $50,000, but he expected it to fall below $25,000 in the following year. Moore told LD that although the risk of a foreclosure existed, the investment was backed by a first deed of trust and that LD could recover his investment through a trustee's sale. LD understood that his investment was for two years and that the developers could extend that period for an additional two years.

When VC invested $25,000 in the Stewart Thomas Trudy Pat, she was 72, a widow, and retired from 20 years of secretarial work. In her written questionnaire, she stated that her net worth, liquid assets, and annual income were all below $25,000 when she purchased the Trudy Pats. She listed her investment objectives as income through short-term trading and her investment experience as including more than ten years in non-speculative stocks, mutual funds, and certificates of deposit. Moore showed her a color brochure with pictures of the property, but he did not show her the circular or discuss the specific risks associated with the Stewart Thomas Trudy Pat. She received monthly dividend payments for only four or five months.

The DBCC found that Moore's recommendation to purchase the Trudy Pats was unsuitable for each of the nine customers who testified or submitted questionnaires. The DBCC concluded that Moore did not understand the risks inherent in Trudy Pats, that he failed to ensure that the customers understood those risks, and that the risks were inconsistent with his customers' desire to preserve their principal.

Discussion

Moore has never disputed the facts set forth above. In his answer to the complaint, Moore alleged only that he believed the recommendations to be suitable when he made them. He did not appeal the DBCC's findings of violation, and this case was not called for review on that basis. We have, however, reviewed the record de novo, and we affirm the findings of violation as to eight of the nine customers who purchased the Trudy Pats through Moore.

Conduct Rule 2310 provides that "[i]n recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." This rule obligates representatives (1) to fully understand the securities they recommend and the consequences of those recommendations, and (2) to make a customer-specific determination of suitability and to tailor their recommendations to the customer's financial profile and investment objectives. In re F.N. Kaufman & Co. of Virginia, 50 S.E.C. 164 (1989).

Moore breached both of these duties. The Trudy Pats were based upon loans collateralized by undeveloped real estate. The primary asset of the borrower was the undeveloped land itself, appraised on the basis of the borrower's ability to develop the land. Since the value of the land was contingent upon its being developed, if the borrower could not continue to finance the development of the land, it was unlikely that the land would be sold at its appraised value. Any economic downturn that affected either the value of property or the borrower's ability to refinance the project would seriously jeopardize the entire investment. Thus, the Trudy Pats were inherently speculative.

We reached a similar conclusion in In re Frederick Morton Woolley, Complaint No. C01950005 (October 23, 1996), where we found that Woolley's recommendation of Trudy Pats to a single customer was unsuitable. In that case, Woolley induced the customer to invest $180,000 in three Trudy Pats, two of which are also involved in this case. The customer was recently widowed, had three dependent children, and had one large asset, a $450,000 life insurance settlement. Woolley had conducted significant due diligence on the Trudy Pats, and had also thoroughly analyzed his customer's financial situation and investment objectives. We concluded that the Trudy Pats were inherently speculative. We also found that, due to her need to preserve principal, it was unsuitable to recommend that she allocate 40 percent of her portfolio to Trudy Pats. We fined Woolley $5,000 plus his commissions.

As explained below, Moore's misconduct was more serious than Woolley's in several ways: (1) Moore made unsuitable recommendations to eight customers, not just one; (2) Moore's conduct fell further below the standard of care required of registered representatives in that he failed to understand the security that he was recommending; (3) he failed to make customer-specific suitability determinations; (4) Trudy Pats were less suitable for Moore's clients because they had less money; and (5) Woolley had committed no prior suitability violations.

Moore's testimony shows that he did not understand the risks inherent in the Trudy Pats when he recommended them to his customers. Moore admitted that he did not fully read the risk factors listed in the Trudy Pat offering circulars. Instead, he relied on representations made by the issuer during a presentation to Moore and other salespeople. He also admitted that he had little real estate experience, that he knew northing about the financial condition of the three issuers, and that he did no due diligence beyond reading the sales brochures that his employer gave him. Because Moore did not understand the inherent risks of Trudy Pats, he could not convey those risks to his customers.

Moore admits that he made few suitability inquiries, much less the customer-specific determinations that are required under the rule. Moore did not consider the customers' overall financial situation, their level of investment experience, their sophistication, or their financial needs. Nor did he consider the amount of the Trudy Pat investment as a percentage of his customers' liquid assets, investing between 20 and 70 percent the customers' liquid assets in Trudy Pats. Rather, Moore admitted that he looked at nothing beyond the minimum suitability requirements set forth in the Trudy Pat offering circulars. When asked "what other factors did you consider when you were looking at suitability besides the stated requirements in the circular," Moore responded that "You know what, I didn't consider any, you know, as far as requirements are concerned, to me that filled the requirement." This is particularly troubling because at least five of the customers -- JC, TA, WS, AB, and VC -- fell below even this minimal threshold. We find that Moore's recommendations to these five customers were unsuitable.

Moore claimed that he recommended the Trudy Pats because his customers' investment objectives included generating income. The evidence suggests that Moore's customers, who were all in their 60s and 70s, did seek investments that produced income. It also shows, however, that the customers wanted to preserve their capital, and that they did not fully understand the risk to their principal. For example, JR testified that she invested in Mission Santa Fe because it was short-term and "we didn't like to leave our money in somewhere very long because we might need it. We didn't have that much to where we could put it away." Customer WT testified, "I told him definitely I wanted the money, you know, in a secure situation . . . I said that's all the money we have." We find that Moore's recommendations to JR and WT were unsuitable because they were inconsistent with those customers' financial needs.[3]

Moore's recommendation that FT purchase $37,000 of Trudy Pats was also unsuitable. FT was a 77-year-old retiree living on $20,000 annual income. She redeemed over $25,000 from a Kemper U.S. Government Securities mutual fund to purchase the Trudy Pats. In her written questionnaire, FT said that she wanted short-term, income-producing investments, and her account opening form indicated safety as an objective. She purchased the Trudy Pats because she could retrieve her principal in two years, but she did not understand that the issuer, and not she, had the option of extending the length of the loan for two more years. Based upon FT's financial situation, lack of investment experience, and low annual income, we find that Moore's recommendation to her was unsuitable.

The ninth customer, LD, submitted a questionnaire that provided inadequate information upon which to conclude that Moore's recommendation was unsuitable. The questionnaire indicated that his net and liquid assets both exceeded $200,000, but it does not indicate by what

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[3] Moore's recommendation to JR was also unsuitable because he recommended that JR invest 57 percent of his liquid assets in Trudy Pats. Moore's recommendation to WT was also unsuitable because WT had no investment experience, was disabled, and was living on a small, fixed income.

margin. Thus, it is unclear what percentage of LD's assets he invested in Trudy Pats. In addition, LD was, at age 63, Moore's youngest client, he had some investment experience, and he admits to having thoroughly quizzed Moore about the Trudy Pats and to understanding the risks associated with them. There is insufficient evidence to conclude that Moore's recommendation to LD was unsuitable.

Accordingly, we find that Moore violated Conduct Rule 2310 by making unsuitable recommendations to eight customers. We separately find that Moore violated Conduct Rule 2110 because his conduct fell substantially below the standard of just and equitable conduct that is required of registered representatives.

Sanctions

We called this case for review to assess whether the sanctions imposed were too lenient and to determine whether Moore should be required to pay restitution. The NASD Sanction Guideline ("Guideline") applicable to Moore's violation, entitled "Suitability," suggests fining away all commissions to the respondent, plus a $5,000 to $25,000 fine.[4] In cases involving numerous recommendations of clearly unsuitable securities and no prior similar misconduct, the Guideline suggests suspending the respondent in all capacities for 10 to 30 business days and requiring requalification by examination.

The principal considerations for determining where, in the range of available sanctions, Moore's conduct falls are: (1) prior or other similar misconduct; (2) amount of commission or other benefits to respondent; (3) extent of harm or injury to customers; (4) number of unsuitable recommendations involved; (5) attempts to conceal misconduct by misstating customer information; (6) honest misunderstanding of the customers' financial resources, other security holdings, and investment objectives; (7) investment experience, sophistication, and resources of customers(s); (8) prompt and voluntary restitution by the respondent; and (9) other mitigating or aggravating factors.

The DBCC fined Moore $5,000 plus $6,900 in commissions that Moore earned on the Trudy Pat transactions. It ordered no suspension, requalification, or restitution. In arriving at these sanctions, the DBCC noted that Moore was new to the industry when the violations occurred, that he was ignorant of his obligations to his customers, and that he himself did not appreciate the risks involved in the Trudy Pats. The DBCC noted that Moore had committed one prior suitability violation, but the DBCC observed that it occurred just prior to those at issue here. In the previous case, Moore paid a $6,700 fine and $20,000 in restitution to the customer, and the other respondents avoided liability by seeking bankruptcy protection.

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[4] See NASD Sanction Guidelines (1993 ed.) at 43 (Suitability). The Suitability Guideline was revised in 1998, and now recommends a fine of between $2,500 and $50,000. The revised Guideline also suggests that, in egregious cases, the adjudicator consider suspending the respondent for up to two years or imposing a bar.

The sanctions imposed by the DBCC are not remedial. Moore's violation involved eight customers and more than $200,000 in purchases based on his clearly unsuitable recommendations. Moore's conduct fell significantly short of the duties he owed to his clients to understand the recommendations that he was making and to conduct a customer-specific suitability determination. As a result, Moore recommended an inappropriately risky security to customers who were inexperienced, unsophisticated, and lacked the resources to invest high percentages of their liquid assets in Trudy Pats. Moore's ignorance of his obligations and his inexperience in the industry do not mitigate his violations. Nor does Moore earn credit for making restitution for his earlier suitability violation, as he was obligated to do so.

A $25,000 fine and a 10-day suspension in all capacities will better impress upon Moore the seriousness of his obligations to his customers. Further, requiring Moore to requalify by examination within 90 days following the release of this decision will protect the public by educating Moore about his duties. We will not order Moore to make restitution to his customers, although Moore's misconduct and his customers' harm would justify that sanction. The customers who purchased Trudy Pats through Moore still own their interests. Although no longer in their original form, the Trudy Pats still operate and sporadically pay dividends and distribute capital. Therefore, the circumstances do not permit an accurate calculation of restitution. Recission is also impracticable due to the time that has elapsed since the transactions occurred.

Accordingly, we order that Moore be censured, fined $25,000, suspended in all capacities for 10 business days, required to requalify by examination as a general securities representative within 90 days following the release of this decision or to cease his association until he does so, and assessed DBCC costs of $914.90. The suspension will take effect 30 days following the release of this decision.[5]

On Behalf of the National Adjudicatory Council,

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Joan C. Conley

[5] 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.

Corporate Secretary