

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
NASD

In the Matter of

Department of Enforcement,

Complainant,

vs.

Guang Lu
Gaithersburg, MD,

Respondent.

DECISION

Complaint No. C9A020052

Dated: May 13, 2004

Hearing Panel found that respondent traded an account at an NASD member firm while registered with another firm without providing written notice to both firms; exercised discretion in a customer's account without written authorization; and failed to disclose required information on a Form U4. Hearing Panel also dismissed other allegations. Held, findings of violations affirmed in part and reversed in part and sanctions modified.

APPEARANCES

For the Complainant: David F. Newman, NASD Department of Enforcement.

For the Respondent: Guang Lu, Pro se.

DECISION

Guang Lu ("Lu") appeals a May 21, 2003 Hearing Panel decision pursuant to NASD Procedural Rule 9311(a). The Hearing Panel found that: (1) Lu had traded a customer's account at Charles Schwab & Co. ("Schwab") while Lu was a registered representative with New York Life Securities, Inc. ("NY LIFE") without giving prior written notice to both firms in violation of NASD Conduct Rules 3050(c) and 2110; (2) Lu had exercised discretion in a customer's NY LIFE account without written authorization in violation of NASD Conduct Rules 2110 and 2510(b); and (3) Lu had failed to disclose the required information on a Uniform Application for Securities Industry Registration or Transfer Form ("Form U4") in violation of NASD Conduct Rule 2110 and IM-1000-1. The Hearing Panel found that NASD's Department of Enforcement ("Enforcement") had failed to prove by a preponderance of the evidence that Lu had (1) effected unauthorized trades in a customer's account; (2) engaged in unsuitable and excessive trading; and (3) induced a customer to provide false information in a new account application. The Hearing Panel barred Lu and assessed hearing costs of \$2,400.98.

After a thorough review of the record in this matter and for the reasons discussed herein, we affirm in part and reverse in part the Hearing Panel's findings of violations and modify the sanctions.

I. BACKGROUND

A. Lu's Employment History

Lu first entered the securities industry in 1995 in an unregistered capacity with a member firm. In January 1996, Lu became registered as an investment company and variable contracts products limited representative. Lu left the securities industry in September 1996. Lu was self-employed as a writer and a translator until March 1998 when he began working for New York Life Insurance Company and its broker-dealer subsidiary, NY LIFE. In 1999, Lu became registered as a general securities representative in order to qualify for a possible promotion at NY LIFE. Lu primarily sold life insurance, but he also was qualified to sell mutual funds and variable products. NY LIFE terminated Lu in October 2000 for failure to follow company policies. Globalink Securities, Inc. ("Globalink") hired Lu on October 25, 2000, as a registered representative, but terminated his employment in January 2001 for insufficient production. Lu currently is not employed.

B. Procedural History

On November 21, 2002, Enforcement filed a six-cause complaint against Lu. On December 16, 2002, Lu denied all substantive allegations in the complaint. Lu filed a motion to compel production of documents and testimony on March 10, 2003, which the Hearing Officer denied on March 28, 2003. On April 15, 2003, a Hearing Panel held a hearing in Washington, DC. On May 21, 2003, the Hearing Panel issued its decision, finding that Lu engaged in three of the six causes of misconduct alleged in the complaint. This appeal followed.

C. Facts

Lu is an immigrant from Beijing, China. In February 2000, Lu met a fellow immigrant from Beijing, XH.¹ Lu invited XH to attend a meeting at the Bethesda, Maryland, office of New York Life Insurance Company to discuss trading options.² XH, like Lu, had read the book

¹ XH came to the United States in 1991 to obtain a medical residency. Because she had difficulty obtaining a residency, XH became a licensed acupuncturist in Rochester, New York. XH earned approximately \$50,000 in 1999 as an acupuncturist. In 2000, XH relocated to Washington, DC, to volunteer at the National Institutes of Health ("NIH"), and had received money from her brother that she used for investment purposes. In July 2000, XH had obtained a paid position at NIH.

² XH testified before the Hearing Panel that she learned about the financial lecture being offered by Lu through an advertisement placed in a local Chinese newspaper. Lu testified that XH called him "out of the blue" and that he did not advertise the lecture.

written by Wade Cook titled Wall Street Money Machine, which led to her interest in options trading. Lu recounted at the meeting his successful experiences trading his personal options account, and after the meeting concluded, XH stayed to discuss options trading further with Lu. According to Lu's testimony, XH asked Lu to trade options for her. Lu agreed to begin trading options for XH vis-à-vis her on-line general securities account at Schwab. XH offered to pay Lu for trading on her behalf. Lu explained that NY LIFE policy prohibited him from accepting commissions while trading her account, but he agreed to help her for free because she was from his native Beijing. XH gave Lu the on-line password to her Schwab account, and Lu began trading options in the account on March 3, 2000.

Between March 3, 2000, and March 16, 2000, Lu made 26 options purchases in XH's Schwab account over the course of six days. Lu purchased 16 options with a March 18, 2000 expiration date. Nine of these options expired worthless. The remaining 10 options that Lu purchased had an April 22, 2000 expiration date, and seven of these expired worthless. Lu purchased approximately \$100,000 worth of options in XH's Schwab account, which, when Lu began trading, had a total value of over \$166,000. At no time did Lu notify either NY LIFE or Schwab that he was trading XH's Schwab account. Lu did not discuss any aspect of the options trades with XH prior to making them, and XH incurred over \$57,000 in losses in her Schwab account as a result of Lu's options trading. Lu, however, received no compensation for effecting these transactions. When XH questioned Lu about the losses, Lu assured her that his performance would improve if she would be patient. Lu encouraged her to transfer funds into a NY LIFE account because he was more familiar with the NY LIFE on-line trading format, which he contended would likely improve his performance.

At some time between the end of March and the end of April 2000, XH changed her on-line password to her Schwab account and disabled Lu's access. In April 2000, XH transferred \$15,433.67 worth of shares from a Vanguard mutual fund into a new account with NY LIFE. When XH completed the new account forms for the NY LIFE account, she indicated that her annual gross income was \$50,000; however, at the time, XH was a volunteer at NIH and earned no income. XH listed her net worth as \$200,000, which she stated represented real estate that she owned. XH testified that her brother gave her the money that she used to trade with Lu, and that she had also borrowed money from her sister. XH listed her investment objectives as speculative and her investment risk tolerance as aggressive. XH also completed a securities options account application. XH falsely indicated that she had eight years of experience investing in securities, averaging 150 trades per year, and had two years of experience investing in options, averaging 100 trades per year.³ According to XH, Lu advised XH to exaggerate her income and trading experience to ensure that NY LIFE would approve her application to trade options. Lu, however, testified that he gave no such advice to XH and that she completed the forms on her own and returned them directly to NY LIFE.⁴

³ In actuality, XH testified that she had minimal trading experience beyond buying mutual funds.

⁴ XH testified that she completed the NY LIFE account forms and gave them to Lu. She stated to the Hearing Panel that she completed all but the margin agreement in March or April
[Footnote continued on next page...]

At some point in April or May 2000, XH verbally authorized Lu to begin trading in her NY LIFE account and provided him with her on-line password. Lu liquidated the Vanguard mutual fund shares and proceeded to trade options. Lu had not obtained written authorization from XH to exercise discretion in her account. In addition, NY LIFE policy prohibited its representatives from discretionary trading even after obtaining written authorization from a customer.

XH periodically communicated with Lu via e-mail about her NY LIFE account. XH retained these e-mail communications beginning in May 2000.⁵ On June 12, 2000, XH wrote to Lu expressing concern over the losses in her account. XH told Lu "three months have passed and I haven't recovered any loss from my account yet." She told Lu to "be more careful" and to "work quicker to make up" her losses. In his response on June 13, 2000, Lu assured XH that he would be careful with her account but that the market was volatile. The next day, XH told Lu that they should discuss the manner in which Lu planned to recoup her money. Lu responded on June 15, 2000, stating that because the market was "crazy," "there [was] no way to make quick money." He told her "[w]e have to be patient and work hard"; "I am still trying to make quick money on this acc., but the timing is not right. We don't have a bull [market] yet." In a second e-mail that same day, Lu told XH "it's NOT a good time to close your NYLIFE acc.! Please be patient!" On June 21, 2000, XH expressed her frustration to Lu and stated that she felt he traded her accounts "recklessly" and he "betrayed her trust" because she had waited patiently as he advised, but her losses continued to mount. Lu responded on June 22, 2000, assuring XH that the market "is going to turn and we will have a great chance to make all our money back." "Please be patient one more time!"

On July 7, 2000, Lu sent XH an e-mail telling her that he was trying a new trading strategy. He stated, "I am confident to make back all your margin debt SOON! In order to employ the new method, I decided to sell all your options. Also I changed your password [to your NY LIFE account] because I want to give you a surprise and I don't want you to worry about it at all! Please trust my GOODWILL and my intelligence!" Lu explained at the hearing below that, when he had changed XH's password, he had given XH \$10,000 of his own money to

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2000. The forms, however, are dated February 29, 2000. She completed the margin agreement in June 2000. XH also listed her income as \$50,000 on an options trading authorization form for Schwab, which she signed on February 25, 2000—prior to completing the NY LIFE new account form. There is no evidence in the record showing that Lu assisted XH in completing the form for Schwab.

⁵ According to XH's testimony, she began corresponding with Lu via e-mail in March 2000 but only retained the e-mail correspondence with Lu from May 2000 forward. The first e-mail communication between XH and Lu contained in the record, however, is dated June 12, 2000.

"purchase" the account from her and thereafter considered the account his own.⁶ When Lu gave XH the \$10,000, XH's NY LIFE account was valued at less than \$7,500. After Lu changed the on-line password, XH had no access to the account until she contacted NY LIFE.

XH continued to write to Lu expressing her frustration. On July 11, 2000, XH stated, "I told you so many times I want to close this account you insist in [sic] trading I couldn't even write a check out, that's why I asked you [to] write some checks for me." On July 13, XH told Lu to deposit the money he lost because she needed to close her account. XH told Lu in a July 15, 2000 e-mail that she did not want him to "play with her account anymore" and did not want to "count on [his] mercy to get \$15,000 from [his] pocket. I need my own money back." Again on July 21, 2000, XH stated, "I don't want you to trade my NY Life account." After making these statements, however, XH told Lu in an e-mail dated August 3, 2000, to "be careful with [her] account. I hope you can recover the lose [sic] this year." On August 15, 2000, XH told Lu to "apply for a [sic] check writing in [her] NY Life account." In this e-mail, XH indicated that she wanted Lu to continue trading in her account in an effort to recover her losses. Specifically, XH stated, "[t]he matter is how do we get [the money] back. We need to find a solution for this because of tax reasons."

Lu received a \$6 flat fee from NY LIFE for the on-line trades that he effected in XH's NY LIFE account, which Lu testified totaled less than \$300. Throughout the time Lu was trading for XH, he gave her approximately \$13,000 in cash and incidentals, which included writing her two \$5,000 checks, buying her a new computer, and paying for her car repairs and acupuncturist license.

In a letter dated September 18, 2000, XH filed a complaint with the Maryland Attorney General ("AG") against Lu. The letter recounted XH's version of the events that occurred between her and Lu. The AG's Office sent a letter dated September 26, 2000, to NY LIFE describing the allegations contained in XH's complaint and requesting that NY LIFE provide information to the AG's Office in response.⁷ The AG's Office suggested to XH that she also contact NY LIFE directly. After speaking with James Adkins ("Adkins"), Lu's supervisor at NY LIFE, XH submitted a written complaint against Lu directly to NY LIFE. XH requested that NY LIFE compensate her for the losses that Lu incurred in both her Schwab account and her NY LIFE account. NY LIFE paid XH \$80,000, which fully remunerated her losses.

Adkins received a copy of the AG's letter on October 2, 2000, and immediately contacted Lu. Lu met with Adkins later that same day. Adkins explained to Lu that NY LIFE had received a customer complaint against him and showed Lu a copy of the AG's letter along with the

⁶ XH testified before the Hearing Panel that she accepted \$10,000 from Lu for the purpose of him purchasing her NY LIFE account. XH's testimony shows that she acquiesced to Lu "buying" her account.

⁷ The September 26 letter from the AG to NY LIFE included several attachments consisting of copies of e-mail communications between XH and Lu. The AG's letter described XH's complaints, but did not include a copy of XH's complaint letter.

attached e-mail communications, which Lu read while in Adkins's office. The AG's letter characterized Lu as failing to follow a client's directives and described Lu's activities as "unauthorized" and "unsuitable." Adkins requested that Lu provide NY LIFE with a written explanation as soon as possible. Lu presented Adkins with a written explanation on October 3, 2000.⁸ In this statement, Lu referenced the uncompensated work that he performed for XH through her account at Schwab:

SHE WAS NOT MY CLIENT AT ALL AND THERE IS NOTHING TO DO WITH NYLIFE SECURITIES. NO THIRD PARTY SHOULD EVER BE INVOLVED IN THIS MATTER AND I DO NOT HAVE ANY RESPONSIBILITIES FOR ANY MONEY LOSS. ALSO, I EMPHASIZED THAT I DID NOT WANT ANY OF HER MONEY. ONLY UNDER THIS AGREEMENT, I HELP HER TRADING. . . . Several days later, she gave me her username and password of her Charles Schwab account.

. . . .

I NEVER CONSIDERED HER AS MY CLIENT AND WE ARE JUST GOOD STOCK FRIENDS.

. . . .

[XH] told me that she did transfer some of her money to NYLIFE Securities and she insisted to give me her password and asked me to trade for her again. Frankly, I was scared. I really didn't want to involve her money in any way and I told her that I couldn't trade her NYLIFE Securities account due to our company rules. However, because of my noble sympathy, I still felt that I should help her out. Then I told her that I decided to give her all her NYLIFE Securities money and bought her NYLIFE Securities account entirely by using my own personal money. . . . In this way, her account actually became my own account

NY LIFE's compliance personnel reviewed Lu's response and determined to terminate Lu's employment. On October 9, 2000, Adkins and another NY LIFE employee met with Lu and presented him with a termination letter. Lu then presented Adkins with a second statement, which denied XH's allegations against him, and requested withdrawal of his prior statement dated October 2. Adkins contacted a NY LIFE compliance staff person and read Lu's second statement over the telephone. The compliance employee told Adkins that nothing had changed and to terminate Lu effective immediately.

After NY LIFE fired Lu, he applied for employment with Globalink. On October 20, 2000, Lu completed and signed a Form U4 in connection with his registration as a representative for Globalink. Question 23J(1) on the Form U4 asked Lu: "[h]ave you ever voluntarily resigned, been discharged, or permitted to resign after allegations were made that accused you of . . .

⁸ While the letter was dated October 2, 2000, Adkins did not receive the letter from Lu until October 3, 2000.

violating investment-related statutes, regulations, rules or industry standards of conduct?" Lu answered "no" to this question.

II. DISCUSSION

A. Failure to Give Notice

The first cause in the complaint alleged, and the Hearing Panel found, that Lu failed to notify his employer, NY LIFE, in writing that he was exercising discretion in an account maintained by Schwab. Lu also failed to notify Schwab in writing of his association with NY LIFE. Conduct Rule 3050(c) requires that an associated person "prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member in writing of his or her association with the other member." While Rule 3050(c) applies to accounts held by a person associated with a member and maintained by another member, Rule 3050(e) extends the written notification requirement of Rule 3050(c) to accounts over which an associated person has discretionary authority.⁹

Lu argues that he did not violate Rule 3050 because "he was not associated with another member" and "did not open the account or place an initial order with another member." Lu misreads Rule 3050. First, Lu denies that he was associated with another member. At the time he was trading XH's Schwab account, however, Lu was a registered representative for NY LIFE. Both NY LIFE and Schwab are NASD member firms. Second, Lu ignores subpart (e) of Rule 3050, which extends Rule 3050(c)'s applicability to discretionary accounts.

At the hearing before the Hearing Panel and before the NAC, Lu readily admitted that he traded XH's Schwab account while he was associated with NY LIFE and that he gave no written notice to either member firm.¹⁰ The following colloquy between Lu and the Hearing Officer is telling:

Hearing Officer:	"You did the options trading in her account, her Schwab account"?
Lu:	"Correct."

⁹ NASD introduced the substance of what is now Rule 3050(e) in Article III, Section 28(d) of the NASD Rules of Fair Practice in 1983. Notice to Members 83-17 explained that the notification requirements of the Rule were extended "to transactions or accounts over which associated persons exercise discretion." As an example of such a discretionary account, the Notice to Members listed "an account for a relative of a registered representative of another member . . . if the registered representative places the orders for the account."

¹⁰ Throughout the month of March 2000, Lu made 26 option purchases in XH's Schwab account.

Hearing Officer: "Did it occur to you at all that maybe there was a problem with you as a registered representative trading on somebody else's account?"
Lu: "I never think it's a problem"

Likewise, before the NAC Subcommittee, Lu stated: "I did not ever associate with Charles Schwab. . . . I never register with them. That means associate. I never associate with any other member." When asked whether he had placed trades through XH's account at Schwab, Lu admitted that he had. Irrespective of Lu's misunderstanding of Rule 3050, the record clearly demonstrates that Lu violated Rules 3050 and 2110, as alleged in cause one of the complaint.¹¹ We therefore affirm the Hearing Panel's finding of violation.

B. Unauthorized Trading

The second cause of the complaint alleged that Lu engaged in unauthorized trades in XH's NY LIFE account during the period of July 2000 through August 2000 in violation of Conduct Rule 2110. The Hearing Panel dismissed the cause, finding that XH gave Lu discretionary authority to trade her NY LIFE account. We agree.¹² The record amply demonstrates XH's acquiescence to Lu's trading notwithstanding her passing frustrations that correlated with Lu's trading performance.

We have held that a customer's testimony alone, if credible, is sufficient to establish unauthorized trading. Dist. Bus. Conduct Comm. v. Hellen, No. C3A970031, 1999 NASD Discip. LEXIS 22, at *12 (NAC June 15, 1999). In this case, however, the Hearing Panel found that the communications between XH and Lu were ambiguous and insufficient to prove that Lu engaged in unauthorized trading because, on balance, XH approved of Lu trading her account.

The e-mail communications between XH and Lu illustrate that XH was distressed about the losses in her account, but demonstrate that ultimately XH authorized Lu's continued trading despite intermittent protestations to the contrary. Beginning in June 2000, XH complained to Lu that three months had passed, and Lu had not recovered her losses. She told Lu that he needed to work quicker and asked Lu to deposit money into her NY LIFE account because she wanted to close the account. Two weeks later, Lu told XH that he changed her on-line password to her NY LIFE account because he wanted to "give [her] a surprise" and did not want her to worry about

¹¹ Conduct Rule 2110 provides that members shall "observe high standards of commercial honor and just and equitable principles of trade." Violations of other NASD rules also constitute violations of Rule 2110. L. H. Alton & Co., 53 S.E.C. 1118, 1121 (1999).

¹² We note that Enforcement did not allege in the complaint that Lu's paying XH to cover her losses and to "buy" her account violated Conduct Rule 2330, NASD's prohibition against guaranteeing a customer against loss. Instead, Enforcement alleged that Lu traded XH's account without authorization. Our finding that Lu did not engage in unauthorized trading is based solely on the allegations of the complaint and should not be construed to suggest that his actions did not also violate Rule 2330.

her account. XH again asked Lu to deposit money into her account and indicated she wanted to close the account. XH clearly told Lu in an e-mail dated July 15, 2000, "I don't want you [to] play with my account anymore." Even after her unequivocal statement, however, XH continued to acquiesce to Lu's trading as illustrated by her interactions with Lu. XH testified before the Hearing Panel that Lu, in July 2000, paid her \$10,000 to "buy" her NY LIFE account, and she deposited these proceeds into her Schwab account.¹³ XH wrote to Lu several times after he paid her. She reminded him to be "careful" with her NY LIFE account and hoped he could recover the losses. She later requested that he apply for check writing privileges on her behalf in her NY LIFE account and expressed concern that Lu recover the losses in her account because she needed the funds to pay her overdue taxes. She stated, "We need to find a solution for this." (Emphasis added). Her statements illustrate that XH understood that Lu would continue to trade her account and gave him authorization to do so.

Although it is clear that XH was distressed over the financial losses that Lu had incurred, the record evidence shows that XH gave Lu authorization to trade in her NY LIFE account. Thus, we find that Lu did not engage in unauthorized trading and uphold the findings of the Hearing Panel.

C. Falsifying Records

Enforcement alleged in the complaint that Lu had violated NASD Conduct Rules 3110 and 2110 by encouraging XH to falsify her income and investing experience on her NY LIFE account application.¹⁴ The Hearing Panel found the only evidence that supported this allegation was XH's testimony. Because the Hearing Panel found that XH's testimony was inconsistent with a letter that XH had previously provided to the AG's Office in January 2002 and was in conflict with Lu's testimony, the Hearing Panel concluded that Enforcement failed to prove this charge by a preponderance of the credible evidence and dismissed the allegation.

Like the Hearing Panel, we do not believe that Enforcement met its burden in proving this allegation. According to XH, she completed the NY LIFE new account forms in which she falsified her income and trading experience, but she only exaggerated this information because Lu advised her to do so. Specifically, XH stated on the forms that she had earned an annual income of \$50,000, had obtained a net worth of \$200,000, and had traded options for two years, all of which was false. Lu denied that he advised XH to falsify her account forms and pointed to

¹³ When XH deposited the \$10,000 into her Schwab account, XH's NY LIFE account was valued at less than \$7,500. Lu therefore was paying XH more than her NY LIFE account was worth at the time.

¹⁴ Conduct Rule 3110 requires members to make and preserve books, accounts, records, memoranda, and correspondence in conformity with all NASD rules. The NAC has previously sustained a Rule 3110 violation for falsifying customer records. See Dist. Bus. Conduct Comm. v. Mangan, Complaint No. C10960162, 1998 NASD Discip. LEXIS 33, at *10-11 (NAC July 29, 1998) (altering customer account address without customer's permission and creating false account statement was a violation of Rules 3110 and 2110).

two corroborating pieces of evidence. First, XH stated on February 25, 2000, in a Schwab options trading application, that her income was \$50,000. She completed the form for Schwab four days prior to completing the forms for NY LIFE in which she stated again that her income was \$50,000. Second, XH stated at the hearing below that she completed the NY LIFE account forms herself, but in a January 2002 letter to the AG's Office, XH stated that Lu completed the NY LIFE account forms for her and she merely signed the forms.

After a de novo review of the record, we agree with the Hearing Panel's finding that XH's testimony was inconsistent and therefore not credible. The initial fact finder's credibility determinations are entitled to considerable deference, which may only be overcome by substantial evidence. Joseph S. Barbera, Exchange Act Rel. No. 43528, 2000 SEC LEXIS 2396, at *21 n.30 (Nov. 7, 2000); see also Dane S. Faber, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004) (stressing that deference is given to initial decision maker's credibility determination based on "hearing the witnesses' testimony and observing their demeanor"). Hence, we find that Enforcement failed to prove by a preponderance of the credible evidence that Lu encouraged XH to falsify her NY LIFE account forms in violation of NASD Rules 3110 and 2110.

D. Exercising Discretion Without Written Authority

Conduct Rule 2510(b) prohibits a registered representative from exercising discretionary power in a customer's account without prior written authorization from the customer and the firm. The Hearing Panel found, and Lu repeatedly admitted, that Lu used his own discretion in trading XH's NY LIFE account without obtaining written permission from NY LIFE. Adkins, Lu's supervisor at NY LIFE, testified that an NY LIFE policy prohibited a representative from exercising discretionary authority over any client accounts either with or without a client's written permission. This policy was in effect while NY LIFE employed Lu and was communicated to all NY LIFE representatives through the company handbook.

Lu argues that because he charged no commissions to XH and he engaged in these trades from his home computer in an attempt to help a "hometown person," he is somehow absolved from liability. Whether Lu received compensation or whether Lu's intent behind trading XH's account was noble is irrelevant to our finding of liability. Cf. Protective Group Sec. Corp., 51 S.E.C. 1233, 1240 (1994) (finding liability for discretionary trading without written authorization after representative admitted making discretionary trades in customer accounts and had obtained oral authorization prior to the trades as well as written ratification subsequent to the trades). Compliance with the requirements of NASD Rule 2510(b) is an additional means of ensuring effective supervision of sales practices at securities firms—supervision that Lu evaded by failing to obtain written permission from NY LIFE prior to effecting trades in XH's account. Thus, we affirm the Hearing Panel's finding that Lu violated NASD Rules 2510(b) and 2110.

E. Unsuitable and Excessive Trading

The Hearing Panel found that Enforcement failed to prove by a preponderance of the evidence that Lu had effected unsuitable options trades in XH's Schwab and NY LIFE accounts in violation of NASD Conduct Rules 2310, 2860(b), and 2110.¹⁵ The Hearing Panel also found that Enforcement failed to prove that Lu had engaged in excessive trading in XH's Schwab account in violation of 2510(a).¹⁶ We find that Lu ignored the heightened suitability standard set forth by Rule 2860 for options trading by effecting speculative purchases that represented over half of XH's account value without a reasonable basis for concluding that XH understood the risks involved or that she could bear the significant losses that could result. We therefore conclude that Lu engaged in unsuitable options trading in violation of Rules 2860(b) and 2110. Accordingly, we reverse the Hearing Panel's findings with respect to these rules. We affirm, however, the Hearing Panel's finding that Enforcement failed to meet its burden of proving Lu traded excessively in violation of Rule 2510(a).

Even if a customer seeks to engage in highly speculative or otherwise aggressive trading, a broker is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile. See John M. Reynolds, 50 S.E.C. 805, 809 (1991); see also Gordon Scott Venters, 51 S.E.C. 292, 294-95 & n.8 (1993) (stating that a representative has a duty to abandon recommendations that were unsuitable despite client's wish to the contrary). When a broker effects transactions in an account over which he has discretionary authority, the transactions are implicitly recommended. See Rafael Pinchas, Exchange Act Rel. No. 41816, 1999 SEC LEXIS 1754, at *20 n.22 (Sept. 1, 1999).

The test for whether Lu's options trades were unsuitable for XH is not whether XH acquiesced in them, but whether Lu's recommendations were consistent with her financial situation. See id. at *19-20. Rule 2860(b)(19), the suitability rule specific to options, provides that at the time when a representative effects an options transaction for a customer, the representative must have a reasonable basis for believing that "the customer has such knowledge and experience in financial matters that [s]he may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the option contract." Thus, despite the inconsistencies in XH's financial disclosures and XH's willingness to begin trading options, Lu had a heightened

¹⁵ Conduct Rule 2310 provides that a representative in recommending a transaction to a customer "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 financial situation and needs." Conduct Rule 2860(b) prohibits a representative from making unsuitable recommendations in regard to options transactions and establishes a heightened standard for suitability for options trading. A violation of NASD's suitability rules is also a violation of Conduct Rule 2110. See Wendell D. Belden, Exchange Act Rel. No. 47859, 2003 SEC LEXIS 1154, at *14 (May 14, 2003).

¹⁶ Conduct Rule 2510(a) prohibits excessive trading by a representative in an account over which he is exercising discretionary authority.

obligation to evaluate XH's financial profile and abstain from effecting options transactions that were incongruent with XH's financial situation. See Arthur Joseph Lewis, 50 S.E.C. 747, 749 (1991). Lu undertook no such analysis prior to effecting options trades for XH.

Lu's discretionary trading in XH's account pursued a course of haphazard and risky transactions that resulted in significant losses to XH. Between March 3, 2000, and March 16, 2000, Lu effected 26 options purchases in XH's Schwab account over the course of six days that resulted in over \$57,000 in losses. Sixteen of Lu's options purchases were made with a March 18, 2000 expiration date. Nineteen of Lu's options purchases expired worthless. Lu did not discuss with XH which options he intended to purchase (or the underlying securities), the timing of his purchases, or the quantity of the options contracts. When XH's losses started mounting, Lu encouraged her to transfer funds into a NY LIFE account because he found the Schwab on-line trading format confusing. Instead of discussing with XH the significant financial risk associated with options trading, Lu encouraged the continuation of these risky transactions by blaming the trading format for his losses. Moreover, there is no evidence in the record to demonstrate that Lu explained to XH the risks involved with the options trades that he was making. In total, Lu paid over \$100,000 buying options for an account with a value at the beginning of March of \$166,109.27—an account representing a significant portion of XH's net worth. We find that Lu lacked a reasonable basis to conclude that XH could bear these losses.

We also find that Lu lacked a reasonable basis to conclude that XH evaluated and accepted the risks of Lu's options trades. When XH repeatedly expressed concerns to Lu about the losses, Lu assured her that his performance would improve if she would be patient. He told XH that he was more familiar with the NY LIFE on-line trading format, which would likely improve his performance. Beginning in April or May 2000, Lu began trading options for XH in her NY LIFE account; however, Lu's losses continued to mount despite his assurances to XH that the change in the trading platform would assist him. Again, XH questioned Lu about the losses and told Lu that he needed to work quicker to make back her lost money. Lu should have realized that XH was ill prepared to accept the degree of risk associated with this particular course of options trading and recognized that these trades were inappropriate for her. See Larry Ira Klein, 52 S.E.C. 1030, 1037-38 (1996) (finding that high-risk investments were unsuitable when customers could not afford to risk principal); Lewis, 50 S.E.C. at 750 (affirming suitability violation and finding registered representative failed to adequately determine customer's ability to understand and accept risks involved with trading options).

We affirm the Hearing Panel's finding that Enforcement failed to meet its burden of proving that Lu engaged in excessive trading in violation of Rule 2510(a). Enforcement presented no analysis to support the excessive trading charge.

Based on the evidence as presented in the record, we reverse the Hearing Panel's dismissal of cause three, alleging unsuitable trades, and find that Lu effected unsuitable options trades in violation of Rules 2860(b) and 2110.

F. Failure to Disclose Information on a Form U4

NASD Rule 2110 and IM-1000-1 require associated persons to disclose accurately and fully information required in the Form U4. The accuracy of disclosures on a Form U4 "is critical to the effectiveness" of a self-regulatory organization's ability to screen and monitor the professionals within the securities industry. Rosario R. Ruggiero, 52 S.E.C. 725, 728 (1996); see also Daniel Richard Howard, Exchange Act Rel. No. 46269, 2002 SEC LEXIS 1909, at *9-10 (July 26, 2002) ("The candor and forthrightness of applicants is critical to the effectiveness of this screening process.").

Based on the evidence in the record, it is undisputed that Lu provided false information on his Form U4. "The violation of providing false information to the NASD requires only that the complainant prove that the information was false." Dist. Bus. Conduct Comm. v. Prewitt, Complaint No. C07970022, 1998 NASD Discip. LEXIS 37, at *7 (NAC Aug. 17, 1998). Prior to discharging Lu, Adkins showed Lu the letter and attachments from the AG's Office. That letter characterized Lu's conduct as "unauthorized" and "unsuitable," and stated that he failed to follow a client's directives. Adkins requested that Lu prepare a written response to the allegations as soon as possible. Lu submitted two written responses to Adkins: the first he submitted on October 3, 2000, and the second he submitted on October 9, 2000.¹⁷ Adkins testified before the Hearing Panel that NY LIFE explained to Lu that it was terminating him for violating company policies prohibiting discretionary trading in a client's account.

Lu argues that when he answered Question 23J(1) on the Form U4, his answer was truthful because, at that time, he had not seen a copy of XH's complaint letter against him. Lu contends that despite having read the AG's September 26 letter to NY LIFE, XH's letter and the AG's letter were substantially different. Lu's argument is irrelevant to a finding of violation. Lu admitted in his testimony before the Hearing Panel that he had received from Adkins and read a copy of the AG's September 26 letter to NY LIFE. Lu denied that Adkins told him he was terminated because of discretionary trading; however, Lu acknowledged at the hearing before the Hearing Panel that he knew he was terminated for "some reason." Moreover, Lu's subsequent actions belie his denial. Lu inquired about a job with another member firm prior to applying for a position with Globalink. During his conversation with a representative from this other firm, Lu disclosed that he "left New York Life because of some complaint." The representative told Lu that the firm would wait for the outcome of the complaint before it would hire him. Lu then applied for employment with Globalink and completed the Form U4 that is at issue here without disclosing XH's complaint. We find that Lu had sufficient notice of the reasons behind why NY LIFE had terminated him.

We also reject Lu's assertion that he relied upon the advice of a supervisor. Lu testified that he sought guidance from Globalink's president as to how he should have completed the

¹⁷ While Lu essentially admitted in the October 2 letter that he engaged in the conduct alleged in the AG's letter, in Lu's October 9 letter, he denied the allegations and requested to withdraw his first submission. The Hearing Panel, in finding a violation, relied not upon Lu's first submission to NY LIFE but upon other evidence in the record.

Form U4 given XH's complaint against him. According to Lu, Globalink's president told Lu that because the complaint was pending, Lu was not required to acknowledge the complaint on the Form U4. The Hearing Panel concluded that Lu's reliance upon the president of Globalink did not excuse Lu's responsibility to file an accurate Form U4. We agree. As a registered representative, Lu "is responsible for his actions and cannot shift that responsibility to the firm or his supervisors." See Pinchas, 1999 SEC LEXIS 1754, at *14.

Lu should have answered "yes" to Question 23J(1) when he completed a Form U4 on October 20, 2000. Lu's answer of "no" was false. We affirm the Hearing Panel's finding that Lu violated Conduct Rule 2110 and IM-1000-1. We do not find, however, that Lu acted willfully when he completed the Form U4. Lu disclosed the customer complaint against him and his termination from NY LIFE to Globalink's president and relied upon the president's advice that Lu was not required to acknowledge the complaint on the Form U4.

III. PROCEDURAL ARGUMENTS

Lu raises two procedural arguments. First, Lu suggests that he is a victim of selective prosecution by NASD because he is Chinese. In order to prove a claim of selective prosecution, Lu must show, and not merely suggest, that he was singled out for an enforcement action when others who were similarly situated were not and that his prosecution was motivated by an arbitrary or unjust consideration such as nationality. See Nicholas T. Avello, Exchange Act Rel. No. 46780, 2002 SEC LEXIS 2833, at*20 & n.19 (Nov. 7, 2002); Sheen Fin. Res., Inc., 52 S.E.C. 185, 193 n.34 (1995). Lu has made no such showing and offers no evidence to support his argument. See Avello, 2002 SEC LEXIS 2833, at *20 n.19 ("The NASD has wide discretion in deciding against whom to proceed and [respondent] has not presented a scintilla of evidence suggesting that [his nationality] influenced NASD's enforcement decision."). We have reviewed the record in this proceeding and reject Lu's charge.

Second, Lu contends that the Hearing Officer erroneously denied his motion to compel the production of documents.¹⁸ Pursuant to NASD Procedural Rule 9252, a respondent may request that NASD invoke Rule 8210 to compel a member to provide documents and testimony for use at a hearing. A motion to compel shall be granted "only upon a showing that: the information sought is relevant, material, and non-cumulative;" and "the requesting Party has previously attempted in good faith to obtain the desired Document and testimony through other means but has been unsuccessful in such efforts." NASD Procedural Rule 9252(b) (emphasis added). Additionally, in considering such a request, the Hearing Officer determines whether the request is unreasonable, oppressive, excessive, or unduly burdensome. Id. Lu argues that, by

¹⁸ Lu requested all documents related to Adkins's affidavit filed with the AG's Office; all NY LIFE communications with XH and with NASD related to Lu; all documents related to the settlement and discrimination complaint filed by another Chinese NY LIFE employee; all documents related to customer XH; all documents concerning XH's settlement with NY LIFE; all documents related to NY LIFE's request to the AG's Office requesting restitution from Lu; and all documents related to NY LIFE's use of proceeds from Lu's liability insurance policy.

denying Lu's motion to compel, the Hearing Officer deprived him of due process.¹⁹ We disagree. Enforcement represented that it had produced to Lu all the materials it was required to produce pursuant to NASD rules. See NASD Rule 9251. Furthermore, Lu had an opportunity to cross-examine all the witnesses at the hearing. Indeed, the transcript of the hearing illustrates that Lu extensively questioned each witness on cross-examination. Moreover, Lu had requested material that was irrelevant to this proceeding and cumulative of evidence already in the record. Lu has failed to make an adequate showing. We therefore reject Lu's argument as meritless.

IV. SANCTIONS

The Hearing Panel barred Lu from associating with any member for each of the three findings of violation and assessed costs of \$2,400.98. A confluence of factors leads us to the conclusion that Lu's misconduct was egregious, and the appropriate sanction is a bar. We conclude that Lu's violation of Rule 3050, standing alone, warrants a bar. In light of our finding that Lu engaged in unsuitable trades and exercised discretion without written authority, we also find it apt to impose a bar for these two causes when taken together. We further find that a bar is appropriate for Lu's failure to provide accurate information on a Form U4. We affirm the assessed costs.

A. Failure to Give Notice

When a registered representative engages in transactions and fails to comply with the requirements of NASD Rules 3050 and 2110 by not providing requisite notice, the NASD Sanction Guidelines recommend a fine ranging from \$1,000 to \$25,000, and suggest that in an egregious case, a two-year suspension or bar of an individual respondent may be appropriate.²⁰ The Guidelines also list the following specific considerations for determining sanctions for a violation of Rule 3050: (1) the presence of real or perceived conflicts of interest; (2) the involvement of "hot" issues; (3) the existence of free riding and withholding violations; and (4)

¹⁹ NASD is not a state actor, but a private corporation. See, e.g., Datek Sec. v. NASD, 875 F. Supp. 230, 234 (S.D.N.Y. 1995) (dismissing Fifth and Fourteenth Amendment claims regarding a disciplinary proceeding because NASD is not a state actor). As such, constitutional and common law due process requirements do not apply to NASD proceedings. See D.L. Cromwell Inv. Inc. v. NASD Regulation, Inc., 279 F.3d 155, 162 (2d Cir.), cert. denied, 537 U.S. 1028 (2002); First Jersey Sec., Inc. v. Bergen, 605 F.2d 690, 698-99 (3d Cir. 1979), cert. denied, 444 U.S. 1074 (1980). Section 15A(h)(1) of the Securities Exchange Act of 1934 requires NASD proceedings to be fair. The procedural safeguards required by Section 15A(h)(1) were satisfied here. See, e.g., Sundra Escott-Russell, Exchange Act Rel. No. 43363, 2000 SEC LEXIS 2053, at *13 (Sept. 27, 2000) (finding requirements of Section 15A(h)(1) met when the NASD brought specific charges, the respondent had notice of such charges, the respondent had an opportunity to defend against such charges, and NASD kept a record of the proceedings).

²⁰ Sanction Guidelines (2001 ed.) at 21 (Transactions for or by Associated Persons—Failure to Comply with Rule Requirements).

the occurrence of verbal notice and acquiescence.²¹ None of these specific considerations applies to the circumstances of Lu's case.

In determining the appropriate sanctions, we have also considered the Principal Considerations applicable to all violations.²² Lu repeatedly has refused to accept responsibility for the lack of notice given to NY LIFE or to Schwab prior to exercising discretion in an account maintained by Schwab. Lu's lack of written notice allowed him to evade oversight by his employer while he engaged in a course of discretionary and unsuitable trading for XH that resulted in significant losses. Had Lu notified NY LIFE of his intentions to trade on XH's behalf, NY LIFE may have prevented the spiraling losses that XH incurred by monitoring Lu and ensuring his compliance with NASD's rules. Cf. Dist. Bus. Conduct Comm. v. Prendergast, Complaint No. C3A960033, 1999 NASD Discip. LEXIS 19, at *60 (NAC July 8, 1999) (reporting requirement of Rule 3050 allows members to monitor transactions of associated persons), aff'd, Exchange Act Rel. No. 44632, 2001 SEC LEXIS 1533 (Aug. 1, 2001). By itself, therefore, this violation supports barring Lu from association with any NASD member.

B. Exercising Discretion Without Written Authority and Unsuitable Options Trades

The Sanction Guideline for exercising discretion without written authority in violation of NASD Rules 2510 and 2110 recommends a fine of \$2,500 to \$10,000, and in an egregious case, a suspension in any or all capacities for 10 to 30 business days.²³ The Guideline lists two factors to consider in determining the proper remedial sanction: whether the customer's authorization of discretion was express or implied, and whether the firm's policies prohibited discretionary trading. In this case, we find both factors applicable. We find mitigating that XH asked Lu to trade on her behalf and twice gave Lu her on-line password to her accounts, thereby authorizing his trading. We find highly aggravating, however, that NY LIFE had a strict policy prohibiting representatives from exercising discretionary authority over any client accounts. Had Lu advised NY LIFE of his trading activities in XH's account, NY would have required that he stop trading. NY LIFE's policy was communicated to all NY LIFE representatives, including Lu.

The Sanction Guideline for unsuitable recommendations suggests a fine of \$2,500 to \$75,000.²⁴ In addition, the Guideline suggests a suspension of 10 business days to one year, and

²¹ Id.

²² Sanction Guidelines (2001 ed.) at 9-10 (Principal Considerations in Determining Sanctions).

²³ Sanction Guidelines (2001 ed.) at 94 (Discretion—Exercise of Discretion Without Customer's Written Authority).

²⁴ Sanction Guidelines (2001 ed.) at 99 (Suitability—Unsuitable Recommendations). Because there is no Sanction Guideline specific to a suitability violation under Rule 2860, we find the Guideline for unsuitable transactions under Rule 2310 the most analogous and apply it here. See Sanction Guidelines (2001 ed.) at 2 (Overview) (encouraging adjudicators to look to

[Footnote continued on next page...]

in egregious cases, adjudicators should consider a suspension of up to two years or a bar.²⁵ We find that Lu's misconduct was egregious. Lu engaged in a course of highly speculative trading without concern for the customer's understanding of risk or her willingness to accept that risk. Lu's actions were reckless; Lu's options trading involved numerous trades over a short period of time; and Lu's trading caused very substantial losses to the customer.

Turning to the Principal Considerations applicable to all violations, throughout these proceedings, Lu repeatedly emphasized that he was only acting to help a "hometown person" from Beijing and had no intent to harm XH. Lu testified below that he "never tried to cheat [XH]" and that he only "had good intentions to help" XH. Moreover, it is apparent to us that Lu was trading for XH because she asked him to help her. Lu also did not profit from his conduct and refused to accept payment from XH when she offered it. While we believe that Lu acted only in an effort to help XH, his honorable intentions are insufficient to overcome the startling deviations from the standards imposed upon registered representatives as demonstrated by his misconduct.

We find Lu's continued failure to appreciate the gravity of his misconduct and the potential threat that his actions posed to be significant aggravating factors. Lu clearly has not accepted responsibility for his conduct and is patently unrepentant. Lu conspiratorially characterizes this regulatory action brought against him as a "kind of scheme designed by somebody inside understanding the security rules." Furthermore, despite his registration as a general securities representative, Lu did not consider himself a stockbroker and failed to recognize the obligations attached to registration and the requirement that he understand and follow NASD's rules. We believe that Lu's demonstrated indifference to and misunderstanding of NASD's rules poses a serious risk to the investing public.

We conclude that Lu's misconduct warrants a bar for the finding that Lu violated Rule 2510 by exercising discretion without written authority and for engaging in unsuitable options trading in violation of Rule 2860. Lu's misconduct exemplifies a gross deviation from the standards imposed upon registered representatives. Lu's exercise of discretion in XH's account enabled him to execute unsuitable options trades and, when taken together, necessitates a bar.

C. Inaccurate Form U4

The Guideline for filing a false or inaccurate Form U4 provides for fines ranging from \$2,500 to \$50,000 and a suspension in any or all capacities for 5 to 30 business days or, in egregious cases, a suspension for up to two years or a bar.²⁶ The Guideline for submission of a

[cont'd]

the most analogous Guideline when determining sanctions for violations not address specifically by the Sanction Guidelines).

²⁵ Id. at 99.

²⁶ Sanction Guidelines (2001 ed.) at 77-78 (Forms U4/U5—Filing of False, Misleading, or Inaccurate Form).

false Form U4 delineates three considerations bearing on sanctions: (1) whether the information at issue was significant and the nature of that information; (2) whether the respondent's failure to disclose information resulted in a statutorily disqualified individual associating with a firm; and (3) whether the respondent's misconduct resulted in harm.²⁷

Only one of these considerations applies to Lu's conduct. When Lu completed the Form U4 for employment with Globalink, NY LIFE had not yet filed a Form U5; thus, Lu's undisclosed termination was significant and impeded Globalink's ability to adequately screen Lu's application at the time it was made. While Lu ultimately disclosed XH's complaint against him and his subsequent termination to the president of Globalink, as a registered representative, Lu had a duty to provide accurate information to his prospective employer and in turn to NASD through submission of an accurate Form U4. See Thomas R. Alton, 52 S.E.C. 380, 382 (1995).

Adequate disclosure of all information requested on the Form U4 is of the utmost importance not only to NASD and other self-regulatory organizations, but also to state regulators and broker-dealers who use the information to determine the fitness of an applicant for registration as a securities professional. See David B. Harman, 48 S.E.C. 950, 952 (1988). Because of the importance on full and accurate disclosure, we find Lu's concealment egregious. Lu failed to disclose a termination for cause, which stemmed from a customer complaint. We find that a bar is the appropriate sanction for the Form U4 violation.

* * * * *

In sum, we believe that Lu's conduct warrants significant sanctions. We therefore bar Lu in all capacities. The bar imposed herein shall be effective upon release of this decision. We affirm the Hearing Panel's imposition of \$2,400.98 in hearing costs and impose appeal costs of \$1,413.62.²⁸

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

²⁷ Id. at 77.

²⁸ We also have considered and reject without discussion all other arguments of the parties.

Pursuant to NASD Procedural Rule 8320, any member that 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 nonpayment. 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 nonpayment.