BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of

District Business Conduct Committee
For District No. 2,

Complainant,

vs.

Harry Gliksman
Beverly Hills, CA,

and

William Gallagher
Glendale, CA,

Respondents.

DECISION

Complaint No. C02960039

District No. 2 (LA)

Dated: March 31, 1999

Registered representative engaged in unsuitably frequent trading for his customer's account and president of member firm failed to supervise properly the trading activity in that account. Held, DBCC's findings and sanctions affirmed.

Respondents Harry Gliksman ("Gliksman" or "Respondent Gliksman") and William Gallagher ("Gallagher") appealed the February 11, 1998 decision of the District Business Conduct Committee for District No. 2 ("DBCC") pursuant to Procedural Rule 9310. After a review of the entire record in this matter, we affirm the DBCC's conclusion that Gliksman made unsuitable recommendations to customer CH and that Gallagher failed to supervise the trading in CH's account. We order that Gliksman be censured, fined $25,000, suspended for a period of six months from associating with any member of the Association, and required to requalify as a general securities representative within 60 days of the conclusion of his suspension. We order that Gallagher be censured, fined $5,000, and required to requalify as a general securities principal within 60 days of the date of the

decision. Gallagher must also demonstrate to NASD Regulation, Inc. ("NASD Regulation") District No. 2 within that 60-day period that his firm, W. J. Gallagher & Co. ("Gallagher & Co." or the "Firm"), has put into place an effective system to supervise activities at the firm's Offices of Supervisory Jurisdiction ("OSJs").

Background

Gliksman first entered the securities industry in May 1970 as a registered representative. At the time of the incident that forms the basis of this proceeding, he was employed by Gallagher & Co., where he had worked since June 1991. He was terminated from Gallagher & Co. as a result of this action. He is registered as a general securities principal and a municipal securities representative and principal.

Gallagher entered the securities industry in August 1958 as a registered representative with Merrill Luther, Kalis & Co., Inc. He is currently president and owner of Gallagher & Co., which he founded in 1986. He is registered as a general securities representative, general securities principal, municipal securities representative and a municipal securities principal.

Facts

Respondent Gliksman worked in one of the Firm's OSJs, which was located on Wilshire Boulevard in Los Angeles, California.[1] Respondent Gliksman's wife, Alyse Gliksman, also worked in the OSJ. Gallagher worked at the main office of Gallagher & Co. in Pasadena, California.

Respondent Gliksman's son, David Gliksman, befriended CH, who was the Vice President and Secretary, as well as the sole United States employee, of a company called Wilshire-Dayton Fine Arts ("Wilshire-Dayton").[2] Wilshire-Dayton, a wholly owned

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[1] Under Conduct Rule 3010(g)(1), an OSJ is an office of a member at which any one or more of the following functions takes place: order execution or market making; structuring of public offerings or private placements; maintaining custody of customers' funds or securities; final acceptance (approval) of new accounts on behalf of the member; review and endorsement of customer orders pursuant to Conduct Rule 3010(d); final approval of advertising or sales literature for use by persons associated with the member pursuant to Conduct Rule 2210(b)(1); or responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

[2] Susan DeMando, the NASD Regulation examiner (the "NASD Regulation Examiner") who interviewed CH, a Japanese national, described her as "very fluent" in English.

subsidiary of a Japanese company, bought art from American artists and resold it to Japanese purchasers through its parent company in Japan.

Opening the Wilshire-Dayton Account in February 1993. Wilshire-Dayton kept $500,000 in a money market account to fund its purchases. CH mentioned to David Gliksman that she wanted to get a slightly better rate of return than she was getting in the money market account, but that she did not want to put Wilshire-Dayton's capital at risk. David Gliksman offered to contact his father, Respondent Gliksman, to see if he could help her. CH testified that at this time, she had had no experience investing in U.S. markets, and that she had had only minimal investment experience in Japan, where she had invested in Japanese government bonds.[3]

It is undisputed that in February 1993, CH, David Gliksman and Respondent Gliksman spoke together on a conference call (the "February 1993 Call") during which CH explained to Respondent Gliksman her objectives for the Wilshire-Dayton account.[4] According to CH, she made clear that she wanted a conservative investment because she needed to preserve Wilshire-Dayton's capital to purchase art. Respondent Gliksman recommended liquid yield option notes ("LYON bonds"), which he said would give her both the return and the safety that she sought.[5] They also may have spoken about trading in depressed equities.

CH testified that after deciding to open the account, she translated the Gallagher & Co. new account documents into Japanese and sent them to Japan so that Katsumi Nozawa ("Nozawa"), another officer of Wilshire-Dayton, could sign them. After Nozawa returned the signed forms to CH, CH forwarded them to Gallagher & Co. CH testified that the "investment objective" boxes on the form were blank when she forwarded the signed application forms to Gallagher & Co. She stated that the only information she supplied to Gallagher & Co. was Wilshire-Dayton's name, its California business address, its tax identification number and a bank reference. She also testified that she had indicated

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[3] In this opinion, references to CH's "testimony" refer to testimony CH gave during the arbitration proceedings that resulted from the formal complaint she registered with the NASD, or to testimony she gave under oath in the DBCC proceedings in the form of an affidavit and a declaration signed "under penalty of perjury." CH did not testify in person at the DBCC hearing.

[4] Although David Gliksman did not, and was not authorized to, act as Wilshire-Dayton's representative, he did act as an informal advisor to CH throughout the time the Wilshire-Dayton account was open.

[5] A LYON bond can be converted into common stock. It also has a call feature, whereby the issuing company can buy the bond back, and a put feature, which allows an investor to sell the bond at a predetermined price.

on the forms that Wilshire-Dayton had no previous investment experience. She testified that in addition to the new account application, she completed a margin agreement and a corporate resolution form. She testified that she did not complete an options trading agreement, a power of attorney or a form granting discretionary authorization to trade.

According to the NASD Regulation Examiner, the copies of Wilshire-Dayton's account forms that Gallagher & Co. produced at the DBCC hearing were different from those CH had forwarded to Gallagher & Co. For instance, Gallagher & Co.'s copy of Wilshire-Dayton's customer account application showed checks in the "investment objective" boxes marked "Aggressive Income," "Speculation" and "Other." Respondent Gliksman testified that he assumed CH had checked these boxes, although he said that he could not be certain who had checked them. Similarly, the corporate resolution form that was in Wilshire-Dayton's file at Gallagher & Co. was different from the form CH's attorney provided to the NASD Regulation Examiner. Gallagher & Co.'s copy of the corporate resolution form contained the following additional language not contained on CH's copy: "to trade on margin and LYONs with trading authority." CH told the NASD Regulation Examiner that she had not typed this on the form, and she testified that she did not give Respondent Gliksman discretionary authority. Finally, Gallagher & Co. had an undated option agreement for Wilshire-Dayton with what appeared to be Nozawa's signature. CH, however, testified that she never prepared an options application or agreement, a power of attorney or a discretionary authorization to trade. She testified that all Wilshire-Dayton correspondence went through her, and there was no way that Nozawa could have received any forms that she did not see first.[6]

Trading in the Wilshire-Dayton Account. CH opened Wilshire-Dayton's account with a $300,000 cash investment in February 1993. The account was closed in March 1994. As soon as the account was opened, Respondent Gliksman began to trade the account actively, and a total of 118 trades were executed on 129 different trading days over the course of the fourteen months during which the account was open.[7] Of these 118 trades, only the last 12, which were executed to liquidate the account, were authorized by CH.

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[6] The District did not charge Respondent Gliksman with forgery, and we do not reach any conclusions on appeal concerning the discrepancies between these documents. We include this information because it is relevant to the suitability analysis.

[7] For unexplained reasons, the "investment executive" listed on the monthly account statements through June 1993 was Alyse Gliksman, rather than Respondent Gliksman. There is nonetheless no dispute that Respondent Gliksman was responsible for trading in the Wilshire-Dayton account. Indeed, the last three digits of the Wilshire-Dayton account number comprise Respondent Gliksman's broker number.

CH and Respondent Gliksman gave conflicting testimony concerning the nature and frequency of their communication during the time that the Wilshire-Dayton account was open. CH testified that after she opened the account, she began receiving two to three confirmation slips in the mail each week. She said that she did not understand these confirmation slips, and she asked David Gliksman to explain them to her. She also testified that after the February 1993 Call, she did not speak with Respondent Gliksman again until the account was closed in 1994. She claimed that during the year that the account was open, no one from Gallagher & Co. ever contacted her and she never authorized a trade, except for those she authorized to liquidate the account in February 1994.

CH testified that she understood the net worth entry on the monthly account statements she received. She said that she called Respondent Gliksman after she received the second monthly statement, which indicated that the value of her account had dropped $15,000. She testified that she was unable to reach him, and that he did not return her call. CH asserted that David Gliksman assured her that the decline was nothing to be concerned about and that the value of her account would most likely increase over the next couple of months. In July 1993, after several more months during which the value of CH's account did not increase, David Gliksman wrote Respondent Gliksman a letter that expressed CH's concerns about the account. Respondent Gliksman did not respond.[8] The account showed a slight increase in value in October 1993, but by January 1994, the account had lost approximately $40,000.

During the course of the year, Respondent Gliksman began trading in the Wilshire-Dayton account by buying and short-selling LYON bonds. He also traded in equities, and toward the end of the period during which the account was open, he traded options. It is undisputed that the commissions, mark-ups and mark-downs charged to the Wilshire-Dayton account totaled $56,867. The profits on long sales totaled $22,327 and the losses on short sales totaled $25,497, for an overall trading loss of $3,169. The overall loss for the account was thus $60,036.[9] The annual turnover ratio was 12.28.[10] Fifty-one percent of the trades were held for 30 days or less and 85 percent were held for 60 days or less.

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[8] From that date forward, Alyse Gliksman's name ceased to appear as the "Investment Executive" on the account statements Gallagher & Co. sent to CH.

[9] Wilshire-Dayton recovered these losses through an arbitration award against Respondents.

[10] Respondent Gliksman argued that the turnover ratio should be calculated by using the value of the "buying power" of the Wilshire-Dayton account, which was margined, and not just by using the value of the equity in the account. We find that the DBCC properly rejected this argument, as turnover ratios are always calculated by using the value of the equity in the account.

Respondent Gliksman defended his decision to engage in short-selling by arguing that it had unlimited upside potential in the event the market fell. He said his strategy of frequent, short-term trading enabled him to sell when he detected softness in the market, reposition and buy back at a later date.

CH testified that she closed the account in February 1994, approximately six months after David Gliksman sent the letter to Respondent Gliksman. She claimed that by that time, she had given up hope that the account would regain its value, and she wanted to mitigate the losses. She wrote a letter to Respondent Gliksman on February 4, 1994, and she sent a copy to Respondent Gallagher. She stated many concerns that she had about the trading in the Wilshire-Dayton account, including the huge amount of commissions charged to the account, churning, inventory trades and the use of Alyse Gliksman as the broker of record. She requested that all trading in the account cease and that the account be closed. One trade was executed after she gave these instructions.

Gallagher wrote to CH on February 15, 1994 and told her that Gallagher & Co. had frozen her account, that the last trade had been canceled, and that Gallagher & Co. would review her account for evidence of the conduct she cited in her letter. She faxed Gallagher in March 1994 and again instructed him to close her account, and the account was closed. A balance of $247,759 was returned to Wilshire-Dayton.

Respondent Gliksman's version of events was quite different from CH's. He testified before the DBCC that he and CH had approximately 20 to 30 phone conversations during the year after the February 1993 Call. He said that during these conversations, he and CH spoke about trading, and that they covered several trades during each call. Similarly, in an August 1, 1994 letter to Adam Schneir, another NASD Regulation examiner, Respondent Gliksman stated that the account was opened after "a number of telephone conferences," and that he was "given to understand that the principals of [Wilshire-Dayton] wished to speculate in the U.S. market." He also wrote that it was "always [his] understanding from [CH] and her investment advisor . . . that this account was for . . . speculation."[11]

Respondent Gliksman's testimony before the DBCC contradicted his earlier testimony during the arbitration proceedings in this matter. Respondent Gliksman testified during the arbitration proceedings that he did not communicate with CH during the year "[b]ecause [he] was told that she doesn't know anything about the market." Respondent Gliksman testified at the DBCC hearing that he might have said that during the arbitration proceedings, but that what he said at that time was not accurate. The NASD Regulation Examiner asked Respondent Gliksman for phone records from his office several times in order to verify Respondent Gliksman's claim that he spoke frequently with CH over the course of the year, but despite his assurances that he would produce them, he never did

[11] Respondent Gliksman did not identify who this "investment advisor" was.

so. The only evidence that CH suggested any trades other than those made to liquidate her account is therefore Respondent Gliksman's own testimony before the DBCC, which testimony contradicted his earlier testimony at the arbitration hearings.

Daily Supervision at the OSJ. The respondents offered conflicting testimony regarding who had supervisory responsibilities at the OSJ, and it is unclear who at the OSJ, if anyone, was ultimately in charge of supervision. Gallagher's testimony on this subject was inconsistent. Gallagher testified that Alyse Gliksman was the supervisor, but he also testified that Respondent Gliksman was the supervisor.[12] Gallagher argued that Alyse Gliksman had been "accepted by the NASD" as a supervisor in 1991. When questioned further, Gallagher explained that he actually meant that the NASD had not objected to her being listed in the records of the Central Registration Depository ("CRD") as the "supervisor," and he admitted that Alyse Gliksman was listed on CRD records as the supervisor merely because Schedule E of the Form BD that Gallagher & Co. submitted to CRD listed her as the OSJ supervisor. We note that the NASD neither "accepts" nor "rejects" the designation of supervisors. The NASD merely records the data that members provide. Although a CRD form dated December 6, 1991 indicated that she was a "supervisor," the NASD Regulation Examiner testified that contrary to representing herself as the supervisor, Alyse Gliksman "basically relayed her position as one of office manager." According to the Examiner, Alyse Gliksman "negotiated leases," "paid rent," and "paid bills."

CRD records show that Alyse Gliksman passed the Series 7 and Series 27 exams in June 1991 but that she did not become registered as a general securities principal by taking the Series 24 exam until June 1994. Gallagher testified that the Securities and Exchange Commission (the "SEC"), after performing a branch inspection in 1994, told him that Alyse Gliksman needed to be registered as a general securities principal in order to be an OSJ supervisor. Gallagher insisted that he had been unaware that Alyse Gliksman was not registered with the NASD as a general securities principal, but he stated that she had "supervisor capabilities." It is unclear precisely when Gallagher became aware that Alyse Gliksman was required to be registered as a general securities principal, but CRD records show that she did not do so until June 1994, several months after the Wilshire-Dayton account had been closed. Nonetheless, according to Gallagher, from February 1993 to March 1994, Alyse Gliksman was responsible for supervising her husband, Respondent Gliksman.[13] And yet, despite this testimony, Gallagher signed a declaration that the

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[12] Gallagher testified, however, that despite her alleged role as "supervisor," Alyse Gliksman never forwarded to him the letter from David Gliksman to Respondent Gliksman regarding the Wilshire-Dayton account.

[13] Respondent Gallagher also stated that he did not see any conflict in having Alyse Gliksman supervise her husband. We find that such a relationship could be inconsistent with the objectivity a supervisor needs in supervising a broker's trading activity.

NASD Regulation Examiner had sent to him in which he attested that Respondent Gliksman was "self-supervised in that no other principal at the OSJ reviewed his trades."

Respondent Gliksman, however, testified that he was the general securities principal who supervised the OSJ. Alyse Gliksman's letter to the NASD in March 1995 also stated that Respondent Gliksman was the supervisor of the OSJ during the relevant time period.

Gallagher's Role as Supervisor. Gallagher testified at the DBCC hearing that he reviewed trade blotters from the various OSJs on a daily basis, but that he never performed a thorough review. He explained his supervision technique of reviewing the blotters for overall activity and patterns:

> The main thing that we would look for in blotters would be the quality of the stocks, the commissions that were charged . . . As far as the customers themselves go, again, we had an OSJ supervisor in place, that in turn had that responsibility. They had all the documentation on the customers; we had none. They had the account files; we had none. Because they are kept in the OSJ; they are not kept in the main office . . . This was more or less a rudimentary type thing on my part to make sure that the quality was there, that we didn't get into any penny stocks, which was not a situation that the NASD cared for . . . and to make sure that the commissions were not excessive, that they came in under the guidelines . . . .

When Gallagher was asked, however, whether he had checked for excessive commissions, mark-ups and mark-downs, he responded: "I didn't total them, so the concern wouldn't be there. If I saw an eighth of a point or a sixteenth of a point, that doesn't sound like an awful lot to me. . . Collectively, I had no way of – I had no compilation of them to know whether it was excessive. Individually, they were not excessive."

Gallagher did not have a compilation of the commissions, mark-ups and mark-downs because he did not review the monthly statements. The monthly statements remained at the respective branch offices. He conducted reviews of the OSJ twice a year, during which he randomly chose accounts to review and discussed them with the registered representatives. He did not produce a written report in connection with these semi-annual reviews.

Gallagher defended his oversight methods. Gallagher told the NASD Regulation Examiner that he felt that his actions were sufficient because Respondent Gliksman had a lot of experience as well as general securities principal registration. He also asserted that he was not alarmed by the trading in the Wilshire-Dayton account because he assumed that the account was one of Respondent Gliksman's personal accounts. Gallagher

explained that the OSJ was on Wilshire Boulevard, and the Wilshire-Dayton account was called the "Wilshire" account on several trade blotters. Gallagher testified that the frequent trades of LYON bonds would have been consistent with an account that Respondent Gliksman would hold. Gallagher claimed that he therefore assumed that the "Wilshire" account was Respondent Gliksman's personal account, and Gallagher consequently did not find the trades excessive. When Gallagher was asked during the DBCC hearing whether he would have approved those transactions for the account of a customer, however, he responded: "Absolutely not."

The Wilshire-Dayton account was at times also listed as "W/D" on the trading blotter. When Gallagher was asked what he thought "W/D" had stood for on the blotters, he responded: "I had no idea." Furthermore, the account number always remained the same on the blotters, whether the account was referred to as "Wilshire" or "W/D."[14]

Discussion

After reviewing the record and considering the arguments made on appeal, we find that Respondent Gliksman engaged in a course of unsuitably frequent trading for the Wilshire-Dayton account in violation of Conduct Rule 2310. We also find that Gallagher failed to supervise properly the trading in the Wilshire-Dayton account in violation of Rule 3010. We therefore affirm the DBCC's findings.

We will first explain why Respondent Gliksman's trading in the Wilshire-Dayton account was unsuitable, and then address Gallagher's supervision of the trading. We begin our discussion, however, by addressing the principal argument that both parties made on appeal.

Respondents Gliksman and Gallagher both argued that the DBCC's decision was inherently flawed because it relied on the prior statements of CH, who was in Japan and thus was not present for the hearing. It is well settled, however, not only that such hearsay evidence is admissible in the proceedings of self-regulated organizations, but also that if certain reliability factors are satisfied, it can actually "form the basis for findings of fact" in DBCC decisions. In re Charles D. Tom, Exchange Act Rel. No. 31081 (Aug. 24, 1992). According to the SEC, the following factors must be considered: possible bias of the declarant; the type of hearsay involved; whether the statements are signed and sworn to rather than anonymous, oral or unsworn; whether the statements are contradicted by direct testimony; whether the declarant was available to testify; and whether the hearsay is corroborated. Id.

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[14] Respondent Gliksman's personal accounts were in fact listed as "CN" ("Cal National") and "Harry Gliksman."

We recognize that CH's interests were adverse to those of Respondents Gliksman and Gallagher, and that there is therefore the possibility, as there is with all dissatisfied customers, that her testimony was biased. An analysis of the remaining factors, however, clearly weighs in favor of finding that the DBCC properly relied on CH's testimony.

With the exception of the NASD Regulation Examiner's recollection of conversations with CH, the testimony consisted of direct evidence from CH in the form of a sworn affidavit, a declaration that CH signed "under penalty of perjury," and CH's oral, sworn testimony from the arbitration hearings. No one contradicted CH's assertions that she had no prior investment experience or that the account's objective was to obtain a slightly better rate of return than it was getting from the bank without putting the principal at risk. Indeed, Respondent Gliksman himself corroborated these statements. He stated that he understood Wilshire-Dayton's objective to be "to make money without too much risk," and at the arbitration hearing, he said that he never contacted CH before making a trade because he understood that she did not know anything about the market. Respondent Gliksman's assertions that he spoke with CH throughout the year the account was open are contradicted by his own prior sworn testimony before the arbitration panel.

The DBCC found CH's testimony more credible than Respondent Gliksman's testimony. We may only reject credibility determinations by the initial fact finder when the record contains "substantial evidence" for doing so. See In re Joseph H. O'Brien II, Exchange Act Rel. No. 34105 (May 25, 1994). We do not find any such evidence to reject the DBCC's findings, and we therefore accept the DBCC's determination that CH's testimony was credible.

Finally, CH's counsel advised the District staff that she was in Japan and unable to testify. "[T]he NASD cannot compel a customer . . . to appear at a hearing before it." In re Charles D. Tom, supra. We therefore find that CH was unavailable for the hearing.

Thus, it was permissible for the DBCC to rely on CH's earlier testimony. We note, however, that her testimony was not essential to the decision, because a finding of unsuitability can be based other evidence.

Respondent Gliksman Engaged in Excessive Trading in the Wilshire-Dayton Account. The SEC has made clear that "[d]epending on a particular customer's situation and account objectives, the extent of trading alone may render transactions unsuitable. Hence, excessive trading represents an unsuitable frequency of trading and violates NASD suitability standards." In re Paul C. Kettler, Exchange Act Rel. No. 31354 (Oct. 26, 1992).[15] We find that Respondent Gliksman recommended and engaged in just such a course of unsuitably frequent trading in the Wilshire-Dayton account.

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[15] The NASD Board of Governors' policy statement with respect to fair dealing with customers, which appears in the NASD Manual following the suitability rule, also provides in pertinent part as follows: "Some practices that have resulted in disciplinary action and

The first step in analyzing an allegation of excessive trading is to determine whether the representative controlled the account. This element is satisfied if the account is discretionary. See In re Peter C. Bucchieri, Exchange Act Rel. No. 37218, 7 n.11 (May 14, 1996) ("If a broker is formally given discretionary authority to buy and sell for the account of his customer, he clearly controls it.") (citations omitted). The first element can also be satisfied by a showing of de facto control. De facto control of an account may be established where the client does not understand the trading activity in his or her account or habitually follows the advice of the broker. See Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980); In re Gerald E. Donnelly, Exchange Act Rel. No. 36690 (Jan. 5, 1996).

In the present case, the evidence clearly shows that under either theory, Respondent Gliksman controlled the Wilshire-Dayton account. CH testified that she had no experience investing in U.S. markets and only minimal investment experience in Japan, where she invested in Japanese government bonds. CH also testified that she did not understand the confirmation slips that she received in the mail. CH therefore did not understand the extent of the trading in the account, and according to Respondent Gliksman, she lacked the investment sophistication to understand the nature of the trading.[16] Respondent Gliksman therefore had de facto control over the account. Furthermore, while CH testified that she did not complete a form granting Respondent Gliksman discretionary authorization to trade, Respondent Gliksman testified at the arbitration hearing that in his opinion, he had "discretionary [authority] as to time and price and the types of securities." Thus, although CH may never formally have given Respondent Gliksman discretionary authority to trade in the account, his own testimony at the arbitration hearing corroborated her testimony that he nevertheless exercised such discretionary authority. Respondent Gliksman therefore also controlled the account by virtue of his discretionary trading.

The trading activity in the Wilshire-Dayton account also was excessive. Although there is no single test for making such a determination, factors such as the turnover ratio,[17]

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that clearly violate this responsibility for fair dealing are . . . [e]xcessive activity in a customer's account . . . ." IM-2310-2.

[16] Respondent Gliksman testified at the arbitration hearing that he did not call CH to get her verbal authorization before he traded because "[he] was told that she doesn't know anything about the market."

[17] The turnover ratio is calculated by applying the "Looper formula," named after In re Looper & Co., 38 S.E.C. 294 (1958), which divides the total cost of purchases made during a given period by the average monthly investment. See In re Frederick C. Heller, 50 S.E.C. 275, 276-77 (1993). The turnover ratio is computed "by dividing the aggregate amount of the purchases by the average cumulative monthly investment, the latter

the cost-equity ratio,[18] the use of "in and out" trading,[19] and the number and frequency of trades in an account introduce some measure of objectivity or certainty into the analysis and provide a basis for a finding of excessive trading. See Costello & Oppenheimer & Co., 711 F.2d 1361, 1369 (7th Cir. 1983); Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 435-36 (N.D. Cal. 1968), modified on other grounds, 430 F.2d 1202 (9th Cir. 1970); In re John M. Reynolds, 50 S.E.C. 805, 808 n.12 (1992).

Turnover rates between three and four, for instance, have triggered liability for excessive trading,[20] and the courts and the Commission have held that there is little question about the excessiveness of trading when an annual turnover rate in an account is greater than six.[21] Excessive trading has also been found in cases in which the cost-equity

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representing the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number of months under consideration." Id. at 279 n.10. A modified Looper formula divides the total cost of purchases by the average monthly equity. See In re Allen George Dartt, 48 S.E.C. 693 (1987); Report of the Special Study of the Options Markets to the Securities and Exchange Commission, H.R. Com. Print IFC3, 96th Cong., 1st Sess. (1978).

[18] This is sometimes expressed as the "break-even cost factor." The phrases refer to identical calcuations. See In re Donald A. Roche, Exchange Act Rel. No. 38742 (June 17, 1997). This calculation represents the percentage of return on the customer's average net equity needed to pay broker/dealer commissions and other expenses, such as margin interest. See Frederick C. Heller, supra, at 276-77.

[19] The term "in and out" trading refers to the sale of all or part of a portfolio, with the money from the sale being reinvested in other securities, followed by the sale of the newly acquired securities. See Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369 n.9 (7th Cir. 1983).

[20] In re Donald A. Roche, Exchange Act Rel. No. 38742 (June 17, 1997) (turnover rates of 3.3, 4.6 and 7.2 provided strong support for finding of churning); Gerald E. Donnelly, supra, (noting that respondent acknowledged that "an annualized turnover rate of between two and four percent is presumptive of churning"); In re Michael H. Hume, Exchange Act Rel. No. 35608 (Apr. 17, 1995), at 4 n.5 (noting that turnover rates of 3.5 and 4.4 were found to be excessive in past cases); John M. Reynolds, supra, at 808 n.12 (1992) (finding excessive trading, in part, based on the fact that the account was turned over more than four times on an annualized basis); In re R.H. Johnson & Co., 36 S.E.C. 467, 469-70 (1955) (turnovers of 3.26 to 11.1 annually found to be excessive).

[21] See, e.g., In re Peter C. Bucchieri, Exchange Act Rel. No. 37218, at 7 (May 14, 1996) ("[w]hile there is no clear line of demarcation, courts and commentators have suggested that an annual turnover rate of six reflects excessive trading") (citing Mihara v.

ratio was between 15 and 30 percent, or more.[22] With regard to evidence of "in and out" trading, the Seventh Circuit Court of Appeals has remarked that, "it is a practice extremely difficult for a broker to justify." Costello, 711 F.2d at 1369 n.9; see also Peter C. Bucchieri, supra, at 7.

Here, Respondent Gliksman effected a total of 118 trades in the Wilshire-Dayton account during a 14-month period, from February 1993 through March 1994. Of the 118 trades, 34 percent were held for fewer than 15 days, 51 percent were held for fewer than 30 days, 85 percent were held for fewer than 60 days, and 94 percent were held for fewer than 90 days. The annualized turnover ratio for the Wilshire-Dayton account was 12.28, more than double the turnover ratio that is generally accepted to be indicative of excessive trading. See note 21, supra. Given the Wilshire-Dayton account's overall $60,036 loss, which was comprised mostly of mark-ups, mark-downs and commissions, the account would have had to appreciate by 20% just to break even. Thus, the cost-equity ratio was squarely within the range that demonstrates excessive trading.

A representative is obligated to recommend and effect only those trades that are suitable based on the customer's situation. See John M. Reynolds, supra, at 809; In re Gordon Scott Venters, 51 S.E.C. 292, 294-95 (1993). In this case, Respondent Gliksman had a duty to recommend and effect a course of trading that offered a degree of risk commensurate with Wilshire-Dayton's overriding need for retention of principal. This Respondent Gliksman obviously did not do. Respondent Gliksman's trading strategy was likely to and in fact did put Wilshire-Dayton's principal at risk. Indeed, he effected a course of frequent short-term trading that benefited him in the form of large commissions at the expense of his customer, Wilshire-Dayton. We therefore affirm the DBCC's finding that Respondent Gliksman engaged in unsuitable trading in violation of Rules 2110 and 2310.

Gallagher Was Ultimately Responsible for Supervision of the OSJ. As President of Gallagher & Co., Gallagher was "responsible for the firm's compliance with all applicable requirements unless and until he . . . reasonably delegate[d] a particular function to

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Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980)); In re Shearson Lehman Hutton Inc., 49 S.E.C. 1119, 1122 (1989) (same).

[22] See, e.g., Peter C. Bucchieri, supra, at 2-7 (finding that cost-equity ratio for accounts of 22.4 percent, 25.6 percent, 21.8 percent, and 24.9 percent supported finding of excessive trading); In re Thomas F. Bandyk, Exchange Act Rel. No. 35415 (Feb. 24, 1995) ("[h]is excessive trading yielded an annualized commission to equity ratio ranging between 12.1% and 18.0%"); Frederick C. Heller, supra, at 277 (cost-equity ratio of 36 percent evidenced excessive trading); In re Michael David Sweeney, 50 S.E.C. 761, 763-65 (1991) (cost-equity ratios of 27 percent, 44 percent, 36 percent, and 22 percent indicated excessive trading).

another person in the firm, and neither [knew] nor [had] reason to know that such person [was] not properly performing his or her duties." In re Rita H. Malm, Exchange Act Rel. No. 35000 (Nov. 23, 1994). Conduct Rule 3010(a) provides that each member firm "shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with the applicable securities laws and regulations . . . ." Therefore, as well as having responsibility for the overall operations of the firm, Respondent Gallagher had ultimate responsibility for ensuring that the firm's employees were properly supervised. Indeed, "[a]ssuring proper supervision is a necessary component of broker-dealer operations." In re Gary E. Bryant, Exchange Act Rel. No. 32357 (May 24, 1993). Gallagher also had a duty to continue to monitor compliance after he delegated the supervisory responsibility. See id.; In re Castle Securities Corp., Exchange Act Rel. No. 39523 (Jan. 7, 1998); In re Mabon, Nugent & Co., 47 S.E.C. 862, 867 (1983) (one must "provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised").

Gallagher argued that he satisfied his obligation under these rules by delegating all supervisory authority at the OSJ to Alyse Gliksman. He argued that her Series 27 registration as a Limited Principal – Financial and Operations ("Limited FINOP") qualified her to act as the OSJ supervisor. He also argued that his oversight methods were "reasonably designed to assist in detecting and preventing violations," as required by Conduct Rule 3010(c). For the reasons stated below, we disagree.

OSJ Supervisors Must Be Registered as General Securities Principals. Under Conduct Rule 3010(a)(4), Gallagher was required to designate one or more "appropriately registered principals in each OSJ . . . with authority to carry out the supervisory responsibilities assigned to that office by the member." (emphasis added). Thus, each OSJ must have a registered principal who is qualified by the appropriate registration to supervise the activities that take place in that office.

The activities in which a registered principal may engage depend on the registrations the principal holds. Membership and Registration Rule 1022 explains the characteristics of various registered principals, some of whom are permitted to act in supervisory roles. Alyse Gliksman, who had passed the Series 27 examination, was qualified to perform the limited duties of a Limited FINOP, as listed in Rule 1022(b)(2). According to Rule 1022(b)(2), a Limited FINOP is authorized to perform certain supervisory functions that involve the supervision of the preparation and maintenance of financial reports, books and records, as well as supervision of the member's compliance with financial responsibility rules.[23] A Limited FINOP is not, however, authorized to

[23] Rule 1022(b)(2) states that a Limited FINOP shall have the following duties: "(A) final approval and responsibility for the accuracy of financial reports submitted to any duly established securities industry regulatory body; (B) final preparation of such reports; (C)

supervise sales of securities. This omission is crucial because a person who is registered solely as a Limited FINOP is expressly prohibited from performing any activities not enumerated in Rule 1022(b)(2).[24]

A person who is registered as a general securities principal, however, may perform a wider range of functions. Indeed, a reading of Rules 1021(b) and 1022(a) together makes clear that managers of OSJs who are actively engaged in supervision must be registered as general securities principals.[25] Both the courts and the SEC also have made clear that persons responsible for supervising the trading activity of others must be registered as general securities principals. See SEC v. Hasho, 784 F. Supp. 1059, 1065 (S.D.N.Y. 1992) (registered person was not a licensed supervisor where he had not passed the Series 24 examination); see also In re Douglas Conrad Black, Exchange Act Rel. No. 33187 (Nov. 12, 1993) (SEC affirmed NASD's finding of firm president's supervisory violation where firm's president allowed person who "held the executive power in the Firm, [but] was not registered as a [Series 24] general securities principal" to supervise sales activities of a registered representative who excessively traded in a customer's account). Thus, the Conduct Rules and the case law make clear that Alyse Gliksman, who was not registered as a general securities principal, was not qualified to supervise the sales of securities at issue in this proceeding.

Gallagher Failed to Delegate Properly the Authority to Supervise the Trading Activity in the Wilshire-Dayton Account. As the testimony revealed, it is unclear who, if anyone, had been delegated the responsibility to supervise trading at the Wilshire Boulevard OSJ. Gallagher testified during the DBCC hearing that Alyse Gliksman was the OSJ supervisor, but he later signed an attestation that Respondent Gliksman was the

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supervision of individuals who assist in the preparation of such reports; (D) supervision of and responsibility for individuals who are involved in the actual maintenance of the member's books and records from which such reports are derived; (E) supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the Act; (F) overall supervision of and responsibility for the individuals who are involved in the administration and maintenance of the member's back office operations; or (G) any other matter involving the financial and operational management of the member."

[24] A Limited FINOP "shall not be qualified to function in a principal capacity with responsibility over any area of business activity not prescribed in" Rule 1022(b)(2).

[25] Rule 1021(b) provides that managers of OSJs, who are actively engaged in supervision, the conduct of business and other activities related to the management of the member's securities business, are to be designated as "principals." Rule 1022(a) specifically requires a person who is included in the definition of Rule 1021(b) to be registered as a general securities principal.

OSJ supervisor. Respondent Gliksman also testified that he, and not Alyse Gliksman, was the supervisor. In fact, it does not matter for our purposes whether Alyse Gliksman or Respondent Gliksman was the supervisor because neither of them was appropriately qualified.

As explained above, at the time of the events that form the basis of this action, Alyse Gliksman was registered as a Limited FINOP and as such, she was allowed to perform only those duties enumerated in Rule 1022(b)(2). Supervision of sales activities is not included in these enumerated duties, and she was therefore ineligible to act as OSJ supervisor.

The only remaining possibility is that Respondent Gliksman was the OSJ supervisor. Respondent Gliksman, however, was conducting the trading activity in the Wilshire-Dayton account, and the NASD does not permit registered persons to supervise themselves. See In re Bradford John Titus, Exchange Act Rel. No. 38029 (Dec. 9, 1996) (registered person could not act as his own supervisor); cf. In re Stuart K. Patrick, 51 S.E.C. 419, 422 (1993) ("[s]upervision, by its very nature, cannot be performed by the employee himself"). Thus, although Respondent Gliksman, who was registered as a general securities principal, could have supervised other registered persons in the OSJ, he could not have supervised himself. Another general securities principal in the office was required to supervise Respondent Gliksman's trading activity, and no such person was identified. We therefore find that Gallagher failed to delegate properly the responsibility to supervise trading in the OSJ.

Because Gallagher failed to delegate supervisory responsibility to a qualified principal, he retained the duty to supervise. Gallagher argued on appeal that his supervision of trading at the OSJ was "reasonable" under Conduct Rule 3010(c).[26] Rule 3010(c), however, requires that a member's review be "reasonably designed to assist in detecting and preventing violations . . . ." We find that Gallagher's method of reviewing OSJ trading activity fell short of what is required by Conduct Rule 3010(c).

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[26] Rule 3010(c) states:

> [e]ach member shall conduct a review, at least annually of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of and achieving compliance with applicable securities laws and regulations, and with the rules of this association. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities and abuses and at least an annual inspection of each office of supervisory jurisdiction.

Gallagher testified that the OSJs had "all the documentation on the customers" and all of "the account files," and that the main office, where he worked, had none. He also testified that his daily review of the trading blotters was designed to make sure that good quality stocks were being purchased. He did not check for cumulatively excessive commissions, mark-ups or mark-downs. Indeed, he testified that he did not review the monthly statements, and that his oversight methods therefore would not even have allowed him to detect excessive trading in a customer's account. Gallagher's review was thus not "reasonably designed to assist in detecting and preventing violations" involving excessive trading in a customer's account. We therefore affirm the DBCC's findings and conclusion that Gallagher failed to supervise properly the trading in the Wilshire-Dayton account and thus violated Conduct Rules 2110 and 3010.

Sanctions

The DBCC ordered that Respondent Gliksman be censured, fined $25,000, suspended for a period of six months from associating with any member of the Association, and required to requalify as a general securities representative. We affirm these sanctions.

The DBCC noted that Respondent Gliksman showed little regard for his customer. Neither CH nor Wilshire-Dayton had any prior investment experience. Moreover, Respondent Gliksman admitted that he understood that CH wanted a safe alternative to a money market account, and yet he effected numerous trades throughout the year the account was open. Respondent Gliksman's conduct cost the Wilshire-Dayton account more than $60,000, much of which went to him in the form of commissions.

We note that the 1996 edition of the NASD Sanction Guideline ("Guideline") for suitability violations recommends a fine in the range of $5,000 to $50,000, plus the amount of any profits to the respondent, and requalification by examination.[27] The Guideline also recommends a suspension in all capacities for 10 to 30 business days in cases involving numerous unsuitable recommendations and no prior similar misconduct.

We find that the DBCC's sanctions are appropriately remedial even though the suspension exceeds the range recommended by the Guideline. We have determined, as did the DBCC, that Respondent Gliksman demonstrated a complete lack of understanding of his role as an account executive. Rather than bearing in mind at all times that his client sought a moderate return and retention of principal, Respondent Gliksman engaged in a course of frequent buying and selling that made money for him at his customer's expense. We also note that Respondent Gliksman has a prior disciplinary history.[28] We believe that

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[27] See Guidelines (1996 ed.) at 52 (Suitability).

[28] In May 1989, the NASD accepted a Letter of Acceptance, Waiver and Consent from Respondent Gliksman and Gliksman Securities Corp. pursuant to which they were

the $25,000 fine, the six-month suspension and the requalification requirement are appropriate given the nature of the violation and these aggravating factors. Therefore, we order that Respondent Gliksman be censured, fined $25,000, suspended for six months from associating with any member of the Association, and required to requalify as a general securities representative by examination within 60 days after the conclusion of his suspension.

With respect to Gallagher, the DBCC imposed a censure and a requirement that he requalify as a general securities principal by examination no later than 60 days after the date of the decision. In addition, the DBCC ordered that within 60 days of the decision, Gallagher demonstrate to the District No. 2 staff that Gallagher & Co. has developed and implemented a system to supervise the firm's OSJs. The DBCC stated that this requirement could be met in one of two ways: (1) Gallagher could hire "an appropriately registered principal," whose responsibilities would include the supervision of the activities at the firm's OSJs; or (2) Gallagher could provide documentation that Gallagher & Co.'s clearing firm had provided him with reports that would allow him to conduct surveillance of trading at the OSJs.

The Guideline for supervision recommends a $5,000 to $25,000 fine, a 10- to 30-day suspension, and requalification by examination.[29] We recognize that Respondent Gallagher has a disciplinary history.[30] We also find that he demonstrated a serious lack of understanding of his supervisory responsibilities as president of a broker/dealer: He designated as supervisor a principal who was not qualified to supervise trading activity; his own written statements showed that he allowed Respondent Gliksman to supervise himself; and his oversight methods did not allow him to discover the excessive trading in the Wilshire-Dayton account at the OSJ.

We find that requiring Gallagher to requalify by examination as a general securities principal will impress upon him the seriousness of his violation and will

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censured and fined $2,500 jointly and severally for operating a securities business without sufficient net capital, in violation of Article III, Section 1 of the Rules of Fair Practice. Then, in March 1993, the NASD accepted an Offer of Settlement from Respondent Gliksman to resolve allegations made against him in a complaint, which alleged that he had failed to satisfy an arbitration award. In his Offer of Settlement, he agreed to a censure and a $1,000 fine.

[29] See Guidelines (1996 ed.) at 53 (Supervision).

[30] In April 1993, Gallagher and his firm consented to an Order of Prohibition issued by the State of Wisconsin following a finding that a registered representative of Gallagher & Co. solicited the sale of securities in Wisconsin without being registered there. Gallagher and Gallagher & Co. agreed to an administrative assessment of $1,000.

reeducate him about his responsibilities as president of Gallagher & Co. We further find that requiring him to cause Gallagher & Co. to present District No. 2 with a new system for OSJ supervision will serve to protect members of the public from future violations of this kind. Finally, in addition to the sanctions imposed by the DBCC, we fine Gallagher $5,000, as recommended by the Guideline.

Finally, the costs of the DBCC proceeding, which amounted to $1,356.70, are assessed against the respondents, jointly and severally. Pursuant to Procedural Rule 9360, the Chief Hearing Officer shall set the date on which Respondent Gliksman's six-month suspension shall begin.[31]

Accordingly, Respondent Gliksman is censured, fined $25,000, suspended from associating with any member of the Association for six months, required to requalify by examination as a general securities representative within 60 days after the conclusion of his suspension, and assessed costs associated with the proceedings below of $1,356.70, jointly and severally with Gallagher. Gallagher is censured, fined $5,000, required to requalify by examination as a general securities principal within 60 days of the date of this decision, required to develop and implement an adequate supervisory system for Gallagher & Co. within 60 days of the date of this decision, and assessed $1,356.70, jointly and severally with Gliksman, for the costs of the DBCC proceeding.

On Behalf of the National Adjudicatory Council,

Joan C. Conley, Senior Vice President
and Corporate Secretary

[31] We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.