

**FINANCIAL INDUSTRY REGULATORY AUTHORITY  
OFFICE OF HEARING OFFICERS**

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DEPARTMENT OF ENFORCEMENT,		
	Complainant,	Disciplinary Proceeding No. 2009018771602
	v.	Hearing Officer—LOM
	Respondent.	<b>ORDER DENYING RESPONDENT'S MOTION TO PRESENT EXPERT WITNESS</b>

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**ISSUE**

Respondent has filed a motion pursuant to FINRA 9242(a)(5) to present testimony of [DP] as an expert witness. The Department of Enforcement ("Enforcement") opposes. For the reasons set forth below, the Hearing Officer denies Respondent's motion.

**NATURE OF CASE**

Enforcement alleges that Respondent made an unsuitable recommendation in violation of NASD Conduct Rules 2310 and 2110.<sup>1</sup> According to the Complaint, Respondent recommended and sold a Collateralized Mortgage Obligation ("CMO") on March 29, 2007, to a 92-year-old widow. The widow purchased 400,000 units at a price of \$1.00 per unit. The investment represented 47% of her liquid net worth. The CMO was sponsored by Countrywide Home Loans

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<sup>1</sup> The Financial Industry Regulatory Authority, Inc. ("FINRA") is responsible for regulatory oversight of securities firms and associated persons who do business with the public. It was formed in July 2007 by the consolidation of NASD and the regulatory arm of the New York Stock Exchange ("NYSE"). FINRA is developing a new "Consolidated Rulebook" of FINRA Rules that includes NASD Rules. The first phase of the new consolidated rules became effective on December 15, 2008. See FINRA Regulatory Notice 08-57 (Oct. 2008). Because the Complaint in this case was filed after December 15, 2008, FINRA's procedural rules apply. The conduct rules that apply are those that existed at the time of the conduct at issue. FINRA's Rules are available at <http://finra.org/Rules>.

and was comprised of loans that were not guaranteed by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Association. The widow has sold 40,000 units for a realized loss of almost \$5,000, and as of October 2010 she had an unrealized loss on the remainder of approximately \$183,000.

In his Answer, Respondent asserts that the CMO was generally suitable for investors seeking income from their investments, as the widow was, and that the CMO was suitable for her in particular because it replaced an equity investment with a triple-A-rated investment that would generate more income. Respondent believed that the concentration risk of the CMO was outweighed by its benefits. He consulted the widow's CPA in recommending the investment, and he also believed that she and the CPA understood and accepted the risks involved. Respondent further argues that to the extent that the value of the customer's investment declined, the diminished value was the result of the financial market crisis and not the Respondent's recommendation.

## **DISCUSSION**

### **A. Legal Framework**

Hearing Officers have broad discretion to accept or reject expert testimony.<sup>2</sup> FINRA Rule 9235 empowers a Hearing Officer to "do all things necessary and appropriate" to fulfill his or her duties in the conduct the proceeding, including resolving procedural and evidentiary issues that may arise.

With respect to evidence generally, relevance is the guiding principle in disciplinary proceedings such as this. Under FINRA Rule 9263, a Hearing Officer shall receive relevant

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<sup>2</sup> *Dep't of Enforcement v. Fiero*, No. CAF980002, 2002 NASD Discip. LEXIS 16, at \*89-90 (NAC Oct. 28, 2002) (citing *Pagel, Inc.*, 48 S.E.C. 223, 230 (1985), *aff'd sub nom. Pagel, Inc. v. SEC*, 803 F.2d 942 (8<sup>th</sup> Cir. 1986)). See also OHO Order 11-04 (2009017798201) at 3.

evidence but may exclude evidence that is “irrelevant, immaterial, unduly repetitious, or unduly prejudicial.”

With respect to expert testimony in particular, a primary focus is on whether the offered testimony would be helpful to the fact-finder. Federal Rule of Evidence 702, which governs the admissibility of expert testimony in federal litigation, is not binding here but provides guidance.<sup>3</sup> It states that an expert may testify if the witness is qualified by “knowledge, skill, experience, training, or education” as an expert and if the expert’s “specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue.”<sup>4</sup> Federal courts typically engage in a three-part analysis in determining whether to admit expert testimony. As succinctly summarized by one court: “The inquiry breaks down into three general areas: (1) the testimony must be ‘helpful,’ which dovetails with the relevance requirements . . . ; (2) the expert must be qualified by knowledge, skill, experience, training or education; and (3) the testimony must be reliable and fit the facts of the case.”<sup>5</sup>

Federal courts take a “liberal” view, tending to admit expert testimony that meets the requisite conditions even if it is “shaky” on the theory that it can be tested by cross-examination and the presentation of contrary evidence.<sup>6</sup> In determining whether expert testimony would be helpful, the nature of the forum must be taken into account, however. In a FINRA disciplinary proceeding, a Hearing Panel is composed of a professional Hearing Officer and two industry

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<sup>3</sup> FINRA Rule 9145(a) specifies that the Federal Rules of Evidence do not apply in FINRA disciplinary proceedings such as this, but those Rules and case law analyzing issues arising under them can provide helpful guidance. *See* OHO Order 11-04 (2009017798201) at 3-4.

<sup>4</sup> Fed. R. Evid. 702.

<sup>5</sup> *Lyman v. St. Jude Medical S.C., Inc.*, 580 F. Supp. 2d 719, 722 (E.D. Wis. 2008). *See also SEC v. Retail Pro Inc.*, 2011 U.S. Dist. LEXIS 13095, at \* 12-13 (S.D. Cal. Feb. 10, 2011).

<sup>6</sup> *SEC v. Badian*, 2011 U.S. Dist. LEXIS 111517, at \*7-8 (S.D.N.Y. Sept. 29, 2011). *See also SEC v. Retail Pro, Inc.*, 2011 U.S. Dist. LEXIS 13095, at \*13 (“Expert testimony is liberally admitted under the Federal Rules”).

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members, who have securities industry experience and expertise. In this context, because of the specialized knowledge of the decision-makers, expert testimony is less frequently admitted than in the federal courts.<sup>7</sup> A Hearing Panel itself acts as an “expert” body whose “businessman’s judgment” is based on the Panel’s collective experience.<sup>8</sup>

It is the proponent’s burden to show that the expert’s testimony satisfies the conditions for admission.<sup>9</sup>

## **B. Scope Of Proposed Testimony**

Respondent describes the testimony the expert would give as follows:

- a. The applicability of FINRA’s suitability rule to investment recommendations to senior citizens, which recommendations resulted in concentrated positions;
- b. Technical and factual details regarding collateralized mortgage obligations, and in particular, the Countrywide CMO at issue;
- c. The economic meltdown and credit crisis that occurred in 2008, and, specifically, how Countrywide was affected by those events; and
- d. Any rebuttal testimony that may be presented by FINRA at the hearing.

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<sup>7</sup> *Dep’t of Enforcement v. U.S. Rica Fin., Inc.*, 2003 NASD Discip. LEXIS 24, at \*27-28 (NAC Sept. 9, 2003); OHO Order 99-11, (C8A990015) (June 17, 1999) at 3 (“Generally, in NASD disciplinary proceedings, because two of the three Hearing Panelists will have considerable expertise about the securities industry and industry practice, the use of expert witness testimony is far less necessary or routine than it may be in federal court proceedings. Typically, expert witness testimony is not offered in NASD disciplinary matters, unless novel issues or new, complex, or unusual securities products are involved.”).

<sup>8</sup> *Richard G. Cody*, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, at \*66-67 and nn.65-67 (May 27, 2011).

<sup>9</sup> *See* OHO Order 05-07 (CAF040070) (Apr. 21, 2005) at 3; *LaSalle Bank N.A. v. CIBC Inc.*, 2012 U.S. Dist. LEXIS 18503, at \*11 (S.D.N.Y. Feb. 14, 2012) (*citing Bourjaily v. United States*, 483 U.S. 171, 175-76 (1987)).

**C. Qualifications Of Proposed Expert**

Respondent contends that DP is qualified to give expert testimony on the outlined topics because he has extensive experience in the industry, both as an examiner employed by NASD from 1982 to 2005 in increasingly responsible positions and as a consultant. Since leaving NASD, DP has provided advice on potential sales practice investigations and enforcement proceedings and reviewed numerous broker-dealer and investment advisory practices for potential FINRA rule violations, including suitability and concentration. Respondent describes DP as “a well-recognized expert” on “application of FINRA’s rules, including suitability rules.” DP has been an expert witness in over 50 matters, although Respondent does not indicate the subject matter of the testimony. The majority of the matters in which he has been an expert witness were customer arbitrations. He is a co-author of an article on “Identifying and Preventing Securities Fraud” for the National Business Institute. The article describes itself as a “simple overview” and a “basic level seminar.” It does not address CMOs.

**D. Respondent Has Not Demonstrated That The Proffered Expert Testimony Would Be Helpful**

Respondent has not demonstrated that the proposed testimony would be helpful to adjudicators who also have industry expertise. Respondent describes the topics to be covered by the proposed expert testimony in a broad general way.<sup>10</sup> Two of the topics are general subjects that the panel members would have sufficient knowledge and experience to comprehend – the application of FINRA’s suitability rule to investment recommendations to senior citizens and the 2008 economic crisis and credit crunch. Furthermore, the applicability of FINRA rules is more a question of law than of fact, and an expert may not usurp the adjudicators’ role of determining

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<sup>10</sup> The fourth item merely states that the expert would give testimony regarding any rebuttal testimony Enforcement might present.

legal issues and their application to the facts of the case.<sup>11</sup> The third topic is focused on CMOs and the particular CMO sold to the widow. While CMOs can be a complex type of investment, and expert testimony on CMOs might be helpful in some instances, that is not the case here. The focus of the Complaint is on the concentration of the widow's portfolio in this one investment. Panel members will be familiar with the issue of undue concentration. Panel members will also have a general understanding of instruments like CMOs and will be capable of reviewing the relevant offering materials in order to address the concentration issue. Moreover, on this topic nothing in the description of the proposed expert's background indicates a particular expertise with respect to CMOs or the Countrywide CMO in issue.

**E. Conclusion**

The Hearing Officer finds that Respondent has failed to establish that the proffered expert testimony would be helpful and denies Respondent's motion.

**SO ORDERED.**

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Lucinda O. McConathy  
Hearing Officer

March 14, 2012

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<sup>11</sup> *Badian*, 2011 U.S. Dist. LEXIS 111517, at \*5-6, \*7-8 (use of expert testimony “must be carefully circumscribed to assure that the expert does not usurp either the role of the trial judge in instructing the jury as to the applicable law or the role of the jury in applying that law to the facts before it.”) (proposed expert testimony excluded where it was “replete with inadmissible generalized statements of law, legal conclusions and conclusory statements....”).