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NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C05030023
v.	:	
	:	Hearing Officer - SW
RESPONDENT	:	
	:	**Hearing Panel Decision**
	:	April 19, 2004
Respondent.	:	

Respondent found not liable for violation of NASD Conduct Rules 2310 and 2110 for the alleged unsuitable recommendation that his customer sell income-producing securities and purchase a variable annuity, and found not liable for violation of NASD Conduct Rule 2110 for the alleged failure to disclose a material fact in connection with his recommendation that his customer purchase a variable annuity. Complaint dismissed.

Appearances:

Laura Leigh Blackston, Esq., Senior Regional Attorney, and Ralph J. Veth, Esq., Regional Counsel, New Orleans, LA, for the Department of Enforcement.

LN, Esq., and TH, Esq., St. Louis, MO, for Respondent.

DECISION

I. Introduction

On June 10, 2003, the NASD Department of Enforcement ("Enforcement") filed a two-count Complaint with the Office of Hearing Officers, alleging that Respondent ("Respondent"): (1) violated

NASD Conduct Rules 2310 and 2110 by making unsuitable recommendations in March 2000 to customer LJ that she sell her shares of (i) preferred stock,

(ii) a real estate investment trust, and (iii) certain income producing mutual funds, to purchase a variable annuity contract; and (2) violated NASD Conduct Rule 2110 by failing to disclose to customer LJ that there was a 10% tax penalty on early distributions from the variable annuity when he made the recommendation that Ms. LJ purchase the annuity.

On June 10, 2003, Respondent filed an Answer denying the allegations.[1] Specifically, Respondent admitted that he recommended that Ms. LJ sell certain securities and purchase a variable annuity, but he denied that the recommendations that Ms. LJ sell certain securities and purchase the annuity were unsuitable, and he denied that he failed to disclose the 10% percent tax penalty to Ms. LJ, when he made the recommendation that she purchase the annuity.

A hearing was held in Springfield, Missouri, on October 23-24, 2003 before a Hearing Panel composed of the Hearing Officer and two current members of the District 5 Committee.[2]

II. Discussion

A. Jurisdiction

Respondent entered the securities industry in January 1999 as a general securities representative with NASD member firm Cambridge Investment Research, Inc. (Stip. at ¶1). On March 8, 1999, Respondent became registered with NASD member Edward Jones as a general securities

[1] The Complaint was served on Respondent on May 5, 2003.

[2] References to the testimony set forth in the transcripts of the Hearing will be designated as "Tr. p." with the appropriate page number; references to the exhibits provided by Enforcement will be designated as "CX-"; and references to the exhibits provided by Respondent will be designated as "RX-".

representative, which registration remains currently in effect. (Id.). Accordingly, NASD has jurisdiction over Respondent.

B. Recommendations to Sell the Securities and Purchase the Annuity were Not Unreasonable

Count one of the Complaint alleges that Respondent's recommendation that Ms. LJ sell shares of her preferred stock, her real estate investment trust, and her mutual funds in order to derive funds for the purchase of a variable annuity was unsuitable in relation to the customer's need for, and dependence on, current income from her investments, i.e., Ms. LJ should not have been deemed a long-term investor.

NASD Conduct Rule 2310 requires that, in making securities transaction recommendations to their customers, registered representatives have reasonable grounds for believing that the recommendations are suitable for their customers based upon the facts, if any, disclosed by their customers as to their other security holdings and their financial situation and needs. Registered representatives are required before effecting any transactions for their customers to make reasonable efforts to obtain information concerning their customers' financial status, tax status, investment objectives, and such other information used or considered reasonable by the registered representatives in making recommendations to their customers.

Enforcement argued that Respondent did not have reasonable grounds to recommend that Ms. LJ sell her preferred stock, real estate investment trust and certain mutual funds, i.e., income producing securities, to purchase an annuity, which is typically viewed as a long-term investment. Specifically, Enforcement argued that if Respondent had clearly understood Ms. LJ's financial condition, Respondent would have recognized that Ms. LJ needed the funds in her Edward Jones account to meet her current living expenses. According to Enforcement, Ms. LJ was not a long-term investor, and Respondent

should not have recommended that she sell her income producing securities to purchase an annuity to obtain long-term growth.

The Hearing Panel finds that Respondent made reasonable efforts to obtain comprehensive information concerning Ms. LJ, including her investment objectives, occupation, marital status, age, risk tolerance, previous investment experience, and tax status. Considering that Ms. LJ was 58 years old in March 2000, and considering the aggressive risk of the particular income producing securities already in Ms. LJ's account, Respondent had reasonable grounds to recommend the sale of those income-producing securities. In addition, the Hearing Panel finds that Respondent could reasonably conclude that Ms. LJ, who expected in March 2000 to live another 28 years, had a realistic long-term investment objective of growth that could be satisfied by the purchase of an annuity. Accordingly, the Hearing Panel finds that Respondent had reasonable grounds for recommending that Ms. LJ sell certain of her income producing securities and purchase the annuity.

1. Background

On June 6, 1997, Ms. LJ, as trustee of the LJ trust, executed an account agreement with Edward Jones. (RX-21, p. 7). Ms. LJ intended that the investment income from the LJ trust and her wages would meet her living expenses until her death. (Tr. p. 117). In 1997, Ms. LJ was 55 years old, and she estimated her life expectancy to be 86 years. (Tr. p. 117; Stip. at ¶6). One of the reasons that Ms. LJ transferred her LJ trust account from her prior broker Merrill Lynch to Edward Jones was because Merrill Lynch had prepared an analysis that predicted that the LJ trust would run out of money prior to her death. (Tr. pp. 118, 164; RX-101; RX-102). The 1997 Edward Jones account form listed Ms. LJ's net worth as $265,000, her annual income as $12,000, and her investment objective as balanced. (CX-3, p. 1).

On October 1, 1998, Ms. LJ's account was transferred to an Edward Jones representative, RR, who was located in Searcy, Arkansas. (CX-3, p. 1). On January 18, 2000, Ms. LJ opened an IRA account as a second account with Edward Jones through RR. (CX-3, p. 2; RX-66). This second account form listed Ms. LJ's net worth as $265,000, her annual income as $15,600, and her investment objectives as income and growth. (CX-3, p. 2).

On January 28, 2000, Ms. LJ's trust account showed a total estimated asset value of $248,359.34. (CX-7, p. 5). The assets included, but were not limited to, the following income producing securities: (i) 1,000 shares of HL&P Capital Trust ("HL&P Trust") valued at $22,438;[3] (ii) 780 shares of Realty Income Corp ("Realty Income") valued at $16,916.64;[4] (iii) 1,485.898 shares of Putnam High Yield Trust Class A ("Putnam High Yield") valued at $15,275.03;[5] and (iv) 2,416.850 shares of Aim Emerging Markets Debt Fund Class A ("Aim Debt Fund") valued at $20,978.26.[6] (CX-7, pp. 6-7). Edward Jones categorized each of the above securities as aggressive, i.e., there was a high risk of "permanent loss" of principal. (Tr. p. 374; RX-36). When Respondent became Ms. LJ's representative, he had access to the above information. (Tr. p. 442).

At her January 2000 "Wealth Accumulation Club" meeting, Ms. LJ met Respondent, who made a presentation to the investment club members. (Tr. p. 47). At the investment club meeting, Ms. LJ arranged to meet with Respondent at his office to discuss an IRA account that she held at a bank. (Tr. p. 49).

[3] The purchase price of the HL&P Trust was $25,000. (RX-76, p. 4; RX-103, p. 2).

[4] The purchase price of the Realty Income was $18,678.86. (RX-103, p. 1). Ms. LJ listed the purchase price of the Realty Income as $20,125 on her tax return. (RX-76, p. 4).

[5] The purchase price of the Putnam High Yield was $21,856. (RX-76, p. 4).

[6] The purchase price of the Aim Debt Fund was $30,259. (RX-76, p. 5).

At the initial office meeting, Ms. LJ also discussed her Edward Jones trust account and expressed an interest in transferring the trust account to Respondent because he was located nearer to her home than Mr. RR.[7] (Tr. p. 159). Ms. LJ estimated that she had four or five meetings with Respondent between her first office meeting and the March 24, 2000 meeting, at which the transactions that are the subject of this Complaint were discussed. (Tr. p. 171).

On March 20, 2000, the trust account was transferred from Mr. RR to Respondent. (Tr. p. 442). When Ms. LJ transferred her account to Respondent, she had at least four years of investment experience. (Tr. p. 359). Respondent testified that Ms. LJ told him that: (i) she did not want to keep losing money; (ii) she needed supplementary income; and (iii) she wanted her money to grow. (Tr. p. 361). Ms. LJ testified that she told Respondent she needed income from the portfolio to meet her living expenses. (Tr. pp. 55-56).

2. The Sale of the Securities and the Purchase of the Variable Annuity

On March 24, 2000, Respondent and Ms. LJ had a meeting in which Respondent presented a before and after analysis of LJ's current holdings. (Tr. pp. 361-363; CX-9). Respondent testified that he always conducted his presentation to clients in the same way. (Tr. p. 364). First, Respondent discussed the client's current investment portfolio starting with the investment pyramid page of the investment portfolio analysis. (Tr. p. 364; CX-10, p. 7). Second, Respondent would explain his recommendations and how the recommendations would impact the client's portfolio.

[7] Mr. RRs' office was more than one hour away from Ms. LJ's home, whereas Respondent was located within one mile of Ms. LJ's home. (Tr. p. 159).

Respondent testified that, at the March 24, 2000 meeting, he initially suggested that Ms. LJ invest in three mutual funds: (i) Investment Company of America; (ii) Growth Fund of America; and (iii) New Perspective Fund. (Tr. p. 381).

Ms. LJ told Respondent that she was concerned about purchasing mutual funds because she did not want to pay capital gains tax on imbedded capital gains. (Tr. pp. 385, 387-388). Respondent then described the annuity to Ms. LJ as an investment on which she would not have to pay taxes on imbedded capital gains. (Id.). Respondent stated:

> [W]hat I always discuss first is tax deferral because most of the time you are buying an annuity for tax deferral. It's not necessarily just for the benefit - or the death benefit, but you're wanting your money to grow sheltered from the taxes. . . I think it's a good way to explain it is that it's similar to IRAs in that IRAs grow tax deferred and most people understand that because they own IRAs. And then, also like IRAs, you need to make your withdrawals and your distributions after age 59-1/2. If you decide to take them out before the[n], it needs to be done with what's called a 72-Q and the 72-Q is specific to the annuity. . . . I always go over the fact that there is a contingent deferred sales charge, meaning that if you make withdrawals [above] what is stated in the contract, which most of them that we take care of is at 10 percent or 15 percent, but if they withdraw more than that 10 percent, that they will be hit with a contingent deferred sales charge. All annuities that carry this should be a long-term investment. I discuss that with them, that this needs to be something they plan on holding. It's not something they plan on liquidating right off the bat. It's not short-term needs. [8] (Tr. pp. 338-340).

Respondent testified that after his presentation, Ms. LJ agreed to his recommendations.[9] (Tr. p. 402). Respondent also testified that the March 24, 2000 meeting was on a Friday afternoon, and that because the meeting extended past the close of the stock market, he did not execute the sales until

[8] Before becoming a registered representative, Respondent, from January 1999 to December 1999, was an insurance agent with Modern Woodmen of America, selling "different types of life insurance as well as annuities and IRAs." (Tr. p. 335-336).

[9] Respondent testified that, in recommending that Ms. LJ sell certain of her income-producing securities, he provided the following information: (i) the Aim Debt Fund was a bond fund that invested in high-risk bonds in developing countries; (ii) the Putnam High Yield Fund contained below investment grade bonds and had a default ratio of 4% to 6%; and (iii) Realty Income paid out more money than it made in order to attract investors. (Tr. pp. 346-347, 372, 375-376).

Monday, March 27, 2000. (Tr. pp. 404-405). Ms. LJ testified that she did not agree to anything on March 24, 2000. (Tr. pp. 52-53).

On March 27, 2000, Respondent executed the sale of the following aggressive income-

producing securities: (i) 1,000 shares of HL&P Trust for $20,857.97; (ii) 780 shares of Realty Income for $15,774.08; (iii) 1,485.898 shares of Putnam High Yield for $15,156.16; and (iv) 2,416.85 shares of Aim Debt Fund for $22,331.69. (Stip. at ¶10; RX-37)

Ms. LJ executed an application to purchase the American Legacy III deferred variable annuity ("Legacy Annuity") on March 24, 2000. (CX-11, p. 3). Respondent testified that, at the March 24, 2000 meeting, he completed the Legacy Annuity application, dated it, and had Ms. LJ sign it in his presence. (Tr. p. 410). Although Ms. LJ admitted that she signed the Legacy Annuity application, she denied that she signed it on March 24, 2000, and denied that Respondent discussed the annuity with her at the March 24, 2000 meeting. (Tr. pp. 54, 77).

Respondent testified that he recommended that the $60,000 premium in the annuity be allocated to the following sub-accounts: (i) 33% to Global Growth; (ii) 33% to Growth; and (iii) 34% to Growth/Income. (Stip. at ¶6). Respondent recommended these particular sub-accounts because they had a similar investment strategy to the original mutual funds that he had recommended to Ms. LJ. (Tr. p. 391).

3. Ms. LJ's Testimony Regarding the Subject Transactions

Ms. LJ's testimony concerning the circumstances surrounding the sales of the securities and the purchase of the Legacy Annuity was inconsistent, and did not match the documentary evidence. Ms. LJ testified that, after receipt of several confirmations from Edward Jones, she met with Respondent on April 7, 2000 to complain about the sales of her income producing securities. (Tr. p. 66). Although Ms. LJ signed the variable annuity application dated March 24, 2000, she testified that it was not until the April 7, 2000 meeting that Respondent mentioned that he had purchased a variable annuity for her

account.[10] (Tr. p. 77). Edward Jones issued her confirmation for the annuity purchase on April 7, 2000, but Ms. LJ denied that she received a confirmation. (Tr. p. 55; RX-41, p. 1).

Ms. LJ testified that, during the April 7, 2000 meeting, Respondent also told her that he had purchased several other securities for her account. (Tr. p. 77). However, the purchase of securities that Ms. LJ claimed Respondent described to her at the April 7, 2000 meeting, when he also allegedly told her about the annuity purchase, did not occur until April 14, 2000. (Tr. p. 77; RX-40). Accordingly, the Hearing Panel does not find Ms. LJ's testimony regarding the securities purchased or how she found out about the annuity to be credible.

Ms. LJ denied that she knew what an annuity was, and initially denied that Respondent explained what an annuity was.[11] (Tr. pp. 56, 105). When asked whether Respondent discussed the mutual funds or the annuity sub-accounts with her, Ms. LJ initially testified that Respondent discussed the funds, and then she testified that Respondent discussed the sub-accounts at the March 24, 2000 meeting. (Tr. p. 162). In response to a question asking whether Respondent at any point explained the annuity, Ms. LJ testified "not clearly, no." Ms LJ further explained that Respondent put some figures on the blackboard and explained "something about not paying capital gains." (Tr. p. 107). Subsequently, Ms. LJ testified that it was possible that she had a discussion with Respondent about the annuity, when he gave her the prospectus. (Tr. pp. 110-111).

4. Ms. LJ's Actions after the Subject Purchase

Respondent testified that Ms. LJ did not complain about the transactions in 2000.

[10] Ms. LJ denied that Respondent discussed the annuity with her at the March 24, 2000 meeting. (Tr. p. 53).

[11] The Hearing Panel did not find Ms. LJ's suggestion that she was an unsophisticated investor credible. During the relevant period, Ms. LJ subscribed to the magazine, "Better Investing." (Tr. p. 114). In 2000 and 2001, Ms. LJ, separate and apart from her Edward Jones account, executed futures transactions. (CX-4, p. 10; CX-5, p. 22; CX-6, p. 10).

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(Tr. p. 409). The documents show that Respondent met with Ms. LJ on April 14, 2000. (RX-30). On April 14, 2000, Ms. LJ authorized the purchases of shares of: Nokia Corp., Novellus Systems, Inc., Koninklijke Philips Electric, and Dell Computer Corp.[12] (RX-40).

In addition, on April 14, 2000, Ms. LJ opened an IRA account with Respondent.[13] (Tr. pp. 74-75, 355; RX-70). In an April 20, 2000 letter to Ms. LJ, RG of Edward Jones invited Ms. LJ to contact him if she had any problems. (RX-72). Ms. LJ did not write to Edward Jones in 2000 in response to RG's letter.[14]

Ms. LJ executed a contract verification form on April 20, 2000, which acknowledged her receipt of the Legacy Annuity policy. (CX-12, p. 17). Respondent testified that Ms. LJ signed the contract verification in his presence. (Tr. pp. 412-413; RX-42).

Respondent testified that, at the April 20, 2000 meeting, he handed Ms. LJ the Legacy Annuity policy and discussed the 10-day "free look" period. (Tr. p. 413). The Legacy Annuity contract had the following provision:

> **NOTICE OF 10-DAY RIGHT TO EXAMINE CONTRACT. Within 10 days after this Contract is first received, it may be cancelled for any reason without penalty (e.g., no contingent deferred sales charge will be deducted) by delivering or mailing it to the Home Office of LNL. Upon cancellation, LNL will return the value of any payments made to the Variable Account and/or any Purchase Payment paid under the fixed portion of the Contract."** (CX-12, p. 5; RX-107, p. 6).

Ms. LJ testified that she discovered the 10-day "free look" period, "several days after the period was up" but she does not recall how she discovered it. (Tr. p. 157).

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[12] Ms. LJ had been assigned to give a presentation on Dell Computer Corp. for her investment club in March 2000. (Tr. p. 96).

[13] Ms. LJ deposited a personal check for $2,000 on April 14, 2000 to open an IRA account with Respondent. (RX-71, p. 1). On April 19, 2000, Ms. LJ deposited an additional, $6,077.78 into the IRA account. (RX-71, p. 2).

[14] Ms. LJ's initial complaint letter was written to Edward Jones on March 28, 2001. (RX-75). The complaint letter triggered an NASD investigation, which resulted in Enforcement filing the Complaint in this proceeding.

In her signed affidavit, Ms. LJ stated that she executed the annuity verification form on April 20, 2000 in order to obtain systematic withdrawals from the Legacy Annuity. (RX-97). Respondent testified that there was no discussion about Ms. LJ taking income from the Legacy Annuity at the April 20, 2000 meeting. (Tr. p. 416).

Even though Ms. LJ testified that she wanted to withdraw funds from the Legacy Annuity in April 2000, the form commencing the systematic withdrawals from the annuity was not generated until May 22, 2000. (Tr. p. 418-419; RX-53). The first withdrawals from the annuity occurred in June 2000. (Tr. pp. 295-296; RX-48).

As of January 26, 2001, the value of the Legacy Annuity had declined from $60,000 to $51,928.57. (RX-57, p. 1). Although Ms. LJ testified that she reviewed her statements every month, Ms. LJ did not complain to Edward Jones about Respondent's actions until February 2001. (Tr. p. 67). The actual complaint letter was written in March 2001.[15] (Id.).

5. Discussion

Enforcement needed to establish by a preponderance of the credible evidence that Respondent did not have "reasonable grounds" for recommending the annuity as a suitable transaction for Ms. LJ. Although Enforcement argued that Respondent should have known that the purchase of the long-term annuity would not satisfy Ms. LJ's need for her portfolio to generate current income, the credible evidence did not support Enforcement's claim that Respondent lacked reasonable grounds for recommending that Ms. LJ sell certain of her income producing securities to purchase the annuity.

[15] The 2001 letter alleged that: (i) in 2000, Respondent, without Ms. LJ's consent or knowledge, sold securities from her Edward Jones account and purchased a variable annuity, and that both the purchase of the annuity and the sale of the securities were unsuitable; and (ii) in 2001, Respondent executed unsuitable mutual fund switches in Ms. LJ's account. (RX-75).

Although Ms. LJ wanted her portfolio to generate some income, the Hearing Panel finds Respondent's testimony that Ms. LJ also wanted to place a portion of her portfolio in growth-oriented products while avoiding paying taxes on imbedded capital gains to be credible. Respondent's testimony that one of Ms. LJ's articulated objectives was growth is supported by Ms. LJ's subsequent actions. When Ms. LJ moved her trust account from Edward Jones to AG Edwards in March 21, 2001, the AG Edwards account form indicated that Ms. LJ's investment objectives were: (1) growth (aggressive); (2) taxable income (aggressive); and (3) growth (conservative). (RX-109, p. 2). The Hearing Panel finds that Ms. LJ was a long-term investor interested in growth investments.

Enforcement argued that the annuity was not an appropriate recommendation because Ms. LJ was not a long-term investor and had no interest in tax deferral. Instead, Enforcement argued that Respondent should have recommended mutual funds. Respondent testified that he did initially recommend the purchase of mutual funds, but in response to Ms. LJ's concerns about taxes, he recommended the annuity. Deciding that Respondent's testimony was credible, the Hearing Panel finds that Respondent initially recommended that Ms. LJ purchase certain mutual funds and subsequently recommended that Ms. LJ purchase the annuity because of her articulated desire to avoid taxes on imbedded capital gains.

Enforcement suggested that Ms. LJ could not have an interest in tax deferral because she was in the lowest tax bracket. The Hearing Panel finds that Enforcement's view of the value of tax deferral is too narrow because it ignores the advantage of compounding tax-free.[16] In addition, if Ms. LJ had purchased the Class A shares of mutual funds, which had been initially recommended by Respondent,

[16] Because Ms. LJ was in the 15% tax bracket, the conversion of her capital gains to ordinary income would have resulted in any gains being taxed at a lower rate.

instead of the annuity, a 4 % sales load on the mutual funds would have reduced her investment immediately. (Tr. pp. 408-409). A review of the transactions and the credible evidence demonstrates that Respondent reasonably recommended that Ms. LJ utilize 25% of her portfolio to meet her goal of growth for the future to help her avoid outliving her resources.

Enforcement also argued that Ms. LJ's systematic cash withdrawals from the annuity to meet her current living expenses substantiated its view that Respondent should not have suggested that Ms. LJ invest in a long-term investment. However, at the time that the systematic cash withdrawals from the Legacy Annuity were implemented, Ms. LJ did not need to utilize the funds from her long-term annuity to meet her current living expenses because she had $11,672.88 in her money market account.[17] (RX-48, p. 1).

The Hearing Panel finds that Respondent was candid and forthright in his testimony, and that his testimony was consistent with the documentary evidence. The Hearing Panel credited Respondent's testimony that he believed Ms. LJ was overly invested in aggressive income producing securities because, before his recommendations, approximately 30% of Ms. LJ's holdings were classified as aggressive by Edward Jones. (Tr. p. 383). The Hearing Panel also finds that after Respondent's recommendations, there remained substantial income producing products in Ms. LJ's trust account. (Tr. p. 298). Although the projected annual income of her portfolio was reduced from $18,678 to $10,278, the overall risk level in the portfolio had been substantially reduced.[18] (Tr. pp. 197-198).

There is also no evidence to show that personal financial gain was Respondent's primary motivation in recommending the purchase of the annuity and the sale of the aggressive income producing

[17] In 2000, Ms. LJ received $2,250 in systematic withdrawals from the Legacy Annuity. (CX-5, p. 47).

securities, including the Putnam High Yield and the Aim Debt mutual funds. Respondent earned $1,140 in commissions on Ms. LJ's purchase of the Legacy Annuity. (Stip. at ¶9). Respondent would have earned $960 in commissions if Ms. LJ had purchased the Class A mutual funds that Respondent initially recommended; the difference in commissions between the two investments would have netted Respondent only an additional $180.[19] (Tr. p. 408). In addition, Edward Jones did not charge commissions on the sales of the mutual funds.[20] (Tr. p. 405; RX-37, pp. 1-2).

In contrast to Respondent, Ms. LJ was not a credible witness. Her testimony was internally inconsistent, and it was also inconsistent with contemporaneous documents that she signed and her actions during the relevant period. The Hearing Panel, therefore, finds that Respondent obtained appropriate information from Ms. LJ, and explained the annuity to her. Unlike David Joseph Dambro, 51 SEC 513, 1993 SEC LEXIS 1521 (1993), Respondent did not fail to elicit sufficient information to enable him to make an informed decision as to whether the investment was suitable for his customer. After meeting with Ms. LJ approximately four times, and having access to her prior Edward Jones account information, Respondent had sufficient information to determine that Ms. LJ wanted to, and indeed should, utilize a portion of her portfolio for a long-term investment.

Unlike Gordan Scott Venters, 51 SEC 292, 1993 SEC LEXIS 3645 (1993); Jack H. Stein, Exchange Act Release No. 47335 (February 10, 2003), 2003 SEC LEXIS 338 (2003); and

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[18] The aggressive positions in Ms. LJ's portfolio after Respondent's recommendation were reduced from 30% to 3%. (Tr. p. 535).

[19] In 2000, only 2.7% of Respondent's production involved the sale of variable annuities. (Tr. p. 336).

[20] Approximately 50% of the sale proceeds of Ms. LJ's income-producing securities were derived from the sale of the two mutual funds. (RX-37).

Richard Howard, Exchange Act Release No. 46269 (July 26, 2002), 2002 SEC LEXIS 1909 (2002), this case does not involve the recommendation of a highly speculative security involving significant risk of loss that is inconsistent with the financial condition or investment objectives of a conservative customer. Although the recommended Legacy Annuity did decline in value, it was not a speculative security unsuitable for a conservative long-term investor.

The Hearing Panel concludes that Respondent had reasonable grounds to believe that his recommendations to Ms. LJ were suitable. Therefore, Respondent did not violate NASD Conduct Rules 2310 and 2110. Accordingly, the Hearing Panel dismisses count one of the Complaint.

C. Enforcement Failed to Provide Credible Evidence that Respondent Failed to Advise Ms. LJ of the 10% Tax Penalty at the Time that He Recommended the Purchase of the Legacy Annuity

Count two of the Complaint alleges that Respondent violated NASD Conduct Rule 2110 by failing to communicate the material fact to Ms. LJ that there was a 10% tax penalty on early withdrawals when he recommended that she purchase the Legacy Annuity. Enforcement argued that the failure to disclose the 10% tax penalty on early withdrawals was a material omission of a material fact made in connection with the sale of a security.

Ms. LJ testified that Respondent did not tell her anything about the annuity before he purchased it for her account, and that when he subsequently told her that he had purchased the annuity, he did not tell her that there was a 10% tax penalty on withdrawals made before she was 59½ years old. (Tr. pp. 53, 155).

Respondent testified that he always discussed the penalties associated with "pre-59 ½" withdrawals when recommending an annuity. (Tr. p. 396). Respondent stated, "It's part of when I

explain how the annuity works." (Id.). Respondent testified that he explains to customers that the annuity is "like IRAs, you need to make your withdrawals and your distributions after age 59-1/2. If you decide to take them out before the[n], it needs to be done with what's called a 72-Q." (Tr. p. 339). Respondent's demeanor was consistent with his testimony that he methodically followed a routine when recommending annuities to his customers. Respondent did admit that he failed to recheck Ms. LJ's age and to remind her of the possible 10% tax penalty in May 2000 when she requested that systematic withdrawals be made from the annuity.[21] (Tr. p. 420).

The Hearing Panel agrees that the failure to disclose the 10% tax penalty at the time of the recommendation would have been a violation of NASD Conduct Rule 2110. However, as discussed earlier, the Hearing Panel finds that Respondent's testimony was more credible than Ms. LJ's testimony. Consequently, the Hearing Panel did not find credible Ms. LJ's testimony that Respondent failed to discuss the annuity or its features, including the potential surrender charges, the IRS tax penalty, and the mortality and expense charges, with her at the March 24, 2000 meeting.

The Hearing Panel finds that Enforcement failed to satisfy its burden of showing by a preponderance of the evidence that Respondent violated NASD Conduct Rule 2110. Accordingly, the Hearing Panel dismisses count two of the Complaint.

III. Conclusion

The Hearing Panel concludes that Enforcement has not established by a preponderance of the evidence that Respondent violated NASD Conduct Rule 2310 or NASD Conduct Rule

[21] In 2000, the distributions from the Legacy Annuity that were not taxed. (CX-5, p. 47).

2110. Accordingly, the Complaint in this proceeding is dismissed in its entirety.[22]

HEARING PANEL

By: Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
April 19, 2004

[22] The Hearing Panel has 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.